



"I LIKE A LITTLE COMPETITION" - J.P. MORGAN

**COMPETITION POLICY AND
THE COMPETITION REGULATORY AUTHORITY
IN GEORGIA**



TRANSPARENCY INTERNATIONAL GEORGIA
TRANSPARENCY AND ACCOUNTABILITY IN ACTION

COMPETITION POLICY AND THE COMPETITION REGULATORY AUTHORITY IN GEORGIA

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The cover page includes Art Young's cartoon published in The Masses, February 1913, in which J.P. Morgan mixes a little competition/soda water with his monopoly/whiskey. At the Pujo Committee, December 19, 1912, Morgan was asked by Samuel Untermyer if he disliked competition and replied "I like a little competition."

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EXECUTIVE SUMMARY

In the "Competition Policy in Georgia" report published last year, Transparency International Georgia highlighted the need for effective competition policy in the country, and accordingly, for a reform of public policy in order to ensure the exercise of an effective state oversight of competitive environment and free and fair market competition. The organization also offered the government concrete recommendations necessary for the implementation of an effective competition policy reform.

Reforming anti-monopoly policy (i.e. competition policy) was a publicly stated pre-election promise of the "Georgian Dream" Coalition. Transparency International Georgia was also involved in the process of competition policy reform. The organization believes that the discussion of draft competition policy reform and collation based on proposals received from various business associations and international organizations are now completed. It is equally important to keep in mind the need for timely implementation of the competition policy reform in the country. Announcement of this reform by the Government and the subsequent delay in its implementation has put business in the so-called standby mode, whereas the expectation of changes in institutional environment has an adverse effect on investment decisions and creates an unfavorable environment for business activities, which also has a negative impact on the country's economy as a whole. Hence, it is important that the Georgian Government takes into account potential threats resulting from the delay in the anti-monopoly reform process and initiates the mentioned draft in the Parliament of Georgia in timely manner.

Competition policy is also very important for the country in terms of

prevention of corruption. One of the forms of the so-called elite corruption, which is often discussed in Georgia, is the creation of privileged conditions for specific companies (with political connections) on the market. An independent and strong competition agency equipped with relevant powers and resources is a necessary prerequisite for preventing this type of corruption.

This report examines the work that has been conducted since the October 2012 parliamentary elections and the current situation in the field of competition regulation. The first chapter reviews the institutional framework of competition in Georgia and the measures carried out by the "Georgian Dream" Coalition since coming to power. The second chapter describes the gaps of the institutional framework on competition, including the flaws of "the Law on Free Trade and Competition", and also provides concrete recommendations for the implementation of effective competition policy reform in Georgia.

KEY FINDINGS

- Regulatory legislation for competition was revoked in Georgia in 2005. Consequently, effective state supervision over observance of competition rules and principles was no longer carried out and the market logic was dictating the process in different sectors of the economy. This created risks of anti-competitive practices and of the abuse of market power by players already established on the market;
- Competition policy reform was identified as one of the priority areas for successful completion of negotiations between Georgia and the EU over the Deep and Comprehensive Free Trade Agreement (DCFTA). In accordance with these requirements, basic definitions needed for competition policy were restored on May 8, 2012, when the Parliament of Georgia adopted "the Law on Free Trade and Competition". The same year, the Competition and State Procurement Agency was established through a Presidential decree;

■ To date no cases of unlawful restriction of competition on the market or of violation of Georgian competition law have as yet been investigated or initiated by the Competition and State Procurement Agency. For this reason, the state budget money spent since January, 2012 to finance the Agency can be described as inefficient spending of public funds. The Agency's activities were further hindered by the Georgian Government's failure to enact secondary legislation set by the Law on Free Trade and Competition in order for the Agency to implement the Competition Law;

■ Competition policy reform was among the pre-election promises of the "Georgian Dream" Coalition. Transparency International Georgia was also involved in the competition policy reform: In February 2013, the Parliamentary Committee on Sector Economy and Economic Policy examined the legislative proposal on Competition. The Committee decided that the Ministry of Economy and Sustainable Development of Georgia would initiate the draft law before the end of March 2013. Further, a memorandum¹ signed by the International Monetary Fund (IMF) and the Government of Georgia in March 2013 stated that respective legislative amendments had been initiated and that the new Competition Agency was to start functioning in June 2013, which did not happen. The EU – Georgia Association Agreement², initialed during the 29 November Eastern Partnership Summit, also highlights that the parties shall maintain in its respective territory comprehensive competition law which effectively address anti-competitive agreements, concerted practices and anti-competitive unilateral conduct of enterprises with dominant market power and authority responsible and appropriately equipped for the effective enforcement of the competition laws;

■ There is a need to secure a timely implementation of competition policy reform in the country. The fact that the government announced about the need for this reform but delayed its implementation has put business in the so-called standby mode, whereas the expectation of changes in institutional environment

1 <http://www.imf.org/external/np/loi/2013/geo/030113.pdf>

2 http://eeas.europa.eu/georgia/assoagreement/assoagreement-2013_en.htm

has an adverse effect on investment decisions and creates unfavorable environment for business activities, which also has a negative impact on the country's economy as a whole. The Government of Georgia should therefore consider the potential threats resulting from the delay in the anti-monopoly reform process and initiate the draft law in the Parliament of Georgia in a timely manner;

- Anti-monopoly policy (i.e. Competition policy) requires timely reform, so that conditions are created for effective state oversight of competitive environment and free and fair competition on the market.

RECOMMENDATIONS

"Transparency International Georgia" believes that, in order to ensure effective state oversight of competitive environment and support free and undistorted competition on the market, as well as to increase the compatibility of the Georgian and the EU markets, the Georgian authorities should take into consideration the following recommendations:

- Competition legislation must be amended to address the gaps of the current institutional framework for competition. The Government of Georgia must initiate the draft Law on the competition policy reform in the Parliament of Georgia in a timely manner, while Parliament must establish the institutional basis for this reform;

- Functions of the Competition and State Procurement Agency and the independent regulatory authorities' active in various business sectors must be separated effectively. The competition policy must be coordinated and the independence of the Competition and State Procurement Agency must increase. The Agency should be authorized to independently start investigating any market, provided that signs of restriction of competition in this market exist and the structure and characteristics of the market requires intervention of the competition regulatory authority;

- Respective exceptions envisaged by the competition legislation framework (in particular, by the Law on Free Trade and Competition) must not create the possibility of eliminating competition with respect to substantial part of the products in question;

- One of the key tools of struggle against anti-competitive practices by economic agents on the market – the “Leniency Program” – must be developed and implemented in the Georgian legislation.

CHAPTER 1. GENERAL BACKGROUND

Competition is an essential element for the functioning of market economy, while competition policy aims to ensure that the competition is not restricted in the market to the extent it is detrimental to the society. International experience illustrates that the process of liberalization and deregulation cannot succeed without an effective competition policy. Thus, an effective competition policy and relevant legislation are essential components of a country's development.

WHAT WAS HAPPENING IN GEORGIA?

Competition regulatory legislation was revoked in Georgia in 2005. Consequently, effective state supervision over observance of competition rules and principles was no longer carried out and the market logic was dictating the process in different sectors of the economy. This created risks of anti-competitive practices and of the abuse of market power by players already established on the market.

Competition policy reform was identified as one of the priority areas for successful completion of negotiations between Georgia and the EU over the Deep and Comprehensive Free Trade Agreement (DCFTA). In accordance with these requirements, basic regulations needed for competition policy were restored on 8 May 2012, when the Parliament of Georgia adopted "the Law on Free Trade and Competition". The same year, the Competition and State Procurement Agency was established through a Presidential decree; To date no cases of unlawful restriction of competition on the market or of violation of Georgian competition law have as yet been investigated or initiated by the Competition and State Procurement Agency.

Transparency International Georgia reviewed the spending of allocated public funds since the establishment of the Competition and State Procurement Agency. Tables 1-3 (Annex 1) provide data on the budgets and salary funds for 2012-2013. Considering the fact that the Agency has not

discussed this draft as legislative proposal in February 2013. The Committee decided that the Ministry of Economy and Sustainable Development of Georgia would initiate the draft Law before the end of March. Further, the Memorandum³ signed by the International Monetary Fund and the Government of Georgia in March 2013 stated that respective legislative amendments had been initiated and the new Competition Agency was to start functioning in June 2013, which did not happen. The EU – Georgia Association Agreement⁴, initialed during the 29 November Eastern Partnership Summit, also highlights that the parties shall maintain in its respective territory comprehensive competition law which effectively address anti-competitive agreements, concerted practices and anti-competitive unilateral conduct of enterprises with dominant market power and authority responsible and appropriately equipped for the effective enforcement of the competition laws.

The draft Law on the competition policy reform was publicly discussed at several events with participation of experts of the Georgian Development Research Institute, Transparency International – Georgia, GIZ, the Swedish International Development Agency (SIDA), the EU Delegation to Georgia, and the business community. Concrete recommendations developed by the World Bank and US Chamber of Commerce were also incorporated into the draft.

In order to determine position of the Ministry of Economy and Sustainable Development of Georgia on the current status of reforming the competition policy, Transparency International – Georgia met with Deputy Minister Natia Mikeladze⁵. Official response of the Ministry was as follows: “Because the draft Law fundamentally and substantially changes the competition policy in Georgia, which will, in turn, have an impact on the activities of economic agents, the Ministry treats this reform with extreme caution and tries to submit to the Parliament text elaborated to the maximum extent so that the committee and session debates occur in a peaceful environment ... A finalized draft will be sent to the Parliament during the autumn sessions.”

3 <http://www.imf.org/external/np/loi/2013/geo/030113.pdf>

4 http://eeas.europa.eu/georgia/assoagreement/assoagreement-2013_en.htm

5 Interview conducted by the author, August, 2013

Transparency International Georgia believes that discussion of draft competition policy reform and collation based on proposals received from various business associations and international organizations are now completed. It is equally important to keep in mind the need for timely implementation of the competition policy reform in the country. Announcement of this reform by the Government and the subsequent delay in its implementation has put business in the so-called standby mode, whereas the expectation of changes in institutional environment has an adverse effect on investment decisions and creates an unfavorable environment for business activities, which also has a negative impact on the country's economy as a whole. Hence, it is important that the Georgian Government takes into account potential threats resulting from the delay in the anti-monopoly reform process and initiates the mentioned draft in the Parliament of Georgia in timely manner.

Competition policy is also very important for the country in terms of prevention of corruption. One of the forms of the so-called elite corruption, which is often discussed in Georgia, is the creation of privileged conditions for specific companies (with political connections) on the market. An independent and strong competition agency equipped with relevant powers and resources is a necessary prerequisite for preventing this type of corruption.

CHAPTER 2: PROBLEMS OF CURRENT INSTITUTIONAL FRAMEWORK FOR COMPETITION: WHY HAS THE COMPETITION AND STATE PROCUREMENT AGENCY FAILED TO CARRY OUT EFFECTIVE OVERSIGHT OF COMPETITIVE ENVIRONMENT?

This Chapter reviews the current problems of institutional framework for competition and offers the authorities concrete recommendations for the implementation of effective competition policy reform and mitigating the corruption risks associated with the business sector in Georgia.

Since the launch of its operations in January 2012, the Competition and State Procurement Agency (hereinafter — the "Agency") has not investigated any cases of unlawful restriction of competition on the market or of violation of Georgian competition law in general. According to the Ex-Head of the Agency, Mr. Tato Urjumelashvili⁶, the Agency's activities were further hindered by the Georgian Government's delay in adopting secondary legislation envisaged by "the Law on Free Trade and Competition" (hereinafter — "the Competition Law"), adopted in May 2012 by Parliament of Georgia. The following legal acts had to be developed to enforce this Law (see Article 34):

- a) On defining the de-minimis individual state aid before June 30, 2012;
- b) On priorities of the Agency's activities before January 1, 2012;
- c) On the general rule of state aid granting procedure before June 30, 2012;
- d) On the rule and procedure of investigation before November 1, 2012;
- e) On the form of the complaint and application, rule of submitting them and procedures and terms related with the admissibility of the complaint and the application before December 1, 2012.

The Agency developed the drafts of all legal acts envisaged by the Law and submitted them to the Government, but the Government of Georgia has delaying the adoption of this secondary legislation. Accordingly, the

6 Interview conducted by the author, August, 2013

Agency cannot exercise effective state oversight of the observance of competition rules and principles in the country.

Georgia's institutional framework for competition has the following gaps:

1. LACK OF THE AGENCY'S INDEPENDENCE AND PRO-GOVERNMENT BIAS: the Competition Law places too much powers vis-a-vis the Agency:

- a. The government defines which priority sectors will be regulated by the Competition Agency (see Art. 19, para.1, Competition Law);
- b. The Agency investigates complaints only in line with the Government-approved priority sectors. While, complaints from non-prioritized sectors can be ignored by the Agency (see Art. 19, para.2, Competition Law);
- c. The government can determine exemptions from competition regulation (see Art. 9, para.3, Competition Law);
- d. The head of the Agency does not have the power to issue secondary legislation (orders) relevant to regulating competition. It further reduces the Agency's independence as well as creates a significant time delay in waiting for the legislature to approve each order (see Art.4, Competition Law).
- e. The Agency is not empowered to initiate an investigation unless a complaint has been lodged by a private party (see Art. 18, Competition Law);

These legislative sections should be amended to empower the head of the Agency to issue the necessary secondary legislation, permit the Agency to initiate an investigation without a complaint having been lodged and finally, to do so in any segment of the market, if that segment requires intervention by the competition authority.

2. CONFLICTING FUNCTIONS: the Agency now has the following combined functions:

- a. implementing competition legislation (Competition function),
- b. coordinating state procurement (Procurement function), and
- c. monitoring state procurement (Competition function),

but these are three very distinct responsibilities. It is more appropriate and effective for these functions to be performed by two independent, separate authorities

3. TOO GREAT A THRESHOLD FOR DE MINIMIS: percentages quantifying de minimis agreements must be reduced in line with the European Commission Notice on de minimis agreements. By placing a number of significant agreements between economic agents outside of the regulation, the current thresholds do not conform with EU legislation (see Art.8, Competition law and Commission Notice (2001/C 368/07).

4. ELIMINATING COMPETITION: the list of exemptions in Art. 9 of the Competition Law is not qualified as per Art. 101(3)(b) of the Treaty on the Functioning of the European Union stating that exemptions must not create: "the possibility of eliminating competition in respect of a substantial part of the products in question." This condition must be incorporated into the Competition Law in order to avoid the possibility of eliminating competition in a substantial part of the relevant market.

5. LACK OF DETERRENCE: Fines are limited to 10 percent of the previous year's profit, or if there was no profit, 2 percent of the previous year's turnover (see Art.33, Competition Law). It is possible that a company, which declared less profits, will pay a smaller fine than a company, which did not declare any profits. If it is more profitable for a company to run the risk of a limited fine but continue pursuing anti-competitive practices, it makes economical sense for it to do so. TI Georgia believes that, in order to deter companies from engaging into anti-competitive practices, the criteria for charging fines should be specified in a way that the amount of a fine is calculated based only on the company's turnover and that such a fine should be sufficiently high to act as a deterrent.

6. PRICE CREATION: the Agency's power is severely limited by being explicitly barred from analyzing price creation (see Art.1, para.5, Competition Law). Price creation (the components to price setting, cost conditions) is a crucial part of analyzing whether a company is engaged in anti-competitive practices. Hence, the Agency must be able to perform such evaluations.

7. LENIENCY PROGRAM: this has proven to be a highly effective instrument to detect the facts of violation of competition rules by economic agents in the US and Europe. The Competition Law must implement and provide for such a tool.

8. OVERLAP OF FUNCTIONS: the Competition Law should clearly state how the functions of the Agency and the two remaining independent sector regulators – the Georgian National Communications Commission and the Georgian National Energy & Water Supply Regulatory Commission – will be divided to ensure an effective separation between the three authorities.

9. PROMPT INVESTIGATION OF COMPLAINTS: Art.25 of the Competition Law stipulates that the Agency must complete an investigation within 6 months. The Agency is allowed to extend the term of investigation up to further 15 months, depending on the "importance and gravity" of the case. After a period of 21 months, any evidence gathered may be out of date and a decision could have an irrelevant impact on the market. We believe this provision is open to abuse and may hinder the timely conclusion of cases.

10. NEED FOR COMPETITION POLICY REFORM IN CONNECTION WITH FACTS OF UNLAWFUL RESTRICTION OF COMPETITION THROUGH STATE ASSISTANCE: Indeed especially in part of control over state assistance related to facts of unlawful restriction of competition, so that the openness and transparency of the market is secured, the principle of

equality is observed in the activities of economic agents, and the state authority does not impose administrative, legal and discriminatory barriers for entering the market or restrict competition unlawfully.

11. TRANSPARENCY AND ACCOUNTABILITY: the Agency is a public institution funded by taxpayers' money. The Agency must give an account of its activities, in order for the parliament, the public and civil society to be able to monitor and scrutinize the quantity and quality of the Agency's work.

12. REQUIREMENT FOR FURTHER LEGISLATION IN COMPLIANCE WITH THE CONSTITUTION OF GEORGIA: there is currently no law defining the amount of the service fee to be charged to complainants. This fee must be established by a law, it cannot be established by a by-law, as per Art.23, Para.8 of the current law, as this would be a violation of Art.94 of the Constitution of Georgia, pursuant to which "the structure of taxes and duties and the procedure for the introduction thereof shall only be determined by law". Of significance in respect of this norm is the 10 January 2003 decision №2/1/187-188 of the Constitutional Court of Georgia, which has found a fee introduced by by-law as unconstitutional.

13. REQUIREMENT FOR SECONDARY LEGISLATION: it is vital that further secondary legislation be enacted (rule and procedure of investigation, methodology of investigation etc.) within the deadlines set by the Competition Law, in order for the Agency to effectively implement the Competition Law.

Transparency International Georgia believes that Georgia's current institutional framework for competition requires timely reform based on the recommendations discussed above in order to ensure the exercise of an effective state oversight of competitive environment and free and fair market competition.

Table 1: 2012 Budget of the Competition and State Procurement Agency (*thousand GEL*)

Program Code	Title	Including			
		Plan for 2012	Budgetary Funds	Grants	Credits
43 00	LEPL – Competition and State Procurement Agency	1 200,90	711,2	489,7	0
43 00	Number of employees	59	59	0	0
	Costs	712,4	682	30,4	0
	Salaries	626	626	0	0
	Growth of non-financial assets	488,5	29,3	459,2	0

Table 2: 2013 Budget of the Competition and State Procurement Agency (*thousand GEL*)

Program Code	Title	Including			
		Plan for 2013	Budgetary Funds	Grants	Credits
43 00	LEPL – Competition and State Procurement Agency	680,00	680	0	0
	Number of employees	59	59	0	0
	Costs	680	680	0	0
	Salaries	626	626	0	0

Table 3: Remuneration of the Competition Department of the LEPL Competition and State Procurement Agency for 2012-2013 (GEL)

Title	2012	2013
Salaries of the Competition Department of the LEPL Competition and State Procurement Agency (GEL)	121 667,00	79 200,00