NEW COMPETITION POLICY: A POLICY PAPER

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A POLICY PAPER

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Content

Foreword

In the recent 2002 EBRD Transition report, competition policy in FR Yugoslavia was again evaluated with a bad (least possible) mark. Progress in transition noted in some other areas has obviously been missing in the field of competition policy.

The aim of the CLDS project "New Competition Policy for FR Yugoslavia" is to build new competition legislation as a first step towards the development of competition policy and competition institutions. The end products of the project are the policy paper that follows and the draft legislation (Draft Competition Law) that has already been submitted to the Serbian Ministry for Foreign Economic Relations.

The policy paper that follows was developed in an interactive process that included CLDS team members on the one side, and a number of foreign competition policy experts, on the other. The key event of this collaboration was a closed international conference held in Belgrade on 14th and 15th November 2002. We are grateful to all participants of the Conference for their contributions towards the formulation of the new competition policy

We are grateful to Nicholas Banasevic, William Baumol, Russell Damtoft, Itzhak Goldberg, Tim Hughes, Patrick Lindberg, Steve Pejovich, Russell Pittman, Richard Posner, Anne Purcell, Peter Sanfey, Jozsef Sarai, Eugene Stuart, Gabor Szoboszlay, Zoran Tomić and Maria Vagliasindi who read early versions of the policy paper and draft legislation and provided very useful comments and suggestions. We are particularly grateful to Russell Pittman who spent substantial time with the CLDS team members in putting together the first Draft legislation. Naturally the usual caveat applies: none of them is to be held responsible for any possible remaining errors or opinions in the policy paper or draft legislation. Furthermore it should be understood that their comments and suggestions do not necessarily reflect the views of the institutions of their affiliation.

The Project "New Competition Policy" is a part of the USAID Economic Policy for Economic Efficiency Project. The EPEE project is engaged in providing technical and professional assistance aimed at institutionalizing Serbia's economic restructuring process. This work is key in establishing and enforcing the rule of law in commercial

transactions, thereby creating the incentives for legitimate market behavior. We are grateful to EPEE personnel for their support. Finally we are grateful to the Serbian Ministry for Foreign Economic Relations for their support for this project.

Belgrade, 10th January 2003

Boris Begović
Boško Mijatović

Executive summary

1. The competition policy in Yugoslavia/Serbia should be compatible with EU competition policy in broad terms (key competition policy principles, general legal principles, legal terminology, i.e. EU legal language etc.), using the same general legal framework, but nonetheless utilizing some of the other elements of competition policy (criminal liability, for example) suitable for the domestic legal and economic environment.
2. Competition legislation should, up to a point, enable flexibility, i.e. various types of competition policy to be enforced. On the one hand, competition policy (particularly in terms of its enforcement) should be narrower than competition legislation – the legislation should provide a legal basis for quite a wide range of policies in terms of their implementation. On the other hand, there should be some legal constraints (provided by the Competition Law) on competition policy enforcement to minimize the possibility of its abuse and to reduce uncertainty for the parties involved.
3. Legal constraints on competition policy and the competition authority should be substantial, particularly taking into account that checks and balances other that the legislation itself are not yet very developed and are unlikely to be developed soon. Some basic economic freedoms should be protected by the law.
4. Taking into account the existing market structures and market practices in FR Yugoslavia/Serbia, as well as the limited resources available for competition policy enforcement, the priorities (at least the short-term priorities) of the new competition policy/legislation should be as follows: (a) to combat and prevent cartels; (b) to enhance and foster privatization and economic restructuring; (c) to increase the economic freedom of firms and private entrepreneurs; (d) to decrease uncertainty to all parties, particularly to firms and private entrepreneurs; (e) to avoid price control as a mechanism of competition policy; (f) to influence other polices that have an impact on market competitiveness, particularly those that create barriers to entry.
5. Economic efficiency should be the only aim of competition policy. All aspects should be taken into account (allocative vs. productive efficiency and consumer vs. producers welfare). Artificial protection of inefficient producers (big or small) should be avoided at

any cost. The first article of the new Competition Law should explicitly stipulate that economic efficiency is the only aim of competition policy.

6. As to the segments of competition policy, legislation enforcement is traditional, inevitable and very resources consuming, i.e. it inevitably creates a huge administrative burden for the competition authority. By effective advocacy the competition authority can influence virtually all the policies that affect competition on the domestic market. These policies are the first-best policies in many cases, compared with traditional competition legislation enforcement. Development of a competition culture, i.e. education of all parties concerned regarding competition policy is a method for making the previous two segments of the competition policy more effective as the existence of pro-competitive public option creates the possibility for the competition authority to recruit many allies. Competition law should provide a legal basis for the competition authority to have a consultative role in the case of new policies and legislation and initiating review and examination of existing policies and legislation relevant for competition policy.
7. Merger control provisions should be a part the new competition legislation. There should be a suspension in merger control enforcement and the whole new legislation enforcement for a specific time after adoption of the new legislation – 12 months from the legislation enactment. This suspension of the legislation enforcement will enable the competition authority to prepare for effective merger control enforcement.
8. The suspension will enable the relatively smooth introduction of merger control in the privatization process by changing the privatization sub-statutory text (Decree), creating obligations for buyers of the state owned companies. All the participants in the privatization process (buyers) should obtain clearance (if necessary, i.e. if they are above the notification threshold) before signing the privatization contract in the case of both tenders and auctions. The burden of obtaining the clearance should be on the buyers; hence all information relevant for merger should be presented to them (i.e. to the public) in the early stages of privatization.
9. Prior authorization of mergers as a method of merger control is based on compulsory pre-merger notification with two stages of decision-making and is a reasonable option. All firms liable to notification requirement (above the notification threshold) must submit the notification to the competition authority asking for clearance of the planned merger. There should be standardized information that will be required from the parties – the best way of enforcement will be a standardized form of pre-merger notification request that should be filled in by all the parties notifying their merger. The competition authority in short time (30 days) should decide about

further action: a) there is no action so the merger is cleared; or b) there will be further investigation after which the merger can be cleared, conditionally cleared or prohibited. The final decision must be reached within 90 days from the beginning of the further investigation. Mergers below the specified threshold are not subject to the competition law, i.e. they are not under the jurisdiction of the law, and hence these mergers cannot be challenged.

10. The standard merger notification threshold for all industries and types of mergers (horizontal, vertical and conglomerates) is to be established. The thresholds should be objective, so turnover data should be used as threshold, both (cumulative) minimum combined turnover of the firms that will merge and minimum turnover of one of the firms. Combined turnover of the merging firms and minimum turnover of one of them are both necessary conditions. The merging firms are liable to compulsory notification only if both conditions are met simultaneously.
11. The legal standard for challenging the mergers is the rule of reason for all mergers and there should be no differentiation between horizontal and vertical mergers. The burden of proof should be on the competition authority, i.e. the authority will have to demonstrate that the merger effects are adverse to competition and consumers' economic welfare in each case. Accordingly, all mergers should be presumed to be pro-competitive, and the job of the competition authority is to demonstrate that they are not, if the authority decides to challenge a merger.
12. The dominance test should be used as the standard/criterion for merger evaluation, i.e. examination of the impact of the merger on economic efficiency and economic welfare. The criterion is to be applied so as to enable evaluation of the impact that the merger will have on overall economic efficiency (both allocative and production efficiency). There should be strict guidelines for the ruling (structured rule of reason), i.e. the decision-making process should be strictly defined rather than the outcome. Sub-statutory texts should precisely specify the procedures for applying the dominance test.
13. Apart form merger control, competition policy/authority should address the creation of non-competitive market structures, but only by firms that have already secured dominant position on the market. Exclusionary behavior by firms should be treated only as a specific abuse of the dominant position of the firm. There should be no legal provision for compulsory divestiture, expect in the case of the sanctions for the failure to notify mergers or failure to notify accurately.
14. Restrictive agreements should be treated differently. There are three groups of restrictive agreements.
15. **H1 group** of agreements. These agreements are hard-core anti-competitive horizontal agreements (cartel agreements). They should be *per se* prohibited, clearly specified in the law by exhaustive list

(*numerus clausus*) and should should give rise to both imposition of fines and criminal prosecution. Only three types of agreement should be encompassed by this group: price fixing (including bid rigging), market division and agreements on maximum output. There will be no exclusions (clearance), no exemptions and no *de minimis* rule in the case of these agreements. The competition authority should only be involved in fact finding, not in considering the consequences since these agreements are *per se* prohibited.

16. **H2 group** of agreements. This group consists of all other horizontal agreements not belonging to the H1 group. They should not be *per se* prohibited, but the rule of reason should be applied. Detailed guidelines for the rule of reason procedure should be specified in a sub-statutory text. The competition law could provide only a non-exhaustive list (indicative enumeration, i.e. *exampli causa*) of the agreements and these agreements if proclaimed to be illegal should give rise only to imposition of fines. There will be exclusions (clearance), exemptions and *de minimis* rule in the case of these agreements. The competition authority should consider the consequences of these agreements since they are not *per se* prohibited. H2 group of horizontal agreements should be presumed to be pro-competitive. The burden of proof should rest with the competition authority.
17. **V group** of agreements. This group consists of all vertical agreements. They should not be *per se* prohibited, but the rule of reason should be applied. Effectively, no vertical agreement should be *per se* prohibited. Detailed guidelines for the rule of reason procedure should be specified in a sub-statutory text. The competition law could provide only a non-exhaustive list (indicative enumeration, i.e. *exampli causa*) of the agreements and these agreements if proclaimed to be illegal should give rise only to imposition of fines. There will be exclusions (clearance), exemptions and *de minimis* rule. In the case of these agreements – *de minimis* rule should be emphasized. The competition authority should consider the consequences of these agreements since they are not *per se* prohibited. All the vertical agreements should be presumed to be pro-competitive. According to a presumption of that kind, the burden of proof should rest with the competition authority.
18. Only voluntary notification of the agreement is stipulated. The competition authority should be legally obliged to respond to the agreement notification within 60 days. Special care should be taken to safeguard against potential abuse of the right to notification for companies that already have enforced the agreement.
19. Relevant market definition should be based on the three basic elements: (a) product market (inter-changeability of products, i.e. demand substitutability); (b) geographic market (transportation and transaction costs magnitude/share); and (c) import component (imports onto the domestic market should be calculated as a

part of that market). Supply substitutability should not be a part of market definition, but should be included in the more complex procedure of identification of market dominance.

20. Dominant position definition is based on 40% market share taken as a prerequisite (necessary condition) of dominant position, i.e. no firm whose market share is less than the specified one can be classified as having dominant position. Accordingly, market share of 40% is a necessary, but not sufficient condition for establishing that a firm has dominant position. If the market share of the firms exceeds the specified (40%), other criteria are to be applied for determining market power, i.e. dominant position of the firm: barriers to entry (scale, character and durability), potential competition (domestic or international), i.e. supply-side substitutability, and potential countervailing strength of buyers, as well as other relevant features of the market/market power.
21. Only the abuse of this dominance should be prohibited, not the dominant position as such. Accordingly, the competition authority should monitor the behavior of the firms with dominant position more closely that they do the behavior of all other companies. There should be no formal monitoring (i.e. no legal obligation for the competition authority to monitor dominant firms behavior), nor a list (register) of firms with dominant position.
22. Both exploitative abuse (i.e. earning economic profit in the short-run) and exclusionary abuse (i.e. strengthening and further developing dominant position to increase market power and to earn bigger economic profit in the long-run) should be explicitly separated in the legislation, i.e. separate legal definition of the abuse of dominant position aimed at the appropriation of short-term profit, on the one hand, and aimed at the creation of non-competitive market structures, on the other.
23. There should be two separate lists of indicative enumeration of the abuses of dominant position (non-exhausting lists, i.e. *exampli causa*) leaving room for prohibition of other types of abuse of dominant position. The indicative enumeration in the case of exploitative abuse should consist only of: (a) pricing that is not cost based; and (b) reducing output. The indicative numeration in the case of exclusionary abuse should consist of: (a) pricing that is not cost based; (b) creation of barrier to entry (c) price and other discrimination; (d) tie-in sales.
24. In the enforcement of the Law, the competition authority should focus on the exclusionary abuse of dominant position, rather than exploitative. That will prevent the competition authority becoming a price control authority as has happened in many cases in the CEE countries with numerous bad effects. The legal standard for challenging abuses of dominant position is always the rule of reason. The burden of proof is with the competition authority, i.e. the authority must prove that the party has abused its dominant position and the

adverse, anti-competitive effects, i.e. adverse effects to economic efficiency and welfare resulting.

25. The new Competition Law shell be a self-standing competition law. An enquiry should be made into the urgency of amendment of the existing Fair Trading Law along the lines of the draft of the new Competition Law, even to the extent of drafting a new Fair Trading Law.
26. Natural monopolies should be regulated according to special legislation (*lex specialis*) for industries considered to be natural monopolies. These pieces of legislation will provide the legal framework for economic regulation, particularly regarding the methods of economic regulation and institutions (authorities) that will enforce economic regulation. Such a solution will be quite consistent with competition legislation/policy in terms of the economic basis of economic regulation. For example, economic regulation will enable pricing in these industries to be cost based, hence no abuse of the dominant position of that kind will occur. Furthermore, competition legislation will be enforced by the competition authority in all other activities of natural monopolies, i.e. operators in these industries that are not covered by special legislation. Natural monopolies (regulated industries) should be exempted from some provisions of the competition legislation by special laws (*lex specialis*), applying the principle: one industry – one special law.
27. The new Competition Law should not have provisions for control of state aid. Possible future changes in the competition legislation will depend on the independent development of state aid control legislation and relations between state aid control and competition policy.
28. There should be no special provision in the competition legislation regarding public companies (enterprises), nor should they be exempted from the competition legislation, i.e. public enterprises should be subject to the competition legislation.
29. The only exemption mechanism should be special legislation (*lex specialis*) by which some industries (i.e. companies in these industries) will be exempted from some provisions of the competition law. It is very important that special legislation should exempt these industries/companies from only some provisions of the competition legislation, not entire exemption from the competition legislation. The activities of the companies that are exempt from some provisions of the competition legislation should only be those that are regulated by the special law whose provisions are enforced by authorities other that the competition authority.
30. All legal entities, their associations as well as individuals and their associations directly or indirectly involved in commercial activities or activities that have an impact on commercial activities should be subject to the competition law. The Serbian legal doctrine allowing the prosecution of the executives of legal entities in criminal

proceedings should be taken into account. The state should be subject to the competition law as far as it is directly or indirectly involved in commercial activities. Nonetheless, the state should not be subject to the competition law in its capacity as regulator, i.e. activities of creation and enforcement of the rules

31. There should be a legal provision that foreign undertakings (companies) are subject to the domestic competition law so far as their activities on the domestic market are concerned ('Effects doctrine').
32. Due to the possibility of legal controversy, two sectors should be explicitly exempted/excluded from competition legislation: (a) trade unions, in their activities regarding the collective bargaining process; (b) sports association in their activities of organizing athletic competition. Both exemptions should be specified in the exhaustive list (*numerus clausus*) as a paragraph of the Competition Law itself.
33. Sanction of the new Competition Law should encompass: (a) remedies – ordering the end to the illegal conduct; (b)civil sanction – proclaiming agreement null and void; and prohibition of future abuse (i.e. the same conduct or different conduct with a similar effect); (c) fines to all the subjects of the competition law; (d) criminal liability/sanctions for company officials in the case of the most severe breaches of competition law, only in the case of *per se* prohibited H1 agreements – all company officials breaching the law should be liable to criminal sanctions, not only chief executives.
34. As to the settlement issue, very serious breaches of competition law should generally always be pursued more officially (i.e. with official decisions and sanctions) as a point of principle, and to create a precedent/example, particularly in FR Yugoslavia/Serbia where competition policy is young, and a useful deterrent effect on others is to be expected. Accordingly, the settlement policy should not be abused, i.e. there must be enough cases pursued officially. The competition authority should have the discretionary right to decide in which cases a settlement can be a useful way to conclude the case. Nonetheless, the monitoring of the use of that right is essential,
35. As to the leniency issue, it is important to enable all company officials (individuals) involved in breaching competition policy to be prosecuted for criminal liability. Leniency should also be offered to legal entities (corporate leniency). An efficient leniency policy can provide incentives for both individuals and legal entities to turn themselves in and to provide precious insider information, i.e. testimony regarding the criminal offenses and breaches of competition law they were involved in.
36. A strong deterrent effect is essential for general prevention in the field of competition policy legislation. There are a few cornerstones for building the strong deterrent effect of the sanctions. There

should be stringent criminal liability/punishment for company executives only in the case of H1 horizontal agreements, i.e. most hard-core abuses. The other crucial cornerstone in building the strong deterrent effect is severe fines for companies (undertakings). The deterrent effect can be more convincing if the first convictions are those of big and powerful firms. Increased probability of convictions in both civil and criminal cases, i.e. an efficient competition authority and courts, is a prerequisite for a strong deterrent effect. A crucial factor in the probability of conviction is the probability that breaches of the competition legislation will be detected.

37. The competition authority operations should be free (independent) from the influence of politics, partisan politics and public choice pressures on government. Accordingly, the proposed competition authority should be an independent authority; i.e. a body independent from the government. Its operations should be monitored by the National Parliament and the public. Responsibilities (obligations) of the competition authority towards the Parliament and the public (annual reports, public hearings, etc.) should be specified in the Competition Law.
38. The competition authority should comprise three branches (sectors) with difference tasks/operations:
    - Competition authority General Secretariat;
    - Competition authority Office;
    - Competition authority Commission.
39. The competition authority should be under the control of the President of the Competition authority who (as well as General Secretariat) will not be directly involved in law enforcement, but will monitor all the activities of the competition authority (including law enforcement). Furthermore, President and general secretariat will be directly involved in the activities of advocacy and education (competition culture). The President will be elected (appointed) by the Parliament, and will be in charge of competition authority operations overall.
40. The competition authority Office will be an investigative body (quasi-prosecution) that will file cases of breaches of the competition law. The Office will be under the operational control of the Vice President of the competition authority and the head of the Office. It will have the right to initiate investigations *ex officio*, or to process complaints filed by third parties. All cases will be filed to the competition authority Commission. The Vice President and the head of the Office will also be elected (appointed) by the Parliament.
41. The competition authority Commission will be a decision-making body (quasi-judicial body) that will make decisions on the cases of breach in the competition law filed by the Office. The Commission will be under the operational control of the other Vice President of the competition authority and the head of the Commission (Chief Commissioner). The Commission will comprise seven members: a Chief Commissioner and

six Commissioners. Decisions should be reached by majority voting of all seven Commissioners.

42. The President of the Competition Authority, two Vice Presidents and all Commissioners should be elected/appointed by the Parliament for a fixed term. The president should be appointed for six years, a vice president in charge of the Office for five years and the Vice president in charge of the Commission (chief commissioner) for seven years. All commissioners should be appointed for a fixed term, but the term should be different for each commissioner, staring with two years ending with seven years (Chief Commissioner). There should be a statutory limit for each official of one consecutive term in the authority. All of them should be nominated to the parliament by the Government, i.e. by the Cabinet of Ministers.
43. The procedure for dismissal (removing from office) should be specified very precisely and an exhaustive list of reasons for dismissal should be specified by the Competition Law. The list should include the things (deeds) detrimental to the reputation of the competition authority (office or commission), such as serious criminal offenses by official, but should not offer any legal grounds whatsoever for dismissal due to the specific decision of the Commission.
44. The legal powers of the competition authority should be divided into the legal powers of the competition authority Office and the legal powers of the competition authority Commission. It is extremely important that the Office should have the legal power to collecting all relevant data/information from the subjects of the law, irrespective of whether the case has been triggered *ex officio* or by the complaint of a private party. However, the Office must be legally obliged to respect the confidentiality of the data collected in this way. Furthermore, all relevant government institutions (for example Statistical Office, Security Exchange Commission, etc.) must be legally obliged to provide all relevant data and information to the authority.
45. The Commission should be empowered to order cessation of infringing activities, proclaim infringing agreements null and void and to impose fines. As to the general secretariat, there should be a legal provision that will provide a legal power for the secretariat to be involved in consultations in preparations of all new policies and legislation. Furthermore, general secretariat should have the legal power to initiate review of any existing policy and legislation relevant for competition policy. Nonetheless, the general secretariat should not have any power to veto any other policy/legislation however relevant it is for competition policy.
46. There should be two types of procedural rules of the competition authority: (a) procedural rules *strictu senso*; and (b) substantive rules. Procedural rules *strictu senso* shall specify precisely all the

procedures that will be used in all the cases and segments of the decision-making process within the competition authority. These procedures should be formal/written to minimize room for abuse of competition legislation enforcement. The substantive rules should provide basic criteria for competition authority decision making. These criteria should enable clear and unambiguous decisions on issues such as what a relevant market is, whether a legal entity has a dominant position, whether the abuse of the dominant position is exploitative or exclusionary, etc.

47. Both types of rules should be specified in sub-statutory texts (decrees, bylaws, guidelines, etc.), according to the legal provision provided in the statutory text – the Competition Law. All the rules should be made public; published in the Official Gazette before becoming effective and being available from the competition authority at any time free of charge in both printed and electronic versions.
48. The competition authority provides information to the public regarding its legislation enforcement activities. That should include: (a) Publishing all the decisions in the Official Gazette; (b) Create a website with all relevant legislative texts (statutory and sub-statutory) and all other legal documents; (c) Provide accurate website information on the status of all cases; (d) Provide website information on the competition authority (commission) decisions on all cases; (e) Guidelines for the notification (with forms) for mergers and agreements; (f) Guidelines for filing complaints (cases) with the competition authority (office).
49. The decision-making process should be public in certain instances. Formal decision-making sessions of the Commission of the competition authority (as a quasi-judicial body) should be public. The public should have an opportunity to monitor and contribute to the decision-making process in which each party concerned should have the right to make its case (for example, the office as quasi-prosecutor and the party that is prosecuted). Transcripts from all the sessions should be available in electronic form. Special attention should be made to protect confidential data (legitimate business secrets) of the concerned parties.
50. The role of the judiciary in enforcement of competition legislation is basically divided in to two roles (1) the role of the specialized (commercial) courts in the process of judicial review; (2) the role of general courts in criminal prosecution. In both cases institutional structures exist, the only short-term improvement that can be expected is linked to training of the judges both regarding the basics of competition policy and regarding the recent developments in competition policy/legislation, i.e. to enable them to enforce this legislation efficiently.

New Competition Policy: A Policy Paper

1. ENVIRONMENT IN WHICH THE NEW COMPETITION POLICY IS TO BE ESTABLISHED

There are four pillars of the environment in which the new competition policy for FR Yugoslavia/Serbia will be established.

1.1. Accession to the WTO and the path/pace of foreign trade liberalization

The new competition legislation/policy must be consistent, in general terms, with World Trade Organization (WTO) requirements. Nonetheless, there are no strict WTO requirements regarding competition legislation and policy. There are only a few specific requirements, limited to certain areas and/or industries (trade in services, intellectual property rights, telecommunication policies etc.). These requirements basically constitute the obligation of a WTO member country not to violate a number of provisions of agreements signed and ratified as a part of WTO accession/membership. Accordingly, there are some specific restrictions regarding the enforcement of competition policy of a WTO member, not restrictions regarding the general concept of competition policy and competition legislation. In other words, there are no constraints for the formulation of new competition policy and legislation stemming from the WTO accession process of FR Yugoslavia (Serbia & Montenegro).

Nonetheless, a very important result of accession to and eventual membership of the WTO is the expected acceleration of foreign trade liberalization. Although substantial foreign trade liberalization of FR Yugoslavia happened at the end of 2000 and in the first half of 2001 (decreasing tariff rates and simplification of their structure as well as removal of non-tariff import barriers), tariff protection is still substantial (average non-weighted tariff rate is 9.2%), hampering import competition in many industries.

As to the path/pace of future foreign trade liberalization, there are at least two possibilities (scenarios):

a. **Scenario A:** Strong and fast liberalization of foreign trade and adoption of the comprehensive FTAs; commitment of both Serbia

and Montenegro to the process – generating competition from import, decreasing barriers to entry to the domestic market and making the value of an aggressive domestic competition policy rather limited.

b. **Scenario B:** Sluggish and delayed liberalization of foreign trade and huge barriers to entry to the domestic market. That would inevitably limit the effects of import competition on the domestic market. Accordingly there would be a substantial need for a rather aggressive domestic competition policy.

Currently **Scenario B** is the more probable, particularly because no substantial driving force for foreign trade/import liberalization can be seen at this moment. It is highly probable that in next three to five years there will be no substantial liberalization of foreign trade. WTO accession/membership will inevitably foster foreign trade liberalization, but it is not quite certain what the political relevance/value of WTO accession would be on the domestic political market.

Recommendation: Competition legislation (Competition Law) should provide a legal basis to accommodate competition policies of various levels of intensity; at least for both aggressive and conservative competition policy: the choice between them will be dictated by the actual pace of foreign trade liberalization. Furthermore, competition policy, particularly in the field of controlling and preventing vertical restraints (foreclosure) is very important for foreign trade (import) liberalization to materialize, i.e. to enable foreign trade liberalization to generate import-based competition. Substantial foreclosure could be a relevant import barrier, at least in the short-term. Because of this short-term effect, competition policy formulation and enforcement should not be delayed, otherwise the full benefits to import liberalization will not be fully felt.

1.2. Stabilization and association process with the EU and the long-term prospect for EU accession

The stabilization and accession process (SAP) with the EU and the prospects for EU accession are relevant for domestic competition policy/legislation for at least two reasons. The first one is the path/pace of foreign trade liberalization, because the foreign trade regime and policy of the country must be consistent with the EU foreign trade regime and policy and at some point the domestic market will become a part of a single market of the EU. That will effectively strongly liberalize the foreign trade regime and generate import competition from the other EU countries (no trade barriers on the single market) as well as decreased import barriers for the import based competition from other (non-EU) countries. Accordingly, the swifter the accession to the EU, the smaller the need for stringent enforcement of domestic competition policy/legislation because a lot of competition will be generated by imports from EU countries. The second reason is the EU institutional framework for domestic competition policy that will be imposed on FR

Yugoslavia (Serbia & Montenegro) in the SAP and accession process toward the EU. Regarding the second aspect of the SAP, there are a few feasible options for competition policy.

a. **Option A:** Development of strictly EU compatible competition policy – the greatest value will arise if FR Yugoslavia (Serbia & Montenegro) adheres as quickly as possible to the basic principles and mechanisms of the EU's competition policy. One can argue about whether the EU or the US has a better competition policy, but both systems are more and less grounded according to the same fundamental, basic principles of competition. Given that in reality, it is the EU system to which FR Yugoslavia (Serbia & Montenegro) will eventually have to adhere (and already *de facto* in the context of a Stabilization and Association Process), it is much simpler if it adopts as many of these principles and mechanisms as soon as possible.
b. **Option B:** Developing our own path of domestic competition policy, taking into account primarily the American solutions. Due to the difference of legal system, American style competition policy can be applied only in terms of basic principles. One could argue that American style aggressive competition policy is more suitable for FR Yugoslavia, due to the inherited highly non-competitive market structures.
c. **Option C:** Developing domestic competition policy that is compatible with the EU competition policy in broader terms (key competition policy principles, general legal principles, legal terminology, i.e. the EU legal language etc.), using the same general legal framework, but still utilizing some of the elements of the US competition policy (criminal liability, for example) suitable for the domestic legal and market environment, and some elements that will be the product of creative thinking taking into account some specific features of the domestic legal and market environment.

Taking all pros and cons into account, **Option C** is looking rather good. The **Option C** is the best way out of this conceptual dilemma. There are some additional arguments in favor of **Option C**: (a) FR Yugoslavia (Serbia & Montenegro) will not join the EU for at least next 10 years, so there is substantial room (time) for fine tuning of the legislation to make it completely compatible with *acquies communitaire*. (b) EU general principles of the competition policy/legislation does not exclude some creativity in their implementation, i.e. in the creation of a specific national piece of legislation; in such a way some drawbacks of the EU competition policy can be evaded, particularly taking into account specific conditions in FR Yugoslavia (Serbia). (c) There is general convergence of the US and EU competition policy and the differences between the two are mainly due to the difference of the legal system, not so much due to the different concepts of the competition policy.

Furthermore, the full accession to the EU cannot be expected in next 10 years, so there should be some trade-offs regarding short-term and long-term solutions. Accordingly, some of the short-term solutions

regarding competition policy should not necessarily be EU compatible, if there are some strong domestic reasons to use these solutions. Since these solutions will inevitably be abolished/replaced by strictly EU compatible solutions in the long-run (as the country moves towards full membership of the EU), the scope for theses solutions is somewhat limited, otherwise too much work will have to be done in the future.

Recommendation: Bring forward **Option C**, prepare the draft legislation and keep an open mind to political feedback, particularly international, as well as the long-term requirements in the SAP and the process of accession to the EU.

1.3. New Constitutional Charter of Serbia and Montenegro and the harmonization of economic policies

Although a political consensus regarding the Constitutional Charter was achieved at the beginning of December 2002, it is still uncertain when the Charter will come into force (i.e. when the new common state of Serbia & Montenegro will be operational), what the content of the legal framework for the Charter's enforcement will be, how fast and to what extent the Charter will be implemented, when the single market of Serbia & Montenegro will be established and at what pace and in what way the "harmonization" of the currently very different economic legalization and policies in Serbia and in Montenegro will be undertaken.

Taking all this into account, a reasonable dilemma is should new competition policy, legislation and institutions be allocated to the (con)federal level (level of the common state of Serbia & Montenegro), or on the level of the Republics.

a. **Option A:** (Con)federal competition policy, legislation and institutions. Advantages and drawbacks of this option are mainly inverse to **Option B**. An additional drawback is the uncertainty of the political and institutional constellation of the new (con)federation.
b. **Option B:** Republican, i.e. Serbian competition policy, legislation and institutions. Advantages of this option are: (1) Existing Parliament, which is operational (in session), so it will pass the legislation; (2) There is feasible political support to the new competition policy/legislation from the incumbent Serbian Government, with already identified champions of the new legislation/policy; (3) Building brand-new republican institution (from scratch) could be more effective than reforming the existing federal body. Drawbacks of this option are: (1) Possible overleaping and duplication of institutional (administrative) capacities between (con)federal and republican level; (2) Possible political discontent, particularly from the EU/EC side (3) Single market argument – a single market demands a single competition policy and competition authority. The relevance of the single market argument is not overwhelming because EU member states still

have national competition policies, although there is a supranational single market.

Taking into account the current political constellation and provisions provided by the agreed Constitutional Charter, it is much more likely that competition policy will be developed and implemented at the republican (i.e. Serbian) level. Accordingly, Serbian market only will be taken into account and firms from Montenegro will be treated as "foreign" firms in the same way as firms from all other countries, applying the effects doctrine of competition policy.

Recommendation: The draft legislation should be prepared to fit both (con)federal and Serbian level. The draft legislation should be submitted to the Serbian Government (Ministry for Foreign Economic Relations) with suggestions regarding its implementation. The new Competition Law should be a Serbian piece of legislation – nonetheless, it will be, at the end of the day, a political decision by the Serbian Government: either to pass it to the Serbian Parliament or the future (con)federal one.

If the political decision is to have two competition legislations/policies and competition authorities (one for Serbia and the other one for Montenegro) there must be a body in charge of coordination of these legislations/policies and coordination of policy development and institutions building process, particularly regarding the EU, i.e. regarding the Stabilization and Association Process (SAP), leading towards the Stabilization and Association Agreement (SAA).

The Office for European integration at the (con)federal level of FR Yugoslavia (Serbia & Montenegro) that is in charge of the SAP will also be in charge of further activities regarding European integration, i.e. full EU membership. The office should be in charge as a communication channel between the EC and republican authorities regarding the competition policy, particularly regarding daily communication with the EC and its DGs. That role of the Office in coordinating the content of the competition policy, legislation and its enforcement, would be negligible, particularly because it should be expected that differences between Serbian and Montenegrin competition policy will be negligible. Of course, the best option regarding the coordination issues is for both republics to adopt the same piece of legislation. Nonetheless, the role of the Office in terms of the communication with the EC in process and receiving/distributing the EC's suggestions and guidelines for legislation changes, their enforcement and various policy adjustments in the course of SAP will be substantial.

1.4. General path of economic and legal reform

The general path of the reform has a significant impact on the development of new competition policy and legislation. The impact is based primarily on the general public (political) attention to the reform and supply and demand of the available resources (primarily human resources) for the new policies' development and particularly their

enforcement, i.e. the institution building process. Two general scenarios can be envisaged at this moment.

a. **Scenario A:** Fast, sustainable, thorough and broad economic and legal reform in the country that will mean that public/political attention will be focused on reform and there will be political incentives for decision-makers to be allocated resources in that field. As to the general demand for human resources in the reform enforcement (enforcing competition and other reform policies), it will, in principle, be higher as more reform policies are to be implemented. On the other hand, since there are political invectives for more resources to be poured into the reform institutions, the supply (particularly in the long-run) of the human resources to the institutions, i.e. to the policy enforcement will be greater. Furthermore, successful reform (thorough price and foreign trade liberalization, privatization, etc.) decreases the administrative burden of the competition policy/legislation enforcement.
b. **Scenario B:** Sluggish, unsustainable (stop-and-go), partial and narrow economic and legal reform in the country that will mean that political energy and public attention is directed away from the reforms. Some other political priorities (partisan politics, national security issues, etc.) will be at the focus of public attention and there will be no political incentives for decision-makers to be heavily involved in the reforms. Furthermore, there could even be some political incentives to frustrate reform if that reform (particularly the consequences) are harmful to the current political agenda. In short, the basic features of this scenario are inverse to the **Scenario A**.

One way or the other, at the beginning of the process of competition policy reform and the introduction of the new legislation there will be an inevitable lack of human resources for its enforcement, particularly for the law enforcement. Accordingly, suggested solutions should not be too demanding regarding the administrative burden, i.e. they should keep the administrative burden to the minimum. It is very important that advocacy, i.e. influencing other policies that create non-competitive market structures and behavior, should be taken into account as a very cost-effective method of advancing competition policy. Coordination between the competition policy and other reform policies is essential for obtaining efficient competition policy outcomes. There is also a political value of competition policy in the cases of price and foreign trade liberalization – from a political point of view it is easier to fight political opponents of the liberalization when competition policy/authority is in place, because it can be argued that such a policy will be used if anything goes wrong for consumers (the electorate). Furthermore, in the long run some of the reform policies and institutions will inevitably vanish because their job is done (the privatization agency, for example) and human resources from these institutions will be (in the long run) available for other institutions.

Recommendation: Both scenarios imply that at least in the short-run the supply of suitable human resources and administrative capacities for reform implementation will be limited. New competition policy design should take into account very limited human resources available (particularly in the short run), limited administrative capacities and possible abuses of the competition policy. Accordingly, competition policy in both scenarios should be very focused to the most significant violations of competition law, i.e. violation of the competitive market.

2. THE NEED FOR A COMPETITION POLICY AND ITS CHARACTER

2.1. The need for any competition policy

The basic question is should FR Yugoslavia/Serbia have some/any competition policy at all? Obviously, there two options regarding the issue.

a. **Option A** – The country should have some competition policy. Basic reasons for the establishment of a competition policy and legislation in FR Yugoslavia/Serbia are: desirable change of inherited market structures, inhibiting the creation of new non-competitive market structures, sanctioning of non-competitive market behavior, producing incentives for allocative efficiency, danger of privatized monopolies and/or non-competitive structures, political value of competition policy regarding price and foreign trade liberalization (it is easier to implement these liberalizations), enabling/fostering import competition by preventing foreclosure, etc.
b. **Option B** – The country should not have any competition policy. Basic reasons against any competition policy in FR Yugoslavia/Serbia are: classical arguments of economic liberalism, the possibility for abuse of the competition policy by the government and/or competitors, increased uncertainty for firms, decreased incentives for production efficiency, the possibility for tackling the competition problem through import liberalization and removing barriers to entry as the first-best policies, within the framework of scarce human and other resources competition policy and competition authorities that will enforce will drain resources from other policies/authorities like privatization policy fiscal policy/tax administration. The final argument could be the one for not triggering competition policy right now, but to wait for its introduction for some time. For example, when privatization is complete, there will be freely available resources for the competition authority. Furthermore, it has been pointed out that competition policy was not efficient dealing with inherited market structures, particularly in some transition countries. Finally, there is a danger of significant rent seeking prospects and corruption of

the competition authority and the welfare loss due to these activities.

It is highly unlikely that in the case of FR Yugoslavia/Serbia there is no need for competition policy at all. The most important economic argument is that competition policy can focus on the most significant violations of competition both in terms of the type (non-competitive behavior like cartels and abuse of market power) and their intensity measured by the impact on the economic welfare (efficiency) that no other alternative policy can challenge. Even the first-best policies of liberalization cannot deal with some cases of non-competitive behavior. Such a competition policy can increase economic efficiency and improve social welfare.

Recommendation: There should be a competition policy in FR Yugoslavia/Serbia and new draft legislation should be submitted to the Government.

2.2. The character of the new competition policy

As to the character of the competition policy, there are a few options available:

a. **Option A** – Stringent and aggressive competition policy, with both strict merger control (in principle both horizontal and vertical) and strict prohibition of the abuse of dominant position (market power) and restrictive agreements. Advantages of such a policy are : (1) Existing (inherited) market structures are non-competitive, so there are incentives for non-competitive behavior; (2) There are limited prospects for fast foreign trade liberalization; (3) Competition policy will deal with the sources of non-competitive behavior, not the outcome, (4) There is a lack of market tradition and the need to create competitive market criteria in FR Yugoslavia/Serbia. Drawbacks of such a competition policy are: (1) Strong institutional demand and limited administrative capacity, i.e. huge administrative burden without prospects for obtaining efficient institutions and needed human resources in due course; (2) Increased uncertainty for the firms and private entrepreneurs; (3) Increased possibility that perfectly competitive behavior is labeled non-competitive (prohibited), so wrong incentives for firms are created, particularly in the case of price wars and production efficiency; (4) Greater room for the abuse of competition policy, either by the government and/or by competitors.
b. **Option B** – Liberal and focused competition policy, with limited merger control, avoiding price control of abusing dominant firms, focused primarily on restrictive agreements, particularly hard core horizontal agreements (cartels). Cartels should be vigorously attacked. Advantages of such a competition policy are: (1) More economic freedom for firms and private entrepreneurs, fostering economic efficiency; (2) Decreased regulatory (policy) risk

for the firms and private entrepreneurs; (3) Better incentives for economic efficiency, particularly for production (dynamic) efficiency of the firms. Drawbacks of such a competition policy are: (1) With limited merger (structure) control, the monitoring demands on the competition institution/authority will be substantial – dominant position and market power would be more frequent than with structure control; (2) Increased prospect for administrative price control of firms that have dominant position. (3) Due to the limited merger control, non-competitive market structures foster restrictive horizontal agreements; (4) There is a possible loss of some allocative efficiency due to the non-competitive market structures and their abuse.

c. **Option C** – pragmatic, flexible, non-dogmatic policy, but taking into account the theoretical foundations on which it is based (Chicago School), i.e. based on free market ideology. **Option C** will combine the advantages of Option A and B, but will be much closer to **Option B.** Such a competition policy should be focused on the most significant problems of non-competitive market structure and non-competitive behavior (hard core horizontal agreement, for example). The paramount goal of such a policy is to decrease business uncertainty to the market decision-makers and to reduce the competition legislation implementation costs, i.e. the administrative burden of the competition authority.

Option C, in general, is definitely the most suitable option, particularly if crucial elements of option B are included in the general character of the competition policy. That will create the legal groundwork for effective, focused and efficient competition policy.

Recommendation: Draft competition legislation should be up to a point similar to modern legislation in other countries, enabling flexibility, i.e. various types of competition policy to be enforced. On the one hand, competition policy (particularly in terms of its enforcement) should be narrower than competition legislation – the legislation should provide a legal basis for quite a wide range of policies in terms of their implementation. On the other hand, there should be some legal constraints (provided by the Competition Law) of the competition policy enforcement to minimize the possibility of its abuse and decrease uncertainty to the parties.

Basically, there are two options regarding the legal constraints on the character of the competition policy.

a. **Option A:** very broad legislation enabling the competition authority to have substantial freedom in enforcement, i.e. the character of the competition policy will be decided upon in the stage of enforcement. Policy implementation should be fine tuned by sub-statutory texts: decrees, by-laws, guidelines etc, as well as in *ad hoc* decisions of the competition authority.
b. **Option B:** strong legislative constraints on the competition authority regarding the character of competition policy, i.e. although final decision over the character of competition policy

will be made in the stage of its enforcement, the competition authority will not have a wide range of possibilities, hence room for abuse of the competition policy enforcement will be reduced. This position is consistent with the position that there must be some priorities of the competition policy (focused competition policy) and the legislation should enable the competition authority to focus on these priorities and to minimize the abuse of the competition policy and minimizing uncertainty for firms and private entrepreneurs.

Option B is definitely much more sensible for the existing and expected conditions in FR Yugoslavia, particularly taking into account that checks and balances other that the legislation have not been developed very far for the time being and should not be expected soon. Accordingly, some basic economic freedoms should be protected by the law. In the case of competition policy, the law should provide strong legislative constraints on the competition authority.

Recommendation: Taking into account the existing market structures and market practices in FR Yugoslavia/Serbia, as well as the limited resources available for competition policy enforcement, the priorities (at least the short-term priorities) of the new competition policy/legislation should be as follows:

- to combat and prevent cartels;
- to enhance and foster privatization and economic restructuring;
- to increase economic freedom of firms and private entrepreneurs;
- to decrease uncertainty to all parties, particularly to firms and private entrepreneurs
- to avoid price control as a mechanism of competition policy;
- to influence other polices that have an impact on market competitiveness, particularly those that create barriers to entry.

3. THE AIMS OF COMPETITION POLICY

As to the aims of competition policy, there are basically two options, with possible further diversification of option in the case of the second option (Option B).

a. **Option A**: Single competition policy aim. The obvious aim is maximized economic efficiency; economic efficiency (the most efficient market outcome) as the only aim of competition policy – it is irrelevant whether the efficiency is allocative or productive, the aggregate economic efficiency should be examined. It can also be defined as maximized (economic) welfare. In that case it is important to specify that there should be no different treatment of consumer welfare and producers welfare and all the costs (both private and social as the consequence of externalities) should be taken into account. Effectively, that means sticking to the compensation principle (Hicks). As a consequence, competition policy should protect competition, not competitors.

Although the single aim of a competition policy is the superior solution, it can be difficult to implement it due to the political (public choice) pressures (still to be identified). Difficulties in the implementation stage of a superior solution are rather modest for the time being, because competition policy issues are still not on the Serbian political agenda, hence no strong public choice pressure can be expected as yet.

b. **Option B:** Multiple competition policy aims. This means that apart from the maximization of economic efficiency, some other aims of competition policy should also be specified. Without contesting economic efficiency as the primary goal, additional goals can be: free flow of products (goods) within a single market (Serbia & Montenegro) and protection of SMEs, or small entrepreneurs, as was the case in some countries (very few remain today, only two). The first additional aim in the case of FR Yugoslavia has a significant political background – the political aim of the single market of Serbia & Montenegro can capture competition policy and push it away from the aim of economic efficiency. The same finding goes for protection of small entrepreneurs and fostering of SMEs. Political pressure to introduce these components can be substantial, particularly the first one.

Economic efficiency should be the only aim of competition policy. All aspects should be taken into account (allocative vs. productive efficiency and consumer vs. producers welfare). Artificial protection of inefficient producers (big or small) should be avoided at any cost. Good bankruptcy legislation and efficient bankruptcy process is important for the protection of economic efficiency. An additional argument in favor of a single goal competition policy is that politicians are very keen on adding aims to some public policy, particularly in the stage of policy enforcement. Accordingly, a legal provision as a barrier to such behavior of multiplying the goals of public policies should be established.

Recommendation: Article 1. of the new Competition Law should explicitly point out that economic efficiency is (should be) the only aim of competition policy. In the presentation terms this goal should be described as increasing or maximizing consumer benefits (economic welfare), because such a presentation has a substantial political value.

4. COMPONENTS AND PRINCIPLES OF COMPETITION POLICY

4.1. Components of competition policy

There are a few components (segments) of competition policy. These components can be considered as general methods of implementation of competition policy. These components are:

- competition legislation enforcement;
- competition policy advocacy;
- competition culture development – education.

As to the first segment of competition policy (legislation enforcement), it is traditional, inevitable and very resources consuming, i.e. it inevitably creates a huge administrative burden on the competition authority and other institutions. This is undoubtedly the first duty of the competition authority. It should be taken into account that it should not be the only duty of the authority and that substantial resources should be allocated to the two other segments of competition policy.

Competition policy advocacy is a very important segment of competition policy. By effective the advocacy competition authority can influence virtually all the policies that affect competition on the domestic market. For example foreign trade policies (barriers to import), privatization and restructuring policies (breaking-up of existing non-competitive market structures and prevention of the emergence of the new ones), various public policies that affect barriers to entry for new firms, etc. These policies are the first-best policies in many cases, compared with traditional competition policy. The more resources allocated to competition policy advocacy, the more effective the advocacy and the more competition on the domestic market, hence the less need for stringent competition legislation enforcement.

Development of a competition culture, i.e. education of all parties concerned regarding competition policy is a method for making the previous two segments of the competition policy more effective (although sometimes education is classified as a segment of advocacy). Increased knowledge of the parties involved, particularly creation of pro-competitive public opinion, increases the efficiency of competition legislation enforcement. Furthermore, advocacy will be more effective with widespread knowledge about the competition policy, particularly the effects of non-competitive market structures and/or behavior. The existence of pro-competitive public option creates the possibility for the competition authority to recruit many allies for the effort to promote and enforce competition policy/legislation.

4.2. Enforceability of competition legislation

The basic principle is that a suitable policy framework should be established, including competition legislation that can be enforced. A law that is not enforced erodes the credibility of the competition authorities and devalues everything contained in the law. Accordingly, solutions that cannot be enforced (due to, for example, limited administrative capacity or lack of information and/or empirical experience) should not be specified in the legislation.

4.3. Flexibility principle

The legislation shall, on one hand, have certain flexibility so as to allow discretionary decisions of the competition authority, i.e. enable the authority to deal with all anti-competitive actions. On the other

hand, the room for discretionary decisions shall be relatively limited, to focus the activities of the competition authority, reduce the uncertainty for economic decision-makers and to minimize the room for abuse (both by the Government or by the private parties/competitors). In principle, this dilemma can be resolved by the rule that the legislation should provide a firm framework that will exclude the possibility of the competition authority becoming involved in some activities, but also allow flexibility in the fields that are feasible for the remaining authority action. In general, it is better to prevent abuses of competition policy than to control them.

4.4. General character of the competition law

As to the general character of the competition law, the crucial question is: does the law have to specify (enumerate) examples of prohibited acts and actions, both in terms of an exhaustive list (*numerus clausus*) and open ended, non-exhaustive list, i.e. examples only (*exampli causa*)?

a. **Option A:** No specification (enumeration) whatsoever, only the general legal framework for decisions made by competition authorities and courts. Accordingly, the discretionary rights at the stage of enforcement will be substantial. Furthermore, it should be taken into account that in FR Yugoslavia/Serbia there is no widespread legal and economic knowledge (tradition) that would enable enforcement authorities and the parties to grasp competition policy issues. Some benefit can be expected if some specification is given in guidelines (sub-statutory text).
b. **Option B:** Extensive specification (enumeration) of prohibited acts and actions, leaving the possibility for more acts and actions to be proclaimed illegal by the competition authorities. It is debatable whether that specification (enumeration) should be done in the law itself or in the additional guidelines (sub-statutory text).

The EU example is relevant for FR Yugoslavia/Serbia. Article 81 of the Treaty of Rome (on restrictive agreements) prohibits agreements that prevent, restrict or distort competition, and then gives several categories of general agreements which are therefore illegal. More specific examples are then given in guidelines that are not part of Article 81 itself. Similarly, Article 82 of the Treaty of Rome (dominant position) gives some examples of what constitute abuses of a dominant position, but in a broad general sense.

Recommendation: Taking into account the poor tradition of implementation of competition policy/legislation in Serbia, i.e. expected operations of competition authority and the lack of economic knowledge of Serbian judges, **Option B** is the best option, and enumeration should be a part of the statutory text (law), rather than sub-statutory text (guidelines). Enumeration should, in general, be indicative (*exampli causa*) – there must be a sufficient leeway for more acts and actions to be proclaimed illegal by the competition authorities. Exceptions

should be made only in the case of hard-core anti-competitive behavior – here an exhaustive list of offenses (*numerus clausus*) should be provided because these actions are *per se* prohibited.

5. THE METHODS OF COMPETITION POLICY

There is a general division between traditional and non-traditional methods of competition policy. Traditional methods are those that form the arsenal of competition policy/legislation itself. Non-traditional methods are alternative methods and they will decrease the need for enforcement of traditional methods of competition policy. In some cases, they are complementary, because their effective implementation will make competition policy traditional methods easier for implementation and/or more efficient. These methods are specified in other public policies that have a substantial effect to competition, i.e. market structures and the behavior of market decision makers.

Advocacy as a segment of competition policy, i.e. the influence of the competition authority on decision-markers in other fields of public policy relevant to competition policy is the way for the competition authority to be involved in the formulation and enforcement of these public policies. Specifying the advocacy function in the competition legislation will provide a legal basis for the competition authority to be consulted and to mount pressure on the decision-makers regarding new or existing relevant public policies, i.e. policies that have an impact to competition policy.

Advocacy should be implemented in the case of new pieces of legislation, other new legal documents that have an impact on policy and policy enforcement strategies as well as the existing pieces of legislation. Day-to-day enforcement of competition policy/legislation should be left out of the advocacy scope. The dilemma is whether the advocacy role of the competition authority shall include veto power (ruling decisions).

a. **Option A:** Consultative role of the competition authority only over new/existing relevant public policies (alternative competition policies) documents. Advantages of this option (consultative role only) are: (1) Creating incentives to the competition authority for effective advocacy – the authority has to be convincing in the advocacy; (2) Efficient process of government (both executive and legislative branch) decision-making – no stalemates due to the blackmailing veto power of the authority; (3) Efficient influence on policy making in terms of its improvement – the authority has every incentive to focus on those policies that have the maximum impact on competition; (4) The authority will have incentives to focus only on the most important problems – only very convincing cases will change public policy.
b. **Option B:** Ruling (veto power) of the competition authority over new public policies documents. Drawbacks of this option (veto power of competition authority) are: (1) Competition between

public/state authorities – it is likely that such competition would be disadvantageous for the decision-making process; (2) Inefficient procedures for making decisions and enacting new legislation and/or enforcing new public policies.

Option A is definitely the better one. The main reason is that it provides incentives for competition authority officials to do their advocacy job efficiently, i.e. for their advocacy to be effective. That will include persuasion of the decision-makers (both in executive and legislative braches of government) and the public. Veto power will give the competition authority to much power and their position will be too comfortable, i.e. there will not be sufficient incentive for efficient advocacy, because they know that at the end of the day they can block a new piece of legislation. That creates incentives for strategic behavior of the competition authority and policy horse-trading with other agencies/authorities. In short, effective influence does not mean that it is efficient, i.e. that efficient public policies are adopted and enforced at the end of the day.

More effective advocacy of suitable alternative public policies means that this policy will do the job of traditional competition policy and that the workload of the competition authority in (traditional) competition policy enforcement, i.e. in the competition legislation enforcement will be reduced. That is a strong incentive for the competition authority to be efficient in its advocacy role, particularly taking into account that it can publicly claim credit for all the policy improvements.

Veto power will increase the administrative burden of the competition authority, particularly taking into account that in some cases the advocacy should also encompass municipalities, i.e. local authorities and their public policies that affect competition on the local market. In addition, the enforcement leverage of the competition authority in the case of municipalities is rather ineffective, so veto power that is effectively not enforced will ruin the credibility of the authority altogether. Furthermore, there should be no competition between agencies and authorities for policy formulation and enforcement (possible veto retribution strategy, or veto deterrent strategy).

Recommendation: Competition law should provide a legal ground for the competition authority to have a consultative role in the case of new policies and legislation that is relevant for competition policy. Furthermore, there should be a legal provision for the competition authority to initiate review and examination of existing policies and legislation relevant for competition policy.

5.1. Liberalization of foreign trade

Liberalization of foreign trade, particularly import liberalization is one of the main mechanisms for bringing competition to the domestic market. In the case of many products if there is relatively free import, it is not important whether there is only one producer of that product in the country.

a. **Benefits** of the foreign trade liberalization are: (1) It is very effective in the most of the cases, i.e. in the case of most of the products; (2) There are both short-term and long-term beneficial results to the competition; (3) There is no need for the time-consuming and painstaking institutional building process of competition authority; (4) There is no administrative burden to the authority.
b. **Drawbacks** of the foreign trade liberalization are: (1) It is not effective in some cases, i.e. for some products (non-tradables and tradables with substantial transportation costs); (2) There are substantial political pressures against foreign trade liberalization, so such a policy may not be feasible, particularly in Serbia with the recent return of protectionism as the preferred public policy; (3) Possible exclusionary practices by incumbent firms (barriers to entry), particularly regarding distribution networks for new imports or/and foreign producers, can slow down the effects of liberalization on competition.

Although foreign trade liberalization can be a very effective substitute for domestic competition policy, it is not a panacea for all the problems (non-competitive behavior) and the obstacles for further foreign trade liberalization in Serbia in the future will be substantial.

5.2. Removing barriers to entry

Regarding the policy of removing barriers to entry, all barriers to entry should be taken into account as a crucial factor of non-competitive market structures/behavior: import related, administrative, regulatory and other barriers. Barriers to exit are considered as a special case of barriers to entry.

a. **Advantages** of the policies of removing barriers to entry are: (1) These are policies that can bring about competition (new entries) that will provide pressure on non-competitive behavior; (2) Some of the barriers to entry can easily be eliminated; (3) There can be swift beneficial effects to economic efficiency without time-consuming institution building and administrative burden on the competition authority.
b. **Drawbacks** of the policies of removing barriers to entry are: (1) Some administrative barriers to entry are substantial and it cannot be expected (due to the political process) that they will be eliminated swiftly; (2) Some barriers to entry are decentralized (they are on the local authority level), hence very resistant; (3) Some barriers to entry are completely exogenous to political process and public policies (i.e. technological and economic barriers to entry) and they cannot be changed rapidly by any public policy; (4) Barriers to entry due to the high country risk can be removed only very slowly in piecemeal political process.

Removing/decreasing barriers to entry should be paramount for government economic and reform policies, but should not be a burden

for competition policy in terms of competition legislation enforcement. There should be a separate examination of those (administrative and/or legal) barriers that can be removed quickly and those that are of a more permanent nature, be they of political, economic or institutional nature. There should be a separate examination of the prospects for elimination of entry barriers in the next three or five years, drawing on the recent CEE experience.

5.3. Free trade agreements

Widening of the free trade zone (regionally and in the distant future with the EU) can be considered as a way in which the problem of minimum efficient scale for certain undertakings/plants may be overcome. As this will increase the size of the market to accommodate the minimum efficient scale, benefiting Yugoslav/Serbian firms due to the economy of scale production efficiency to be expected. Another component of FTA impact is the impact of import liberalization.

5.4. Privatization and restructuring policies

The privatization model should not be selected according to its effects on the competition policy, but these effects should be taken into account in the implementation of the privatization model, i.e. selecting privatization implementation policies. The competition authority should be in a position to advocate those polices that will create competitive market structure or at least prevent it from creating non-competitive market structures. For example, advocacy in favor of batch tendering for industries with the provision that each bidder can buy-out only a specified number of firms. Furthermore, restructuring of big firms before privatization provides room for the impact to non-competitive market structures. Fragmentation of these firms as a part of pre-privatization restructuring should clear the way for establishing competitive market structures. On the other hand, wrong and inappropriate models of privatization, particularly when implemented consistently can create huge non-competitive market structures that must be treated with stringent competition policy and rigorous enforcement of competition legislation.

There should be no competition and overlapping between the competition authority and privatization agency: increased competition, both in terms of competitiveness of market structures and behavior could be side effects of the privatization, depending on the privatization model and its implementation.

5.5. Traditional methods of competition policy

There is a question regarding traditional methods of competition policy (merger control, control of abuse of dominant position, restrictive agreements prohibition and control) and their enforcement: In the

case of FR Yugoslavia/Serbia, what should be relation/ratio/share of the mentioned four alternative methods of competition policy compared with the traditional methods of competition policy?

There is no way to provide a specific answer to this question. Nonetheless, any breakthrough in the listed substitutes to traditional competition policy should be exploited in the fine-tuning of the competition policy and its enforcement. Although the new legislation should provide a legal groundwork for stringent competition policy for the scenario in which no breakthrough in alternative methods of competition policy materializes, there must be legal safeguards against abuse of the competition policy/legislation.

Alternative competition policies are the first-best policies because there are no discretionary powers, no rulings on cases, as there is with the traditional competition policy methods, no administrative burden and no room for the abuse of the competition policy by the state and/or other competitors. The crucial incentive for the competition agency for their advocacy role, pushing forward alternative methods of competition policy is that it offers the possibility of reducing its administrative burden.

The more effective the advocacy role played by the competition authority, the less the administrative burden on the authority regarding traditional competition policy implementation. This incentive should be clear to everyone in the competition authority and should influence the general strategy of the authority's operations. Smaller administrative burden will also reduce possibility for the abuse of the competition policy.

6. ELEMENTS OF COMPETITION POLICY (1) – MERGER CONTROL

6.1. Merger control – the need and effects of such control

The basic question regarding merger control is whether FR Yugoslavia/Serbia needs merger control as a segment of competition policy at all, particularly having in mind the existing (social ownership) and future ownership structure of Serbian firms (after privatization). Furthermore, it should be taken into account that there has been no merger control in FR Yugoslavia/Serbia for the time being, i.e. there is no experience whatsoever regarding merger control enforcement. In general, of course, the feasible option is to exclude merger control form the competition policy and legislation.

a. **Option A:** Merger control as an indispensable segment of competition policy for FR Yugoslavia/Serbia. The framework for merger control should be a general and consistent one, but which can nevertheless be easily applied to what will undoubtedly be rapidly changing markets in FR Yugoslavia/Serbia, i.e. substantial flexibility must be build into the framework. As FR Yugoslavia/Serbia integrates more and more with the EU economy, the markets in

which firms compete will evolve, and the merger control framework should be able to take this into account. Advantages of having merger control as a segment of competition policy are: (1) By introducing merger control competition policy will prevent the creation of non-competitive market structures as the basis for non-competitive behavior; (2) Competition policy will create conditions within which the free market will operate, rather than focusing on monitoring and control of non-competitive market structures and the behavior of the firms with market power, such as price control of firms with dominant position; (3) Decreasing the possibility for the abuse of competition policy by exerting price control on firms with dominant position; (4) The possibility for cartel control evasion by mergers will be eliminated, (5) Compatibility with modern legislation in the World will be achieved. Drawbacks of the introduction of merger control: (1) Merger control inevitably increases the administrative burden on the competition authority; (2) Merger control will increase business uncertainty among firms and private entrepreneurs; (3) Possibly partly wrong incentives to firms will be created; (4) Merger control is inherently future oriented – it is less exact, more speculative, so it is difficult to establish good and precise policy in that field.

b. **Option B:** No merger control at all. The Advantages and Drawbacks of this option are inverse to **Option A** an additional reason against merger control would be that it cannot be effectively enforced in the case of elusive social ownership. Nonetheless, it should be pointed out that ownership is not so "elusive" as it was ten years ago and, more important, it will disappear through the (compulsory) privatization process in the next few years. The additional drawback of **Option B** is that it is highly probable that the EC will, within the framework of the SAA, insists on inclusion of merger control in competition legislation. Taking that into account, it is better to start right now the development of the whole mechanism of merger control starting with: merger control policy and merger control legal provision.

The advantages of having merger control provision in the legislation (**Option A**), i.e. to have merger control as an instrument of the competition policy are definitely greater than the disadvantages. However, the development of the merger control section of the competition legislation and its subsequent enforcement should be undertaken very carefully, taking into account its drawbacks and possible adverse side effects.

Recommendation: There should be provision for merger control in the new competition legislation. There must be a clear merger control policy and the legal provisions should enable the competition authority to focus on the aims of that policy, i.e. to block the competition authority from any possible abuse of merger control.

6.2. Suspension of merger control enforcement

As to the enforcement of merger control, the crucial question is: should there be a suspension (holiday) of merger control enforcement for some period after enactment of the new legislation (12 months, for example)? Accordingly, there are two options:

a. **Option A:** Some suspension of enforcement of merger control enforcement with precise date from which merger control will be enforced. Advantages of having suspension of enforcement are: (1) Signal that merger control will be enforced in due course, so firms can prepare for it; (2) Slot of time for designing sub-statutory texts (guidelines for decision-making) that will enable efficient enforcement of competition legislation in the field of merger control; (3) Suspension will provide a time for institution building and enabling the competition authority to prepare itself for the enforcement (training) and designing the procedures for merger control investigation and decision-making. (4) The suspension will enable the majority of the privatization process not to be slowed down. Drawbacks of having suspension of enforcement are: (1) The signal will be sent on leniency in competition policy enforcement; (2) Big mergers within the privatization process will happen during the "holiday" time, so an incentive will be created for mergers to happen swiftly.

b. **Option B:** No suspension of merger control enforcement. Advantages and drawback are inverse to Option A. The additional drawback of **Option B** would demand a substantial time needed for the competition authority to be enabled for dealing with merger control, so effective merger control will not be enforceable for some time. This lack of enforcement of the merger control will inevitable undermine the credibility of the whole competition policy.

Option A (temporary suspension of the merger control enforcement) is much more reasonable and its implementation demands answers to two questions: (1) What should be the suspension time (initial suggestion is 12 months)? (2) Should there be a suspension of enforcement of the sections of the new legislation on merger control only or the enforcement of the whole legislation (*vacatio legis*)? The answer to the questions depends on the political dynamics of the legislative bodies activities and the time frame for adoption of the new legislation.

Recommendation: There should be a suspension in merger control enforcement or the whole new legislation enforcement for a specific time after adoption of the new legislation – 12 months from the legislation enactment.

The most suitable way for that suspension of the merger control enforcement is suspension of the new Competition Law enforcement for 12 months. There should be a legal provision/text in the Law like:

"This act will be enforced as from, say, 1st January 2004, i.e. a date from which the legislation will be enforced should be stipulated.

6.3. Merger control and privatization in Serbia

The crucial question is what the influence of merger control will be on the pace and outcome (success) of privatization. There are a few options regarding the link between competition policy and the privatization process in Serbia.

a. **Option A:** There must be a visible and strong link between privatization policy and competition policy, i.e. a procedural link between privatization law and competition policy law. The basic idea is to control mergers that will be enforced through tenders/auctions. Merger control clearance should be given before the final stage of tenders/auctions, so all competitors should be proclaimed eligible for the final stage of the bidding and for the capital transaction. The merger control over privatization should be enforced in the same way that it is enforced in all other cases.
b. **Option B:** General exemption on privatization, i.e. privatization process should not be the subject of merger control. Accordingly, all mergers enforced through privatization will be exempted from merger control.
c. **Option C:** Version of **Option A**, suspension ("holiday") on enforcement of merger control in the privatization process, completely linked to the general suspension on merger control enforcement.

Recommendation: The **Option C** is a reasonable option, the best one out of the three. It will enable the relatively smooth introduction of merger control in the privatization process. Stringent and immediate merger control enforcement will inevitably slow down and complicate the privatization process. Block exemption of privatization mergers is a politically bad solution due to the different treatment of the mergers and it will reduce the credibility of the competition policy and competition legislation enforcement.

Furthermore, the political tension that can be built up along the **Option B**, which effectively exempts privatization mergers from the merger control segment of the competition policy, can be solved, at least in the terms of presentation, but that will demand a lot of wasted political energy. The point is that other provisions of the competition legislation will/should be enforced on the privatized firms exempted from merger control, like the provisions of the abuse of dominant position (if dominant position is created by the merger) or prohibition of horizontal agreement (cartels) that are more probable if the industry is more concentrated. Nonetheless, the general exemption of privatization from merger control could be perceived as the first step towards thorough exemption of privatization, i.e. that no provision of the competition legislation at all

should be enforced in the case of privatization and recently privatized firms.

In general, the privatization of non-competitive market structures would create incentives for non-competitive behavior, i.e. new private owners would exercise market power. Nonetheless, the danger that privatization itself will create non-competitive market structures/behavior in Serbia is not great for four basic reasons: (1) Very few good big firms will be available to be privatized by tender in the near term, particularly after the period of suspension of the new competition legislation enforcement expires; (2) The Privatization Ministry/Agency has already taken into account industrial organization issues in the privatization process, blocking the formation of non-competitive market structures during the privatization process; (3) Strong advocacy activity on the part of the competition authority will be very beneficial giving privatization Ministry/Agency informal guidelines for the remaining batch of privatization tenders and auctions before the merger control legislation is enforced; (4) All big Serbian firms (conglomerates) that are loss making for the time being (and the majority of them are), will be thoroughly restructured (fragmented by spin-offs and creating of new smaller enterprises) before privatization, according to the actual privatization program.

It is of the utmost importance that special care should be taken regarding the design of an efficient enforcement mechanism of merger control in privatization, both in the terms of possible loopholes, on the one hand, and swift implementation of privatization, on the other, i.e. privatization should not be slowed down by a merger control mechanism built into the process. There are a few options regarding the design of the enforcement mechanism for merger control involvement in the privatization process:

a. **Option A:** Not to have any special articles in the Competition Law regarding privatization, merger control will be enforced by straightforward enforcement of the new competition legislation. Some detailed guidance for the enforcement could be provided in sub-statutory texts in the field of competition policy.
b. **Option B:** To have explicit articles in the Privatization law that will deal with merger control within the privatization process. These articles would specify all the details of the enforcement of merger control in the privatization process.
c. **Option C:** Not to change the privatization law, but to include merger control mechanisms' into sub-statutory texts (Decrees) in the field of privatization policy. The amended privatization Decree should specify the obligation of the Privatization Agency to verify that there is a merger control clearance before signing the privatization contact in cases where the parties are liable to merger control.

Option C is the best option for the implementation of merger control in the privatization process after the suspension of competition legislation enforcement expires. The suspension of the enforcement

will provide enough time for all the necessary preparations for the enforcement of the merger control in the privatization. All the participants of the privatization process (buyers) should have obtained clearance (if necessary, i.e. if they are above notification threshold) before signing the privatization contract in the case of both tenders and auctions. The burden of getting the clearance should be on the buyers hence all information relevant for merger should be presented to the potential buyers/investors (i.e. to the public) in the early stage of each privatization transaction. In case of tenders that should be a part of advertisement for financial advisers and in the case of auctions that should be a part of the privatization prospectus. The Competition authority should keep pre-merger notification strictly confidential, i.e. this notification should not be used for the benefit of potential tender or/and auction competitors.

6.4. The range of merger control

As to the range of merger control, the crucial question is should merger control be established only regarding merger *strictu senso* (status change, fusion or takeover of legal entities) or mergers in a wider sense (transfer of ownership without changing the legal status of the legal entity, purchase of shares). Furthermore, the effects of strict takeover control (not merger related) should be taken into account. Finally, the issue of the range of merger control is relevant for the case of the companies in bankruptcy, i.e. should the takeover of a bankrupt company be subject to merger control.

In general, all forms of mergers should be subject to control/challenge. There is no need for special treatment of various forms of mergers (legal entity's status change, fusions, takeovers, concentrative or coordinative joint-ventures, purchase of shares etc.). The crucial element of merger regarding competition policy is obtaining control, i.e. the question is who has effective control over the company (undertaking) after the merger. Case-by-case analysis of the mergers should be able to deal with all the eventualities. The legislation should provide a framework (legal basis) for all the mergers to be challenged, in terms of effective control of the company (undertaking).

One of the crucial questions is about the method of merger control in the case of consecutive purchase of shares, particularly regarding the information on these capital transactions. According to the actual Yugoslav/Serbian legislation, all purchases of shares bigger that 5% of the total value of shares (total value of the capital) of the company must be registered at the Securities Exchange Commission and should be immediately registered by the Central Security Register. Furthermore, if a single investor acquires more than 37.5% of shares of one company cumulatively, that change will also have to be notified to the Securities Exchange Commission and be registered by the Central Security Register. Furthermore, the Central Security Register provides information on all the owners of joint stock companies, i.e. companies

whose shares are floated on the stock market. Accordingly, information gathered by the Securities Exchange Commission and Central Security Register is sufficient for effective control of mergers effected by the consecutive purchase of shares.

Finally, companies in bankruptcy should not be excluded form competition policy legislation, i.e. takeovers of these companies should be challenged as other mergers. Nonetheless, assets sales in the case of companies in liquidation has no economic effect of merger whatsoever, hence it should not be liable for merger control, i.e. these operations should not be under the jurisdiction of the competition law.

6.5. The method of merger control

The crucial dilemma regarding the method of merger control is: whether there should be an obligation to acquire prior authorization/clearance (pre-merger control) for the mergers or obligation to notify only (post-merger control). Accordingly, there are two options:

a. **Option A:** Prior authorization of mergers for all the (above the threshold, i.e. relevant) firms/mergers. Benefits of this option are: (1) Effective merger control is established; (2) There is no need for post-merger activities of competition authorities (3) Uncertainty for the firms and private entrepreneurs is decreased. Drawbacks of this option are: (1) Creating the room for possible delays in merger activities and/or privatization, that could be harmful to economic efficiency; (2) Substantial administrative burden is imposed on the competition authority; (3) There are only speculative grounds for *ex ante* decision-making in the process of merger control – effects of the merger are not known at the time when decision on them is made.
b. **Option B:** Prior notification only as the method of merger control. This option would enable the competition authority to deal with the merged firms after the merger took place. Advantages of this option are: (1) *Ex post* decision of the authority will be based on facts (accurate information) regarding the effects of the merger, rather than pre-merger speculations; (2) There will be a rather limited administrative burden, only more demanding monitoring of the merged firms will be necessary; (3) There will be no delays in merger activities and/or privatization. Drawbacks of this option are: (1) Increased uncertainty for merged firms, so reduced incentives for efficiency-gaining mergers and privatization; (2) Introduction of inefficient and possibly ineffective merger control; (3) There will be increased administrative burden for the competition authority due to the need to monitor the merged firms.

Option A (prior authorization of mergers) is definitely a better model for FR Yugoslavia/Serbia because the drawbacks are much smaller than the advantages. *Ex post* activities of the competition authority (divestitures of already accomplished mergers) should be

avoided at all costs. Hence, all mergers should be cleared (authorized) before becoming legally effective. A clearance/authorization of a merger by the competition authority means that no merger investigation can be launched later, so uncertainty for firms and private entrepreneurs is minimized. Some other cases against the merged firms can be filed (misconduct, abuse of dominant position, etc.), but the merger that has been cleared/ authorized cannot be challenged again.

6.6. The type of merger notification

Since prior authorization of mergers has been selected as the method of merger control, the type of notification that properly fits the selected method of merger control should be introduced. In principle, there are three types of notification that can be used for merger control: (a) compulsory pre-merger notification; (b) compulsory post-merger notification; (c) voluntary (pre-merger) notification.

a. **Option A:** Compulsory pre-merger notification with two stages of decision- making is a reasonable option. All firms liable to notification requirement (above the notification threshold) must submit the notification to the competition authority asking for clearance of the planned merger. There should be standardized information that will be required from the parties – the best way of enforcement will be a standardized form of the pre-merger notification request that should be filled out by all the parties notifying their merger. The competition authority in a short time should decide about future actions: a) there is no action so the merger is cleared; or b) there will be further investigation after which the merger can be cleared or prohibited. Advantages of this option are: (1) Effective notification mechanism for efficient merger control; (2) Reduced uncertainty for the firms and private entrepreneurs. Drawbacks of this option are: (1) Substantial administrative burden on the competition authority; (2) Possible delays in privatization process.
b. **Option B:** Compulsory post-merger notification. This type of notification makes no sense in combination with prior authorization of all mergers as a merger control method already suggested for Serbia, because it is practically mechanism for post-merger monitoring and action.
c. **Option C:** Voluntary pre-merger notification is an approach in which there is no threshold for notification, but the firms voluntarily notify their merger asking the competition authority for these mergers to be cleared/authorized before they take place. Firms will have incentive to notify the merger and to get clearance for the merger, eliminating any possible delayed legal action against the merger. Advantages of this option are: (1) Small administrative burden to the competition authority; (2) Smaller possible delay in privatization and merger activities. Drawbacks of this option are: (1) Virtually ineffective merger control; (2) Weak

incentives for firms to notify their mergers, particularly taking into account legal tradition in Serbia.

Option A is the best option, i.e. effectively the only feasible option for merger control in Serbia, taking into account the method of merger control that has been selected.

Mergers below the specified threshold are not subject to the competition law, i.e. they are not under the jurisdiction of the law, and hence these mergers cannot be challenged by competition authority or private party as a part of private enforcement of the competition law. Such a solution decreases uncertainty for firms and private entrepreneurs.

6.7. Notification threshold

The issue of notification thresholds includes a few issues/questions: (a) threshold levels, particularly the dilemma objective and/or subjective thresholds; (b) possible differentiation of thresholds' types and levels across the industries; (c) possible differentiation of thresholds' types and levels among the type of merger (horizontal and vertical)? As to the threshold differentiation, there are a few options:

a. **Option A:** Standard threshold for all industries and types of mergers (horizontal, vertical and conglomerates).
b. **Option B:** Different thresholds for different industries and types of mergers.

Option A is a simple, straightforward and efficient solution. Option A is virtually the only feasible option because option B (different thresholds for different industries and types of mergers) will provide too much uncertainty, confusion and room for too much discretion for the firms. For practical purposes, specific thresholds should be established only in banking and insurance industry, possibly also in wholesale and retail trade.

Recommendation: Option A (standard threshold for all the merger cases) should be introduced into the legislation.

As to the types of thresholds, there are two possible options:

c. **Option C:** Objective threshold (turnover or/and assets).
d. **Option D:** Subjective threshold (market share, etc.).

Option C is virtually the only feasible option. Turnover data should be used as threshold, both (cumulative) minimum combined turnover of the firms that will merge and minimum turnover of one of the firms. It is possible, but not recommended to involve turnover on domestic/international market, the latter particularly important for a foreign investor. Assets values, in principle, should not be used due to unreliable data (to be used only in banking and, possibly, insurance industry). Some of the proposed thresholds should be tested on existing firms in Serbia and their turnover in the last year to get the idea about the number of firms liable to merger control.

The recommendation is that no international turnover data should be required, only national. Nonetheless, if the foreign company acquires

a domestic firm, its export to the domestic market should be considered as a part of combined revenue of the merged firms. Combined turnover of the merging firms and minimum turnover of one of them are both necessary conditions. The merger/firms are liable to compulsory notification only if both conditions are met simultaneously.

Indirect ownership control of the firms should always be taken into account in the case of mergers. It is still unclear how to select a relevant cut-off point for indirect ownership. Nonetheless, it is clear that this cut-off point should not be specified by the statutory text (Competition Law), but rather by guidelines (sub-statutory text).

Since there is a legal obligation for the firms to notify their mergers, failure to notify is illegal, so there must a sanction for the failure. The sanction, apart from the fine, is that the merger is to be proclaimed null and void. Accordingly, the merger registration in the court will be proclaimed null and void.

If the merger is already registered and the firm is established, the sanction then will effectively be divestiture of the new firm, or compulsory selling of the shares, i.e. (re)establishing the situation that existed before the merger took place. As to the process, the proof of the failure to notify becomes the effective notification of the merger.

As to inaccurate data submitted in the notification (leading the competition authority to make a decision on the merger on the basis of wrong information), if the disclosure is proven to be inaccurate, the parties should be penalized (fines) for disclosing inaccurate information and a new notification should be submitted.

As a sanction for failure to notify accurately, effective divestiture can be ordered. Such a "limited" divestiture is due to the fault of the parties (not to notify or to notify inaccurately). In other words, the risk for their own actions (deeds) lies with the parties. By following simple basic notification rules that risk is eliminated. The divestiture is limited, so no big economic/legal problems can be expected. The sooner failure is disclosed, the simpler divestiture will be.

6.8. Horizontal and vertical mergers – differential treatment

As to the treatment of the mergers, the crucial question is: should the legislation treat horizontal and vertical mergers differently at all, and, if yes, how that should be achieved? Basically, there are two options regarding differential treatment:

a. **Option A:** No differential treatment at all, because there is no benefit from different legal treatments of horizontal and vertical mergers. Case-by-case analysis (the rule of reason) should be able to deal with all the eventualities. Naturally, all the future effects of the proposed merger should be taken into account. It should not be a case of whether there should be a different treatment, but rather that in addition to the competitive and economic efficiency impact on the horizontal level, vertical elements, and any competitive and economic efficiency

effects that these may have, should also be properly taken into account.

b. **Option B:** Yes, horizontal and vertical mergers should be legally treated separately in terms of the burden of proof. Horizontal mergers are to be presumed to be anti-competitive and the burden of proof should be on the parties (firms). Vertical mergers are to be presumed to be pro-competitive and the burden of proof should be on the competition authority.

Option A looks much better. It should be applied as the rule of reason for all mergers and there should be no differentiation between horizontal and vertical mergers. The burden of proof should be on the competition authority, i.e. the authority will have to demonstrate that the merger effects are adverse to competition and consumers' economic welfare in each case. In other words, all mergers should be presumed to be pro-competitive, and the job of the competition authority is to demonstrated they are not if the authority decides to challenge a merger.

6.9. The procedure of merger control

The procedure of merger control has two tiers. The first one is essentially that after the notification, the competition authority (the Office of the competition authority) decides whether the merger can be unconditionally cleared or if some additional research/investigation (considerations) is needed for the final decision. The decision must be reached within 30 days from the date of notification. The decisions can be:

- a formal clearance of the merger;
- information that a second tier investigation has to take place.

Both decisions should be published in the Official Gazette of the country.

If there is no answer within 30 days, that will, form a legal point of view be the same as a formal clearance of the merger – silence means consent. The merger can be registered in the court.

The courts (judges) involved in the registration will have the information on merger thresholds. Accordingly, there is no need for clearance for the mergers/firms below the merger thresholds, i.e. these firms can effectively merge without involvement of the competition authority.

Information of the beginning of the second tier investigation should be followed by a list of the additional information that the parties should submit to the competition authority. The 90 days period for the final decision of the competition authority should start at the moment when this information has been provided by the parties, i.e. there should be a confirmation in writing on that by the competition authority.

The competition authority can extend the period for a final decision for an additional 30 days. If after 90 days, there is no decision from the competition authority, nor extension for an additional 30 days, the merger will be considered cleared – silence means consent. Again if no

decision is forthcoming from the competition authority after an additional 30 days, the merger will be considered cleared – again silence means consent.

The final decisions of the competition authority (i.e. its decision-making body – the commission) can be:

- unconditional clearance of the merger;
- conditional clearance of the merger;
- unconditional blocking (prohibition) of the merger.

The final decision should be published in the Official Gazette. As to the conditional clearance of the merger, there should be no time frame (limit) for meeting the conditions for the merger by the parties. The competition authority will, according to information from the parties and verification of that information, decide if the stipulated conditions have been met and that accordingly the merger is cleared.

6.10. Legal standard of merger control

As to the legal standard of merger control, the crucial question is: should mergers be *per se* banned? Of course, the reasonable answer is no – there should not be a *per se* ban on mergers. A case-by-case analysis carried out on pro-competitive merits of each merger should constitute the basis for the decision. This is the way in which the rule of reason is effectively introduced into the ruling.

Since the mergers should not be *per se* banned, i.e. the rule of reason is introduced as a legal standard, the question is how to set the discretionary criteria for the mergers/blocking approval (the rule of reason guidance)? In other words, what should be the standard for the rule of reason in case of merger examination?

There are two well-known and widely accepted standards for merger clearance/blocking. One is the US standard (substantially lessening the competition), and the other is the EU standard (dominant test – creating or strengthening dominant position). There has been substantial convergence between the two standards in recent times, particularly in the stage of implementation in institutionally developed economies. Nonetheless, there must be a solid and clear doctrine for the structured rule of reason in the case of an institutionally rather undeveloped economy like FR Yugoslavia/Serbia.

Taking into account the proposed concept of competition policy for FR Yugoslavia/Serbia, i.e. that the competition policy should be focused and transparent, the criteria for the rule of reason in the merger case should be rather clear and restrictive. Considering dominance test an option should be based, among other things, on the rather restrictive criteria/thresholds for dominance already suggested in FR Yugoslavia/Serbia.

Taking all this into account, there are two options regarding the test/standard for the merger control:

a. **Option A:** SLC (substantially lessening the competition) standard to be used for merger consideration criteria. Advantages of

Option A are: (1) Possible flexibility of merger control, i.e. more mergers can be challenged under the rule of reason. Drawbacks of this enforcement of SLC standard: (1) Increased uncertainty for firms and private entrepreneurs, because the merger standard is not precise and many mergers can be challenged; (2) room for possible abuses of the competition policy (merger control) will be created. (3) The framework for unfocused/excessive competition policy will be created

b. **Option B:** Dominance test to be used for merger consideration criteria. Advantages of using dominance test are: (1) It is European/EU consistent (2) It enables more restrictive competition policy towards the mergers control, i.e. more liberal towards mergers. (3) It decreases uncertainty in for firms and private entrepreneurs in their business planning.

Option B looks far better; hence the dominance test should be used as the criteria for merger evaluation, i.e. examination of the impact of the merger on economic efficiency and economic welfare. The criteria is to be applied in a way that enables the evaluation of the impact that a particular merger has on overall economic efficiency. There should be strict guidance for the ruling (structured rule of reason), i.e. the decision-making process should be strictly defined rather than the outcome.

It is very important to incorporate production efficiency claims into the consideration and to examine them in the merger approval process, particularly if the dominance test has not been passed, i.e. if the merger will create or strengthen dominant position on the market. It is assumed that dominant position will create allocative inefficiency, but it is crucial to evaluate whether the increase of production efficiency due to the merger will offset losses of allocative efficiency.

Recommendation: Dominance test should be the standard for decision-making in merger control. Sub-statutory texts should precisely specify the procedures for applying the dominance test.

6.11. Decision making procedures

Very important question regarding decision-making procedures is: shall the issue of decision-making procedure on mergers be settled by the Competition Law (statutory text) or though other acts or guidelines (sub-statutory texts)?

It may not be vital which method is chosen, and can be a mixture of both. For example, the EU Merger Regulation contains many of the relevant deadlines and procedures, and this is backed up by other implementing and interpretative regulations and notices. Whatever is decided though, the guidelines should be consistent and transparent, so that there is legal certainty, and so that companies are not discouraged from merging/undertaking economic activity.

Nevertheless, everything that is crucial for the parties involved and their actions (requirement to notifications etc,) and the obligations of the competition authority towards the parties, the courts and the general public should be specified in the statutory text.

Recommendation: Decision-making procedure should be specified in both statutory and sub-statutory texts, i.e. it must be a mixture of both, but it would be very important to have as much as possible of these procedures specified by the statutory text, particularly the obligations of the competition authority and the parties.

6.12. Treatment of mergers already accomplished

Treatment of mergers already accomplished (carried out) before the new merger control legislation is enacted is linked to a few relevant questions: the rationale for an active treatment of these mergers active and possible instruments of such treatment, as well as the problem of the retroactive effects of the new competition law. In principle, there are two options regarding mergers that have already been accomplished:

a. **Option A:** Legal provision for active policy toward mergers already carried out, i.e. towards non-competitive market structures.
b. **Option B:** Lack of legal provision for active policy toward mergers already carried out, i.e. towards non-competitive market structures.

This dilemma is related to the general dilemma regarding the competition policy attitude towards non-competitive market structure whatever is the source of that structure. The solution of this dilemma must be compatible with the general attitude of the competition policy towards non-competitive structures.

6.13. Mergers of companies with dominant position

Since the dominance test has been recommended as the standard/criterion for merger control, a relevant question is the one about the status of the mergers of the companies that already acquired dominant position on the market. In other words, how to deal with mergers where at least one company is already a dominant firm? Does this mean that any merger of a firm that has dominant position should be proclaimed *per se* illegal, or should mergers involving firms with dominant position be examined in some special way?

The reasonable answer to these questions is that mergers of firms with dominant position should not have any special treatment, let alone be proclaimed *per se* illegal. Nevertheless, the probability for the mergers those involve a company with dominant position to be challenged/blocked is bigger compared with the situation when no company involved in merger has a dominant position.

7. ELEMENTS OF COMPETITION POLICY (2) – STRUCTURES AND/OR CONDUCT

7.1. The targets of competition policy

One of the strategic questions regarding any competition policy is: What should the target of the competition policy be: non-competitive market structures or only firms' non-competitive conduct, for example abuse of non-competitive market structures? Taking into account the target of competition policy, there is a difference between the US style and EU style of competition policy. Contrary to the US style, EU style competition legislation does not accommodate policies towards existing (inherited) non-competitive market structures. In general, there are a few options regarding the targets of competition policy:

a. **Option A:** Targets should be both all non-competitive market structures and all firms' anti-competitive conduct.
b. **Option B:** Targets should be some non-competitive market structures (those that are created by the firms conduct) and all firms' anti-competitive conduct.
c. **Option C:** Targets should be only firms' anti-competitive conduct.

Taking into account the Yugoslav/Serbian institutional framework, **Option B** is the most promising one, being a compromise between the two extreme options, and enabling some activities within competition policy regarding market structures, i.e. activities regarding behavior towards creation, maintenance and strengthening of non-competitive market structures (i.e. exclusionary abuse of dominance).

7.2. Market structures as the target of competition policy

Taking into account selected targets of competition policy, a relevant question is to what extent new competition policy should take care of non-competitive market structures (market power) and their creation, irrespectively of the possible abuse of these structures (conduct of the firms with market power)? In other words, should competition policy be more aggressive dealing with the creation and strengthening of non-competitive market structures (apart from the merger control that has already been decided on as an integral part of the legislation)? There are a few options regarding these issues:

a. **Option A:** Merger control only.
b. **Option B:** Merger control with additional mechanisms for dealing with the creation of non-competitive structures, but applied strictly to firms that have already obtained market dominance (market power).
c. **Option** C: Merger control with additional mechanisms for dealing with creation of non-competitive structures, but applied to all the firms irrespectively of whether they have already acquired a dominant position on the market or not.

Option B is the best one, because, on the one hand, it can prevent the creation of more non-competitive market structures than Option A. On the other hand, **Option B** is superior to Option C because it enables competition policy to be more focused, as this is beneficial both it terms of diminishing room for possible abuses of competition policy by the state and/or by competitors, reducing the magnitude of the administrative burden of the competition authority, as well as decreasing uncertainty for firms and private entrepreneurs.

Recommendation: Apart form merger control, competition policy/authority should deal with the creation of non-competitive market structures but only by the firms that have already secured dominant position on the market.

7.3. Exclusionary behavior of the firms

Since it was recommended that the creation of non-competitive market structures should be dealt with only in the case of firms with dominant position, the question arises whether conduct, for example conduct (behavior) aiming at the creation of non-competitive market structures (*to monopolize*) should be prohibited, i.e. should exclusionary behavior be prohibited? For example: (a) creating barriers to entry, (b) predatory pricing, (c) specific price discrimination aimed at harming the competitor. Should this type of conduct be proclaimed illegal as methods of establishing dominant/monopolistic position, rather than the abuse of it.

a. **Option A:** To explicitly prohibit (proclaim illegal) these types of conduct as such, irrespective of the abuse of dominant position.
b. **Option B:** To deal with this conduct implicitly only as a part of abuse of the dominant position.

Option B is more promising because the creation of (more) non-competitive market structure is exclusionary abuse of dominant position. Although it does not create economic profit in a short run, it will lead towards economic profit in the long run – exploitative abuse of the (maintained and/or strengthened) dominant position.

Since this conduct will be proclaimed illegal as a form of abuse of dominant position (i.e. exclusionary abuse of the dominant position), these provisions will only be applicable to firms with dominant position. This is a reasonable solution in terms of focused competition policy, smaller administrative burden on the competition authority, decreased probability of abuse of competition policy and decreased uncertainty for firms and private entrepreneurs. It is, for example, of paramount importance not to discourage price wars by over-enforcement of the predatory pricing provision. By restricting the possibility of that kind only to firms with dominant position, uncertainty for all the other firms is already decreased.

Recommendation: Exclusionary behavior of firms should be treated only as a specific abuse of the dominant position of the firm.

7.4. Compulsory divestiture

As to the issue of compulsory divestiture, the key question is: should the legislation furnish the competition authority and the courts with the right to impose compulsory divestiture of the firms that hold the dominant position in order to enable the creation of competitive market structure? The right to impose divestiture is a very powerful right with far-reaching consequences. In principle, compulsory divestiture can be imposed both on the firms that have already abused their dominant position and the firms that have not done it yet. There are two general options regarding compulsory divestiture:

a. **Option A:** To incorporate a legal provision for compulsory divestiture in the new competition legislation. Advantages of the **Option A** "right to impose divestiture" are: (1) Aggressive competition policy, taking care of the causes, not the consequences, creating the ground for effective competition policy; (2) Substantial non-market structures already exist on the domestic markets, providing the ground for their abuse; (3) Some of these structures (firms) are privately owned, so privatization can not be considered as a vehicle for their divestiture; (4) Efficient outcome regarding administrative burden to the competition authority because after divestiture there is no need for close monitoring of the dominant position and its abuse; (5) The prospect for the Competition Law to be a legal basis for demonopolization and restructuring of existing "natural" monopolies. Drawbacks of the **Option A** "right to impose divestiture" is: (1): Too great a legal power (authority) for the competition authority, which is not capable (and will not become capable quickly) of using these powers; (2) Generation of too great uncertainty (risk) for all business decision makers (firms and private entrepreneurs); (3) Decreased level of investments due to the increased risk; (4) Small domestic market compared with minimum efficient size of many firms, i.e. firms should be allowed to grow; (5) There is no working (let alone efficient) capital market as a precondition for divestiture. Without an efficient capital market, there are severe technical problems regarding divestiture implementation.
b. **Option B:** Not to incorporate legal provision for compulsory divestiture in new competition legislation. Advantages and drawbacks are inverse to Option A.

Option B is definitely the better one, mainly due to the low level of administrative capacity, i.e. institutional development, both in terms of the competition authority and the capital market and decreased uncertainty for the firms and private entrepreneurs. Furthermore, introduction of such a legal provision will contradict the principle of law enforceability and will destroy competition policy credibility. Nonetheless, the way should be found to overcome some drawbacks of **Option A** in due course.

Recommendation: There should be no legal provision for compulsory divestiture, expect in the case of sanctions for the failure to notify mergers or failure to notify accurately.

8. ELEMENTS OF COMPETITION POLICY (3) – BARRIERS TO ENTRY

8.1. Statutory treatment of barriers to entry.

As to the statutory treatment of barriers to entry, the first question is: shall there be a specific statutory formulation, i.e. specific provisions that the establishment of barriers to entry is unlawful/prohibited, or shall there only be provisions relating to illegal maintenance or abuse of a dominant position through anti-competitive means? This dilemma is not directly linked to the advocacy segment of the competition policy that will be the crucial mechanism for impacting upon the public policies that create the most important barriers to entry. Furthermore, education of the public about barriers to entry and their effects is a crucial prerequisite for effective advocacy against policies that create and maintain barriers to entry. There are two options regarding the statutory treatment of barriers to entry:

a. **Option A:** A specific statutory article on barriers to entry. Advantages of this option are: (1) Sending a strong signal that the paramount pillar of competition policy will be the removal of barriers to entry (both short-term and long-term barriers) and that the authorities are committed to establishing free entry; (2) Education of civil servants and the business community about modern competition policy; (3) Deterrent to some specific forms (establishing barriers to entry) of anti-competitive behavior (4) The possibility of deterring all firms from creating barriers to entry, not only those with dominant position. Drawbacks of this option are: (1) Increasing complexity of the competition legislation by adding another rather complicated provision; (2) Problems regarding legal definition of barriers to entry; (3) Majority of the barriers of entry are not created by the subjects of the competition law, but by the state. (4) Possible deterrent to pro-competitive behavior, i.e. legitimate behavior of non-dominant firms.
b. **Option B:** No specific provision on barriers to entry, as barriers to entry can differ widely across the different industries, but rather there should not be any harm in having provisions relating to illegal maintenance/strengthening and/or abuse of a dominant position through anti-competitive means. Advantages of this option are: (1) Avoiding the problem of legal definition of barriers to entry, plus inverse drawbacks of **Option A**. Drawbacks of this option are: (1) Only firms with dominant position will be legally prohibited from creating barriers to entry; (2) There could be

some ambiguity regarding some legitimate conduct, plus inverse advantages of the **Option A.**

Main barriers to entry are either created by the state (administrative and legal barriers), or are due to the technology or/and perfectly pro-competitive behavior of the firms (side effects of this behavior). Only a few barriers of entry are deliberately created by firms. In terms of competition legislation enforcement, the competition authority should deal only with the barriers to entry deliberately created by the firms. Otherwise, the competition authority will end up filing cases against the State as the major player in the field of barriers to entry without much success, because the state as a regulator is not a subject of the competition law (it is excluded from the law). Even in cases in which the state is a subject of the law, the probability of wining the case is rather low.

Recommendation: Taking into account all the features of the barriers to entry, **Option B** is definitely much more acceptable, hence creating barriers to entry can be specified as an exclusionary abuse of dominant position (maintaining and strengthening of dominant position).

8.2. Legal definition of barriers to entry

The legal definition of the barriers to entry should encompass all activities by firms that provide obstacles for market entry complying with the following criteria: (1) The barriers that put only some firms in an unequal position; (2) That they are deliberately created by the firms to stop new competitors entering the market; (3) That these barriers harm competitors and/or create non-competitive market structure. The definition should encompass both the barriers to entry of the new firms (barrier to entry strictly speaking) and import, i.e. other forms of entry to the market.

Recommendation: Definition of barriers to entry should not be part of the statutory, but rather the sub-statutory text, i.e. guidelines for the competition authority. A non-exhaustive list (*exampli causa*) of the barriers should be provided in the sub-statutory text.

8.3. Legal standard for barriers to entry

As to the legal standard of barriers to entry, the question is should establishing barriers to entry be illegal *per se* or subject to case-by-case analysis (the rule of reason)? There are two basic options and they depend on the legal definition of the barriers:

a. **Option A:** Precise legal definition of the barriers and their *per se* prohibition.
b. **Option B:** Flexible legal definition of the barriers and discretionary analysis on a case-by-case basis (the rule of reason).

Comment: Option B is definitely the better one, including flexible legal definition of the barriers to entry and structured rule of reason for their legal challenging.

8.4. Barriers to entry and the dominant firm

The question is whether creating barriers to entry should be prohibited only in the case of dominant firms, or if this conduct should be prohibited for all the firms.

a. **Option A:** Creating barriers to entry prohibited for all the firms. Advantages of this option are: (1) All firms are potential monopolists; (2) A legal provision for aggressive competition policy that will prevent creation of non-competitive behavior. Drawbacks of this option are: (1) Huge administrative burden on the competition authority and other institutions in an undeveloped institutional environment; (2) Decrease the ability to focus competition policy on the major cases with substantial effects on competition, i.e. economic efficiency; (3) Increased uncertainty for firms and private entrepreneurs.
b. **Option B:** Creating barriers to entry prohibited for dominant firms only. Advantages and drawback of this option are inverse to **Option A**.

Recommendation: Since barriers to entry are specified as a form of abuse of dominant position, only **Option B** is acceptable (feasible). Accordingly creating barriers to entry of firms with non-dominant position will be considered as *de minimis* cases.

8.5. Monitoring barriers to entry

The crucial question is how shall competition authority monitor the behavior of firms that create barriers to entry? Shall that be left to the affected companies, and consumer associations harmed by these barriers, while the competition authority only steps in to take action? Of curse, this approach does not exclude *ex officio* provision.

The answer to this question is closely linked to the legal provision regarding actions towards firms with dominant position. Nonetheless, formal registry of dominant firms, i.e. formal monitoring of the firms with dominant position, should be avoided at any cost, due to the bad international experience (particularly Russia).

9. ELEMENTS OF COMPETITION POLICY (4) – RESTRICTIVE AND OTHER AGREEMENTS

9.1. Control of restrictive agreements

As to the control of restrictive agreements, both horizontal and vertical, the question is shall they all be presumed to be anti-competitive or shall they be examined by the competition authority on a case-by-case basis?

It is obvious that not all agreements should be presumed anti-competitive. The agreements do not have to be anti-competitive either

because: (a) they have no effect on competition; or (b) because although elements of the agreement restrict competition, these restrictions are outweighed by countervailing benefits. The presumption of being competitive or anti-competitive may be different regarding the type of agreement. Furthermore, some agreements could be *per se* prohibited and others could be challenged on the legal standard of the rule of reason.

9.2. Different legal treatment of restrictive agreements

The crucial question is, shall different types of agreements have different legal treatment? Accordingly, there are two options regarding that:

a. **Option A:** Different types of agreements should have different legal treatments. Advantages of this option are: (1) Efficient control of restrictive agreements and illegal behavior, (2) Smaller administrative burden to the competition authority; (3) Decreased uncertainty for the firms and private entrepreneurs. The major drawback of this option is: (1) More complicated statutory text.
b. **Option B:** All types of agreements, regardless of the type, should have the same legal treatment. Advantages and drawbacks of this option are inverse to the **Option A**.

There should be a different legal treatment of different types of agreements. This arrangement will provide the foundation for efficient legal treatment of the agreement and control of anti-competitive agreements. Horizontal and vertical agreements should be treated differently and possibly some groups of agreements within these types. The main reason for the differentiation is that horizontal and vertical agreements do not have the same probability for being restrictive or/and anti-competitive. Furthermore, this arrangement reduces the administrative burden to the competition authority.

Recommendation: There should be a different treatment of horizontal and vertical agreements and perhaps differential treatment of both horizontal and vertical agreements.

9.3. Differential division of the restrictive agreements

Two feasible schemes of differential treatment of agreements have been suggested. Both groups have specific (different) legal provision for horizontal and vertical agreements.

9.3.1. Division of agreements into three groups

a. **H1 group** of agreements. These agreements are hard-core anti-competitive horizontal agreements (cartel agreements). They should be *per se* prohibited, clearly specified in the law in an exhaustive list (*numerus clausus*) and should give rise to both

fines and criminal sanctions. Only three types of agreement should be encompassed by this group: price fixing (including bid rigging), market division and agreements on maximum output. There will be no exclusions (clearance), no exemptions and no *de minimis* rule in the case of these agreements. The competition authority should only be involved in fact finding, not in considering the consequences since these agreements are *per se* prohibited.

b. **H2 group** of agreements. This group consists of all other horizontal agreements not belonging to the H1 group. They should not be *per se* prohibited, but the rule of reason should be applied. Detailed guidelines for the rule of reason procedure should be specified in a sub-statutory text. The competition law could provide only a non-exhaustive list (indicative enumeration, i.e. *exampli causa*) of the agreements and these agreements if proclaimed to be illegal should give rise to fines only. There will be exclusions (clearance), exemptions and *de minimis* rule in the case of these agreements. The competition authority should consider the consequences of these agreements since these agreements are not *per se* prohibited. These agreements may be presumed to be anti-competitive or pro-competitive. According to the presumption of one or the other kind, the burden of proof should be with the firms (parties) or the competition authority, respectively.

c. **V group** of agreements. This group consists of all vertical agreements. They should not be *per se* prohibited, but the rule of reason should be applied. Effectively, no vertical agreement will be considered to be *per se* prohibited. Detailed guidelines for the rule of reason procedure should be specified in a sub-statutory text. The competition law could provide only a non-exhaustive list (indicative enumeration, i.e. *exampli causa*) of the agreements and these agreements if proclaimed to be illegal should give rise to fines only. There will be exclusions (clearance), exemptions and *de minimis* rule in the case of these agreements – the *de minimis* rule should be emphasized. The competition authority should consider the consequences of these agreements since they are not *per se* prohibited. All vertical agreements should be presumed to be pro-competitive. According to the presumption of that kind, the burden of proof should rest with the competition authority.

H1 group of agreements (cartel agreements) is the most important and the most frequent anti-competitive behavior in Serbia. Deadweight loss created by such behavior is substantial. The origin of these agreements is the old style socialist "coordination" of production between the producers (partners, rather than competitors). Accordingly, the suggested solution (specifying H1 agreements as *per se* a criminal offense) provides a legal basis for focused competition policy, as well as for both harsh punishment and deterrence for such anti-competitive behavior.

9.3.2. Division into four groups

a. **H1 group** of agreements: same as in *9.3.1.*
b. **H2 group** of agreements: same as in *9.3.1.*
c. **V1 group** of agreements. This group consists only of vertical agreements that are *per se* prohibited – for example, only exclusive dealings, RPM and absolute territorial restraints could be enumerated as these agreements. The competition law should provide exhaustive enumeration (*numerus clausus*) of these agreements. Illegal agreements are to be treated as offenses only. There will be exclusions (clearance), exemptions and *de minimis* rule in the case of these agreements – *de minimis* rule should be emphasized. *De minimis* rule can be emphasized by specifying that only firms with dominant position can be considered violators. The burden of proof should be on the competition authority.
d. **V2 group** of agreements. This group consists of all vertical agreements not included in V1. They should not be *per se* prohibited, but the rule of reason should be applied. Detailed guidelines for the rule of reason procedure should be specified in a sub-statutory text. The competition law could provide an indicative list (enumeration) and these agreements if proclaimed to be illegal should be treated as offenses only. There will be exclusions (clearance), exemptions and *de minimis* rule in the case of these agreements – *de minimis* rule should be emphasized. *De minimis* rule can be emphasized by specifying that only firms with dominant position can be considered violators. The competition authority should consider the consequences of these agreements since they are not *per se* prohibited. All the V2 vertical agreements should be presumed to be pro-competitive. According to the presumption of that kind, the burden of proof should lie with the competition authority.

The only essential difference between the two suggested divisions is the introduction of *per se* prohibited vertical agreements in the second classification. Hence the difference can be specified as:

a. **Option A** (classification *9.3.1.*): Provision of the rule of reason for all vertical agreements, without any vertical agreement to be *per se* prohibited. Advantages of this option are: (1) More room for free entrepreneurship, i.e. increased economic freedom for private entrepreneurs; (2) Fostering import based inter-brand competition; (3) Intra-brand competition is still not a significant problem on the Serbian market, and can be dealt with on rule of reason grounds; (4) Simple and straightforward solution. Drawbacks of this option are: (1) Increased possible uncertainty for firms and private entrepreneurs; (2) Lack of compatibility with the EU regulation/legal practice with some vertical agreements being specified as *per se* illegal; (3) Possibility that some exclusionary practices cannot be proclaimed illegal.

b. **Option B** (classification *9.3.2.*): Provision for *per se* prohibition of some vertical agreements. Advantages and drawback are inverse to Option b.

Option A is definitely preferable, particularly taking into account that the danger of vertical restraints to competition in Serbia is not so big, and it can be challenged by the rule of reason approach to vertical agreements and/or under challenging abuse of dominant position. Accordingly there is no need for *per se* prohibition of any vertical agreement.

9.4. Burden of proof and presumed effects of the horizontal agreements

The issue is with whom the burden of proof should rest and what is the presumed effect on competition of the **H2 group** of horizontal agreements? It is very important to stress that the issue is only the character of presumed effects on competition of H2 group horizontal agreements, because only in that case of H2 horizontal agreements will the rule of reason be applied. H1 agreements are *per se* prohibited and no rule of reason will be applied. There are two feasible options:

a. **Option A:** H2 horizontal agreements are presumed to be anti-competitive and the burden of proof should be on the firms (parties). Advantages and drawbacks of this option are inverse to those of **Option B**.
b. **Option B:** H2 horizontal agreements are presumed to be pro-competitive and the burden of proof should be on the competition authority. Advantages of this option are: (1) Providing incentives for pro-competitive horizontal agreements; (2) Decreased uncertainty for firms and private entrepreneurs; (3) Incentives for more focused enforcement of the competition policy legislation by the competition authority, i.e. focusing their enforcement activities towards more non-controversial cases like H1 horizontal agreements. The major drawback of this option is: (1) Substantial administrative burden to the competition authority.

Option B is much better option, because it will enable more focused competition policy and decreased uncertainty for the firms and private entrepreneurs. Although substantial administrative burden could be *prima facie* treated as a drawback of **Option B**, it is an effective incentive to the competition authority to focus on enforcement in the H1 area, i.e. avoid administratively demanding and controversial challenges in the H2 area of agreements.

Recommendation: The burden of proof should be with the competition authority in all cases of H2 horizontal agreements.

9.5. Burden of proof and presumed effects of the vertical agreement

The issue is to whom the burden of proof should be allocated and what is the presumed effect to competition of vertical agreements? The issue of burden of proof and presumed effects of vertical agreements

on competition should be linked to the legal standards for examination of vertical agreements – all of them should be considered and challenged by the rule of reason.

a. **Option A:** Vertical agreements are presumed to be anti-competitive and the burden of proof should be on the firms (parties). Advantages and drawbacks of this option are inverse to those of Option B.
b. **Option B:** Vertical agreements are presumed to be pro-competitive and the burden of proof should be on the competition authority. Advantages of this option are: (1) Providing incentives for pro-competitive vertical agreements; (2) Decreased uncertainty for the firms and private entrepreneurs; (3) Incentives for more focused enforcement of the competition policy legislation by the competition authority, i.e. focusing their enforcement activities on more non-controversial cases. The major drawback of this option is: (1) Substantial administrative burden to the competition authority.

Option B is better, because it will enable more focused competition policy and decreased uncertainty for firms and private entrepreneurs. Although substantial administrative burden could be *prima facie* treated as drawback of Option B, it is an effective incentive to the competition authority to focus on enforcement in non-controversial cases of restrictive vertical agreements and straightforward cases of horizontal agreements.

Recommendation: The burden of proof should rest with the competition authority in all cases of vertical agreements.

Table 1.
Survey of the treatment of restrictive agreements

	H1	H2	V
Legal standard	*Per se*	Rule of reason	Rule of reason
Burden of proof	Authority	Authority	Authority
Liability	Criminal, fines, remedies and nullity	Fines, remedies and nullity	Fines, remedies and nullity
De minimis	No	Yes (numeric)	Yes (dominance)
Exhaustive list	Yes	No	No

9.6. Notification of the agreements.

The issue is whether the notification of the agreements should be voluntary or compulsory? If a compulsory notification of the agreement is to be introduced, what should be the criteria (thresholds) for agreements to be notified and examined? Furthermore, a method must be devised to obtain relevant information on agreements that will never be notified (H1 agreements) due to the lack of incentives to the parities. As to the character of notification, there are two possible options:

a. **Option A:** Compulsory notification of agreements (with exceptions – below threshold). An advantage of this option is: (1) Collecting huge information on economic activities; that could be very useful for competition policy and other economic policies. Drawbacks of this option are: (1) The administrative burden on the competition authority will be immense – unbearable even for a very developed competition authority; (2) The agreements that are most interesting, i.e. cartel agreements, will not be notified one way or the other; (3) Increased uncertainty and transaction costs (administrative burden) for the firms and private entrepreneurs; (4) With such an administrative burden of the competition authority, the major breaches will escape detection; (5) There are substantial problems as to specifying a suitable threshold for compulsory notification.
b. **Option B:** Voluntary notification. Advantages and drawbacks of voluntary notification are inverse to the **Option A**.

Voluntary notification along the EU policy line is that agreements where companies want clearance from the European Commission can be notified – in such cases, companies can either seek negative clearance (where the presumption is that the agreement has no negative effect on competition, i.e. they are not restrictive), or an exemption (where although elements of the agreement may restrict competition, the presumption is that these are outweighed by countervailing benefits). Such exemptions can either be individual exemptions granted by the Commission, or exemptions which fall under the umbrella of the group exemption regimes (e.g. technology transfer agreements, franchising agreements, etc.) where general guidelines are laid out for what is and is not permissible). There is no obligation on companies to notify their agreements and companies therefore do so where they want a confirmation from the Commission that they are not in breach of the law.

Recommendation: Compulsory notification (**Option A**) is definitely out of the question; **Option B** is the only remaining (viable) option – voluntary notification.

Nonetheless, there is a dilemma regarding the legal obligation of the competition authority to respond to the notification – whatever the response will be: a letter of confirmation or the proclamation of the agreement null and void. That dilemma can be considered from the deadline position – if there is a deadline for the competition authority to answer the notification with one of the mentioned answers. Accordingly, there are two options:

a. **Option A:** there should be a deadline for the competition authority to provide the answer. If there is no answer from the competition authority within the deadline the agreement would be considered cleared – silence means consent. Advantages of this option are: (1) Decreased uncertainty for the firms and private entrepreneurs; (2) Incentives for the competition authority to examine the notified agreements; (3) Increased information base and the knowledge of the competition authority regarding the types of agreements and their legal language. Drawbacks of this option are:

(1) Huge administrative burden for the competition authority; (2) Due to the huge burden, incentives for superficial (only formal, not substantial) analysis of the agreements.

b. Option B: there should be no deadline whatsoever for the competition authority to provide the answer. Advantages and drawbacks of this option are inverse to **Option A**.

In general, advantages and drawbacks of both options are rather balanced. Further analysis should provide more information on the benefits and costs of both options. Since some legal position must be taken, the balance of arguments is slightly if favor of **Option A**, i.e. establishing a deadline for the competition authority to respond to the notification of agreement.

Recommendation: There should be a legal obligation of the competition authority to respond to the agreement notification within 60 days.

As to the timing of notification, there will be two cases of notifications that will appear before the competition authority:

- Notification of agreements that have been concluded but still not enforced (i.e. the enforcement of the agreement has not started yet).
- Notification of the agreements that have been both concluded and enforced (i.e. the enforcement of the agreement has already started before the notification).

Special care should be taken about safeguarding the potential abuse of the notification right for the companies in the second case.

9.7. Horizontal agreements vs. horizontal mergers

It should be examined whether the horizontal restrictive agreements (cartels) are, from the public policy or social welfare prospective, better or worse case than horizontal mergers. Furthermore, the question is what are the legal solutions that create incentives to horizontal mergers as substitutes for horizontal agreements (cartels)?

On the one hand, cartels (H1 horizontal agreements) are inherently non-stabile structures, so an established cartel is not very likely to last for a long time. Contrary to that, mergers are very stabile and they petrify non-competitive market structures. On the other hand, mergers have some advantages because, contrary to cartels, some economies (economy of scale, for example) can materialize. It is essential that the parties do not substitute one behavior to the other: for example, to evade cartel control by merging. Accordingly, it is necessary that no loophole exist in the legislation. Such a loophole would be, for example, the lack of control of integration, so cartels under risk of detection and punishment will decide to go for merger and solve their problems by creating a problem for the consumers/customers.

9.8. Examination of vertical agreements

The question is what the principles of examining vertical agreements and treating vertical agreements as barriers to entry should be. There is

a need to establish a careful approach regarding vertical agreements, especially when it comes to import and competition stemming from the import.

Harmful vertical agreements (i.e. anti-competitive vertical agreements with adverse effects on economic efficiency and welfare) are only those that have horizontal effects. The crucial prerequisite (necessary but not sufficient condition) for vertical agreements to be harmful is substantial market power (dominant position) of at least one of the parties. In other words if there is no substantial market power of the parties, vertical agreement cannot be harmful. This position gives grounds for rejecting *per se* prohibition of some vertical agreements (RPM), but rather the application of the rule of reason.

10. ELEMENTS OF COMPETITION POLICY (5) – MARKET DEFINITION AND MARKET POWER

10.1. Market definition

It is very important to correctly specify the relevant market as opposed to a single market. All pertinent elements for the specification of relevant market should be carefully considered. Furthermore, the question is whether the issues of relevant market should be regulated by statutory or sub-statutory acts?

Relevant market definition should be based on three basic elements:

- product market (demand and, perhaps, supply substitutability);
- geographic market (transportation and transaction costs magnitude/share);
- import component (import to the domestic market should be calculated as a part of that market).

Demand and supply substitutability are both, in principle, pertinent for relevant market definition. As to the introduction of supply substitutability, there are two options regarding that: (a) including supply substitutability and (b) not including supply substitutability, i.e. using only demand substitutability for market definition. For the rather small Serbian market it is better not to include supply substitutability in the market definition, particularly taking into account that much of the supply substitutability will come form import, i.e. it is virtually impossible to obtain relevant information regarding supply substitutability. Accordingly, supply substitutability should not be a part of market definition, but should be included in the more complex procedure of identification of market dominance.

The basic elements of the definition of the market and criteria for specifying the relevant market, i.e. features of the notion of relevant market should be included in the Competition Law (i.e. statutory text). Procedures for establishing relevant market should be a part of a substatutory text (Guidelines for the competition authority decision-making process).

10.2. Market power (dominant position) definition

It is crucial to specify the way in which market dominance is identified by the competition authority. Furthermore, what happens when the market dominance of a firm is established? What are then the powers of the competition authority (strengthened supervision, monitoring company's behavior, preferably without a formal list of firms with dominant position)? To what extent shall all these issues be regulated by statutory, as opposed to sub-statutory texts?

A specified (40%) market share should be taken as a prerequisite (necessary condition) of market power (dominant position), i.e. no firm whose market share is less than the specified threshold can be classified as a firm with dominant position. Accordingly the specified market share (40%) should be a necessary, but not sufficient condition for establishing the dominant position of a firm.

If the market share of the firm exceeds the specified one (40%), other criteria are to be applied for proclaiming market power, i.e. dominant position of the firm: barriers to entry (scale, character and durability), potential competition (domestic or international), i.e. supply-side substitutability, and potential countervailing strength of buyers, as well as other relevant features of the market/market power. In essence, the procedure is to identify whether a company has market power, i.e. whether it can exert this power by acting independently of its competitors and customers.

If market dominance is identified, then the dominant position itself is not prohibited, i.e. there is no liability whatsoever. It is only the abuse of this dominance that should be prohibited. Accordingly, the competition authority should monitor the behavior of the firms with dominant position more closely than all other firms. There should be no formal monitoring (i.e. no legal obligation for the competition authority to monitor dominant firms behavior), nor the list (register) of the firms with dominant position.

There should be no legal provision for challenging collective (joint) dominance, since the concept of collective dominance is rather vague (even in the EU legislation), so it is difficult to provide a good and unambiguous legal definition. Accordingly, there is room for the abuse of the concept, so it should not be made part of competition legislation.

11. ELEMENTS OF COMPETITION POLICY (6) – ABUSE OF DOMINANT POSITION

11.1. Concepts of the abuse of dominant position

There are two distinct concepts of the abuse of dominant position. Both of them can be established within the framework of the Article 82 of the Treaty of Rome. Accordingly there are a few options to be included in the Yugoslav/Serbian legislation.

a. **Option A**: Exploitative abuse of dominant position, i.e. earning economic profit in the short-run.
b. **Option B:** Exclusionary abuse of dominant position, i.e. maintaining strengthening and further developing dominant position (restraining competition) to increase market power and to earn greater economic profit in the long-run.
c. **Option C:** Combined exploitative abuse and exclusionary abuse of dominant position.

Option C is the best solution, because it can encompass both types of behavior. These two types in behavior should be explicitly separated in the legislation, i.e. legal definition of the abuse of dominant position aimed at the appropriation of short-term profit, on the one hand, and the abuse of dominant position aimed at the creation of non-competitive market structures like predatory pricing, barriers to entry, tie-in sales, etc., on the other.

11.2. Elements of the abuse of dominant position

There should be two separate lists of indicative enumeration of the abuses of dominant position (non-exhaustive list, i.e. *exampli causa*) leaving room for prohibition of other types of abuse of dominant position. Indicative enumeration should be more elaborated than Article 82 of the EEC treaty, following some of the recent CEE countries' legislation like, for example, Hungarian legislation.

a. The indicative numeration (*exampli causa*) in the case of exploitative abuse should consist only of:
- pricing that is not cost based
- reducing output

b. The indicative numeration (*exampli causa*) in the case of exclusionary abuse should consist at least of:
- pricing that is not cost based
- creation of barrier to entry
- price and other discrimination
- tie-in sales

The most important abuse of the dominant position that is usually specified as unfair pricing should be reformulated as "pricing that is not cost based". Such a formulation enables prohibition of standard monopolistic behavior (prices above the costs) in the case of exploitative abuse as well as predatory pricing (prices below the costs) in the case of exclusionary abuse. The type of the costs (marginal, average, average incremental, etc.) as well as the procedure for cost estimations should be specified in the sub-statutory text (guidelines).

Price and other discrimination and tie-in sales should be considered only as exclusionary abuse of dominant position. Since in the case of abuses of dominant position there are only indicative (non-exhaustive) lists for both exploitative and exclusionary abuses, there is room that, say, price discrimination can be found illegal also in the case of exploitative abuse. Nonetheless, the decision-makers should be given a signal,

by the careful wording of the statutory text, that price discrimination is, first and foremost, an exclusionary abuse of dominant position.

The competition authority should be focused on the exclusionary abuse of dominant position rather than exploitative. That will prevent the competition authority from becoming the price control authority as it has happened in many cases in CEE countries, with a lot of bad effects regarding competition policy enforcement.

The prerequisite for abuse of dominant position is proving the existence of dominant position. If there is no dominant position, no firm can be charged for the behavior, i.e. for its abuse of dominant position. Burden of proof rests with the competition authority.

11.3. The legal standard of the abuse of dominant position

The legal standard for challenging abuses of dominant position is always the rule of reason. The burden of proof is with the competition authority, i.e. the authority must prove that the party has abused its dominant position and the adverse, anti-competitive effects, i.e. that adverse effects to economic efficiency and welfare occurred.

12. THE SCOPE OF THE LAW

12.1. Self-standing Competition Law

Basically, there are two options for the competition legislation that are based on: (a) self-standing Competition Law, i.e. a specialized piece of legislation and (b) legal provision for competition policy based on a broader piece of legislation like "Commercial Trading Law", integrating competition policy legislation with other policies, protection of fair trading, for example. Accordingly there are two options:

a. **Option A:** Self-standing Competition Law. Advantages of this option are: (1) More specific and precise legal formulation as a suitable legal basis for focused and efficient competition policy; (2) Legal foundation for specialized institution (competition authority) that will enforce the competition law, hence increased probability for specialization and more efficient enforcement of the legislation. The major drawback of this option is: (1) Possible duplication of institutional capacity (competition authority and the office of fair trading).
b. **Option B:** Broad law including other commercial legislation (Fair Trading Law, etc.). Advantages of this option are: (1) Almost every relevant market behavior is considered in one piece of legislation; (2) Good publicity for the authority/institution with cases of protecting consumers. Drawbacks of this option are: (1) The possibility for the legislation to be diluted/compromised; (2) room for an inefficient, unspecialized institution/authority.

Option A is definitely the better one, particularly taking into account domestic legal tradition. i.e. the fact that existing competition law ("Antimonopolski zakon") is a self-standing law and that a specialized competition authority already exists.

Recommendation: A self-standing competition law should be drafted. An enquiry should be made if there is an urgent need for amendment to the existing Fair Trading Law ("Zakon o trgovini") to bring it in line with the draft of the new Competition Law, or even the drafting of a new Fair Trading Law.

12.2. Natural monopolies and their regulation

One of the most controversial issues of competition policy is the treatment of natural monopolies, particularly network industries. The questions are: what should be the regulatory framework for economic regulation of these industries and should the industries under economic regulation be liable under Competition Law? There are a few possible options regarding these issues:

a. **Option A:** Natural monopolies (regulated industries) to be exempted only from some provisions of the competition legislation and regulated by other pieces of special legislation (*lex specialis*) that will provide the basis for the operations and economic regulation of these industries.
b. **Option B:** Natural monopolies (regulated industries) to be exempted from all provisions of the competition legislation and regulated by other pieces of special legislation (*lex specialis*) that will provide the basis for the operations and economic regulation of these industries.
c. **Option C:** Natural monopolies (regulated industries) to be exempted from provisions of the competition legislation by block exemptions given by the competition authority.

Option A looks good, particularly taking into account that the possibility of regulatory capture (by the regulated industries) is reduced because there is a general purpose competition authority that takes care even of the regulated industries, i.e. some aspects of their behavior. Furthermore, restructuring and deregulation of the regulated industries is more likely under the continued jurisdiction of the competition authority.

Natural monopolies should be regulated according to special legislation (*lex specialis*) for the industries considered to be natural monopolies. These pieces of legislation will provide the legal basis for economic regulation, particularly regarding the methods of economic regulation and institutions (authorities) that will enforce economic regulation. Such a solution will be quite consistent with the competition legislation/policy in terms of the economic basis of economic regulation. For example, economic regulation will enable pricing in these industries to be cost based, hence no abuse of dominant position will occur. Furthermore, competition legislation will be enforced by the

competition authority on all other activities of the natural monopolies, i.e. operations of these firms/industries that are not covered by special legislation.

Recommendation: Natural monopolies (regulated industries) should be exempted from some provisions of the competition legislation by special laws (*lex specialis*), applying the principle: one industry – one special law.

12.3. State aid

One of the strategic dilemmas regarding the new competition policy and legislation is whether state aid issues should be integrated into the new competition legislation or should new, separate state aid legislation be designed and enforced? Accordingly, there are two options:

a. **Option A:** Integration of state aid into competition legislation. Advantages of this option are: (1) Obvious link between preservation of competition and its undermining by state aid; (2) Principal consistency with EU legislation, particularly taking into account potential political pressure within the SAP. Drawbacks of this option are: (1) State aid provisions within the competition legislation make little sense – state aid is provided by the government and it's prohibition is to be enforced by the governmental body specialized in other area – competition authority; (2) Possible strong pressure from the executive branch of the government on the competition authority, so state aid control could not be effectively enforced; (3) Such pressure would be against the whole competition policy, i.e. competition authority, hence affecting other, much more important segments of competition policy (antitrust policy, strictly speaking) as a negative side effect.
b. **Option B:** Separate state aid legislation. Advantages and drawbacks are inverse to **Option A**. Furthermore, separate state aid legislation will enable the creation of a consistent piece of legislation with the best enforcement mechanism, although at some cost in the possible loss of a link between competition policy and the distorting aspect of state aid. A further advantage of separate state aid piece of legislation is that, although it is not thoroughly consistent with the EU legislation it is accepted by the EC as a suitable institutional arrangement for candidate countries.

The state aid issue is certainly politically and economically very important. Within the EU competition policy framework and according to EU terminology, competition policy comprises antitrust law and state aid law, and the prominence and importance of state aid has grown in the EU in the last ten years. State aid control is clearly a feature that distinguishes EU competition policy from the competition policy of other countries. Taking into account the SAP and eventual EU membership, its is not enough to integrate a few lines on state aid into the basic competition law; State aid requires its own independent legal framework. Central and East European countries in transition,

some of them EU membership candidates, have adopted separate competition and state aid laws.

The state aid issue has been and will be a politically very sensitive subject. Hence it should be developed very carefully and from the beginning of the process the relevant ministry and the whole cabinet should be included in the process. It is a far better solution to have separate state aid legislation that will be designed in due course, taking into account the advances in the privatization process and the SAP. It is better to have a separate institution (authority) that will take care of state aid implementation.

Recommendation: The draft of the new competition Law should not have provisions for control of state aid. Possible future changes of the competition legislation will depend on the independent development of state aid control legislation and relations between state aid control and competition policy.

12.4. Competition legislation and public enterprises

Public enterprises are rather widespread in the Serbian economy, being involved not only in the case of natural monopolies, but also operating in competitive industries. Many public enterprises operate at the local level, being under effective control of local public authorities and frequently protected by these authorities by creating administrative barriers to entry.

The EU position regarding public companies (enterprises), publicly backed companies or public bodies which are economic operators, is that it should be a basic principle that these bodies should not be exempt from competition law. Because of the significant impact of the public enterprises on the Serbian economy, there may therefore need to be transition periods for certain areas, depending on the nature of the whole process of liberalization and reform/restructuring of the public companies.

Recommendation: There should be no special provision in the competition law/legislation regarding public companies (enterprises), nor should they be exempted from the competition legislation, i.e. public enterprises should be subjects of the competition legislation. The need for substantial reform of the public enterprises legislation should be underlined in some other policy documents. The advocacy role of the competition authority is very important regarding reform of public policy towards public companies, i.e. reform of the public companies conduct and regarding their restructuring (with possible subsequent privatization).

12.5. Exemption mechanism

The only exemption mechanism should be special legislation (*lex specialis*) by which some industries (i.e. companies in these industries) will be exempted from some provisions of the competition law. It is

very important that special legislation should exempt these industries/companies only from some provisions of the competition legislation, not from the entire competition legislation. The activities of the companies that are exempt from some provisions of the competition legislation should be only these that are regulated by the special law whose provisions are enforced by authorities other than the competition authority.

13. THE SUBJECTS OF THE COMPETITION LAW

13.1. Subjects of the Law

Who should be the subjects of the law? Basically, there are two relevant options regarding that:

a. **Option A:** EU style subjects: "undertakings", covering any collection of resources to carry our economic activities.
b. **Option B:** US style subjects: "every person" with exceptions provided by the competition law itself and other pieces of legislation.

The sorting out of the dilemma depends on the type of the liability and the sanctions of the competition legislation. The US style definition directly enables criminal liability/sanctions to be implemented. Perhaps that the EU style definition should be amended slightly to enable every natural person "in charge of decision-making within undertakings" be liable to criminal liability/sanctions.

There should be a notion that all legal persons (entities), their associations as well as private persons and their associations directly or indirectly involved in commercial activities or activities that have an impact on commercial activities should be subjects of the competition law. Serbian legal doctrine should be taken into account that enables executives in charge of a "legal person" to be prosecuted in criminal cases. Special care should be taken to ensure that all the officials of the "legal person" involved in breaching the law are liable to the criminal sanctions, not chief executives alone. This is very important as leverage for leniency policy that will provide incentives for all those involved to provide insiders information on cartels.

The state should be a subject of the competition law in so far as it is indirectly or directly involved in commercial activities. Nonetheless, the state should not be subject of the competition law in its capacity as regulator, i.e. activities of creation and enforcement of the rules. Advocacy to promote competition should be the main mechanism of competition policy towards the state as regulator, not enforcement of the competition legislation.

13.2. Foreign companies as subjects of domestic competition law

There is no doubt that the 'effects doctrine' should be adopted and that foreign companies (undertakings, i.e. legal persons) should be

subject to domestic competition legislation. The competition authority should be able to act (should have powers) with regard to any company (undertaking), irrespective of whether it is domestically or foreign owned or located (in terms of domicile), subject to its actions having an effect on Yugoslav/Serbian territory, i.e. the Yugoslav/Serbian domestic market. This is the basic principle of competition legislation in both the EU and the US, as well as other countries and has been confirmed many times.

Recommendation: There should be a legal provision that foreign undertakings (companies) are subjects of domestic competition law so far as their activities create effects on the domestic market.

13.3. Exemptions from competition law

In the EU, competition law is applicable to "undertakings." An "undertaking" is any entity engaged in economic activity and offering goods and services on an economic market, i.e. legal entities involved in commercial activities. In practice therefore, undertakings are companies, partnerships, sole traders, associations etc. They can naturally include public bodies/enterprises that are engaged in economic activity and offering goods and services on the market, i.e. the state is included in so far as it is directly or indirectly involved in commercial activities, but not as the regulator of commercial activities. All other legal entities and individuals, i.e. the conduct of legal and natural persons in non-commercial activities are not subject to the competition law.

Recommendation: Due to possible legal controversy, two sectors should be explicitly exempted/excluded from the competition legislation:

- trade unions, in their activities regarding the collective barraging process;
- sports association in their activities of organizing athletic competition.

Both exemptions should be specified on the exhaustive list (*numerus clausus*) as paragraph of the Competition Law itself.

14. SANCTIONS OF THE NEW COMPETITION LAW

14.1. Sanctions at disposal of the competition authority and the courts

There is no controversy that remedies (i.e. the end of illegal conduct) and fines should be the sanctions at disposal both of the competition authority and the courts. Nonetheless, the crucial dilemma is whether criminal liability should be introduced in the new competition legislation. Accordingly there are two feasible options, one is the set of sanctions without criminal sanctions, and the other includes criminal sanctions.

a. Option A: Sanctions without criminal liability:
- remedies – an end to the illegal conduct
- civil sanctions – proclaim the agreement null and void;
- fines on the subjects of the competition law – these should be of sufficient magnitude to produce a significant deterrent effect;
- no criminal liability whatsoever.

Advantages of this option are: (1) Full consistency with existing EU competition policy/legislation; (2) Rather simple legislation enforcement, because enforcement in the case of criminal liability is much more complicated. The major drawback of this option is: (1) Decreased deterrent effect of the sanctions.

b. Option B: Sanctions including criminal liability:
- remedies – as in option A;
- civil sanction – as in option A
- fines to the subject of the competition law – as in option A;
- criminal liability/sanctions for company officials in the case of the most severe breaches competition law, only in the case of *per se* prohibited H1 agreements – all company officials breaching the law should be liable to criminal sanctions, not only chief executives.

Advantages of this option are: (1) Strong deterrent effect, especially in Serbia where deterrent effect of fines is not big, particularly taking into account long and inefficient judicial procedures; (2) Criminal sanctions are consistent with domestic legal tradition of competition legislation; (3) Although criminal sanctions are not strictly speaking consistent with existing EU competition policy/legislation, some of the EU countries national legislation provides room for criminal sanctions – criminal liability is not prohibited with the EU. The major drawback of this option is: (1) Rather complicated enforcement of the sanctions, particularly taking into account that different authorities will be included and that different standards for the burden of proof must be applied.

Remedies and fines are commonly used in all modern competition legislation across the World. Only some of the national legislation provides legal grounds for criminal liability and related sanctions. Although existing Yugoslav competition legislation ("Antimonopolski zakon") provides for criminal liability, that legal provision has not yet been enforced– no criminal prosecution has as yet been undertaken. One of the most important considerations of including criminal liability in the legislation is whether there is a judicial capacity/will for efficient enforcement of criminal liability.

Recommendation: In principle, all sanctions including criminal should be at the disposal of the competition authority/courts. There is no need for any change to be made in the Penal Code (criminal legislation).

14.2. The implementation of sanctions

Criminal sanctions should be reserved only for the most severe offenses against competition legislation, only in very limited cases of actions that are *per se* prohibited, i.e. only in the case of the **H1 group**

of horizontal agreements. These offenses should also (simultaneously) be subject of fines and civil liability. All the breaches of the competition law other than H1 should be subjects to fines only (alongside civil sanctions).

As to the procedure of criminal sanctions enforcement, there should be strict collaboration between the competition authority and the public attorney, who should be the only one that can file competition law criminal cases before the court. The investigation powers of the public attorney should be the same as in the investigation of all criminal cases. The role of the competition authority will be substantial because the authority is the only institution that has the specialized knowledge (know-how) relevant for the investigation of breaches of competition law. As in all other criminal cases, the decision-making body is the court.

As to the procedure of non-criminal sanctions, all decisions are made by the competition authority as a quasi-judicial body. The judicial revew should be exercised through the courts.

It should be feasible to hold a company (legal person) liable under civil law for an infringement, and at the same time to hold officials of that company criminally responsible. If a H1 type of horizontal agreement breach of competition law occurs, that means that there is a possibility that, at the same time, fines (legal person) and criminal sanctions (legal entity's executives and officials) are imposed. There should be two separate procedures for law enforcement, because possible stumbling blocks in the criminal procedure should not slow down the rest of the procedure. Nonetheless, information on the case must be shared.

As regards EU standards, whilst it is the case that there are no criminal sanctions for anti-trust abuses at the EU level, this does not necessarily mean that criminal sanctions at a national level under EU competition laws are inconsistent. For example, the UK and Ireland have the possibility of criminal sanctions in their domestic competition laws. Therefore, it appears that as regards liability, different concepts can co-exist, and that what is important is that the basic principles of competition law are similar across all the EU Member States. It is reasonable to assume that the same approach will be taken for the candidate countries and the countries involved in the SAP.

14.3. Settlements and leniency

It is naturally the case that once a preliminary yet credible conclusion has been reached by a competition authority that there has been a potential breach of competition rules, the threat of sanctions can be an effective way of bringing the abuses to an end. It may be the case that the likely abuse is not one of the more serious ones, and therefore that pursuing the case further would constitute a disproportionate use of administrative resources. If this is the case, then it may be worthwhile to enter into a settlement with the company in question, or for the company to offer a formal undertaking to the competition authority,

under which the company pledges that it will cease and not repeat the conduct in question.

In the EU, such undertakings do not have any formal legal standing, although they can prove very valuable – it is likely that the company will take any such undertaking very seriously as any breach of it will result in a harder subsequent position from the competition authority and hence a more serious sanctions.

Very serious breaches of competition law should generally always be pursued more officially (i.e. with official decisions and sanctions) as a point of principle, and as precedent/example, particularly in FR Yugoslavia/Serbia where competition policy is young, and there can be a useful deterrent effect to others. Accordingly, such a policy should not be abused, i.e. a sufficient number of cases must be pursued officially. The competition authority should have the discretionary right to decide in which cases a settlement can be a useful way to close the case. Nonetheless, monitoring of the use of that right is essential, i.e. there must be clear disclosure of all pertinent information (for example, in the annual report).

Another issue to be considered in this area is that of leniency. It is important to enable all company officials (natural persons) involved in breaching the competition policy to be prosecuted for criminal liability. Leniency should also be offered to legal entities (corporate leniency). An efficient leniency policy can provide incentives for them (both individuals and legal entities) to turn themselves in and to provide vital insider information, i.e. testimony regarding the criminal offenses and breaches of the competition law they were involved in.

The EU has recently issued a revised leniency notice under which immunity from fines, or reduced fines are granted to companies in cartels that bring abuses to the attention of the competition authorities. This is generally considered to be an effective approach. Accordingly, Yugoslav/Serbian competition policy, i.e. competition law enforcement should also (alongside leniency provisions for natural persons) provide for leniency granted to companies (legal entities).

14.4. Methods for achieving strong deterrent effect of the sanctions

Strong deterrent effect is essential for general prevention in the field of competition policy legislation. There are a few cornerstones for building strong deterrent effect of the sanctions.

There should be stringent criminal liability/punishment for company executives only in the case of H1 horizontal agreements, i.e. most hard-core abuses. That will enable competition and judicial authorities to focus their efforts on these offenses. Such an attitude will increase the probability of convictions for the offenders and decrease business uncertainty for all other subjects of the law. The increased probability of conviction together with severe sanctions will create a strong deterrent effect.

The crucial cornerstone in building a strong deterrent effect is severe fines for companies (undertakings). It is evident that deterrent effects in the EU is built only on the character of civil sanction and the level of fines. Again the probability of conviction is essential as is a sufficiently high level of fines. A strong deterrent effect in FR Yugoslavia/Serbia can be created only by demonstrating the commitment of the competition and judicial authorities to pursue a stringent sanctions policy. The demonstration effect can be more convincing if the first cases of conviction are of big and powerful firms. That will demonstrate two things: (a) that competition legislation enforcement is independent from partisan politics; (b) that competition and judicial authorities are committed to the enforcement and courageous in that enforcement. When the big and powerful are convicted, all smaller and less powerful no longer feel comfortable.

Fines for not acting, failure to notify, for example, could be incentive based. i.e. the parties should have incentives in the structure of these fines to act in line with the provisions of the competition law. For example, the fines for failure to notify a merger could be per day fines, where the number of days is calculated between the day of the merger and the day the failure to notify the merger is detected. That can provide an incentive to the parties to notify the merger, even after it has occurred.

Increased probability of conviction in both non-criminal and criminal cases, i.e. an efficient competition authority and courts, is a prerequisite for a strong deterrent effect. It has been demonstrated in many cases that a stringent punishment policy, i.e. sever punishments that can be passed are not effective if the probability of conviction is very low. The crucial factor of the probability of conviction is probability of detection of breaches of the competition legislation. That is particularly significant in the case of H1 horizontal agreements/offenses. In other words, increased probability of detection will improve probability of conviction and create a strong deterrent effect.

The strong deterrent effect is also linked to a sound leniency policy. On the one hand, the leniency policy can be effective only if the possible sanctions are severe, i.e. if at least one component of deterrence is fulfilled. On the other hand, an efficient leniency policy will enable the competition authority to detect more breaches of the competition law and thus to increase the probability of conviction that will provide a stronger deterrent effect.

An important segment of creating a strong deterrent effect is building the reputation of the competition authority as a capable and effective institution, able to detect and swiftly process all breaches of competition legislation. Nonetheless, it is not enough that such an institution be built. It is of equal importance to build the image of such an institution in the public, i.e. public perception of the competition authority must be the perception of a competent and efficient institution.

Together with building the reputation of the competition authority, the reputation of the courts regarding competition law cases should

also be improved for a strong deterrent effect. This is very important because, to date, the courts have very limited experience in the enforcement of competition legislation. A good starting point for this is that it will be specialized commercial courts that will be involved as the second instance in the cases of the competition law, so the institution building process in the case of the judiciary can be more focused.

15. INSTITUTIONAL ISSUES (1) – STRUCTURE OF THE COMPETITION AUTHORITY

15.1. Level of the competition authority

There are only two possibilities as to the level of the competition authority: (con)federal competition authority or two republics' competition authorities.

a. **Option A:** (Con)federal competition authority, which will take into account a single market of Serbia & Montenegro. The major advantage of this option is: (1) Consistent solution: one (single) market – one competition authority. Drawbacks of this option are: (1) Single market of Serbia & Montenegro does not exist and it is highly uncertain if and when it will be created; (2) Competition policy will be effectively used for enforcement of the single market (against barriers to trade between the Republics), not for perusing economic efficiency as the main goal; (3) Problems regarding institution building, since it is still highly uncertain (although room for optimism is limited) how the new (con)federation administration will operate, particularly in the decision-making process for institution-building.
b. **Option B:** The Serbian competition authority that will take into account Serbian market only and firms from Montenegro will be taken into account only as firms (undertakings) from all other countries. Advantages and drawbacks of this option are inverse to the **Option A**, with the major advantage of **Option B** being: (1) Clear regarding the adoption of the legislation and institution building.

Recommendation: The process of designing new legislation and institution building should at the beginning be at the Serbian level with the possibility of "upgrading" it to the (con)federal level. With two republican competition authorities it is very important to have a single institution that will deal with the EC regarding competition policy/legislation within the SAP. That institution should be a (con)federal European integration office.

15.2. The character and structure of the competition authority

It is the paramount that competition authority operations are independent from politics, partisan politics and public choice pressures on

the authority. Although there is no institutional arrangement that is absolutely safe regarding the political pressures, some of the institutional arrangements provide more safeguards regarding the independent operations of the competition authority. The most important is that the competition authority should be independent from the executive branch of the government.

Accordingly, the proposed competition authority should be an independent authority; i.e. a body independent from the government. Its operations should be monitored by the National Parliament and the public. Responsibilities (obligations) of the competition authority towards the Parliament and the public (annual reports, public hearings, etc.) should be specified in the Competition Law.

The competition authority should comprise three branches (sectors) with difference tasks/operations:

- Competition authority general secretariat;
- Competition authority office;
- Competition authority commission.

The Competition authority should be under control of the President of the Competition authority and he/she (as well as general secretariat) will not be directly involved in law enforcement, but will monitor all the activities of the competition authority (including law enforcement). Furthermore, the President and general secretariat will be directly involved in the activities of advocacy and education (competition culture). The major incentive for the president and the general secretariat of the competition authority to be effective in advocacy and education is that the more efficient the advocacy and the more competitive the environment, so the greater the reductions in law enforcement activities, and the less the need for monitoring of those activities of two other sectors of the authority. The President will be elected (appointed) by the Parliament, and he will be in charge of overall competition authorities operations.

The Competition authority Office will be an investigative body (quasi-prosecution) that will file cases of breaches in the competition law. The Office will be under operational control of the Vice President of the competition authority and the head of the Office. It will have the right to start investigations *ex officio*, or to process complaints filed by the third parties. All the cases will be filed to the competition authority Commission. The incentive for the Office is linked to the success in filing the cases before the Commission. The Office will select the cases very carefully, bring only cases that can be won, i.e. clear cases of breaches in the competition law. The Office will think twice before filing dubious cases, so that will be an incentive for them to prepare cases well or to drop them altogether. This will improve the efficiency of the Office's activities. The Vice President and the head of the Office will also be elected (appointed) by the Parliament.

The Competition authority Commission will be the decision-making body (quasi-judicial body) that will make first instance decisions on cases of breaches in the competition law filed by the Office. The

Commission will be under operational control of the other Vice President of the competition authority and the head of the Commission (Chief Commissioner). The Commission will comprise seven members: a Chief Commissioner and six Commissioners. decisions should be reached by majority vote of all seven Commissioners (four votes for a decision to be made). In the decision-making process the Chief Commissioner will be only the first among equals. The incentive for the Commission to be efficient in their decisions is that each decision can be challenged by the court – commissioners will definitely not like the majority of their decisions to be reversed by the courts. The Vice President and the head of the Commission will also be elected (appointed) by the parliament. There will be no second instance within the competition authority, i.e. all appeals will go to the courts.

All three heads of the departments will be appointed by the Parliament, so they will be accountable for the operations of their departments/sectors of the Competition authority.

15.3. Nomination, election and recall of the decision-makers

As already pointed out, the President of the Competition Authority, two Vice Presidents and all Commissionaires should be elected/appointed by the Parliament. The President, Vice Presidents and Commissioners should be appointed for fixed terms. The president should be appointed for six years, a vice president in charge of the Office for five years and the Vice president in charge of the Commission (chief commissioner) for seven years. All commissioners should be appointed for fixed terms, but the terms should be different for each commissioner, staring with two years ending with seven years (Chief Commissioner). There should be a statutory limit for each official of one consecutive term in the authority.

All of them should be nominated to the parliament by the Government, i.e. by the Cabinet of Ministers. There is no need for separate nominations because that could create a vested interest link (for example nominations by the chamber of commerce, trade unions). There should be some strong constrains regarding the nomination/appointment. The appointed officials should have no conflict of interest whatsoever, and that should be provided for in the competition law. Furthermore some requirements regarding professional background should be specified in the legislation (economists and lawyers, for example).

The process of recalling/dismissal (removal from the office) should be specified very precisely and an exhaustive list of reasons for recalling/dismissal should be specified by the Competition Law. The list should include the acts (deeds) that damage the reputation of the competition authority (office or commission), such as serious criminal offenses by an official, should not offer any legal grounds whatsoever for recalling/dismissal on the decision of the Commission. It is essential to provide legal safeguards of this kind, because this is the only

mechanism that will enable the independent operation of the competition authority, i.e. prevent government influence on the authority's operations and decisions.

15.4. Funding of the competition authority operations

Several important principles regarding the funding of competition authority operations, should be pointed out:

- There are substantial initial (fixed) costs for the competition authority, i.e. costs of building that authority;
- There is a need for regular funding of the operations of the competition authority;
- Regular funding of the competition authority operations must not be influenced by government's satisfaction/dissatisfaction by specific decisions and rulings of the competition authority.

In principle, there are three ways to fund the competition authority building and operations:

a. **Option A:** Budgetary funding of the competition authority;
b. **Option B:** Funding from fees paid by the parties;
c. **Option C:** Funding from foreign donations (grants).

Budgetary funding is the only way to secure regular funding of the competition authority and to provide the basis for financial planning within the competition authority. Nonetheless, there is a great danger that the government will use that leverage to influence the decisions of the authority, i.e. to violate the authority's independence by conditionality imposed on the disbursement of financial resources from the budget. Accordingly, there must be a budgetary planning and disbursement procedure that will safeguard the independence of this regulatory authority.

Fees should be levied from the parties dealing with the competition commission, for example fees for the (merger and agreements) notification and fees for filing the case before the authority (office). These fees would generate a certain amount of money for the competition authority, and that money should remain with the authority, being allocated to its capital budget (i.e. it should be used for capital expenditures only). Whatever the unit fee, the total amount of money generated by fees cannot be the only source of funding for the operations of the competition authority, because it is very difficult to envisage revenues based on fees.

The amount of fees should be set as a deterrent for ridiculous cases to be filed before the competition authority's office. It is obvious that the administrative capacity of the competition authority at the beginning will be rather limited, hence its burden to the authority should be minimized. That is why the amount of fees for merger notification should be lower than the amount of fees for agreements notification. Taking all these considerations into account, it is quite realistic that the expected revenue stream based on the fees would be rather small.

Foreign donations (grants) could be a source of funding, but only for institution building costs, not for operative costs. Furthermore, a

detailed blueprint for institution building must be made, to persuade foreign donors that grants will be used effectively, i.e. that new institutions will become effective in due course.

Revenues from fines for breaching competition law should be allocated straight to the budget, and no single portion of these should be allocated to the competition authority. The reason for such a recommendation is that otherwise there will be a substantial conflict of interest of decision-markers within the authority, i.e. decisions will be biased because there will be a vested interest of the decision-maker (the Commission of the competition authority) to increase the total amount of revenues based on the fines *ceteris paribus.*

15.5. Legal powers of the competition authority

The legal powers of the competition authority should be divided between the legal powers of the competition authority Office and the legal powers of the competition authority Commission.

As to the Office, it is extremely important that the Office should have the legal power of collecting all relevant data/information from the subjects of the law, irrespective of whether the case has been triggered *ex officio* or by the complaint of a private party. On the other hand, there must be a legal obligation of the office regarding confidentiality of the data collected in that way. Furthermore, there must be a legal obligation for all relevant government institutions (for example Statistical Office, Security Exchange Commission, etc.) to provide all relevant data and information to the authority.

As to the Commission, its legal power should be to proclaim law-breaching agreements null and void and to impose fines.

As to the general secretariat, there should be a legal provision that will provide a legal power for the secretariat to be involved in consultations in preparations of all new policies and legislation. Furthermore, the general secretariat should have the legal power to initiate review of any existing policy and legislation relevant for competition policy. Nonetheless, general secretariat should not have any power to veto any other policy/legislation however relevant it is for the competition policy.

16. INSTITUTIONAL ISSUES (2) – OPERATIONS OF THE COMPETITION AUTHORITY

16.1. Procedural rules of the competition authority

There should be two types of procedural rules of the competition authority:

- procedural rules *strictu senso*;
- substantive rules.

Procedural rules *strictu senso* shall specify precisely all the procedures that will be used in all the cases and segments of the decision-

making process within the competition authority. These procedures should be formal/written to minimize the room for abusing competition legislation enforcement.

The substantive rule should provide basic criteria for the competition authority decision-making. These criteria should enable clear and unambiguous decision on issues such as what is a relevant market, whether some legal entity has a dominant position, whether the abuse of the dominant position is exploitative or exclusionary, etc.

Both types of rules should be specified by sub-statutory texts (decrees, bylaws, guidelines, etc.), according to the legal provision provided in the statutory text – the Competition Law. All the rules should be made public; published in the Official Gazette before becoming effective and be available from the competition authority at any time, free of charge, in both printed and electronic versions.

16.2. Providing public information

It is very important that the competition authority provides information to the public regarding its legislation enforcement activities. This should include:

- Publishing all the decisions in the Official Gazette.
- Create a website with all relevant legislative texts (statutory and sub-statutory) and all other legal documents.
- Provide accurate website information with the status of all cases.
- Provide website information on the competition authority (commission) decisions on all cases.
- Guidelines for the notification (with forms) for mergers and agreements.
- Guidelines for filing complaints (cases) to the competition authority (office).

Providing public information is very important in the other segment of the competition authority activities – advocacy. Efficient advocacy crucially depends on provision of relevant information on the actual/proposed competition policy and the effects of other actual/proposed policies relevant for competition, i.e. policies that have an impact on the competitiveness of the market structures.

Creating good public relations of the competition authority is a prerequisite for effective advocacy. Furthermore it is one of the prerequisites (necessary, but not sufficient condition) for building the reputation of the competition authority.

16.3. Public debate

The decision-making process should be public in certain instances. Formal decision-making sessions of the commission of the competition authority (as quasi-judicial body) should be public. The public should have an opportunity to monitor and contribute to the decision-making process in which each party/concern should have the

right to make its case (for example, the office as quasi-prosecutor and the party that is prosecuted). Transcripts from all the sessions should be available in electronic form. Special attention should be made to protect confidential data (legitimate business secrets) of the concerned parties.

17. THE ROLE OF THE JUDICIARY

The role of judicially in enforcement of competition legislation is basically twofold:

- The role of the specialized (commercial) courts in the process of judicial revew.
- The role of general courts in criminal prosecutions.

In both cases institutional structures exist, the only short-term improvement that can be expected is linked to the training of judges both regarding the basics of the competition policy and regarding the recent development on competition policy/legislation, i.e. to enable them to enforce this legislation efficiently.

18. BLUEPRINT FOR COMPETITION INSTITUTION BUILDING

18.1. Time frame for institution building

The initial stage of institution building of the new Yugoslav/Serbian competition authority will be three years. This initial stage can be divided into two periods:

- period of the short-term activities (the first year);
- period of the medium-term activities (the next two years).

The first year activities are crucial for the institutional development of the competition authority. If the right activities are performed in the right way during the first 12 months, a solid foundation is developed for further institution building of the competition authority. On the contrary, if the short-term institutional development is done in the wrong way, a lot of resources will have to be allocated to correct the mistakes and to, in that way, provide a solid basis for further development. That is why it has been decided that the following blueprint should focus only on the first, crucial year of the institution building of the competition authority.

Furthermore, a blueprint for medium-term activities, i.e. the activities of the second and third year of the institution building process can be specified only when the results of the first year activities are known and have been analyzed. In other words, it makes no sense to specify the medium-term activities before the short-term activities have even started to be implemented.

As to the political constellation and constitutional set-up, it can be expected that the new common state of Serbia & Montenegro will be

operational in the first quarter of 2003. According to the political agreement, the existing Federal structures will cease to exist at the end of January 2003, although there are some possibilities for this cut-off date to be postponed. According to the institution building plan for the new common state of Serbia & Montenegro, there is no plan whatsoever for building a (con)federal competition authority – a rather clear signal that competition policy has already been allocated to the member states. Accordingly, if there is no dramatic political change, the new competition legislation will be passed and adopted in the Serbian Parliament and the new competition authority will be developed at the Serbian level, i.e. will take care of the Serbian market only.

Since the Draft of the new Competition Law was submitted to the Serbian Ministry for Foreign Economic Relations before the end of 2002, it can be expected that the Cabinet of Ministers (the Serbian Government) will adopt the Draft, and the Competition Law Bill will reach the Parliament and be enacted/adopted in the first quarter of 2003. The new Competition Law will provide a legal basis for the new competition authority to be built.

The final Article of the Draft Competition Law stipulates that the Law shall enter into force on the eighth day following the day of its publication in the Official Gazette of the Republic of Serbia, and the first day of its enforcement shall be January 1st, 2004, except for the provisions on the establishment of the competition authority which shall be enforced from the day on which the Law enters into force. This provision of the Law gives enough time for the institution building process, before the new legislation is enforced.

One of the most urgent jobs in the institution building process is enabling the competition authority to start its operations and to enforce effectively the competition legislation. The crucial prerequisite for that is developing the sub-statutory legal documents that will enable the competition authority to enforce the Competition Law.

18.2. Development of legal documents

There are two groups of legal documents that must be developed in a short time: (1) the By-laws, i.e. the Statue of the competition authority; and (2) the Guidelines for the procedures and decision-making process within the competition authority.

18.2.1. By laws (Statute of competition authority)

Drafting and adopting the Statute of the competition authority, as a crucial By-law, will enable the authority to be built, to provide a division of labor (powers and responsibilities) within the authority, and to provide the groundwork for authority operations. Furthermore, the Statute will provide the detailed procedure for establishing relations between the competition authority and the parties. The Statute of the competition authority will cover all activities of the authority specified

by the Competition law: legislation enforcement, advocacy and education – competition culture.

This is most urgent job to be done – the Statute is the very first legal document that should be adopted after the authority has been formally established (strictly speaking formal decision on establishing the authority should be made simultaneously with the adoption of the Statute of the competition authority). Accordingly, the draft of the By-law, i.e. the Statute of the competition authority should be prepared within 3 months after the legislation has been adopted.

18.2.2. Guidelines

There are three sets of guidelines that must be developed, enabling the Competition Authority to enforce the law:

a. Guidelines for merger control investigation and decision-making are the most important guidelines because there is no experience whatsoever in enforcing merger control in Serbia. These guidelines should include detailed specifications on the process of market definition (particularly geographic market and product substitutability) as well as procedures to identify barriers to entry, potential competitors and countervailing strength of customers/buyers. All these procedures are of the utmost importance because the mergers will be challenged on the grounds of creating and strengthening dominant position. The guidelines should also provide clear specification of the merger notification process, including the draft notification forms that will be used in the compulsory merger notification process.
b. Guidelines for abuse of dominant position investigation and decision-making are also very important, because it can be assumed that there are many cases of dominant position in the Serbian economy. These guidelines should include all market definition issues already mentioned in the previous guidelines (crucial for identification of dominant position on the market). Apart from that the guidelines should also include procedures for detection of the abuses of dominant position, both in cases of exploitative and exclusionary abuses. Special attention should be paid to the process of identification of non-cost based pricing (including appropriate definition of the types of costs) and price discrimination. The identification process for other forms of abuses of dominant position should also be specified.
c. To provide Guidelines for restrictive agreements investigation and decision-making. These guidelines will include procedures for detecting the H1 group of horizontal agreements that are *per se* prohibited, as well as the procedures for evaluation of H2 horizontal and V (vertical) agreements to which the legal standard of the rule of reason will be applied. The guidelines will also provide guidelines for the notification process, including the draft notification forms that will be used in the voluntary notification process.

All of the guidelines are necessary for the legislation enforcement. Accordingly, all of the guidelines should be prepared within 6 months after the legislation has been adopted.

18.3. Staffing and Recruiting

The staffing of the competition authority is essential for its effective and efficient operations. This is of paramount importance, particularly taking into account the lack of skilled and experienced personnel.

Total employment of the competition authority at the end of the 2003 should be about 45 people. It is estimated that this staff would be sufficient for the initial operations of the authority. There should be internal division of the staff in line with the organizational structure of the competition authority. Accordingly, the total target employment should be divided into sectoral targets:

a. **General Secretariat** – 8 employees;
b. **Office** – 25 employees;
c. **Commission** – 12 (including Commissionaires).

General Secretariat is in charge of monitoring overall operations of the competition authority and particularly in charge of advocacy and competition culture development, as well as developing authority's public relations. Since advocacy and building PR should start as soon as possible, it is essential that General Secretariat get its entire staff within the first six months from the establishment of the competition authority.

The main operations of the **Office** are investigations – a very time consuming activity. Accordingly, the Office is, in terms of employees, the biggest sector of the competition authority (more that 50% of it's the whole staff). There should be some specialization within investigations, at least to the three major cases that the competition authority will deal with: (1) mergers review; (2) abuse of dominant position; and (3) restrictive agreements. Such a specialization would increase the efficiency of investigations, i.e. will foster efficient operations of the Office. Furthermore, additional specialization is recommended in terms of the specialization within trades (economic and legal expertise). For example, economists should specialize in: industrial organization (economics), accounting, corporate finance, etc.

Finally, apart from the Commissioners, the **Commission** should employ a limited number of non-elected (non-appointed) civil servants, i.e. officials that would provide support to the Commissioners in their decision-making activities. There is no need for many of them, so as to the number of civil servants, the Commission is planned to be the smallest sector of the competition authority.

As to the steps of staffing and recruitment, the first step should be election/appointment of the key personnel, i.e. top executives in charge of the competition authority and its sectors: the President and two Vice Presidents of the competition authority. These executives should be the champions of the competition authority institution building project.

The sooner these three executives are appointed, the better regarding the institution building project. It would be beneficial, although not obligatory, to appoint all the Commissioners simultaneously. Nonetheless, if that appointment will delay the appointment of the three chief executives, the Commissioners apart from the Chief Commissioner (Vice President) should be appointed separately.

Civil servants should be selected and recruited form the staff of the existing competition authority, experts in the relevant fields of economics and law out of the Government (including universities), local university graduates, as well as Serbian graduates from Western universities willing to return home. Not all of the people from the existing competition authority ("Antimonopolska komisija") should be employed automatically at the new competition authority, some selections should take place.

Apart from the full-time employees (civil servants), the competition authority should develop a network of experts/consultants (predominantly economists and lawyers) that are outside the competition authority (university professors, think-tanks and institutes, consulting companies, etc.) who will provide the authority with relevant expertise. Two networks of that kind should be developed. One of the regular consultants, i.e. for regular and general kind of consultancy and the other of *ad hoc* consultants, i.e. for consultancy that is likely to take place in the case of some specific industries.

18.4. Training

Skills needed for the activities of the competition authority are rather scarce in Serbia, hence a good training program for all the employees is of the paramount importance for institution building and for efficient operations of the authority. The training courses should be flexible to accommodate all the employees but they should have the same core, i.e. some essential economic and legal knowledge indispensable for each employee of the competition authority.

There should be an individual training program for each employee of the competition authority. Individual benchmarks for the training progress should be established, together will incentives for each individual to meet these benchmarks. It must be clear for each employee that his/her professional career is in question if the benchmarks are not met. The President and two Vice Presidents should be in charge of the individual training program and its implementation.

Training courses should be organized together with supranational competition authorities (like the EC DG COMPET, for example) and big and successful national competition authorities (like US DOJ and FTC). The EC/EU training link is very important, taking into account the SAP as well as available funds for covering the costs of the training. Since the US competition authorities (DOJ and FTC) have already established specialized training courses it is equally important that the competition authority staff to participate at these courses.

Strong and regular links should be established with the relevant competition authority of the transitional countries. A segment of these links should be regular exchange of personnel, enabling exchange of experience. Since other transitional countries, particularly Poland and Hungary are much more experienced in enforcement of competition policy, these exchanges will effectively constitute training of the competition authority staff. The Hungarian competition authority is particularly important. The first reason being that the organizational scheme of the Hungarian competition authority is very similar to the designed organizational scheme of the domestic authority. The second reason is that Hungary is (alongside Poland) one of the transitional economies with the best track record regarding competition policy. Furthermore, officials of the Hungarian competition authority have already indicated that they are willing to collaborate with their Serbian counterparts. Finally, collaboration with Hungarian counterparts, due to the geographical proximity, will generate only reasonable costs (transportation costs, etc.)

A very important part of the training of the executives and other officials of the competition authority is active participation in activities of the International Competition Network (hereafter ICN). This network was established in September 2002 (the Naples Conference) and has a number of very active working groups on various topics highly relevant for competition policy. The main objective of these activities is international standardization, in terms of identification of the best practice of competition authorities the world over.

18.5. Public relations and early advocacy

Developing good public relations (PR) and early advocacy (including development of the competition culture) should be the priorities of the competition authority even before the authority starts to enforce the competition legislation.

Good public relations of the competition authority should help the authority to create the image of a committed, efficient and unbiased authority. This will enable the authority to create alliances with stakeholders, particularly with consumers and their associations. These alliances will enhance the power of the competition authority and create an environment for its efficient operations.

The first activity in the field of PR and competition culture should be writing and publishing a monograph (book) "The Commentary of the Competition Law" that will consist of all pieces of legislation (both statutory and sub-statutory texts) with relevant comments on these pieces as well as notification forms. The book will be a User Manual for competition legislation and competition policy, and should be only the first step in the publishing activities of the competition authority or on the behalf of the competition authority.

From the first year of its operations the competition authority should publish the annual report with all relevant information on

the authority's activities during the year, including a balance sheet and income statements. The annual report should be published in both Serbian and English, distributed free of charge and should be available for downloading in electronic form from the authority's web site.

In terms of developing competition culture, there is a need for other publications about competition policy/legislation, its aims and origins. Apart from domestic publications, these publications should include translations of EC publications regarding the common competition policy of EU member states.

Another important move regarding PR is designing the competition authority web site with active communication with all parties and stakeholders. The site should contain all the relevant information on competition policy/legislation and information on the current activities of the competition authority including: relevant legal documents, annual reports, review of all the cases, rulings/decisions of the authority, electronic copies of application forms, etc. The site should be multilingual (bilingual for the beginning, Serbian and English). The site should be interactive provide incentives for two-way communication between the parties and the competition authority.

A PR campaign should be launched at some point during the first year of the competition authority. Timing and the content of this operation should be selected by the PR consultants of the competition authority. The aim of the campaign would be to let the public know about the new authority, about the new policy/legislation (competition policy) and what the major benefits of implementation of the policy are. The PR campaign will help the authority to build alliances as well as to recruit personnel.

Regular contact of the competition authority with other government bodies (Statistical Office, Security Exchange Commission) should be established in the early stages of institutional building. Such regular contact is important as a platform for sharing all relevant information, hence it is very important to specify lines and methods of easy communication at the very beginning. It is important to establish mutual trust between government bodies.

18.6. Costs and funding

It is not feasible to specify the total costs of the first year of operation of the competition authority because it is still uncertain what the pace of the institutional development will be. As to the initial costs, two of them are substantial.

The first one is getting new premises for the competition authority. It is not so important whether the new premises will the owner occupied or rented. It is very important, however, that the new premises are not a government property , because renting the premises to the authority can constitute leverage for the Government to exercise influence over the authority's operations.

The second initial cost is establishing a solid IT foundation (both in terms of hardware and software) and establishing links with all relevant IT links/networks. Creation of specific data bases should also be considered as initial IT cost. Furthermore, the costs of developing a resource library and subscription to all electronic documents should be added to this group of costs.

As to the operational costs, the labor costs of the competition authority will be substantial, i.e. rather high wages of the employees are envisaged. There are some good reasons for the high wages of the competition authority employees. Among them, the first is the opportunity for recruitment of high-quality people for the competition authority. The second one is that high wages provide a substantial (although not impenetrable) barrier against corruption, i.e. against biased decisions of the competition authority and abuse of competition policy by competitors.

As to the funding, institution building and the operations of the competition authority should be funded from the budget and foreign grants (donations). It is expected that all operational costs, or at least the major part of them, will be funded from the budget. Since the Serbian budget for 2003 has already been adopted by the Parliament, there is a need for budget restructuring during the year. Since many authorities will be moved from the existing Federal to the Serbian level, the budget restructuring can be expected one way or the other, i.e. it is not only the new competition authority that will trigger such budgetary restructuring.

Foreign grants (donations) can be expected as one-off payments (or in-kind contributions) for covering some of the initial costs of institution building. Foreign donors should be approached by the champions of the competition authority institution-building project as soon as possible to evaluate the prospects for donations of this kind.