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Barriers to Exit – Note by Italy

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More documents related to this discussion can be found at http://www.oecd.org/daf/competition/barriers-to-exit.htm

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1. Introduction

1. The OECD Roundtable on "*Barries to exit*" offers a valuable opportunity for the Italian Competition Authority (the ICA or the Authority) to present its experience in the assessment of barriers to exit both in its advocacy and enforcement interventions.

2. The competitive assessment of barriers to exit is particularly relevant for the Italian economy as, according to the Bank of Italy, the growth gap accumulated in the past years may be reduced only if economic policies aim, among others objectives, also at favouring the exit of inefficient firms to use resources in better performing sectors. In particular, to benefit growth, more efficient mechanisms of entry of new firms and exit of the least productive ones should act as a permanent challenge to the incumbent firms[1].

3. In many sectors, the structure of the market and the weak competitive dynamic allow also to inefficient companies to remain into the market. A large part of the competition deficit seems to be linked to excessive fragmentation and the low scale that does not allow to tackle the challenges of globalisation and innovation. More broadly, the lack of effective competition and of exit from the market of inefficient firms may *de facto* act as improper social welfare measures to guarantee social protection. Instead of defining direct appropriate public policies to address these issues, that would determine a cost for tax payers, this cost is indirectly transferred to consumers not only in terms of prices but also of quality and innovation[2].

4. Also, government's intervention related to the assessment of mergers and acquisitions (M&A) or the design of bankruptcy regimes may affect barriers to exit. Interventions aimed at rescuing undertakings in distress should not, wherever possible, determine unjustified restrictions of competition, whereas bankruptcy regimes should be able to facilitate the exit of non-viable undertakings rather than keeping them artificially in operation to the detriment of the competitive process[3].

5. The remainder of the present submission is organized as follows. Section 2 highlights the ICA's advocacy interventions tackling barriers to exit, while Section 3 describes the ICA's enforcement experience. Section 4 concludes for the need to complement competition with other appropriate public policies.

1 Bugamelli M., Lotti F. et al. (2018), "Productivity Growth in Italy: a Tale of a Slow Motion Change", Questioni di Economia e Finanza, Banca d'Italia.

2 Andrea Pezzoli (2019), "With a little help from my friends": quale politica della concorrenza per l'economia digitale?, ECONOMIA ITALIANA 2019/1.

3 Vittorio Minervini, "Disciplina della crisi di impresa e diritto della concorrenza: esigenza di una lettura "a sistema", Rivista del Diritto Commerciale e del Diritto Generale delle Obbligazioni, Anno CXVI 2018, pagg. 119 – 140.

2. Barriers to exit in the ICA's advocacy

6. The ICA has dealt with barriers to exit in the context of its advocacy powers. More specifically, it has often advocated the need to combine the introduction of competition – through, among others, liberalisations or public tenders – with appropriate complementary public policies aimed at alleviating, at least partially, its social impact. Without those policies, much awaited liberalisations or well-designed public tenders, may be opposed precisely because of the existence of barriers to exit. In this context, the ICA's interventions have provided transparency in the trade-offs existing among different public policy options in relation to decisions that go beyond its remit and require a delicate political balancing.

7. The ICA is aware that competition, if working properly, without barriers to exit, may determine also social costs, as inefficient businesses leave the market with a possible consequent rise of unemployment. However, such negative social outcomes should not lead to the sterilization of competition in the first place but to the improvement of welfare mechanisms and to strengthen the public policies aimed at the re-deployment of workers. In the long term, indeed, the costs arising from the lack of competition can be greater, in terms of the lack of growth, of the creation of new employment opportunities, of innovation, as well as in determining higher prices paid by consumers.

8. In that context, the ICA's advocacy has often tackled the introduction, during liberalisation processes, of social clauses aimed at promoting the stability of employment. Labour related exit costs deriving from legislations aimed at protecting the rights of employees, when they constitute a large part of total costs, may prevent exit. When those costs are transferred to new entrants they may act as a barrier to entry. The assessment of labour related exit costs entails the delicate balancing between different legitimate public interests. More specifically, it requires to conciliate, on one hand, the need of social protection with, on the other hand, the one of competition. Not all limitations of the freedom of economic initiative determine an illegal restriction of competition, if they are strictly necessary to guarantee other legitimate public interests. Even when social clauses can potentially interfere with competition rules, the balancing exercise between different legitimate general interests, is a political choice - based on the proportionality principle - attributed to the legislator.

9. In the wider context described above, the ICA has outlined the potential competitive restrictions linked to social clauses as barriers to entry in relation to the liberalisation of the sectors of airports[4] and railways as well as to the tenders related to the

4 ICA, Opinion n. AS47/1995 "Normativa settore aeroportuale", https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/0A16954626D816C8C125645600527B56/$File/AS47.pdf; ICA, Opinion n. AS123/1998 "Liberalizzazione dei servizi di assistenza a terra degli aeroporti", https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/A07F1BD8E7076579C12565BB0040393F/$File/AS123.pdf; ICA, Opinion n. AS274/2004 "Liberalizzazione e privatizzazione delle attività aeroportuali", https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/7038EE9D5141D2B7C1256E37004DF383/$File/AS274.pdf.

privatisation of public companies[5] and local public services[6]. The opinions were aimed at highlighting the risks that the imposition on new entrants of the obligation to absorb manpower in excess can discourage entry and reduce its competitive impact, limiting the benefits of liberalisation in terms of reduction of prices and improvement in the quality of products or services. It can also damage the awarding public administration as it may impede the introduction of possible innovations in the production process reducing flexibility in managing the cost of labour. Lastly, it may penalise the most efficient allocation of human resources by the new entrant.[7]

10. More generally, social clauses, similarly to other labour related barriers, may introduce frictions in the competitive process that can be particularly significant in industries in which the cost of labour constitutes a large part of total costs.

11. In its advocacy interventions, the ICA has long promoted a pro-competitive reform of the taxi industry even before the appearance of the new digital services[8]. With the emergence of new business models, the Authority has intensified its advocacy role by issuing several opinions addressed to policy makers urging them to come up with an overall reform of the sector. In these advocacy interventions the Authority considered at length the issue of introducing a form of compensation to incumbent taxi drivers in order to favour their exit from the market. While recognizing that this type of discussion invests the competences of other public entities, the Authority nevertheless invited the Government to consider monetary compensations to accompany the liberalization reform by looking at experiences of other jurisdictions.

12. In particular, in a 2017 opinion[9], the Authority favoured the adoption of a new framework in which traditional taxi services, private hire car services and new ridesharing services would compete in the same market. Among the elements highlighted by the Authority in view of this potential reform, it also proposed the introduction of a compensation scheme to attenuate the social costs of the liberalisation. Even though this proposal is not directly linked to competitive aspects, it may be considered as a complementary tool to make competition more effective (see Box 1 below).

5 ICA, Opinion n. AS1137/2014 “Proposte di riforma concorrenziale ai fini della legge annuale per il mercato e la concorrenza anno 2014”; https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/A99086EB62C1B736C1257D0F003383F4/$File/AS1137.pdf.

6 ICA, Opinion AS1200/2015 “Regione Sardegna – Affidamento del servizio pubblico di cabotaggio marittimo”, https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/B8EC10D17AC13051C1257E6C0039455C/$File/AS1200.pdf.

7 ICA, Opinion n. AS1242 “Contratti di concessione, appalti e procedure di appalto degli enti erogatori nei settori dell’acqua, dell’energia, dei trasporti e dei servizi postali”, https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/1B81B0259E030417C1257F2A0038D402/$File/AS1242.pdf.

8 The first advocacy intervention mentioning the problem of compensating the taxi drivers affected by liberalization dates back to 1996.

9 ICA, Opinion n. AS1354 “Riforma del settore della mobilità non di linea”, https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/C12563290035806C/0/E625CF63D39A5B20C12580E3004C5373/$File/AS1354.pdf.

Box 1. Opinion AS1354 Reform of the taxi industry

In particular, the Authority envisaged three forms of compensation matching different degrees of liberalization process while expressing a preference for the one consistent with a full liberalization reform which would contemplate both traditional actors and new players operating in the same market.

Under this scheme, during a defined transition period, existing incumbents may have the option to leave the market by selling its license to the State at a price reflecting the difference between the current value and the "book" value. To finance this scheme, the Authority has pointed out the possibility to consider forms of "entry fee" to be applied all new drivers; and/or a fee to be applied on each ride booked through a platform (to be collected by the platform itself), as it occurred in some jurisdictions.

The other compensation schemes are related to a scenario in which the reform only envisages an expansion of the supply side by increasing the number of licenses. One scheme would use the earning from the sales of these additional licenses to compensate existing incumbents. The other compensation scheme would assign additional licenses at no cost to the existing drivers with the possibility of trading in the secondary markets.

3. Barriers to exit in the ICA's antitrust enforcement

13. The ICA has tackled, indirectly, the issue of barriers to exit in its antitrust enforcement interventions mainly in relation to cartels, determined by structural sectoral issues or general severe economic downturns (hereinafter, "crisis cartels"), that can be used to keep into the market also inefficient undertakings that should instead exit as an outcome of a non-distorted competitive process.

14. Many interventions that under covered hardcore horizontal agreements have, indeed, concerned sectors under distress, where the cartel kept in the market, in a coordinated manner, a significant number of firms, a fringe of which inefficient, instead of a more limited number of more efficient firms. This has often guaranteed the survival of inefficient undertakings that, absent the cartel, would have exited the market. This outcome can affect the overall productivity of the sector and of the most efficient firms. The sectors involved are often relatively not highly concentrated and characterised, at least at the fringe, by the presence of medium and small enterprises. Among others, the ICA has recently intervened in relation to two traditional cartel cases concerning basic industries, more specifically the cement and reinforcing bars for concrete ones.

15. The ICA policy has always been consistent in the application of article 101 of the Treaty on the Functioning of the European Union (TFEU), concerning illegal agreements, also to sectors under distress, that do not warrant an exemption from competition rules. It is, indeed, precisely in situations of economic crisis that the protection of competition becomes even more relevant, considering that a competitive market is the most efficient way to allocate resources contributing to overcome a period of recession.

16. The ICA has, nevertheless, the possibility to take into consideration the crisis of a sector in the way it determines fines.

17. More specifically, the ICA has, in 2014, adopted Guidelines on the method to be applied to set fines in order to increase predictability, accuracy and effectiveness of antitrust intervention. In that context, the ICA can take into consideration individual situations of distress, and even more widely sectoral crisis, when defining fines (see Box 2 below).

Box 2. Guidelines on the method for setting fines[*]

In October 2014 the ICA adopted Guidelines on the method for defining fines, based on the outcome of a consultation process with the relevant stakeholders.

Similarly, to the European Commission's methodology, the Guidelines use a two-step process when setting the amount of the fine: (i) determining the basic amount, and (ii) making upwards or downwards adjustments to consider multiple aggravating or mitigating circumstances.

In any event, the final amount of the fine may not exceed 10% of the undertaking's total turnover in the previous business year, as provided for by Article 15 of the national competition law (law n. 287/1990).

Based on article 31 (entitled "ability to pay"), the ICA can consider the economic situation of the undertaking responsible for the infringement, reducing the sanction to take into account its actual limited ability to pay. In that regard, the undertaking concerned should provide complete, reliable and objective evidence demonstrating that the imposition of a fine, determined on the basis of the Guidelines, would compromise irremediably its profitability, also determining the exit of the undertaking from the market. The ICA will not consider requests based uniquely on losses occurred in the last years.

Moreover, at article 34, the Guidelines foresee the possibility to justify derogations from the Guidelines in relation to specific circumstances of the concrete case under consideration or for the need to obtain a particular deterrent effect. Distress situations of a sector can be recognized as a mitigating circumstance in the overall assessment of the specific circumstances of a case.

Note:
[*] ICA, Decision n. 25152/2014, https://www.agcm.it/chi-siamo/normativa/dettaglio?id=cbb9e335-a9ca-4efb-97ac-71dbd831c491&parent=Concorrenza&parentUrl=/chi-siamo/normativa/index.

18. In the application of the Guidelines, the ICA has approved inability to pay requests, as well as considered sector wide situations of distress, only in exceptional circumstances, as it is still necessary to preserve the deterrence role of sanctions. Undertakings that, independently from the imposition of a sanction, would risk bankruptcy are excluded from the benefit.

19. In 2017, for example, the ICA has intervened in relation to two traditional cartel cases concerning basic industries - cement and reinforcing bars for concrete - signalling that crisis cartels ought not to be justified in any circumstance.

20. In relation to the cement cartel, the ICA has, first of all, recognized that the sector was characterised by a situation of profound crisis that led to a significant reduction of

production. However, it considered that, consistently with the European case-law[10], the state of distress of the sector is not sufficient to exclude the application of the TFEU.

21. Nevertheless, the ICA considered appropriate to reduce fines, to all cement companies and the trade association involved in the case, by 50% because of the situation of distress of the cement sector (see Box 3 below).

22. The ICA applied article 34 of the Guidelines also to the cartel in the supply of concrete reinforcing bars and welded steel mesh[11] to take into consideration the dramatic crisis of the steel sector determined by the crisis of the constructions sector in the years under consideration.

Box 3. Case N. I793 - Cement cartel*

In November 2015, the ICA opened proceedings against four undertakings active in the supply and sale of grey cement, for an alleged price fixing cartel, in breach of Article 101 TFEU. A cement customer complained to the Authority in 2014, after the companies simultaneously raised the price of cement by €9 per tonne. The investigation was subsequently extended to other seven manufacturers (overall amounting to 85% of the market), a cement distributor and the trade association AITEC.

According to the Authority, the cartel consisted of the coordination of the commercial policies on the national market of production and sale of grey cement, packed or unpacked, from at least mid-2011 until the beginning of 2016: in particular, cement companies allegedly colluded on prices by issuing coordinated price lists, which were identical both in content and timing, and that they exchanged information to announce price increases and through cement trade association AITEC. The Authority found evidence of: i) an agreement on timing and amount of price list increases; ii) communication to the customers of the future adoption of price list increases in advance and monitoring the price movements; iii) effective implementation of such increases by all the competitors by way of surveys submitted to co-supplied customers, direct contacts through sales agents and manufacturers' officers; iv) exchange of sensitive information with the support of trade association AITEC, ensuring the overall implementation of the price increases announced by the cement manufacturers.

In particular, the evidence gathered during the investigation outlined the role of the trade association in collecting data on the deliveries of cement on the national territory per macro-areas and then sharing with the members accurate statistical reports with the aim of monitoring market shares. Therefore, according to the ICA, AITEC helped the companies obtain up-to-date information about volumes of cement delivered to each area of the country in order to monitor relevant market positions. Furthermore, the Authority found that the cartel produced significant effects on the market, by maintaining margins and market shares of the cartelists despite a period of severe demand reduction.

10 Judgment of the Court of First Instance (First Chamber) of 13 December 2006, Joined cases Fédération nationale de la coopération bétail et viande (FNCBV) (T-217/03) and Fédération nationale des syndicats d'exploitants agricoles (FNSEA) and Others (T-245/03) v Commission of the European Communities, http://curia.europa.eu/juris/liste.jsf?language=en&jur=C,T,F&num=T-217/03&td=ALL.

11 ICA, Decision n. 26686/2017, https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/41256297003874BD/0/F64346FF594E2286C12581760036BFCA/$File/p26686.pdf.

The overall fine imposed by the Authority in its infringement decision was reduced by half after taking into account the harm the 2007 financial crisis caused to the construction sector.

For what concerns individual request to be granted the inability to pay, only one company obtained a further reduction of the fine of 70%. The requests from two other companies were instead rejected and their situation of economic distress was only recognized with respect to the possibility to dilute the payment of the fines in instalments.

The infringement decision was challenged before the Court of First Instance which rejected the appeals in July 2018. While some appeals are still pending, the Highest Administrative Court has so far upheld the AGCM decision entirely but for one appeal where the sanction has been reduced.

Note: * ICA, Decision n. 26705/2017, https://www.agcm.it/dotcmsCustom/getDominoAttach?urlStr=192.168.14.10:8080/41256297003874BD/0/AE0CAB5C786080C7C125817E004A3660/$File/p26705.pdf.

4. Conclusions

23. Antitrust authorities cannot ignore that the transition to a global and online economy may determine significant social costs, which are exacerbated by the economic downturn. However, impediments to the competitive process - such as cartels aimed at raising prices to allow the survival of inefficient firms or regulatory measures that protect the incumbents undermining the entry of new innovative business models - cannot act as improper welfare measures. Other public policies aimed at accompanying the exit from markets by inefficient firm and alleviating the social costs may therefore play an important role in favoring a rigorous application of competition law and ensuring a competitive market outcome.

24. As observed by Schumpeter, "…*there is certainly no point in trying to conserve obsolecent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout which may become a center of cumulative effects, into orderly retreat…*"[12], it is important to design coherent public policies that introduce social protections that favour competition instead of protection from competition.

25. Vigorous antitrust enforcement is still needed also, and especially, in relation to sector wide situations of distress in order to guarantee a more efficient allocation of resources. This shall be accompanied by measures aimed at facilitating the freedom of exit, protecting sectors in distress through other public policies, that may significantly promote competition contributing to alleviate barriers to exit.

12 Schumpeter, J. (1942), Can Capitalism Survive?, Harper Perennial Modern Thought.