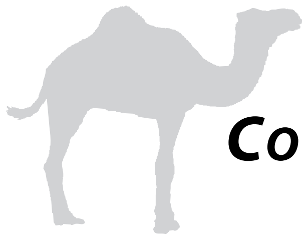

Chapter 14
Competition Policy

Competition policy refers to a set of laws and regulations aimed at maintaining a fair degree of competition by eliminating restrictive business practices by private enterprise. According to Graham (2000, p. 205), competition policy includes 'both anti-monopolies (antitrust) and regulation of state aid (i.e. subsidies and subsidy-like measures)'. Restrictive (or anticompetitive or unfair) business practices are those that limit entry into a market by other enterprises or regulate supply in a way deemed harmful to other (existing or potential) producers or to consumers. Such practices include collusion, predatory pricing behaviour, capacity expansion that deters market entry and mergers and acquisitions that reduce competition.

Competition policy thus aims at limiting monopoly so as to encourage competition and its beneficial welfare effects. While competition policy may help particular firms or consumers, in principle it aims not at helping specific competitors but at establishing conditions of competition. A key characteristic of competitive market conditions is that 'sellers and potential sellers be as free as possible to enter and leave the market as they see fit—or, in other words, that markets be contestable' (Graham, 2000, p. 207).

There are two main analytical questions relating to competition policy. First, are domestic competition policies needed, and if so, what should their nature be? And second, is an international competition policy needed, and if yes, should it be established in the World Trade Organization (WTO)?

As a brief history of competition policy in the international context shows, efforts to produce an international agreement on such policy have long been under way (box 14.1).

Experience with domestic competition policy and lessons for developing countries

Until recently most developing countries have operated without a formal competition policy, because no such policy was needed. Most developing country governments exercised considerable control over economic activity. If a government

BOX 14.1 COMPETITION POLICY IN THE INTERNATIONAL CONTEXT: A BRIEF HISTORY

In the context of trade, competition policy cannot be viewed separate from investment, since the two issues are closely linked. Efforts have been made to reach international agreement on competition policy before. Attempts to reach agreement on the United Nations General Assembly's 1980 'Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Practices' failed because most industrial countries disagreed with developing countries' desire to make rules legally binding. The United Nations Center on Transnational Corporations' code of conduct for transnational corporations, which can be viewed as relating to both investment and competition policy issues, met with a similar fate two decades ago.

Ironically, it is now industrial countries that seek a binding multilateral agreement, though of a very different kind and in a very different forum—the World Trade Organization (WTO). And it is now developing countries that oppose this. Industrial country groups such as the European Union now support a WTO agreement on trade and competition policy largely for reasons of market access much like those motivating their desire for a multilateral agreement on investment in the WTO. While the General Agreement on Trade in Services (GATS) has provided some expansion of market access in public utilities, telecommunications and financial services, a WTO-based competition code would clearly extend industrial countries' market access possibilities further. According to Graham (2000, p. 218),

> U.S. telecommunications services providers are certainly in favour of the ending of government policies that grant monopoly rights in the provision of telecommunications services to local providers. Such rights have long been insurmountable barriers to market access. Although many nations are now in the process of ending or substantially modifying state-sanctioned telecommunications monopolies, these markets nevertheless will remain highly regulated and probably not very contestable. Further market opening measures by the WTO in this domain are welcomed by providers that stand to gain market access.

Japan, while vigorously in favour of a competition policy agreement in the WTO, apparently has a different motivation. It would like to see such an agreement effectively address the panoply of anti-dumping practices (Graham, 2000). According to Graham (2000), this risk to the anti-dumping regime is precisely the reason that the US Department of Commerce is not actively pushing a competition policy agreement in the WTO.

Some WTO agreements already contain elements of competition policy. Anti-dumping actions aim specifically at predatory and below-cost pricing behaviour deemed unfair to domestic producers. Many services in developing countries are provided through state-owned monopolies, and article VIII of the GATS requires signatories to 'ensure that the supplier does not abuse its monopoly position to act in a manner which is inconsistent with the national treatment obligations and specific commitments made by the member in respect of the service' (Vautier, Lloyd and Tsai, 1999, p. 19). Thus the WTO has dealt with competition issues as they relate to specific aspects of trade.

If a binding competition policy were agreed on in the WTO, investment regulation under the Agreement on Trade-Related Investment Measures might need revision. Similarly, conflict might arise with the Agreement on Trade-Related Aspects of Intellectual Property Rights, which allows anticompetitive practices: intellectual property protection restricts contestability based on the grounds that such restrictions promote greater innovation over the long term.

Recognizing the relevance of anticompetitive practices to the direction and volume of international trade flows, the December 1996 WTO Ministerial Conference in Singapore identified competition policy as one of the four 'Singapore issues'. It also established a working

group on 'the interaction between trade and competition policy' whose major tasks included '*ensur[ing] that the development agenda is taken fully into account*' (WTO, 1999, annex 1; emphasis added). The working group was encouraged to seek cooperation with other organizations, such as the United Nations Conference on Trade and Development (UNCTAD). Just as for investment, the 2001 Doha ministerial declaration did not formally launch negotiations but makes it possible to negotiate an agreement after the fifth ministerial conference in Mexico in 2003 if there is explicit consensus to do so.

According to the Doha ministerial declaration (article 23, p. 9), 'negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations' [that is, how the negotiations are to be conducted].

Source: Milberg, 2002; UNDP, 2002.

perceived uncompetitive behaviour, it often intervened directly (such as with the prices of medicines). Indeed, until 1990 only 16 developing countries had a formal competition policy.

But with deregulation, privatization and liberalization over the past two decades, this situation has changed in most developing countries. With encouragement and help from the WTO and international financial institutions, 50 more countries completed their competition law in the 1990s and another 27 are doing so (Singh, 2002). About a third of WTO members still lack such legislation.

The experiences of industrial countries with domestic competition policies provide useful lessons for developing countries as they formulate their own domestic policies. The first and perhaps most important lesson is that a variety of domestic competition regimes coexist across the industrial world. The US, European Union and Japan, for example, have each used different competition policies and have modified them as needed. This approach has required flexibility and domestic policy space.

The US has focused on antitrust actions. Its vigilance in enforcing antitrust policies has fluctuated over time. It recently moved away from automatically prosecuting practices that threaten competition, regardless of the context or consequences, towards a competition policy that considers anticompetitive practices case by case, taking both context and consequences into account (see Baker, 1999).

The European Union's competition policy is aimed at promoting the harmonization of its members' national competition policies. Its competition law has been described as focusing largely on static efficiency and being less specific about issues relating to social policy and state subsidies (see Audretsch, Baumol and Burke, 2001).

Competition policy in Japan has evolved since the 1940s. The period most relevant for developing countries is 1950–73, when Japan was much more like a newly industrializing country than it is today. This period of rapid economic growth and competition policy was coordinated closely with industrial policy. Implemented by the Ministry of Trade and Industry (MITI), industrial policy

dominated competition policy, which was enforced by the Fair Trade Commission. MITI sought high rates of profit and reinvestment for industry, an objective requiring such 'anticompetitive' actions as sponsoring cartels, coordinating investment by rival firms and intervening in firm exit and entry. All these, according to Singh (2002, p. 24), 'contributed to the high concentration ratios observed in the Japanese economy.'

Cartels were not viewed as necessarily bad. MITI managed the situation by playing oligopoly firms off against one another, rewarding those with good performance in exports or technological innovation with subsidies and protection from imports. The ministry's promotion of both cooperation and competition among cartels and oligopoly firms may have sacrificed static efficiency for the sake of maximizing long-term productivity growth—'dynamic efficiency'. The case of Japan may bear some similarities to that of Germany, where the government encouraged rather than opposed cartels in many instances.

A recent World Bank (2002) survey of competition laws in 50 countries that have introduced them also reported important inter-country differences in the definition of dominance, the treatment of cartels and the enforcement of the laws. The variation in competition policies across industrial countries and other countries included in the recent World Bank survey indicates that here, as in trade policy more generally, one size does not fit all. Developing countries should take care to adopt competition policies that fit their circumstances. Countries must retain the flexibility and policy space to regulate competition in a way that supports their long-term development strategy. The design of their competition policy should take into account their level of development, their institutions of labour relations and innovation and their place in the world economy. And given the rapid changes in technology and the heightened mobility of capital today, developing countries must also focus on these dynamic factors in developing their competition policies.

Japan's experience since World War II, with its emphasis on dynamic forces and on combining cooperation and competition, appears to provide the most useful lessons for developing countries. This is supported by the experiences of other East Asian countries, of China more recently and even of industrial districts in Italy (Singh, 2002). But in the context of today, perhaps the more important lesson from industrial country experience is that developing countries should be able to have competition policy regimes that differ from one another. And they should design their domestic competition laws and regulations to be flexible and dynamic enough to respond to and even pre-empt the changing circumstances of a rapidly globalizing world. Indeed, Audretsch, Baumol and Burke (2001) suggest that industrial countries should move to a more dynamic policy as well.

A second lesson for developing countries is that industrial countries have not applied domestic competition policies across the board but instead have been

highly selective across sectors and even firms. According to US competition policy experts Graham and Richardson (1997, p. 34),

> *'Competition policy is usually tailored to sectoral public interest regulation—especially in transportation, telecommunications, and utilities—and often tailored to industrial policies that favor agriculture or high-technology sectors over others. . . . Competition policy has never been applied indiscriminately to financial markets. . . . Occasionally, competition policy even differentiates among competing firms, with state-owned or state-chartered firms treated with more leniency'.*

This implies that an 'across the board' domestic competition policy regime is likely to be inappropriate. Countries will need to retain the flexibility to choose the sectors to which they wish to apply it.

A third lesson for developing countries is that most industrial countries developed competition policy quite recently—certainly only after they had attained levels of economic development far beyond those of most developing countries today (see Chang, 2002, chs 2 and 3). US policy began taking shape during the late 19th century, while Europe and Japan have effectively enforced competition regulations only during the past 50 years. In some cases (France, the UK) statutes existed largely on paper.

Thus competition policy arrived late in the industrial countries relative to their level of economic development. And it has both varied considerably across countries and been applied selectively across sectors and interest groups within countries. This should not be surprising, since most industrial countries pursued economic development strategies allowing considerable protectionist and anti-competitive behaviour, aimed at promoting the development of domestic industrial capacity and attaining dynamic efficiency through technological advance. Developing countries need to learn the right lessons from the experience of countries that have already achieved industrialization.

The need for domestic competition policy in today's world

Both domestic and international economic developments in the past two decades suggest that it is important for developing countries to establish formal competition policies. Domestically, the enormous structural changes caused by deregulation and privatization are the main reason for this need. Without appropriate national competition policies, privatization is much more likely to reduce social welfare and undermine human development (Singh, 2002). Internationally, the boom in cross-border mergers poses a potentially significant threat to competition in developing countries. Mergers can increase the market power of transnational corporations' affiliates operating in developing countries and create 'increased

barriers to entry and contestability' (Singh and Dhumale, 1999, p. 7).[1] Such mergers can be particularly harmful to the interests of the late industrializing countries, whose firms are still building the capacity to compete in international markets.

Moreover, along with the potential benefits of inward foreign direct investment come potential risks.[2] One such risk is that socially beneficial domestic competition will be reduced. Inward foreign direct investment can spur competition among domestic firms and move them to an internationally competitive level of productivity. But in the absence of an appropriate and effective domestic competition policy, foreign firms can crowd out domestic investment, stifle domestic competition, reduce domestic productivity growth, raise domestic prices and diminish prospects for industrialization.

Domestic competition laws and their enforcement should be designed to restrain anticompetitive behaviour by large domestic private corporations, limit or pre-empt abuses of monopoly power by large transnational corporations and support human development objectives. This is where the experience of Japan and other East Asian countries is likely to be most useful.

But even the most effective competition policy will be unable to constrain the global anticompetitive behaviour of large transnational corporations. That will require the cooperation of industrial countries, where most such corporations are based. And it will require an appropriate framework for international cooperation on competition issues, similar to the failed proposals put forth by developing countries two decades ago. The need remains as urgent as ever.

An international agreement on competition policy in the World Trade Organization

Expanded activity by transnational corporations in developing countries might lead these countries to support the adoption of an international competition policy. Many already do so, prompted by concern about the static inefficiency that may result from the anticompetitive practices of such corporations. Although domestic policy could regulate this anticompetitive threat, an international policy would presumably give countries some influence over purely foreign mergers and acquisitions. But should such international cooperation be in the WTO?

Arguments in favour of this include restraining anticompetitive behaviour and cartelization by large industrial country corporations, disciplining the Agreement on Trade-Related Aspects of Intellectual Property Rights and blunting the potency of anti-dumping laws by bringing them into the normal framework of predation under competition law (Singh, 2002). Joseph Stiglitz argues that the predation test is much stricter than the anti-dumping measures that countries have been using under the WTO (Singh, 2002).

Economists disagree about the possible benefits that might accrue to developing countries from a WTO-based competition policy. Perroni and Whalley (1998)

estimate a significant positive effect, equivalent to as much as 6 per cent of developing countries' national income. They argue that gains could result from several factors: fewer predatory anti-dumping actions against developing countries, less price gouging on imported inputs and increased domestic competition.

Hoekman and Holmes (1999), however, are sceptical about the ability of a WTO-based agreement to reduce anticompetitive merger activity in developing countries.[3] They believe there is a risk that negotiations will lead to an agreement serving mainly the industrial countries that want market access, particularly where large private or state enterprises control an industry. According to Hoekman and Holmes (1999, p. 16), a WTO-based agreement is unlikely to be helpful because

> *'the agenda is likely to be dominated by market access issues more than international antitrust. . . . [T]he WTO process is driven by export interests (market access), not national welfare considerations, and there is no assurance that the rules that will be proposed or agreed will be welfare enhancing'.*

These concerns have been mirrored in the discussions of the WTO Working Group on Trade and Competition Policy. Among the issues debated are whether a uniform international competition policy is needed and, if such a policy should emerge, whether the WTO is the appropriate organization to enforce it.

Most important for the issues raised in this book, the working group's annual reports reveal much concern among developing country members that a WTO-based agreement would limit their ability to pursue policies promoting sustainable development, particularly industrial policies and infant industry protection under certain circumstances. The importance of this concern cannot be overstated; such policies have played an essential part in every case of successful industrialization leading to human development over the past 300 years.[4]

A key lesson from the historical and current experience of industrial countries is that any international cooperation framework in this area must allow participating countries the flexibility to design different competition policies and to adapt their policies over time. A uniform competition policy in the WTO seems unlikely to be able to do this.

Equally important, if such a framework is established in the WTO, governments will have to give large transnational corporations 'national treatment'—that is, the same treatment they accord domestic enterprises—both before such firms have decided which sector to enter and after the firms are established. This could easily lead to results harmful to both local development and global efficiency. For example, it should be permissible for a developing country to allow domestic corporations to merge or establish a minimum critical mass of R&D activity, to enable them to compete more effectively with large transnational corporations, while at the same time denying such merger opportunities to foreign transnational corporations. But this would violate the WTO's national treatment principle (Singh,

2002). It could also bring cross-retaliation against the developing country in another area as part of the WTO's dispute settlement procedure.

The way forward

The discussion of the benefits and costs of international cooperation on competition in the WTO highlights a difficult dilemma for developing countries: even the most appropriate and effective domestic competition policy will be unable to contend with the real or potential anticompetitive behaviour of large transnational corporations. This problem suggests a need for an international agreement on competition policy regardless of whether there is one on investment. Yet for the reasons discussed, a competition policy agreement in the WTO is unlikely to provide developing countries with the policy space or the outcomes they need from an internationally agreed competition policy. Moreover, violations of the national treatment or other principles of the WTO will open them to cross-retaliation, causing new problems. This situation calls for at least two sets of actions.

First, developing countries should continue to build their own domestic competition policies, both to regulate domestic monopoly and to control the possible anticompetitive behaviour of transnational corporations. Countries that do not have a domestic competition policy should begin to develop one. Such policies should be designed to thwart anticompetitive practices detrimental to long-term development, whether those unfair practices come from foreign or domestic enterprises. And they should encourage the development of services, technology, genuine infant industries, efficient public utilities and managerial and marketing capacity and allow flexibility in the choice of sectors for application.

Second, developing countries should coordinate competition policy as much as possible with other countries. Member countries of the European Union have done this, and those of Mercosur and the Asia-Pacific Economic Cooperation (APEC) have also begun sharing information and even harmonizing policy. The APEC agreement is based on four core principles: non-discrimination, comprehensiveness, transparency and accountability—a good starting point for any coordinated agreement (see Vautier and others, 1999, for an overview).

There is an important reason why such cooperation should be independent of and outside the WTO framework: international competition policy involves a broader range of issues than those related to international trade. Among these are regulatory and social objectives very different from the WTO's efforts to promote free trade through market access.

Notes

1. Hoekman and Holmes (1999) argue that international mergers that create anticompetitive markets are one important reason for developing countries to pursue an international competition policy in the WTO. Another relates to cases in which

anticompetitive export cartels are not restrained because it is not in the interest of the cartel's home country to do so.

2. For a discussion of the benefits and costs of a development strategy led by foreign direct investment, see Milberg (1999).

3. This point is also made in the 2001 report of the WTO Working Group on Trade and Competition Policy (WTO, 2001b, para 58).

4. Evidence on the first wave of industrialization can be found in Chang (2002). The experience of the late industrializers is described in Amsden (2001).

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