Michigan Law Review

Volume 82
Issue 5 *Issue 5&6*

1984

Competition, Integration and Economic Efficiency in the EEC from the Point of View of the Private Firm

Michel Waelbroeck
Free University of Brussels

COMPETITION, INTEGRATION AND ECONOMIC EFFICIENCY IN THE EEC FROM THE POINT OF VIEW OF THE PRIVATE FIRM

*Michel Waelbroeck**

I

One of the main purposes of the EEC Treaty is to stimulate competition between firms by opening up markets. That free movement of goods and increased competition are closely related objectives is apparent from Article 3 of the Treaty, which states that the activities of the Community shall include, among others:

> a) the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
>
> . . . .
>
> c) the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital; [and]
>
> . . . .
>
> f) the institution of a system ensuring that competition in the Common Market is not distorted.[1]

As early as 1956, experts appointed by the six original Member State governments to investigate measures to pursue integration after the failure of the European Defence Community clearly established this link between the abolition of barriers to trade and an increase in the intensity of competition. In what has come to be known as the "Spaak Report,"[2] the experts noted the technology gap then separating Europe from the United States and proposed, as a remedial measure, the creation of a "vast zone of common economic policy, constituting a powerful production unit, and allowing a continued expansion, and increased stability, an accelerated raising of the standard of living and the development of harmonious relations between the States belonging to it."[3] The authors of the Spaak Report envisioned an enlarged market in which firms would be able to grow to optimum size without acquiring a *de facto* monopoly: "The strength of a vast market is to allow the combination of mass production with the ab-

* Professor of Law, Free University of Brussels. LL.D. 1956, Free University of Brussels; LL.M. 1958, New York University. — Ed.

1. Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 3, 298 U.N.T.S. 3 (1958) [hereinafter cited as EEC Treaty].

2. Report of the Heads of Delegations to the Ministers of Foreign Affairs presented to the Intergovernmental Committee established by the Messian Conference, Apr. 21, 1956 [hereinafter cited as Spaak Report].

3. Spaak Report, *supra* note 2, at pt. 1, Introduction.

sence of monopoly."[4] Moreover, it was felt that this wider market would compel firms to do away with obsolete production methods and to increase the quantity and quality of their goods. Thus, free movement of goods was seen as a means of increasing competition, which itself was seen as a means of enhancing economic efficiency.

The authors of the Spaak Report saw a need for rules on competition, as a necessary complement to rules guaranteeing free movement of goods. They stressed, among other considerations, the risk that private firms could reestablish barriers between Member States by market sharing agreements, dual-pricing practices, dumping and other discriminatory practices.[5]

However, the authors were aware that "a Common Market is not in all cases the same thing as a completely free market."[6] In two sectors, agriculture and transport, it was realized that, in view of the extensive control exercised by States over market mechanisms, the mere abolition of barriers to trade would give rise to unequal conditions of competition. In order to avoid serious social problems, it was felt that State interventionism should not be abolished, but should instead be replaced by a Community intervention system providing for equivalent guarantees. Therefore, in these two areas, the Treaty provides not only for free trade but also for the establishment of common regulatory policies based on uniform or harmonized legislative provisions.

In other areas, with a few exceptions,[7] the elimination of trade barriers is automatic; although approximation of legislation and coordination of economic policies are called for, they are not a necessary pre-condition for the realization of the free movement of goods, persons, services and capital across national borders. In these other areas,[8] the end of the transitional period (December 31, 1969) was the cut-off date by which all barriers, restrictions and discriminations in intra-Community relations had to be abolished, whether or not measures had been taken by that time to equalize conditions of competition.[9]

The practical difficulties which the opening up of State borders might cause were to be met by the adoption of safeguard measures, under Community supervision. Most of these measures, however, could be granted only during the transitional period.[10]

II

The transitional period expired more than fourteen years ago. Nevertheless, in many industries, economic conditions diverge widely among the

4. *Id.*

5. Spaak Report, *supra* note 2, at pt. 1, tit. III, ch. 1, § 1.

6. Spaak Report, *supra* note 2, at pt. 1, Introduction.

7. *See, e.g.*, EEC Treaty, *supra* note 1, art. 57(3) ("In the case of the medical and allied pharmaceutical professions, the progressive abolition of restrictions shall be dependent upon coordination of the conditions for their exercise in the various Member States.").

8. Except for capital movements: *see* EEC Treaty, *supra* note 1, art. 67; *see also* Public Prosecutor v. Casati (Case No. 203/80), 1981 E. Comm. Ct. J. Rep. 2595.

9. *See* Reyners v. Belgian State (Case No. 2/74), 1974 E. Comm. Ct. J. Rep. 631.

10. *See* EEC Treaty, *supra* note 1, art. 226.

Member States. Different national policies concerning State aid, price control regulations, "buy national" purchasing policies, discriminatory tax regimes, differences in purchasing power, exchange rate fluctuations, and incomplete harmonization of commercial policies vis-à-vis non-Member countries give rise to unequal conditions of competition. To ignore these differences and force private firms to treat the Member States as a single market imposes on such firms a rather severe burden.

The Treaty provides a variety of remedies for these problems. If the distortion of competition arises from a Treaty violation by a Member State, articles 169-171 provide that the Commission and other Member States have the right to bring an action before the Court of Justice. However, this procedure is time consuming and individuals have no right to compel action to be taken against a Member State.[11] If the distortion is due to State aid, articles 92-94 furnish the Commission with far-reaching remedial powers, which the Commission has only recently begun to exercise to any considerable extent. Here too, the process is time-consuming, and individuals probably lack the right to force the Commission to take action. Distortions resulting from other sources can only be eliminated by approximation of legislation under articles 99-102, a procedure even slower and more cumbersome than that under articles 169-171 and 92-94. Nor do individuals have any standing to demand that approximation activities be commenced. Finally, the Treaty provides in general terms in articles 103 to 109 for the coordination of Member States' economic policies. It is generally recognized that progress in that area has lagged far behind the realization of free movement of goods, persons and services.

III

It is likely that the problems resulting from the lack of unified market conditions will persist for some time to come. What, in the meantime, should be the Community's reaction if firms opt for "self-help" in dealing with this problem of nonuniformity, attempting unilaterally to remedy what they often rightly perceive as severe handicaps?

Until now, the orthodox view, exemplified by the practice of the Commission and the case law of the Court of Justice, has been to ignore or minimize the gravity of the problem. Numerous decisions have condemned firms' attempts to protect themselves against the consequences of operating in a free but nonunified market.

Thus, in *Centrafarm BV v. Sterling Drug Inc.*,[12] the court was asked whether a patent owner could prevent importation of products which had been sold by him or with his consent in another Member State where he owned a parallel patent, where price differences existed resulting from the exporting country's efforts to control the price of the products. The Court stated:

> It is part of the Community authorities' task to eliminate factors likely to distort competition between Member States, in particular by the harmonization of national measures for the control of prices and by the prohibi-

11. *See* Lütticke v. Commission (Case No. 48/65), 1966 E. Comm. Ct. J. Rep. 19, 27.

12. (Case No. 15/74), 1974 E. Comm. Ct. J. Rep. 1147.

> tion of aids which are incompatible with the Common Market, in addition to the exercise of their powers in the field of competition.
>
> The existence of factors such as these in a Member State, however, cannot justify the maintenance or introduction by another Member State of measures which are incompatible with the rules concerning the free movement of goods, in particular in the field of industrial and commercial property.
>
> The question referred should therefore be answered in the negative.[13]

In *United Brands v. Commission*,[14] United Brands was found to have abused its dominant position by charging its distributors prices which differed according to the Member State in which distributors were established. In addition to denying its dominant position, United Brands argued, among other things, that it had only been adjusting to different marketing conditions in the various Member States and charging in each Member State the maximum price the market would bear. The Court answered:

> Although the responsibility for establishing the single banana market does not lie with the applicant, it can only endeavor to take "what the market can bear" provided that it complies with the rules for the regulation and coordination of the market laid down by the Treaty.[15]

In *BMW Belgium SA v. Commission*,[16] the Belgian sales subsidiary of a German car manufacturer had been fined by the Commission for having prevented a number of its Belgian dealers from reexporting German-made cars to Germany. Although the Court noted that prices were appreciably lower in Belgium than in other Member States, at least in part because of the price-freezing measures imposed by the Belgian government, it upheld the Commission's decision, finding that BMW Belgium had committed an intentional infringement of the competition rules.

Finally, in *Distillers v. Commission*,[17] the Commission condemned the dual pricing system which The Distillers Company Limited (DCL), an important producer of Scotch whisky, used in response to different marketing conditions in the United Kingdom and in the continental EEC countries. Distillers' claim that it was impossible to market the same brand of Scotch whisky successfully at the same price in the United Kingdom and in the rest of the EEC was rejected.

IV

How should one judge the "orthodox view"? Several responses can be given to this question.

1. At first sight, it may seem unduly harsh to force firms to compete in a nonunified economic environment without the right to protect themselves from the resulting adverse consequences. It seems that the firms are correct

13. 1974 E. Comm. Ct. J. Rep. at 1164-65.

14. (Case No. 27/76), 1978 E. Comm. Ct. J. Rep. 207.

15. 1978 E. Comm. Ct. J. Rep. at 298.

16. (Case Nos. 32/78, 36-82/78), 1979 E. Comm. Ct. J. Rep. 2435.

17. Commission Decision 78/163/EEC, The Distillers Company Limited, Conditions of Sale and Price Terms, Art. 85, 21 O. J. EUR. COMM. (No. L 50) 16 (Feb. 22, 1978) [hereinafter cited as Commission Decision].

to object, as did United Brands, that the responsibility for establishing a single market is not theirs.

However, this answer is superficial. It is not the purpose of the Treaty to treat firms "nicely." Economic integration necessarily causes painful adjustments and requires sacrifices. Established producers will have to reorganize themselves, or even shut down, if they cannot adapt to new market conditions.

2. A more fundamental objection is apparent if one considers an important goal of the opening-up of national borders: the elimination of less efficient firms. In a situation of distorted competition, there is no guarantee that this will happen: the brunt of the adjustment process may very well be borne by efficient firms. The result may well be a decline in overall market efficiency.

3. Even so, however, a proponent of the orthodox view might answer that such a sacrifice may be temporarily necessary to stimulate further integration. Indeed, the process of European unification may have to proceed for a time at a faster pace in some areas than in others, thereby creating temporary imbalances. If adversely affected firms were allowed to shelter themselves against these inequalities, part of the pressure towards further progress would be removed. For instance, in Belgium the authorities are becoming increasingly aware of the difficulty of enforcing price control measures which are out of line with price levels in other Member States. If the attempts of Sterling Drug and BMW Belgium to prevent parallel trade had been permitted on the ground that the price differences causing that trade were caused by nationally imposed controls, the pressure on the affected governments to avoid price discrepancies would be decreased.

Although the importance of this factor should not be overestimated, it remains true that the "harsh" consequences of the orthodox view often help further the integrative process. To put it differently, if the Commission considered the differences in the legislative and economic situations of the Member States as justification for private obstacles to trade, part of the pressure for further progress towards harmonization of market conditions would be eliminated. The notion of a "common" market may appear in some respects to be a legal fiction; however, as with many legal fictions, it can be a useful tool for developing the law.

4. There are, however, limits to the validity of this reasoning. The willingness of private firms to accept the fiction of a "common" market as if it were reality is not limitless. When the Commission prohibited DCL's dual pricing system, DCL withdrew its leading brand, Johnnie Walker Red Label, from sale in the United Kingdom and priced three other brands (Vat 69, Dewars and Black & White) out of the U.K. market. Instead of flowing freely into the Continent at the U.K. price, as the Commission had expected, DCL's main brands simply stopped being sold in the U.K. and prices on the Continent remained unchanged. The Commission's decision seemingly ignored the idea that firms cannot be forced to continue to sell in parts of the Common Market where they consider market conditions to be distorted to their detriment. Thus, by prohibiting firms from imposing restrictions on cross-border trade within the EEC, "orthodox" competition policy occasionally compels firms to abandon a market totally, where the

alternative involves the risk that their sales in that market will cause undesirable exports to other Member States. Such a result seems to be neither economically nor politically justified. It is in direct contrast with the Treaty's goal that goods purchased within the Community be supplied without restriction to consumers throughout the Community. Arguably, when distortions in market conditions are so great that firms deem it preferable to give up selling altogether in certain markets to protect their position in other markets, allowing some restrictions of trade may be a "second best" alternative to complete freedom of trade.

The Commission may be coming to realize this. For example, it recently published a notice under article 19 (3) of regulation No. 17 indicating its intention to exempt for three years DCL's "Promotion Equalization Charge" system for Johnnie Walker Red Label.[18] The system constitutes an amended version, limited to one brand, of the dual pricing system which had been condemned by the Commission in December 1977.[19]

Will the Court follow the same trend? It is too early to be able to answer with certainty. However, recent signs are not encouraging. Thus, in *Merck & Co. Inc. v. Stephar BV*,[20] the Court considered whether a patent owner in one Member State (The Netherlands) was entitled under Article 36 to prevent the importation of a pharmaceutical product ("Moduretic") which had been marketed in another Member State (Italy) where no patent protection existed for the product. The Court answered negatively:

> It is for the proprietor of the patent to decide, in the light of all the circumstances, under what conditions he will market his product, including the possibility of marketing it in a Member State where the law does not provide patent protection for the product in question. If he decides to do so he must then accept the consequences of his choice as regards the free movement of the product within the Common Market, which is a fundamental principle forming part of the legal and economic circumstances which must be taken into account by the proprietor of the patent in determining the manner in which his exclusive right will be exercised.[21]

The *Membran v. GEMA* case[22] concerned the right of a copyright owner to prevent imports of copyrighted sound recordings from the United Kingdom (where a system of statutory license was in force) into Germany (where license agreements can be freely negotiated and royalties rates are accordingly higher). The Court stated:

> It should be further observed that in a common market distinguished by free movement of goods and freedom to provide services an author, acting directly or through his publisher, is free to choose the place, in any of the Member States, in which to put his work into circulation. He may make that choice according to his best interests, which involve not only the level of remuneration provided in the Member State in question but other

18. Notice Pursuant to Article 19(3) of Council Regulation No. 17 Concerning Notification No. IV/30.228 (The Distillers Company p.l.c.) 26 O. J. EUR. COMM. (No. C 245) 3 (Sept. 14, 1983).

19. Commission Decision, *supra* note 17, at 16.

20. (Case No. 187/80), 1981 E. Comm. Ct. J. Rep. 2063.

21. 1981 E. Comm. Ct. J. Rep. at 2082.

22. (Case Nos. 55-57/80), 1981 E. Comm. Ct. J. Rep. 147.

factors such as, for example, the opportunities for distributing his work and the marketing facilities which are further enhanced by virtue of the free movement of goods within the Community. In those circumstances, a copyright management society may not be permitted to claim, on the importation of sound recordings into another Member State, payment of additional fees based on the difference in the rates of remuneration existing in the various Member States.[23]

In effect, this means that where the owner of an industrial property right is not entitled to reap the full benefit of his right in one Member State, he risks losing his full reward in the other Member States as well unless he withdraws his goods from the market of the first State.

One may wonder whether this result is consistent with the objectives of the Treaty. In the view of the Treaty's authors, the purpose of the free movement of goods is to promote free competition which, in turn, increases economic efficiency. The Court's interpretation of article 36 of the Treaty in the *Merck* and *Membran* cases seems to make the free movement of goods an objective in itself, rather than a means to attain economic efficiency through increased competition. It may seriously be doubted whether economic efficiency is advanced if Italian consumers are no longer able to obtain Moduretic from Merck in Italy, but have to import it from another Member State. An interpretation of article 36 which would have allowed Merck to preserve its rights in those countries where it owned patents, while continuing to sell in Italy, would arguably have better served economic efficiency, even if it would have involved allowing Merck to restrict imports from Italy to The Netherlands. It would also have been more in keeping with the purpose of article 36 — to allow restrictions of trade when these are "justified on grounds of protection of industrial property." Pending the unification of patent laws, a "second best" alternative would have been preferable to the Court's intransigent insistence on free movement of goods at all costs.

In this context it is worth noting that, in the agricultural sector, the Court has held that charges on trade between Member States, such as monetary compensatory amounts, could be justified by the need to avoid distorting trade in these products. The Court apparently considered decisive the fact that the common organizations of the agricultural markets are based on common prices, whereas economic and monetary policies have not yet been harmonized and therefore lead to fluctuations in exchange rates.

In the *Balkan* case[24] the Court acknowledged that:

Although the compensatory amounts do constitute a partitioning of the market, here they have a corrective influence on the variations in fluctuating exchange rates which, in a system of market organization for agricultural products based on uniform prices, might cause disturbances in trade in these products.

Diversion of trade caused solely by the monetary situation can be considered more damaging to the common interest, bearing in mind the aims

23. 1981 E. Comm. Ct. J. Rep. at 165.

24. Balkan Import-Export GmbH v. Hauptzollamt Berlin-Packhof (Case No. 5/73), 1973 E. Comm. Ct. J. Rep. 1091.

of the common agricultural policy, than the disadvantages of the measures in dispute.

Consequently these compensatory amounts are conducive to the maintenance of a normal flow of trade under the exceptional circumstances created temporarily by the monetary situation.

They are also intended to prevent the disruption in the Member State concerned of the intervention system set up under Community Regulations.

Furthermore, these are not levies introduced by some Member States unilaterally, but Community measures which, bearing in mind the exceptional circumstances of the time, are permissible within the framework of the common agricultural policy.[25]

In the *Racke* judgment,[26] rendered a few years later, the Court repeated:

> The monetary compensatory amounts are not levies introduced by some Member States unilaterally but Community measures adopted to deal with the difficulties resulting for the common agricultural policy from monetary instability; they are not therefore covered by the prohibitions on levying charges having an effect equivalent to customs duties.[27]

Although these cases concerned agricultural goods, it is submitted that there is no fundamental reason not to apply similar reasoning to industrial goods. Provisions of the Treaty, such as articles 36 and 85,[28] should not be applied so rigidly as to effectively compel private firms to withdraw their goods from certain national markets where the conditions of competition within the Common Market are so distorted by the disharmonization of national measures that they are unable to maintain an adequate level of profitability.

---

25. 1973 E. Comm. Ct. J. Rep. at 1113.

26. Firma A. Racke v. Hauptzollamt Mainz, (Case No. 136/77) 1978 E. Comm. Ct. J. Rep. 1245.

27. 1978 E. Comm. Ct. J. Rec. at 1245. *See also*, as to the legality of the "clawback" provision provided for under the common organization of the market in sheep meat, Kind KG v. European Econ. Comm. (Case No. 106/81), 1982 E. Comm. Ct. J. Rec. 2885. As to the legality of a compensatory tax on ethyl alcohol under Article 46 of the Treaty, see St. Nikolaus Brennerei und Likörfabrik v. Hauptzollamt Krefeld, (Case No. 337/82) (not yet published).

28. EEC Treaty, *supra* note 1, arts. 36 & 85.