

Unclassified

CCNM/GF/COMP/WD(2003)22



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

21-Jan-2003

English text only

**CENTRE FOR CO-OPERATION WITH NON-MEMBERS
DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS**

CCNM/GF/COMP/WD(2003)22
Unclassified

OECD Global Forum on Competition

COMPETITION POLICY IN SMALL ECONOMIES

-- SWITZERLAND --

This note is submitted by Switzerland under Session III of the Global Forum on Competition, to be held on 10-11 February 2003.

JT00137907

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SWITZERLAND

SPECIAL ASPECTS OF COMPETITION POLICY IN SMALL ECONOMIES

Switzerland is a relatively small country, both in terms of population and area. It might be considered a relatively "large" economy, however, if measured by the size of its absolute GDP or GDP per capita. The size of an economy is sometimes also defined by economists as the number of competitors that can be sustained when supplying domestic demand only.¹ According to this definition, with its population of 7.2 million, Switzerland is to be qualified as rather small an economy. The question about the economic size of a country is highly depending on the appraisal factors and thus the possible answers can turn out very different.

The present contribution tries to identify competition policy issues that are particular to Switzerland as a small country. It is argued that for a small country such as Switzerland, open markets for exports and imports as well as a well functioning legal system including trade and investment agreements are essential. For markets in which trade related solutions cannot do away with competition problems, competition policy may play a complementary role.

1. What aspects of an economy's "small" size imply a need for competition policy principles, laws, or institutions that are different from those of other, "larger" economies?

A special characteristic of Switzerland is its geographic location between some of the world's largest economies (Germany, France and Italy). Moreover, Switzerland's neighbors are all members of the EU, one of the world's most important single markets. As an open economy, trade between Switzerland and its neighbors as well as other countries is frequent and intensive. Moreover, as an export-oriented economy, Switzerland hosts a number of important multinational enterprises (MNEs) in different economic sectors.

These basic facts lead to the fundamental duty towards the economic community to assure a well functioning legal system that fits the geographical details of Switzerland. Legal security as well as an open and well-connected economy are important incentives for enterprises to settle in Switzerland. In view of Switzerland's geographical situation in the heart of Europe and its desire of political independence, the good functioning of intensive import and export connections needs to be assured by a coordinated system of Free Trade Agreements. Domestically, the legal system of Switzerland has to take into account the various interests of different market players: MNE's and SME's that are located Switzerland.

The first Swiss competition law was introduced in 1964. In 1995 the law has been totally revised ("Federal Act on Cartels and Other Restraints of Competition" (Acart).

In comparison to larger economies like the USA and in line with developments in other European countries, the introduction of a competition law in Switzerland was largely a development of the post-war

¹ See for example Michal S. Gal, Market Conditions Under the Magnifying Glass: General Prescriptions for Optimal Competition Policy for Small Economies. Working Paper #CLB-01-004, New York University Center for Law and Business, April 13, 2001.

period. Although the first court case concerning anticompetitive behavior, a boycott², took place in 1896, the need for a national competition law was not accepted for a long time. On the one hand, the arguments against it were based on grounds of private autonomy of economic subjects and contractual liberty. To make matters worse, in some businesses competition was long considered as an expression of uncooperative, uncollegiate behavior. On the other, there was a consensus that competition problems in relation with other countries in Europe could better be resolved by further developing trade relations than establishing a competition law which was considered superfluous in the light of the smallness of the country.

In other words: the view was widely held that it was in the better interest of a country with a small home market to open itself up to trade with as many partners as possible. In comparison, removing anticompetitive practices in the domestic market was seen as unnecessary or even counterproductive because it reduced the competitive chances of domestic firms against those from larger countries. This was different from countries with large markets like the US or the growing single market of the EU which were more intent on removing anticompetitive practices hindering the full development of their large home markets than on breaking down trade barriers with outside parties. It was only the onset of globalisation which began to reverse these opposing trends and brought smaller and larger countries more in line with each other. As enterprises did no longer have only one business location, but built up several depending on the best conditions of e.g. production, taxes, preservation of rights etc, countries were more and more under pressure of competition with each other. As a consequence, larger economies increasingly opened themselves up to the rest of the world while smaller countries realized that it was also in their own interest to tackle anticompetitive practices in their domestic markets.

As competition policies and rules worldwide progressed in a more efficient direction, awareness was also rising in Switzerland about the impact of anticompetitive behavior on the economy as well as the need for a national competition law. Furthermore, it became obvious, particularly because of the progress made in the EU, that Swiss enterprises could be affected by competition investigations of other countries. Indeed, many market players in the Swiss economy had to behave in a manner consistent with competition standards set by other countries because of their business locations abroad. The need to revise and renew the existing competition rules in order to make them more effective and, inter alia, to counter the increasing influence of foreign competition authorities, thus became apparent in 1993.

The currently valid Swiss competition law, which entered into force in 1996, is largely inspired by the EU rules of competition. Generally speaking, the law also covers the areas of merger control, abuse of dominance, illicit agreements and competition advocacy and basically leads to the same results in its application. In terms of “competitiveness of nations”, this is an important requisite to MNE’s to build a commercial establishment or to settle down in Switzerland, as they do not have to fear a treatment that is different from the single market of the EU.

2. Special attributes of small economies due to economic factors

The smallness of the Swiss market (7.2 Mio. Inhabitants) has several consequences:

First, concentration is comparatively high in many domestic industries. Because of the limited demand within Switzerland, in several sectors only a few firms can be maintained at an efficient scale. As a result, in some domestic industries such as retail distribution, there are only a few very large firms in the Swiss market, which compared to European firms are rather small, however.

² BGE 22, 176 - 179.

High industry concentration may raise different antitrust issues. Large firms relative to domestic demand may result in market dominance, with the possibility of its abuse. Moreover, oligopolies may facilitate concerted practices and tacit collusion. Finally, mergers tend to even further increase market concentration.

Mergers are necessary to adapt to changing economic conditions and enable the realization of economies of scale and scope. By enabling firms to achieve efficient scale, mergers may also increase international competitiveness of firms. Swiss merger control has therefore been designed to avoid concentrations eliminating effective competition by creating a dominant position in markets characterized by high entry barriers. Thus the notification thresholds under Swiss merger control are quite high compared, for instance, to the EU law and taken into account the market size.³

Second, in order to realize economies of scale, Swiss firms tend to expand beyond the national borders. Exports account for more than 40 Percent of GDP. In addition, Switzerland hosts many MNEs in different economic sectors.

The size of firms is not necessarily limited by the size of the economy in terms of territory, population or domestic demand. There are different ways how firms may realize economies of scale and scope and achieve minimum efficient scale by expanding beyond national borders.

Firms producing tradable goods or services may increase their sales by exporting their products. Exports allow firms to achieve efficient scale, particularly in markets whose geographic scope is international. This, however, requires that export markets are open.

For non-tradable goods and services and if markets are purely national, it is often not possible to export. Economies of scale in marketing, financing, research and development etc. may nevertheless be realized by direct investment and by establishing subsidiaries abroad. This is particularly the case for services like banking and insurance. However, like exports, foreign direct investments require open markets and a legal system supporting and protecting the investors. These requirements are essential for small economies to allow firms to achieve efficient scale. Hence, not the size of the economy or the scope of geographic markets, but trade barriers lie at the origin of limitations to achieve efficient scale.

However, open markets are not only important to allow firms to achieve efficient scale, but also to help avoid restrictions of competition in the domestic market. As has already been mentioned, industry concentration is relatively high in many sectors, which raises the possibility of dominance or collusion. This is particularly problematic in markets where there is no actual or potential competition from abroad. The absence of actual and potential competition may thereby be a result of import barriers erected by private firms. Foreign multinationals, for example, try to insulate the Swiss market and charge higher prices by applying vertical restraints such as exclusive dealing or price fixing. Such practices are persecuted increasingly by the Competition Commission if they can not be justified by efficiency reasons. To this end, the Competition Commission published in October 2002 a communication aimed at reducing private import barriers, among others, in car distribution.

³ According to art. 9 Acart, the Competition Commission must be notified of concentrations if

- a) the enterprises concerned reported joint turnover of at least 2 billion Swiss francs or turnover in Switzerland of at least 500 million Swiss francs, and
- b) at least two of the enterprises concerned reported individual turnover in Switzerland of at least 100 million Swiss francs.

In order to prevent restrictions of competition in the domestic market, it is therefore important to reduce import and market entry barriers. There is thus an important role for trade policy, competition policy having a complementary role to create efficient conditions for preventing competition restrictions.

3 Special attributes of small economies due to "political" considerations

It is an argument often heard that smallness of the business elite may be a potential factor favoring tacit collusion. In a small country, the important players in an industry usually know each other personally. Moreover, they often are members of the same trade association or lobbying group. But such phenomenon might be less a problem of small economies and more a question of the size of the concrete market on which attention is focused. Whether firms engage in tacit collusion and whether such a collusion is stable or not, depends on economic incentives of the firms to do so. Enterprises tend to make their decisions based upon economic reasons. It seems likely that a firm engaged in a tacit collusion has calculated the risk of being sanctioned compared to the gain resulting from its illegal behavior.

Another issue involved with competition policy in small economies are the costs of competition law enforcement. In Switzerland, there are almost as many industries present as in large economies. This requires that the competition authority must have a certain size in order to be effective. Therefore, it is probable that the costs of competition law enforcement, relative to GDP, are higher in small than in large economies.

4. Special enforcement issues faced by authorities in small economies

As an open economy, Switzerland is not only affected by restrictions of competition by domestic firms, but may also suffer from anti-competitive practices by foreign firms located abroad. The more or less globally accepted effects-principle is also acknowledged in the Swiss Competition Law and it thus may also apply to restrictions of competition originating outside of the Swiss territory. From an enforcement point of view, these cases may pose problems. However, broader competition cases of different contents may also fall under the scope of application of EC - law.

Traditionally, anticompetitive practices were judged according to a "public interest"- test. In the law that was enacted in 1995 the protection of competition became the primary objective of competition policy. Other objectives can only be taken into consideration by a special request to the Federal Council (i.e. the government). In practice, such a request is made very rarely. Also in terms of enforcement, this new orientation of the law has been very important. Only on this basis the introduction of direct sanctions (and a leniency program), which is envisaged by the revision currently under way, becomes possible in Switzerland.