by R. Shyam Khemani

COMPETITION POLICY AND ECONOMIC DEVELOPMENT

Il se dégage un consensus au sujet des principaux éléments qui constituent les « meilleures pratiques » pour le maintien et la promotion de la concurrence au sein de l'économie. L'auteur esquisse les principes de base qui devraient guider les pays en développement ou en transition au moment de mettre en place ou de modifier un régime de concurrence.

Various factors are driving governments to adopt more market-oriented policies toward economic development. Large and persistent fiscal deficits have limited the ability of governments to impose further taxes or borrow from capital markets. This has generated pressures to downsize the public sector, privatize state enterprises, deregulate markets and avoid policy interventions resulting in high costs and poor economic performance. Also, the globalization of markets and its impact on the flow of trade and investment has left governments with few policy options or room to manoeuvre. The recently completed Uruguay round of trade negotiations and the creation of the WTO will result in greater measures against state aids such as subsidies and the erection of tariff and non-tariff barriers in international trade. In addition, countries with poor infrastructure facilities and inefficient domestic markets are finding that their relative competitive position in exporting gets quickly eroded. And nations are increasingly competing against each other in attracting foreign investment by fostering a more market friendly business environment.

Having an effective competition (antitrust) law is becoming recognized as a critical element in strengthening market forces. Since 1990, over 35 developing and transition market economies have enacted or substantially revised existing competition laws — including virtually all of the former centrally planned countries or republics in Central and Eastern Europe and the former Soviet Union. Industrialized economies too have recently revamped and begun to vigorously apply their competition laws — notable cases being Canada, the European Union, New Zealand and the US.

Notwithstanding these developments, the majority of countries have yet to adopt competition law. Countries with doubts usually raise the following questions:

• Is the promotion of competition policy conducive to industrial growth and international competitiveness? If so, how have East Asian economies with weak or no specific competition law regime been developing so rapidly?

• Is the liberalization of trade and investment, and deregulation of economic activity, not sufficient to foster competition?

• Even if competition law is desirable in the abstract, are the potential costs of improper enforcement, misuse of bureaucratic power or regulatory capture not likely to outweigh the potential benefits?

• What are the essential features of an effective competition law? Will or should these features differ by country?

• When and how should competition law be sequenced among the range of macro- and microeconomic policies that governments need to address in context of restructuring their economies?

Competition, industrial growth and international competitiveness

An argument frequently advanced is that closer integration of business and government is needed to ensure firms are large enough to compete effectively in international markets. The risks, uncertainty and low profits associated with competition limit their ability to conduct R&D, innovate and improve product quality. Markets often fail to guide investments to industries that would generate high growth and governments must therefore "lead the market" by identifying strategically important industries and a few large firms that can act as "national champions" and "engines of growth." In this context, competition law is thought to hinder domestic firms' ability to become competitive because it makes it difficult for them to coordinate their business policies and consolidate operations through such strategies as mergers and acquisitions. The proponents of this view point to the high post-war growth rates of Japan, Korea and other East Asian economies as evidence of "national competitiveness."

There are several flaws in these arguments. First, firms and industries and not nations compete against each other. While nations, through various economic policies, can condition the domestic business environ-

ment in which firms operate, they cannot necessarily determine the conditions under which firms will have to compete in international markets. The high growth rates of East Asian economies have been primarily driven by exports. Intense competition in export markets has been both a stimulus and a transmission mechanism for fostering competition, innovation and efficiency in supporting domestic markets used to source inputs. Moreover, governments through various economic policies such as limiting competition, charging higher prices to domestic consumers and/or providing tax incentives and subsidies for exports are in effect cross-subsidizing foreign consumers. Such policies keep domestic consumer welfare at a low level, and are not in the best interests of a country nor sustainable over the long run. Also, various government support policies and incentives can be replicated, matched or exceeded by other "competing nations" so that any competitive advantage that may be created will likely be transitory in nature.

Second, if firms or industries are seen as having potential economies of scale or other advantages of size, a question that needs to be explored is why these are not being exploited? If the domestic market is small, economies can be attained through exports — as in Singapore, Sweden, Switzerland and Taiwan (China). Various research shows no unequivocal statement can be made on the relationship between firm size, industry concentration and economic performance. No systematic positive relationship has been found to exist between firm size and profits, or export activity or R&D. Cross-country studies which include Japan and Korea have found high industrial concentration to be hostile to technical efficiency. Third, the World Bank study *The East Asian Miracle* (1993) suggests a unique mix of strategies entailing government framework policies and competitive discipline has been applied across 23 economies in East Asia that have experienced higher-than-average growth. However, a common denominator is a high degree of inter-firm rivalry and exposure to competition, both domestic and international. In the case of Japan, for example, such rivalry is intensive in virtually all products where it has been successful — computers, consumer electronics and automobiles to mention a few. Most of these economies have abandoned policies of trade protection and import substitution, licences, entry or exit controls and other regulations inhibiting industrial activity. While in some cases specific industrial sectors may enjoy protection, individual firms do not. All sectoral participants receive equal treatment and clearly articulated and transparent industrial and trade policies have reduced rent-seeking behaviour.

The principal objective of competition law should be to maintain and encourage competition in order to promote economic efficiency and consumer welfare.

International trade liberalization as competition policy

In many economies where high levels of industry concentration prevail, it is suggested that anti-competitive business practices are less feasible if domestic markets are exposed to international competition. In the absence of barriers to trade, domestic monopolists or oligopolists lose their ability to exercise market power irrespective of actual imports' share of the domestic market, in view of the threat of potential competition.

However, the pro-competitive effects of tariff reductions may be diluted if import supply is not very responsive. This occurs when increased demand for imports can be met only at significantly higher prices, or when imports are comparatively insensitive to changes in domestic prices which often seems to be the case in economies with relative small markets. In addition, in an environment of floating exchange rates, if domestic firms fail to rationalize high-cost operations and improve productivity, the domestic currency is likely to depreciate, offering new protection from import competition. In Mexico for example, recent currency devaluations have more than offset the tariff reductions negotiated under the North American Free Trade Agreement (NAFTA).

Furthermore, trade policy consists of more than tariff policy. Quotas, voluntary export restraints (VERs), antidumping and countervailing duties are among the instruments that governments can wield to limit import competition. While a true "free trade" policy would require that all such measures be removed, in reality this never happens. Indeed, as import tariffs are liberalized, the pressure to invoke counter-measures only increases.

There exist other factors that can impede the pro-competitive effect of trade liberalization. Among these is that an increasing share of economic activity in developing as well as industrial countries relates to non-tradeable goods and services. These include high weight-to-value products with high transport costs (such as cement and steel), perishables (such as food) and legal, financial and other services. In addition, interfirm contractual arrangements and vertical integration in highly concentrated markets may prevent market access. This problem has been cited by many American firms as limiting their ability to compete in Japan in the film and automobile markets. Also, international cartels may divide up markets through price-fixing or geographic market-sharing agreements. Recently, Canadian and US competition authorities successfully prosecuted various domestic and international firms engaged in transborder price-fixing and

market-sharing agreements relating to fax paper and ductile iron pipes.

International trade and competition policy measures can thus complement and buttress each other in promoting trade, market access, global economic efficiency and consumer welfare. Promoting objectives of a liberal trade policy supports the objectives of competition law and *vice versa*.

"Best Practice" toward competition law

There is a convergence in the views of economists, lawyers and various practitioners regarding the principal elements of the "best practice" toward maintaining and encouraging competition in an economy. The suggested principles also lower the risks of misuse of bureaucratic power and "capture" that critics of competition law postulate.

Objectives

The principal objective of competition law should be to maintain and encourage competition in order to promote economic efficiency and consumer welfare. Making economic efficiency the principal objective of competition law supports consistent application of policies and is more likely to limit lobbying by vested interests. In some countries, however, competition law has multiple goals under the rubric of "public interest," including fairness, regional development or employment, and pluralism or diffusion of economic power through promotion of small and medium-size businesses. Multiple objectives invite lobbying by different stakeholders in the economy and can lead to inconsistent application of competition law, so that governments end up protecting some firms from competition. That result is at odds with the basic aim of competition law — to protect the competitive process and not competitors. Trying to balance a wide range of (often conflicting) social, political and economic concerns is sure to undermine long-term competitiveness, economic growth and jobs. Instead, different goals are better pursued by different policies.

In recent years, Canada, the European Union, Italy, New Zealand and the US have placed more weight on the economic efficiency objective. Several developing countries, including Colombia and Mexico, have done the same. But some countries, notably France, India, the UK and some economies in Central and Eastern Europe, pitch competition law toward multiple objectives.

Instruments

There are two approaches to the application of competition. The first approach is structural, focussing on market share and industry concentration. The second is behavioural, with the focus on combating anti-competitive business practices.

Economic theory suggests that industry structure has an important bearing on firm behaviour and performance. Large firms operating in industries with few competitors are more likely to engage in anti-competitive practices. In reality, large firm size does not necessarily confer market power. If there are no barriers to entry, the market will be contested by new competitors every time established firms try to hike prices and cut output to earn excessive profits.

Economies with large domestic markets have little difficulty using the structural approach. The large number of firms in these economies generally ensures vigorous competition. The US and Canada use firm market share thresholds in triggering investigations. In countries with small markets, however, the potential risks of misapplying competition law, and the impact on the economy, tend to be greater. These economies tend to be characterized by industries with few firms and high concentration. Applying structural measures to ensure competition in such matters as mergers and acquisitions may prevent domestic firms from achieving the minimum size needed to compete in international markets. In these circumstances, governments can best alleviate worries about high concentration by removing curbs on foreign trade and investment and lifting regulatory barriers to entry, such as licensing.

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The behavioural approach focusses on how firms do business. Some business practices — such as collusion between competitors to fix prices, reduce output, allocate customers and share markets — are clearly anti-competitive and should be *per se* illegal and subject to heavy fines and penalties. But the effects of such business practices as exclusive dealing contracts between sellers and buyers, interfirm cooperation in research and development, and product standards are more difficult to measure. These need to be examined case by case, applying a rule of reason approach. Structural arrangements such as mergers and acquisitions and joint ventures should be examined in the same way.

Triggering an investigation

Competition law requires a mix of structural and behavioural criteria to touch off an investigation. The criteria for triggering cases or investigations must be clear. If they are not, the law will create business uncertainty and undermine the competitive market process. Too lax an approach can allow monopolies to become entrenched, a situation that takes a long time for market processes to correct. Conversely, too vigorous an application of the law may arrest the development of the market and slow economic growth.

Competition authorities can help maintain business certainty by clearly indicating the firm size that, if exceeded, would launch a review by the competition agency. In most jurisdictions, market share figures for merger transactions, defining monopoly or dominant market position of a firm are indicated. Virtually all jurisdictions specify which business practices are strictly prohibited or *per se* illegal (such as price fixing) and which will be examined case by case, weighing the social costs and benefits (such as exclusive dealing and mergers).

Administering a fair redress mechanism

The best watchdog of competition is an impartial, independent competition law enforcement agency. A sound competition law will include a redress mechanism for consumers and firms that have suffered from anti-competitive practices (many complaints to competition offices in industrial countries are in fact raised by business firms). Care must be taken, however, to ensure that this provision does not become an instrument for firms and consumers to impede the competitive process. Although the law should apply equally to government and private firms, some exemptions may be necessary to allow certain kinds of economic activity — for example, collective bargaining, underwriting new stock issues, R&D consortia — without restraining competition in the final market.

The investigation and prosecution functions of the law should be separate from adjudication. Otherwise, a competition agency may become investigator, prosecutor, judge and jury rolled into one. While the competition agency can negotiate settlements or foster voluntary compliance, alternative resolution mechanisms should be available in cases of disagreement. Countries without appropriate or adequately developed legal systems or with courts that get backed up could establish a separate competition board or tribunal of experts from the academic, business, government and legal communities.

Private legal actions by business firms and consumers should also be possible. The burden of enforcing competition law need not rest solely with a government agency.

Intervening in other government decisions affecting competition

Competition law has an interface with a broad range of economic policies affecting competition in local and national markets, including the regulation of transport, power, telecommunications and other sectors where natural monopolies are likely to occur, international trade, foreign direct investment, intellectual property rights, financial markets and privatization policies. These policies can enhance or impede the effectiveness of competition law.

An effective competition agency should clearly spell out the implications of public policies for competition and efficiency so that government decision making takes them into account. This process makes governments and competition agencies more accountable, increases awareness of the costs and benefits of alternative policies and helps ensure that government policy objectives do not work at cross-purposes.

Sequencing and constraints on the effective implementation of competition law

The effective implementation of competition law is not a trivial task. It requires a high level of requisite knowledge and expertise. In this connection, many developing and transition market economies start from a position of having significant disadvantages. Past government interventions and central planning have generally led to industrial structures consisting of high levels of concentration, state ownership and controls, a poor set of economic incentives, segmented markets, paucity of entrepreneurship and managerial skills and weak or inadequate financial-capital markets. There also exist severe rigidities and bottlenecks in the mobility of resources from lower to higher valued uses; while inflation rates are coming down, they are still high enough in some countries to distort price signals and to mask the true nature of profitable investment opportunities. The legal-economic institutions and administrative capacity tend to be woefully inadequate.

While in a number of the above-mentioned areas the difficulties can be surmounted through appropriate technical and development assistance, the process will undoubtedly require significant time.

When should competition law be introduced in the economic restructuring process and what should be the principal priorities in such economies? Certainly countries need to get their macroeconomic environment in order, that is reduce fiscal deficits, lower inflation, address balance of payments and exchange rate issues, and liberalize trade and investment. Macroeconomic distortions hinder the effective development of competitive markets. A number of other legal-economic reforms dealing with such matters as property rights and corporate governance are also necessary in order to foster market-oriented private-sector-led economic development. However, since creation of an effective system of property rights and corporate governance generally requires a long gestation period, the early introduction of competition law should not be delayed. Injecting effective competition into an economy is a speedier process than creating a system of property rights and corporate governance and competition law is not only necessary to support and strengthen market forces, but also to create the right incentive structure for re-deploying productive assets toward more efficient uses.

In this connection, it is advisable for competition offices to first actively engage in "competition advocacy," that is to counter public policies that tend to retard or delay market reforms, impose barriers to entry and prevent market access. In addition, they should embark on an extensive public education program in

order to create a base of support and understanding of the objectives of competition law.

Priority should also be given to enforcing rule-based provisions dealing with collusive practices and, after accumulating sufficient experience, applying the discretionary provisions dealing with mergers and dominance.

The competition offices also need to be involved in privatization and structural de-concentration. State monopolies should be prevented from being transformed into private ones. Most state enterprises in developing and transition market countries have been created by "administrative fiat" rather than being driven by market-oriented considerations. The potential efficiency losses from the break-up of these enterprises is likely to be minimal.

Concluding remarks

Competition law is increasingly being accorded a central place in a nation's economic policy framework. Such a law has a critical role to play in the restructuring of developing and transition market economies. By preventing artificial barriers to entry, it facilitates market access and complements and buttresses other policies that promote competition and investment. Competition fosters both static and dynamic efficiencies and the international competitiveness of firms.

In an increasingly integrated global economy, domestic firms and industries cannot be completely insulated from external competitive pressures. Through implementing effective competition law, governments condition the business environment in which these firms operate, encourage flexibility and adaptability and efficient mobilization of resources. While each nation needs to adopt competition legislation and institutions suited to its particular circumstances, taking into account such factors as the stage of economic development, domestic capacity, industrial market structure and legal-economic framework, the "core" principles of competition law remain the same.

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by Derek Ireland

COMPETITION POLICY AND CONSUMER PROTECTION

Il y a des liens étroits entre la politique de concurrence et la protection du consommateur car elles répondent à l'influence des mêmes facteurs économiques mondiaux et visent toutes deux à privilégier les droits des consommateurs et à élargir l'éventail des choix. C'est pourquoi il faut coordonner étroitement ces deux domaines.

Global forces and the consumer

Competition policy and consumer protection laws are being shaped by the same global forces. In summary terms, these include:

• the globalization of markets — especially financial and other markets for services;

• lower barriers to trade as well as to cross-border flows of investment, technology and ideas which are expanding even faster than trade in goods and services; imports, multi-national firms and goods and services from emerging market economies are now satisfying growing proportions of consumer needs in the OECD countries;

• rapid technological change, leading to the knowledge-based economy and rapid growth in electronic commerce (resulting in turn in new forms of distance selling by mail, telephone and the Internet and thus new forms of consumer scams and frauds);

• government downsizing, regulatory reform and the privatization of state-owned entities in most industri-