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**COMPETITION AND FINANCIAL MARKETS**

**Roundtable 3 on Real Economy: The Challenges for Competition Policy in Periods of Retrenchment**

**-- Note by Turkey --**

*This note is submitted by Turkey to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16-18 February 2009.*

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## **1. The Effect of the Global Financial Crisis on Turkish Economy in General**

1. Financial crisis, which started in mid-2007 in the USA with failing mortgage payments, grew larger in size by spreading from one institution to another due to the horizontal nature of the financial sector, and have reached a global dimension through the recent bank failures and the consolidation of the financial institutions in the United States as well as Europe. Currently, the crisis has effects on the global scale, not only for financial markets, but for the whole economies.

2. The Turkish banking sector, which eliminated most of its structural problems through the restructuring efforts implemented following the 2001 crisis, was prepared and experienced for the current crisis. Another advantage of the Turkish banking sector in the current financial crisis is the fact that Turkey does not have a mortgage sector which operates similar to the one in the US. Since such a sector is non-existent, banks have not invested in the risky derivatives in this sector and therefore the negative effects of the financial crisis on the Turkish banking system have been relatively limited.

3. In spite of this positive outlook in the Turkish banking sector, considering the current environment where markets are significantly globalised and economies are largely dependent on each other, it seems impossible for the Turkish economy to remain unaffected from the financial crisis. First of all, the fall in foreign demand due to the problems in foreign economies will unavoidably create problems for Turkish companies, especially for those whose sales are based on exports. On the other hand, foreign borrowing opportunities of Turkish banks have become restricted due to the difficulties of important financial institutions abroad, which may cause a constriction in the domestic loan channels and may lead to trouble for real sector companies in the mid and long terms. Besides, the decrease in the foreign currency entering into the country through hedge funds and private equity funds would mean problem in terms of foreign exchange liquidity. Last but not the least, the uncertainty environment created by the global financial crisis may have a negative effect on consumer behavior and lead to a decrease in private equity expenditures, thereby negatively affecting economic growth<sup>1</sup>.

## **2. Importance of the Competition Policy in Intervening with the Global Financial Crisis**

4. Under the current conditions where the crisis has turned into a threat for the whole economy, it is observed that governments have been announcing aid packages one after the other with an intention to solve the liquidity problem and reassure the markets. However, within this process, it is crucially important to strike a balance between the goal of ensuring financial stability in the short term, and the goal of protecting the competitive structure of the markets in the mid and long terms. In particular, by-passing or relaxing the application of competition policy in order to ensure economic stability within this process would create new burdens for the society in the long-run, even though it may be useful in achieving some goals in the short-run. Moreover, in the case of anticompetitive market structures, the society would have to pay the bill constantly, instead of paying it periodically as is the case in economic crises.

5. In fact, the relationship between the measures that aim to mitigate the effects of the financial crisis and the application of competition policy is not just a trade-off between short-term goals and mid-to-long-term goals. On the contrary, an efficient application of the competition policy is an integral part of the solution in tackling, the current crisis. As the empirical studies investigating the relationship between competition policy and macro-economic goals reveal an efficient competition law implementation supports economic growth by encouraging innovation, efficiency and production. Within this framework, compromising on the application of the competition policy on the pretext of a crisis may delay the end of

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<sup>1</sup> Türkiye Ekonomi Politikaları Araştırma Vakfı (TEPAV - Economic Policy Research Foundation of Turkey), "2007-2008 Küresel Finans Krizi ve Türkiye: Etkiler ve Öneriler".

the recession instead of solving the problems. This is because in an environment where competition law is not implemented, the firms will prefer to limit production and increase prices, similar to the behavior of a monopolistic company, instead of focusing on innovation, efficiency and making more sales with lower prices and higher quality. This, in turn, would lead to the elimination of the existing jobs within the economy and to a decrease in the spending of consumers, which would negatively affect economic growth.

6. On the other hand, compromise in the implementation of the competition policy during the financial crisis, would pave the way for protection of inefficient firms. Such a situation would be harmful for the whole economy since, it would serve the existence of inefficient firms in the market and thus put the efficient firms in a disadvantageous position in competing with their rivals.

7. After emphasizing the importance of competition policy in intervening with the global financial crisis, critical points concerning the roles and functions of competition policy and competition authorities in the financial crisis environment will be assessed below.

### **3. The Function of Competition Policy As Part of the Solution and the Efficient Participation of Competition Authorities in the Process.**

8. When evaluating the function of competition policy and competition authorities in intervening with the financial crisis, an assessment within the framework of "control of state aids," "control of concentrations," and "control of agreements that restrict competition," will be useful.

#### **3.1 Control of State Aid**

9. State aid is an important policy instrument used by the governments when making interventions in the economy. Aids granted by governments or other state organs may be functional in achieving certain economic and social goals, such as closing the gaps between various regions, encouraging research and development by companies, supporting the development of certain sectors, or rescuing and restructuring the undertakings in trouble as is the case in the current crisis. However, when those aids are not granted carefully, they may distort the level playing field in the market and thus bring some efficient firms in disadvantageous position against their rivals. This may consequently lead to the protection of inefficient firms in the market and therefore diminish the competitiveness of the economy as a whole. Therefore, "control of state aid" is established as an important pillar of competition law enforcement in many jurisdictions.

10. In current global crisis, the control of state aid guarantee that economic measures brought by the governments do not distort the level playing field by favoring certain undertakings or sectors. However, not all countries which implement competition policy have a regime concerning the control of state aids. For instance, in Turkey, although the Act no 4054 on the Protection of Competition came into effect in 1994, it did not introduce a mechanism concerning the control of state aids. Presently, the legislative work on the control of state aids is proceeding, but there is no legal framework in Turkey regulating the control of state aids yet.

11. In countries such as Turkey where a state aid control regime does not exist, competition authorities may bear a specific responsibility within the framework of competition advocacy to ensure that industrial policies and economic measures developed by the governments concerning the crisis do not ignore competition concerns. In this vein, competition authorities may advise governments in shaping the industrial policies not only by emphasizing the importance of protecting competition for the economic development but also by giving concrete recommendations on what elements a competitive industrial policy should contain.

### 3.2 *The Control of Concentrations*

12. Another subject concerning the function of competition policy during the crisis is "control of concentrations". Adoption of a more flexible approach in the evaluation of concentrations during the crisis and even by-passing the supervision of competition authorities on "public interest" grounds constitutes an important debate topic in current crisis.

13. As it is the case in other areas of competition policy, it would be a big mistake to circumvent competition law enforcement in the evaluation of concentrations during the financial crisis on "public interest" grounds. Mergers and acquisitions made in an environment with no competition supervision would increase the concentration within the market, and the burden thereof will be paid by the consumers. At this point, one can claim that anti-competitive effects of those mergers and acquisitions authorized during the crisis may be prevented through ex-post remedies after the crisis has passed. However, we believe that this is far from a real solution. This is because, allowing anti-competitive consolidations within the economy may cause irreparable damages. On the other side, when the operational costs of ex-post supervision on competition authorities are taken into consideration together with the limited resources of those authorities, it may not be possible to conduct an effective ex-post supervision concerning the anti-competitive market structures in the whole economy.

14. Basically, the current case-law in competition law regarding the control of concentrations allows a "flexible" approach concerning the acquisition of undertakings which are in financial distress. As it is known, "failing firm defense" has generally been taken into consideration by competition authorities where one or more of the parties to the transaction are carrying a serious risk of going out of business. Therefore, it is possible to authorize the acquisition of undertakings in trouble without making crisis-specific amendments in the application of the current rules.

15. During the current crisis, Turkish Competition Authority has not yet received a merger notification incorporating the failing firm defense. However, this defense was taken into account in some of the past decisions of the Turkish Competition Authority. The first of these decisions is the *Erciyas*<sup>2</sup> decision. In the decision concerning the acquisition of some of the assets of Toros Biracılık ve Malt Sanayi A.Ş. (Toros) by Erciyas Biracılık ve Malt San. A.Ş. (Erciyas), it can be seen that the failing firm defense was accepted, though not explicitly. It was determined that the dominant position in the market would be strengthened after the notified transaction. Nonetheless, it was stated that it would be impossible for Toros to continue its operations and that disallowing the transaction would lead to a waste of resources for both the economy of the country and for the parties. Also, within the same decision, it was found that no other undertaking wished to acquire the assets owned by Toros and that Erciyas intended to invest and increase its production capacity by acquiring the relevant assets. The transaction under consideration was authorized for the aforementioned reasons, in spite of the possibility for a strengthening of the dominant position and a significant restriction in competition.

16. Another decision whereby the Competition Board accepted the "failing firm defense" was *Uzel*<sup>3</sup> decision. Failing firm defense was considered in the decision concerning the acquisition by Uzel Holding A.Ş. (Inc.) (Uzel), of Efe Otomotiv Sanayi ve Ticaret A.Ş. (Efe Automotive Industry and Trade Inc.) (Efe). In this market where the parties to the acquisition produced components used in automotive sector, Uzel's market share would reach 62 % after the acquisition and there would remain two main undertakings. It was likely that there would be significant restriction of competition in the market in the post-transaction

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<sup>2</sup> Competition Board Decision dated 12.2.1998 and numbered 379-43, (Official Gazette, dated 19.11.1998, and numbered 23528 ).

<sup>3</sup> Competition Board decision dated 20.07.2000 and numbered 00-27/294-164 (Official Gazette dated 05.03.2002 and numbered 24686).

process. However, without the acquisition, Efe would most likely be excluded from the market. The decision expressly stated a view in support of “defending the failing firm”. Even though concentration would increase significantly in the relevant market post-acquisition, it was stated that Uzel’s market share could have increased even where the transaction was not authorized. Furthermore, the decision also mentioned that the production capacity of the failing undertaking would leave the market and that there were no alternative mergers and acquisitions which were less restrictive of competition. It was also stated that machinery and manpower could remain idle. Therefore, the likelihood of negative social effects in the absence of the transaction was also pointed out.

17. In the recently taken *Vatan Newspaper*<sup>4</sup> decision which involves failing firm defense, it was decided that the acquisition of Vatan Newspaper by Doğan Group would result in the group’s market share reaching 40 % in terms of net sales and 64 % in terms of advertisement revenue, and that the synergy and portfolio effect brought about by the inclusion of Vatan Newspaper in the group was capable of increasing the market share even further both in terms of the number of net sales and advertisement revenue, that therefore the transaction would result in the strengthening of the dominant position of Doğan Group; however the transaction was conditionally authorized on the grounds that the indebtedness of Vatan Newspaper to Doğan Group was not a collusive act entered into for making use of failing firm defense, that the bankruptcy of Vatan Newspaper was inevitable, that there was not a better alternative buyer for the competitive structure in the market, that in the absence of the merger the brand of Vatan Newspaper would inevitably be excluded from the market and the resulting gap would most likely and substantially be filled by Doğan Group, and that the effects which restrict competition and which would arise in the market if the transaction is authorized would still arise if the transaction was not authorized.

18. Given the abovementioned decisions of the Competition Board, it can be said that generally four conditions are to be met for the failing firm defense to be accepted in Turkish competition law. The first condition is that the failing firm would leave the market in the near future. The second is the nonexistence of alternative mergers and acquisitions which would restrict the competition less. The third condition is the impossibility of the failing undertaking to stay in the market through methods such as its reconstruction or narrowing down its activities. The last condition is that, even in the absence of the merger and acquisition, the market share of the failing undertaking would pass to the acquiring undertaking.

19. While evaluating mergers and acquisitions in a crisis period, in addition to the evaluations concerning the substance of the transaction, finalization of the merger and acquisition examination in a short time is of great importance as well. This is because, ensuring that the measures taken in a crises period produce maximum benefit depends, before all else, on the timely initiation of the measure. At this point, it might be beneficial if the competition authorities finalize the evaluations of the mergers and acquisitions notified to them as soon as possible, without waiting for the statutory timeframes, and thus ensure legal clarity for undertakings as soon as possible. But of course, an important duty rests with the undertakings in this process too, in terms of notifying the merger and acquisition accurately and cooperating constructively with the competition authority in the evaluation process, so that the final decision can be taken within a short time.

20. Provided that it is limited to the crises period, another solution which can be adopted so that the expected benefit of the planned merger and acquisition takes effect promptly is the finalization of the merger and acquisition without waiting for the competition authority’s final decision. Especially where there are no serious concerns as to the merger and acquisition and where irreparable damages are not likely, adoption of such a method by competition authorities might prove beneficial for the expedition of the process. But there is no doubt that the application of this option in practice is primarily dependent on

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<sup>4</sup> Decision dated 10.3.2008 and numbered 08-23/237-75.

such a power being granted to competition authorities by the relevant legal arrangements. For instance, under Turkish competition law, the Competition Authority does not hold such a power<sup>5</sup>.

### **3.3 Control of Anticompetitive Practices**

21. Another issue which is likely to be raised in relation to the competition policy to be adopted in the financial crisis process is increasing number of anticompetitive practices but namely “crisis cartels”. Given the current period when the financial crisis reduced the demand vis-à-vis the undertakings in the market, it may be raised whether cartelization between firms can be approached more flexibly.

22. “Crisis cartel” defense, which may be considered in the EU competition law under very exceptional cases, has not been taken into consideration as defense in the decisions of the Turkish Competition Board so far in a decisive way. During the economic crisis which mainly broke out in financial markets and influenced rest of the economy soon, the TCA did not accept the existence of crisis as a major defense while investigating the competition infringements.

23. It is thought that acceptance of “crisis cartel” defense even in a financial crisis environment might result in significant damages in the markets in the medium and long term. Therefore, it is thought that there is no need to make any changes in the competition policy in relation to cartels, in a financial crisis environment.

## **4. Conclusion**

24. As a conclusion, continuing to apply the competition policy in the financial crisis period is imperative both to find a way through the current crises environment and not to encounter new structural problems in the medium and long term. In this respect, competition policy enforcement is a part of the solution in preventing the negative effects of the financial crisis. On the other hand, in the current crisis when timing is determining the cost of the measures, it is of great importance that competition authorities expedite the evaluation process especially in mergers and acquisitions and the control of state aid, so that competition policy can perform its given function effectively.

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<sup>5</sup> Under the Act No. 4054 Article 16, carrying out a merger and acquisition without the authorization of the Competition Authority is subject to administrative fines.