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Contribution from Lithuania

-- Session I --

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THE REGULATION ON RESTRICTIVE COMPETITIVE BEHAVIOUR BY PUBLIC ENTERPRISES

--Lithuania--

1. Introduction

1. The main guidelines for the industrial policy of Lithuania are set out in the Long-term Economic Development Strategy of Lithuania until 2015. Its provisions favour the so-called horizontal industrial policy and clearly speak against the sectorial industrial policy. Such a view is based, firstly, on the doubt about the ability of the State to select the "right" activities and the optimal amount of support as regards positive externalities, and secondly, on the lack of comprehensive and reliable information as well as on the risk of retaliation from other countries as regards the pursuit of monopoly profits. It is not enough to take into account the market share of a sector or its growth rate. There is a lack of reliable information and methods to analyse costs and benefits of such a policy. The analysis of examples of other countries can also hardly provide any guidelines for the selection of State-supported sectors.

2. Priority is therefore given to the development of industrial and social infrastructure (energy, transport and telecommunications, education and science, culture, health care and environment) serving as basis for the effective functioning of the economy, as well as of knowledge-based and high-technology activities in all fields of the economy. The need for the sustainability of industrial development is also highlighted. It is however emphasised that those fields should not necessarily be subsidised or otherwise supported by the State.

2. History and Evaluation

2.1. To what extent does the industrial policy in your country target firms on the basis of their nationality (e.g., by granting state aids/subsidies to national firms only, or by controlling their ownership)? If so, how is nationality defined?

3. The Law on Enterprises and Facilities of Strategic Importance to National Security and Other Enterprises Important to Ensuring National Security specifies the enterprises and facilities which are of strategic importance to national security, which must belong to the State by the right of ownership and in which (and the conditions under which) a proportion of the capital may be held by the private national and foreign capital meeting the criteria of European and trans-Atlantic integration provided the power of decision is retained by the State. The latter are e.g., Lithuanian Railways, Lithuanian Radio and Television Centre, AB Kaunas Hydro Power Plant.

4. The Constitutional Law on the Implementation of Paragraph 3 of Article 47 of the Constitution of the Republic of Lithuania defines foreign subjects meeting the criteria of European and trans-Atlantic integration as foreign legal persons as well as other foreign organisations set up in:

- the EU Member states or states parties to the Europe (Association) Agreement concluded with the European Communities and their member states;
- Member states of the OECD, NATO and states parties to the EEA Agreement.

  These criteria are also met by nationals and permanent residents of the said states, as well as permanent residents of the Republic of Lithuania who are not citizens of the Republic of Lithuania.

2.2. What economic conditions have been associated with government industrial policy and support for national champions in your nation and region? Has this changed over time as economic development advanced?

5. The peculiarity of the examples mentioned hereafter lays in the fact that those particular companies were established to supply the vast market of the Soviet Union, they operated under regulated economy conditions and were owned by the State for a long time. After Lithuania declared its independence, the companies had to adapt to a completely different situation, they were also fully or partially privatised. The intention of the State was to get the companies on their feet under the market economy conditions. This policy has now lost its ground, especially after Lithuania joined the EU.

2.3. Are there major success stories of industrial policy or national champions that are prominent in policy discussions? Are there any perceived major failures of industrial or national champion policies? How do you define "success" and "failure" in this context? Are successful national champion stories supported by best practice competition policy standards?

6. There have been no major success stories of industrial policy or national champions in Lithuania.

7. One example that could be presented as a failure is the State policy in respect of AB "Alytaus tekstile". This company is now subject to bankruptcy proceedings, its debts amount to more than EUR 12 million.

8. The company was established in 1965, it was the biggest undertaking in Alytus (a city with 68 thousand inhabitants) and the biggest textile manufacturer in Lithuania. The company was not profitable since Lithuania declared its independence in 1990. In 1998, 47 percent of the company's shares were sold to the Singaporean business concern "Tolaram group". The investor committed to pay 13 million Litas (approx. EUR 3.8 million), to maintain 3500 jobs and to invest 240 million Litas (approx. EUR 70 million). The State kept 11.82 percent of the shares.

9. In 2002, the Competition Council did not approve the plans of the Ministry of Finance to prolong repayment of the loan (approx. EUR 3.4 million, provided in 1995) until 2009 and to lower the annual interest rate to 5 percent, presented along with the restructuring plan of AB "Alytaus tekstile". The Competition Council concluded that the restructuring plan did not ensure restoration of long-term solvency and viability. Moreover, the investor "Tolaram group" had committed, signing the agreement to purchase the shares of the company, to invest money therefore the involvement of the State was deemed to be unnecessary.

10. However, "Tolaram Group" failed to fulfil its commitments: it paid 10 million Litas (approx. EUR 2.9 million), reduced the number of employees to 2648 and invested merely 10 million Litas (EUR 2.9 million). The volume of sales decreased from EUR 49 million in 1999 to EUR 37 million in 2002.

11. In 2003, the State repurchased the 47 percent of the company's shares for approx. EUR 300 thousand. Since the Law on Management, Use and Disposal of State-Owned and Municipal Assets did not allow for buying shares from natural persons and private legal persons, an ad hoc law was passed: the Law on Acquisition of Shares of AB "Alytaus tekstile". In December 2003, the Government approved the rehabilitation plan of AB "Alytaus tekstile" in order to avoid serious social, economic and employment problems in Alytus. Following that and shortly before the accession to the EU, the State provided assistance to the company for approx. EUR 8 million. The assistance comprised release from refunding a loan given on behalf of the State (the same loan of 1995) and from paying fines and interests, a new payment schedule in respect of the Personal Income Tax and social security contributions overdue, and

financial assistance of approx. EUR 1.5 million in the form of capital injection. As the implementation of such measures was not possible pursuant to the national laws in force, an ad hoc law was passed.

12. Despite the assistance, expected results were not achieved: volume of sales did not increase, costs did not decrease, and performance indicators did not essentially improve. In 2004 and 2005, the company suffered a net loss of more than EUR 4.6 million each year.

13. In 2007, AB "Alytaus tekstile" asked for further financial injection of approx. EUR 9 million to continue its activities. After long and very intensive discussions, the decision was taken not to provide any more assistance and to sell the shares owned by the State. The price was set at 1 cent (approx. 0.3 Eurocents) a share; the shares were sold on the Vilnius Stock Exchange in 2007. The new owners (a group of natural and legal persons) declared bankruptcy shortly thereafter.

14. Another example could be the State policy regarding AB "Mazeikiu nafta", the only crude oil refinery in the Baltic States. It illustrates a difficult case where it is very complicated to strike the balance: it is not a failure but it can neither be perceived as a success. The overriding ground to support this company was the strategic importance of oil supply (the company is also included in the list of Enterprises of importance to ensuring national security); beside that, AB "Mazeikiu nafta" has been the main supplier of gasoline and diesel fuel for the Lithuanian, Latvian and Estonian markets, the largest buyer of services in Lithuania, largest Lithuanian company in terms of revenues and payment of taxes (approx. 230 million Euros or 4% of all taxes in 2007) as well as one of the major exporters.

15. The refinery was built in 1970s, the State policy in favour of this company continued until the accession of Lithuania to the EU. It consisted mainly of loans and loan guarantees for 520 million USD in total, import duties for oil products (5% from 1998; 15% from 1999 to 2004) and compensations for some of the losses (e.g., caused by interruption of the supply) until 2003. It has to be mentioned that the State was the owner or controlled the majority of the company's shares at that time (59% in 1999). At the end of 2008, the State held 9.98% of the shares but the decision has been taken to sell the remaining part.

16. Speaking of the effectiveness of the State support, it has to be mentioned that the State did not impose any conditions on the use of the loans / guaranteed loans, no planning took place. It followed that only 8% of the sums received were used for investment, the rest of it covered the operating expenses.

17. AB "Mazeikiu nafta" operated at a loss for a long time. The productivity indicators have been very high all the time, 7-8 times higher than those of the whole economy; however, this could be based on the capital-intensive character of this particular industry and did not help to create new value or to at least ensure revenues covering costs. Only in 2003, after the Russian company "Yukos" became shareholder of AB "Mazeikiu nafta", the company turned a profit. Until that year, it could not demonstrate successful economic activity and the State did not get any Corporate Income Tax revenues from this company. The tax revenues came from excise duty therefore they depended solely on the consumption of oil products and would have been collected anyway, irrespective of the origin of those products.

18. It has to be pointed out that, despite the good performance of the company in the past few years, AB "Mazeikiu nafta" is considerably dependent on the crude oil supply from Russia, and its performance indicators are very susceptible to the interruptions of this supply. Given the importance of this company to the Lithuanian economy, this embodies the risk of considerable negative effects.

19. The Competition Council carried out three investigations concerning AB "Mazeikiu nafta", which resulted in conclusions (in 2000, 2001 and 2005) that AB "Mazeikiu nafta" had infringed the Law on Competition.

20. The first investigation was based on a complaint that the company is providing exclusive conditions of distribution of its products to a limited number of companies, fixing exclusive discounts to them. The investigation concluded that the AB “Mazeikiu nafta” held dominant position in the A-80 and A/92/95/98 brand gasoline and diesel fuel markets and that it took advantage of its unilateral decisive influence in the markets and, concluding similar agreements with different companies, fixed dissimilar conditions for the purchase of oil products. These actions of the company constituted an infringement of Article 9(3) of the Law on Competition, which prohibits abuse of the dominant position through application of dissimilar (discriminating) conditions to equivalent transactions with certain undertakings, thereby placing them at a competitive disadvantage.

21. While conducting the abovementioned investigation, the Competition Council established restrictions with regard to import of oil products. Consequently, the Competition Council initiated an investigation on the compliance of actions of the AB “Mazeikiu nafta” and 5 companies trading in oil products with Article 5 of the Law on Competition (“Prohibition of Agreements Restricting Competition”). AB “Mazeikiu nafta” was operating in the production level of the oil products (gasoline, diesel fuel, aviation fuel and fuel oil), while other 5 companies were engaged in the distribution of the said oil products in the trade level. The investigation established that AB “Mazeikiu nafta” selected companies holding or potentially holding import licenses, also maintaining relations with producers of oil products in other countries and holding a significant share of the market for trade in oil products. AB “Mazeikiu nafta” concluded agreements with 5 companies providing for discounts for them in exchange for their obligations not to import the said oil products. In practice it meant that where any actual or potential foreign producer would have an intention to sell its products on Lithuanian market, the binding contractual obligations would prevent the resellers from purchasing and distributing the products of such a producer. As a result, the possibilities of the AB “Mazeikiu nafta” to increase the sale of its products in the said markets and thus reduce the competition between its own products and imported ones were significantly improved.

22. In 2004, the Competition Council initiated ex officio an investigation to establish whether the activity of the company could have possibly had an impact upon the constant rise in gasoline and diesel fuel price levels in Lithuania as compared to those in other Baltic States, also whether the lasting price differences could have resulted through the abuse of its dominant position in Lithuania. Although initially the investigation was started in accordance with Article 9 of the Law on Competition, suspicions having arisen in the course of the investigation that actions of AB “Mazeikiu nafta” also could affect the trade between the EU Member States (Lithuania, Latvia and Estonia), the Competition Council decided to supplement the investigation with the provisions of Article 82 of the EC Treaty. As the European Commission did not exercise its legal authority to subject the investigation to its jurisdiction, therefore the investigation was further continued by the Competition Council. The investigation allowed a conclusion that higher prices of fuels in Lithuania as compared to those in Latvia and Estonia have resulted from a number of reasons stemming both from the different conditions in individual areas of the Baltic markets, as well as actions restricting competition exercised by AB “Mazeikiu nafta”. To a degree the price differences might have resulted due to differences in the excise duty conversion, also due to the requirements operational in Lithuania to accumulate the reserves of fuel, which in turn results in freezing part of the funds thus increasing the fuel prices, etc. However, the investigation established a number of facts and circumstances constituting a proof of the abuse of dominant position by AB “Mazeikiu nafta” by applying different strategies and economically groundless and discriminative pricing policy for Lithuanian, Latvian and Estonian buyers, as well as the annual loyalty and non-competing obligations, as well as other restrictive practices which resulted in dissimilar conditions for the entities operating in the market and allowed discrimination of individual companies. Therefore the companies were forced to sell fuels to Lithuanian consumers at higher prices than in Latvia and Estonia.

2.4. Does your competition agency use benchmarks to assess the economic costs and benefits of government interventions that promote industrial policy or national champions? Have you communicated benchmarks to other economic policy makers? Is there any dependable analytical approach that allows you to distinguish industrial policy from competition policy? Do you engage in competition advocacy in this policy area?

23. Rules of Procedure of the Government of the Republic of Lithuania stipulate that draft legal acts proposed to the Government and related to competition and state aid to economic entities must be sent for comments to and agreed on with the Competition Council. The analysis is made to ensure that the provisions proposed do not contradict any national or EU competition legislation in force, our agency is however not engaged in any other industrial policy considerations.

2.5. Have merger review laws ever been suspended in your country? If so, why? Were concerns expressed either explicitly or implicitly about the way in which merger efficiencies are typically examined or in the way in which failing firms are analysed?

24. Merger review laws have never been suspended in Lithuania nor were any concerns expressed about the way in which mergers or failing firms are analysed.

2.6. Have any of your decisions ever been overridden on grounds of industrial policy? Are there any recent examples? What reasons were given? To what extent had the competition agency already considered the market characteristics or considerations that were the basis for the override? What have been the consequences of the override for consumers and competition policy?

25. None of our decisions has been overridden on grounds of industrial policy. The existing legal framework does not provide for such a possibility, yet it leaves some freedom of manoeuvre in other aspects.

26. Article 2(1) ("Application of the Law") of the Law on Competition lays down that this law "shall prohibit undertakings from performing actions which restrict or may restrict competition, regardless of the character of their activity, except in cases where this Law or laws governing individual areas of economic activity provide for exemptions and permit certain actions prohibited under this Law".

27. Article 4(2) ("Duty of Public and Local Authorities to Ensure Freedom of Fair Competition") of the Law on Competition stipulates that "Public and local authorities shall be prohibited from adopting legal acts or other decisions which grant privileges to or discriminate against any individual undertakings or their groups and which bring about or may bring about differences in the conditions of competition for competitors in the relevant market, except where the difference in the conditions of competition cannot be avoided when the requirements of the laws of the Republic of Lithuania are complied with.". Moreover, the provisions of Article 19(1)(4) ("Powers of the Competition Council") of the Law on Competition say that if public or local authorities infringe Article 4 of the Law on Competition and fail to comply with the request to amend or revoke legal acts or other decisions restricting competition, the Competition Council shall have the right to appeal against those decisions to the court, with the exception of the statutory acts issued by the Government of the Republic of Lithuania.

28. None of the above-mentioned exceptions were as yet applied in any resolutions of the Competition Council on the conformity of certain actions or decisions with the provisions of the Law on Competition.

2.7. Does your government implement some policies directly dedicated to innovation? If so, could you specify the sectors that benefit from these policies as well as the instruments used to foster innovation?

29. There are different measures, both national and co-financed by the EU Structural funds. These measures are not sector-specific. For the period 2008-2013, there are grant schemes for technical feasibility studies for SMEs, for R&D activities and facilities (labs, research centres etc.), for cluster management and infrastructure, for investment into new equipment and technologies, for investment into launching new e-business systems, new management methods and systems by SMEs, etc. These grant schemes conform to the EU State aid rules. There are also instruments of e.g., funding of public infrastructure in incubators, science and technology parks, i.e. public services in respect of innovation. Tax incentives are also provided: all companies investing in R&D are eligible for Corporate Income Tax reduction.

2.8. Did measures adopted in your country to deal with the recent economic crisis raise competition concerns? If so, could you describe the measures and the concerns? Have these competition concerns been taken into account, and, if so, how? In particular, have initial proposals been amended in order to comply with competition law? Have some of these measures been exempted from competition policy scrutiny?

30. On the contrary, due to the fact that Lithuania has a very limited access to financial resources, there are no measures to support undertakings, e.g., the Government tends to abolish all tax reductions. In case any support measures were to be introduced, the Competition Council would scrutinise them carefully for possible competition and state aid concerns.

3. Means and Goals

3.1. Please specify whether any of the following are instruments of industrial policy in your country:

- Government procurement
- Exemptions from antitrust laws
- Regulatory barriers to competition
- Access to credit
- Arranged mergers and acquisitions
- Control of acquisitions of national companies by foreign investors
- Other?

31. The exemptions provided for in the relevant public procurement laws should not be attributed to the instruments of industrial policy since they are granted to public contracts related to State secrets or official secrets, to international agreements with other countries, to military supplies, to financial services etc. In conformity with the provisions of the relevant EU legislation, exemptions may be granted for entities operating in the water, energy, transport and postal services sectors.

32. The exemption from antitrust laws pursuant to Article 2(1) of the Law on Competition is described in the answer to Question 6 above. Other possible exemptions are only granted to agreements of minor importance which do not appreciably restrict competition (*de minimis*) and to agreements covered by the relevant EU block exemption regulations.

33. Regulatory barriers to competition exist only in respect of activities regarded as public services, e.g., in the field of heat and electricity sectors, universal postal services etc.

34. The Law on State Debt foresees the possibility for legal persons of the Republic of Lithuania as well as of the EU or EEA Member States established in the Republic of Lithuania to receive loans from the funds borrowed on behalf of the State, as well as State guarantees. Undertakings (i.e. legal entities engaged in economic activity) are eligible for loans and guarantees if they carry out an investment project included into the State Investment Programme. Such loans and guarantees must respect the EU State aid rules. In practice, these instruments are now targeted towards financing of public infrastructure.

35. The only arranged merger took place in 2008 when the national electricity company LEO LT was established merging three companies controlling the electricity production and distribution system in Lithuania. This merger was determined by the obligation, included in the Accession Treaty, to close the Ignalina nuclear power plant at the end of 2009. The new company is designated to invest in a construction of a new nuclear power plant and power connections with Poland and Sweden.

36. Control of acquisitions of national companies by foreign investors is exercised only if a particular company is included in the list of enterprises of strategic importance to national security (see above).

3.2. To what extent are industrial policies in your country motivated or rationalised as regional or national economic development initiatives? Has this explanation been used more sparingly over time as your economy expanded?

37. Lithuania is still one of the least-developed regions of the EU, the whole country is regarded as a region eligible for assistance under Article 87(3)(a) of the EC Treaty (aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment) therefore the main objective of different Lithuanian policies, including industrial policy, is national economic development. This explanation has so far not lost its importance and priority. State aids are also predominantly awarded under the objective of "regional development".

3.3. To what extent are industrial policies motivated or rationalised as an effort to help domestic firms withstand the exercise of market power by foreign firms? How does this rationale square with rules against market distortions caused by state aids? How has your competition agency analysed these circumstances?

38. There were no industrial policies motivated or rationalised referring to this motive.

3.4. Are industrial policies motivated or rationalised as a means to correct market failures in your country? If so, what types of market failures have been involved? How do you compare industrial policy or national champions with other policy approaches for correcting these market failures (such as taxes or subsidies on consumption of the product)?

3.5. Do you think that one nation engaging in industrial policy or supporting national champions attracts retaliation from other nations? To what extent are projected gains from industrial policy and national champions dependent on other nations not pursuing these policies, too? Do industrial policy and national champions constitute a "prisoners' dilemma" situation?

39. As an answer to both Questions 4 and 5, the following arguments against industrial policy, presented in the Long-term Economic Development Strategy of Lithuania until 2015, can be highlighted:

- the fact that, even if the market is deformed, there is no guarantee that industrial policy measures will distribute the resources more effectively than the imperfect market and
- the "risk of revenge from foreign countries".