Asia-Pacific Economic Cooperation

Study on Competition Laws for Developing Economies, 1999

APEC Committee on Trade and Investment (CTI)

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Chapter 1

1.1 The task

1.1.1 APEC requested a study on the advantages and disadvantages of competition laws for developing economies, particularly as it relates to and derives from the experience of APEC member economies. The project was focused upon the following issues:

- whether competition laws are essential to attaining competition policy objectives, especially for developing members with open economies;
- how the introduction of competition laws will affect the international competitiveness of their domestic firms;
- how the enactment of competition laws will affect their ability to compete for foreign investment vis-à-vis developing economies that have not enacted competition laws;
- what social impact competition law would create;
- what limits and downside risks of enacting a competition law are within a society; and
- the difficulties in obtaining support for the enactment of a competition law within a society.

1.1.2 The APEC Competition Workshop selected Korea, Mexico, Malaysia and the Philippines as the main case study economies.

1.2 Our approach

1.2.1 Our approach to each issue has been to consider both the theoretical and empirical work in each area. We have sought to illustrate the issues by reference to case study material where relevant, drawing upon our long and wide experience of working within competition authorities and of providing technical assistance to many economies which have recently introduced competition law. We canvassed views on the key topics from several APEC economies and we are grateful for the support and assistance we received. The views expressed remain our own. We present our broad conclusions as an executive summary in Chapter 2. The detailed report forms Chapters 3 to 10 and Annexes 1 to 3.

1.2.2 Annex 4 contains material submitted by various APEC economies on the development of their own competition laws. As such, it represents the views of those economies and not of PwC.

1.3 The team

1.3.1 The team which produced the report consisted of Marie Clark, Sarah Cooke and Professor David Elliott from PwC London, Nigel Knight and Richard Archer from PwC in Hong Kong and Emma Watson from PwC in Singapore. The project was assisted by Dr John Mo of the City University of Hong Kong. The project was led by Nigel Knight, a partner in PwC, and the principal authors were Sarah Cooke and David Elliott.

Chapter 2

Executive Summary

Competition law and the objectives of competition policy

2.1 Scope and links of competition law with other policies

Competition law cannot be considered in isolation

2.1.1 Competition law and policy can be seen as just one of a broad set of policy tools required to create an efficient market economy and as such competition law cannot be considered in an isolated manner. The law itself can never guarantee that markets will function effectively unless a range of other government policies conform to basic market principles. Trade policy, industrial policy, privatisation, deregulation, regional policy and social policy all need to be conducted in a manner compatible with the market mechanism for an economy to function as efficiently as possible. These policies need to be conducted in a complementary manner and it is important that a mechanism exists for incorporating the "competition dimension" within government decisions on such policies. Experience suggests that, in the process of transition to a less regulated and more open economy, the existence and application of competition law can usefully support other policy initiatives.

2.2 Objectives of competition law

Transparency matters more than whether the law has more than one objective

2.2.1 Two models for the objectives of competition law are typically proposed. The first regards competition law as being solely concerned with economic efficiency. The second regards the objective of the law to maximise the "public interest". The public interest is usually defined as including economic efficiency, consumer welfare, a balanced development of the economy and perhaps maintaining employment, technical progress and exports. In practice, the distinction between the two models is overstated with no economy actually following a rigid economic efficiency objective. The main distinction lies between the law having multiple objectives (broad public interest) or a single objective such as maintaining the efficient operation of markets (or free competitive markets). Arguments exist in favour of each approach. Our view is that it would be wrong to be overly prescriptive in suggesting that either model is better. Experience of many economies suggests that the culture and legal forms of each individual economy will determine the institutions and institutional structure that work best in each case. A key issue is that competition objectives, however defined, are pursued in an open and transparent manner and thus subject to the normal checks and balances inherent within the political and legal structure of the economy in question.

2.3 Framework for competition law

The law should cover abuse of dominance, restrictive agreements and M&As

2.3.1 The scope of this project requires us to assess the influence of competition law. To do this, we need to outline the form which competition law might in practice take. For this purpose, we take as a benchmark the framework recently published by The World Bank and OECD. This is framework is set out in Annex 2. Briefly, we envisage a law which covers abuse of dominance, restrictive agreements and mergers and acquisitions.

Are competition laws essential to achieve competition policy objectives, particularly given open economies?

2.4 Competition and trade policies as substitutes or complements

Some APEC economies see trade liberalisation as a substitute for domestic competition law

2.4.1 Some economies within APEC appear to have taken the view that trade liberalisation is sufficient, along with other moves towards deregulation, to create a competitive domestic market. In essence this position regards liberalisation of trade as a substitute for domestic competition law. At a practical level, it is clear that not all goods are tradable either because of high transport costs or because they are location specific i.e. some services, and this limits the general applicability of the substitution argument. We examine in detail the theoretical arguments for trade policies being either a substitute or a complement for competition law.

The impact of trade liberalisation will depend on the strategic reaction of domestic firms

2.4.2 At a simplistic level, a reduction in external tariffs will impact upon domestic price levels. The significance of this impact varies with the nature of the supply and demand for the goods in question. Beyond this, the impact is determined by the nature of competition between domestic firms and importers and, most crucially, upon the strategic reactions of each. Domestic firms facing potential import competition will have every incentive to minimise the effect of trade liberalisation by creating barriers to the entry and growth of imports.

Theory suggests the substitution effect is weak

2.4.3 Our conclusions from surveying the literature is that the theoretical discussion cannot fully resolve the issue of whether trade policy and competition policy are substitutes or complements, although a stronger case would appear to exist for the latter. The theoretical models that assume the substitution hypothesis would suggest that the substitution effect is likely, in practice, to be weak. We also know that a large proportion of goods and services are non-tradable. Thus, we can conclude that the substitution effect, if it exists, is likely to be limited in both scale and scope.

Empirical evidence supports this

2.4.4 The empirical literature, together with case study examples, broadly confirm the importance of strategic reactions by domestic firms to imports. Dominant domestic firms will seek to erect anti-competitive barriers to import competition. For a variety of reasons, imports do not generally appear to provide effective substitutes for all domestic production. The empirical literature would thus suggest that trade policy and competition law are complements. In particular, if the full benefits of liberalisation are to be achieved domestic competition law would seem to be required.

<u>How the introduction of competition laws will affect the international competitiveness of domestic firms</u>

2.5 Competition law as a danger to competitiveness

Competition law is seen by some to limit the formation of large internationally competitive domestic firms

2.5.1 The underlying position of those who see competition law as a danger to competitiveness is that firms need to be large enough to compete in international markets and any such law would hinder the creation of large firms. Competition law is also seen to limit the ability of domestic firms to become internationally competitive because it makes it difficult to co-ordinate their business policies and strategies with domestic rivals by agreement. Equally, a law directed at the control of mergers would also hinder such strategic amalgamations necessary to obtain international competitiveness. Additionally, the risks, uncertainties and lower profit rates associated with a competitive domestic market would prevent domestic firms from engaging in sufficient R&D, innovation and improvements in product quality.

2.5.2 We examine in detail the key issues that emerge from these concerns, namely:

- the role of economies of scale, minimum efficient scale and optimal number of firms for competitiveness;
- the relationship between size and efficiency;
- the role of agreements, particularly export agreements in export success;
- the evidence on mergers and efficiency; and
- the evidence on the relationship between R&D and innovation with firm size.

Increased domestic competition and action against anti-competitive agreements will raise efficiency

2.5.3 Consideration of the empirical literature for each of the above topics leads us to conclude that the concerns that competition law will harm competitiveness are significantly overstated. Increased domestic competition and action against anti-competitive practices and agreements will above all else raise efficiency and thus promote competitiveness. However, any agreements and mergers that generate efficiency improvements would not necessarily be disallowed by competition law. Competition law that allows for a case-by-case assessment of such arrangements would enable economies to achieve a balanced view of all the relevant concerns.

A case-by-case approach to competition law would not harm R&D

2.5.4 In respect of R&D and innovation, the position is less clear cut. Some theoretical work would suggest that size and market power are important in generating innovation. However, the empirical evidence does not support this. Of, perhaps, more importance to small economies is the rate at which new technology is diffused. Again, the position is not clear cut with firm size appearing to be an advantage for diffusion but market power possibly hindering it. We do not find that a case-by-case approach to competition law would in itself harm innovation and hence competitiveness.

<u>How the enactment of competition laws will affect the ability to compete for foreign investment vis-à-vis developing economies that have not enacted competition laws.</u>

2.6 Competition law as a danger to FDI

FDI is driven by many factors

2.6.1 Foreign Direct investment (FDI) will be motivated and directed at particular economies by many factors. Not least the market size, openness and growth prospects of an economy. These factors are broadly related to the extent of competition within an economy.

Competition law should ensure a level playing field

2.6.2 If competition law is applied in a non-discriminatory manner between domestic firms and foreign investors then a level playing field should ensue. Given that dominant domestic firms will seek to erect barriers to new entrants, the existence of law which prevents such anti-competitive behaviour should encourage FDI. Equally, competition law should protect domestic firms from anti-competitive practices by foreign investors.

Empirical evidence suggests anti-trust policies positively impact FDI flows

2.6.3 We have carried out some empirical research that suggests that the strength of anti-trust policies, as perceived by potential investors, has a significant influence upon FDI flows compared across countries.

<u>What social impact would competition law create?</u>

2.7 Social impact

Employment in the economy as a whole will rise

2.7.1 We concentrate upon employment effects. Increasing competition in a given sector of the economy will typically raise efficiency and lower prices. In many economies, the increase in efficiency will be achieved by an increase in labour productivity. Whilst one expects the fall in prices to stimulate demand and raise employment in the sector, this will typically be offset by the labour productivity effect resulting in a fall in sector employment. However, the fall in prices stimulates demand in other sectors and empirical work suggests that employment in the economy as a whole will rise.

Introduction of social and industrial policy to aid mobility and create new firms is required

2.7.2 Whilst this work provides considerable comfort that competition will in practice raise overall employment, it says nothing about the transition process. The first round job losses in the sectors in which competition is introduced can be substantial and are likely to be all the more so if the lack of competition was due to government support and subsidies. Considerable social problems will be created from the loss of employment. It will be important for economies to introduce social measures, which are complementary to competition law, to overcome these short-term problems. Such policies should be directed at the rigidities in the labour market, which prevent redeployment in other sectors, for example, training and measures to assist mobility. Additionally, competition and industrial policy will need to be co-ordinated to ensure that no barriers exist to the creation of new firms and industries.

What the limits and downside risks are of enacting a competition law within a society?

2.8 Risks of competition law

The benefits of competition law will outweigh any costs but there are associated risks

2.8.1 We have considered above the complementary role that competition law has with other key policy areas devoted to economic development. We have also stressed at the outset that competition law is to be seen as one aspect of a wider set of policies designed to increase competition in an economy. However, some risks are associated with the scope and application of the law. Our thesis is that if the law is framed and applied correctly then the benefits of such a law will outweigh any costs and that conflicts with other policies can be resolved in a way which confers the greatest benefit on the economy.

Scope of competition law

The law should include mergers and should apply to all sectors

2.8.2 Competition law should cover cartels and other agreements, abuse of dominant position and mergers. Some economies take the view that competition law should control behaviour and not market structures and thus have not enacted merger control law. Experience suggests this is likely to be an error. Competition law should apply to all sectors and, particularly important, that the views of the competition authority should be considered in any privatisation proposals.

The law must have high status

2.8.3 If the competition law is limited in its scope and applicability, a significant downside risk arises that it will lose credibility. The law, and those who apply it, should have a high status within government and competition objectives will need to be treated equally alongside other policies. In our experience, failure to do this will result in a failure to create competitive markets and a loss of benefits to society.

Application of competition law

There is the risk that the law will be inappropriately used

2.8.4 Markets fail for reasons of market power, externalities and information problems. Each reason raises issues for the application of competition law. Some call for the application of pro-competitive measures whilst others call for limitations upon competition. A risk exists that competition law will lead to the pursuit of "competition" in areas in which it is inappropriate.

Such risks are small

2.8.5 We highlight examples of the risks that could arise from the incorrect application of competition law. We conclude that these risks are small and certainly of insufficient significance to make a case against having competition law. The risks apply both to economies with a long experience of competition law and those new to competition law, although we acknowledge they are greater in the latter case given relative inexperience. The risks are inevitable in any law which requires judgement and in which very clear rules cannot be laid down in advance about every possible aspect of anti-competitive behaviour. Some, very few in practice, rules can be proscribed. This is both a strength and risk of competition law.

The difficulties in obtaining support for the enactment of competition law within a society

2.9 Problems in obtaining support

Competition law prompts a number of concerns

2.9.1 Support for competition requires that the genuine concerns need to be addressed. The concerns which have been expressed to us reflect:

- a potential fear of undue bureaucratic control of the market mechanism and concern from other agencies over loss of policy control;

- competition law is highly interventionist and very costly to the public and consumer. Over-regulation and unnecessary intervention by the Government would only stifle investment and business activities;

- competition legislation would increase the costs of doing business;

- competition legislation would either be too general so as to be unenforceable or too specific to discourage investment;

- vertical and horizontal agreements can be economically efficient and justifiable. Competition law could encourage unfounded or disruptive actions and be counter-productive; and

- competition law may undermine the ability of business to adapt quickly to market changes. It may prevent mergers and acquisitions which have no anti-competitive implications.

Many such concerns arise from an incomplete understanding of the law

2.9.2 Most of these concerns appear to arise from an incomplete understanding of competition law and how it is applied. Competition law and policy should only apply to areas of actual and potential market failure and, thus, it is not in conflict with the effective operation of the market mechanism. Studies suggest that a competition authority will typically generate greater benefits for the economy than its costs of operation. Far from stifling business and investment, a competitive environment in which firms could have a degree of certainty that they would not be subject to anti-competitive practices would lower the cost of capital and have a positive impact on investment. The regulatory cost would fall, in the main, upon those firms that seek to distort the competitive process.

Business uncertainty can be reduced through comprehensive guidelines

2.9.3 We accept that competition law will require the application of a rule of reason with little in the way of *per se* rules. This, it is argued, will increase uncertainty in that it is difficult for businesses to assess in advance what might be viewed as anti-competitive. The uncertainty can be addressed by competition law being accompanied by guidance on how it is to be applied. A competitive economy in which anti-competitive entry barriers are removed will allow for businesses to respond more quickly to the need for change than one in which entry barriers are prevalent. Whilst it is true that many entry barriers are due to government regulation, it is equally true that firms in a dominant position have every incentive to erect strategic barriers.

Developing economies have often faced common difficulties in implementing competition law

2.9.4 Despite what we would argue are the overwhelming benefits of competition law, it is the case that in many economies that have introduced such law the results have been disappointing due to the difficulties inherent in introducing such law. Those economies, particularly developing economies, which are "late comers" to the introduction of competition law, have broadly faced a common list of difficulties:
- political and bureaucratic resistance;
- a bad reputation for the public sector, excessive bureaucracy, corruption and a lack of transparency;
- inadequate judicial systems;
- weak professional and consumer groups; and
- a lack of resources and professional expertise within the competition authority.

2.9.5 Our experience suggests that in addressing these problems it is important to focus on three broad areas:
- clarity within society about the aims and objectives of competition law;
- advocacy of those aims across all sections of society; and
- developing confidence in the ability and institutional strength of the competition authority.

To an extent, these areas are related, clarity aids advocacy and advocacy is an important aspect of building confidence.

Clarity within society about the aims and objectives of competition law.

Education of consumers and producers is key

2.9.6 It is important that both consumers and producers are clear about what competition law can and cannot do. As part of this process, it will be necessary to educate both groups about the law. For consumers, a danger exists that the expectations for competition law are too high. Equally, in economies in which the non-government sector has been traditionally dominated by a few conglomerates a distrust of the "market system" is to be expected. Similarly, within the producer sector, tensions exist in opposite directions. Those with a position of economic and often political power will have an incentive to prevent the enactment of such laws in order to preserve their position. Given the above, a need exists to present the objectives of the law in "lay" rather than legal terms. We see this as part of the advocacy role discussed below. Clarity about the aims will require the existence of other laws, both to reassure society about real concerns that can aris e and to define the role of competition law.

Advocacy

Advocacy of the benefits of the law will promote confidence

2.9.7 Success in establishing a competition law will depend upon the skill and resources used in gaining the confidence and support of society. Advocacy of the benefits in general, and as a result of actions from applying the law, are central to this. The authority should not hesitate to publicise successful cases. Indeed the recipe for success might well be said to choose the initial cases with a view to the publicity benefit that might be obtained. Thus, the application of the law should initially be focused upon cases with little political opposition but with a high and direct consumer benefit.

An independent competition authority will promote confidence

2.9.8 Both consumers and producers will need to be assured that the law will be applied without discrimination. As part of building that confidence, the law will need to enshrine the independence of the authority and its head. Advocacy should initially be directed at specific interest groups such as consumer protection bodies and trade or wider business associations.

Transparency is key

2.9.9 Advocacy will not only be about the competition authority informing society about the benefits of competition law but also about being seen to apply the law correctly. Transparency and adherence to due process are central in developing the confidence of all groups of society.

Internal and external guidance will promote confidence

2.9.10 Our experience suggests that one important area of publicity is guidance on how the law is to be applied. Such guidance has a role in informing society in more detail than the "law" about, for example, what is and is not to be judged as anti-competitive behaviour and how the evidence will be assessed in reaching a conclusion. Equally, such guidance forms an aspect of the "internal procedures" manual of the competition authority.

Instituti onal strengthening

Status and transparency will attract quality staff

2.9.11 Self evidently, the competition authority needs to attract and retain high quality staff. The attraction of the competition authority will be enhanced by its profile and reputation within society. The independence, transparency and regard for due process all serve to create an attractive working environment for the high quality economists and lawyers required. However, many new competition authorities have suffered from high staff turnover that has weakened them.

Universities are a source of advice and quality graduates

2.9.12 Such a high staff turnover can in part be countered by building links with universities. The universities should be seen as sources of both technical advice and of new graduates. More importantly, the consequences of staff turnover can in part be addressed by training both provided internally and by external advisers.

Internal training

Guidance manuals provide training

2.9.13 Guidance manuals would provide new staff with access to the approach to be adopted. These should be supported by case histories so that the collective memory of the authority is available.

External training

Role of advisers and international agencies in building support and institutions

External advisers can provide support

2.9.14 Experience suggests that external advisers have helped greatly in the process of building support. They can advise on the best system given the circumstances of the particular economy. Advisers can assist with institution building, in terms of assessing priorities, the development of suitable organisational, management and accounting structures.

Effective training is case based

2.9.15 Formal training provided by outside experts needs to be carefully structured. Many new competition authorities initially receive a somewhat "academic" training in the relevant law and economics but what they lack is the subsequent confidence to apply these tools in practice. Our experience suggests that the most effective training is case-based, preferably, from actual cases in the particular economies.

The judiciary or tribunal should be trained

2.9.16 A key area for training is the judiciary or administrative tribunal that is required to reach the decision on cases. In several economies, we have seen reluctance in applying competition law because of the fear on behalf of the competition authority of losing cases. This fear stems from a lack of experience in the judiciary of competition cases and of their difficulty in dealing, not with issues of law per se, but with cases that require economic judgement. A vicious circle is created in which the courts never gain experience and cases are never sent. Whilst this is an exaggeration, it has been a factor constraining the application of competition law in many countries.

Advisers can also inform the business community

2.9.17 Finally, external advisers can play an important role in initial advocacy, by informing the business community about the processes involved in competition law and the benefits to be obtained as well as carrying out competition audits for companies to ensure that their current practices are not anti-competitive.

In sum, time and resources are required to advocate the cause of competition

2.9.18 We recognise that the process of obtaining support for competition law and its application is difficult. Support for the law is merely the first stage. Continuing efforts and resources have to be made available to ensure that the competition authority gains support in its work. Some valuable lessons have been learnt on what is required for this. Competition authorities must devote time and resources to advocating the cause of competition and their role and success in achieving this.

Law and Institutional Structure

Two differing forms of law are available: prohibitive or administrative

2.9.19 We provide some observations, drawn from our wider experience, on the nature of the law and institutions required to successfully implement competition law. Broadly, two forms of law are available; the prohibition model as favoured in the EU and much of Eastern Europe or the administrative model. In the prohibition model, the law attempts to say what is likely to be anti-competitive leaving the Courts to enforce the law and set precedent by case law. Under the administrative model more discretion is left to the competition authority to both enforce the law and to set the precedent, perhaps by published guidelines.

The appropriate mix is tailored to the economy

2.9.20 It is our view that no unique model exists for all economies. The mix of institutions and people has to be tailored to the particular economy. No system will work effectively without the suitably qualified people and the necessary political support. However, the appropriate system for a given economy can make much difference. Table 2.1 illustrates the broad relationships which seem to emerge from our experience.

Table 2.1

Conditions	Institution	Policy Emphasis
Independent and expert judiciary	**Specialist courts**	**Prohibition of cartels, monopoly abuse and mergers which create monopolies, powers to impose fines etc.**
Political will, but no independent courts/tribunals	**Ministries, with co-ordinating mechanism**	**Introducing competition upon privatisation, through external trade, through de-regulation and lower entry barriers based upon government regulations**
Political will and tradition of independent tribunals	**Anti-trust authority**	**Case-by-case approach to mergers, monopolies and cartels**
No political will	**None**	**No progress likely until highest level of government convinced of need for competition or coerced by conditionality or desire to join WTO etc**

2.9.21 For example, a prohibition system in which cartels and monopoly abuse are subject to legal penalties would seem to require a tradition of an independent judiciary. Such a system could require specialist courts or be administered by the "ordinary courts". We would favour the former but recognise that, in many countries, ordinary courts carry out this task. In contrast the administrative model has an anti-trust authority countering anti-competitive issues by powers to alter behaviour and perhaps structure but not to levy fines or impose imprisonment. A tradition of independent tribunals would be required to make such a system workable.

2.9.22 Clearly, the distinction between the models can become blurred in practice. It is often the case that an anti-trust authority will have powers to levy fines within a prohibition system. However, such decisions will be potentially subject to appeal to a specialist or ordinary court of law.

2.10 Other factors influencing the implementation of competition law and moves toward increased competition within an economy

We identify factors which hinder competition

2.10.1 Many factors will influence the effectiveness of competition law in creating a more competitive economy. We attempt to draw these factors together in seeking to identify what might be required for the development of greater competition. The data which we use for this is shown in Annex 1.

2.10.2 The data we use is taken from a survey of business executives published in the Global Competitiveness Report for 1997. Given this, we are able to identify areas of perceived weakness of competition within the APEC economies. We note that, in the 4 case study economies, their Action Plans seek to address some of these weaknesses.

Chapter 3

Competition law and the objectives of competition policy

3.1 Scope and links of competition law with other policies

3.1.1 Competition policy is generally regarded as that set of public policy tools which promote the efficient allocation of resources. In this way, the correct incentives to allow the start-up and growth of efficient firms are created. Such efficient firms are required to supply the goods and services needed by an economy as well as engaging in trade and competition in international markets. This is an impossible task for one set of policy tools alone. At best, competition policy can be seen as just one of a set of policy tools required to create an efficient market economy. Competition policy alone cannot achieve this goal as the experience of many in transition shows.[1]

3.1.2 Nevertheless, competition policy is regarded by many as forming one important element in building an efficient market economy. The role of this paper is to explore this point of view by considering some specific issues in detail. However, before doing so it is helpful to clarify some definitional issues. Above, we have defined competition policy in very broad terms; in contrast, competition law is seen as a narrow set of rules which cover the conduct of firms. In practice, the distinction between competition policy and the application of competition law turns, in part, upon the scope of the law and the powers of the competition authority.

3.1.3 For example, where a competition authority has power over both private and government firms and the ability to effectively veto any government proposals on competition grounds, i.e. privatisation structure, then competition law would cover a broad area of what might be regarded as competition policy. In practice, there are many government policies which are traditionally outside the scope of competition law but which have an effect on how markets function and which come within the remit of competition policy. The degree to which competition policy and the application of competition law differ varies between economies. For example, in Sweden, the competition authority has a duty to report to the parliament anti-competitive effects of any government policies whilst, at the other extreme, the role of the competition authority and the extent of competition law is very narrowly proscribed in many economies.

3.1.4 Competition law cannot be considered in an isolated manner. The law itself can never guarantee that markets will function effectively unless a broad range of other government policies conform to basic market principles. Trade policy, industrial policy, privatisation, deregulation, regional policy and social policy all need to be conducted in a manner compatible with the market mechanism for an economy to function as efficiently as possible. In saying this, we do not deny that a role exists for governments to intervene in the market mechanism. At a theoretical level, given an initial distribution of resources, "perfect competition" will give rise to the most efficient allocation of those resources. The actual distribution of resources is a matter for government policy. This dichotomy between efficiency and distribution depends upon some strict theoretical conditions and is, in practice, difficult for governments to maintain[2]. For example, it is widely recognised that privatisation and deregulation can give rise to substantial efficiency benefits. However, in terms of social policy, privatisation and deregulation will not receive political support if the population regards the outcome as socially inequitable. Without such support, social unrest may develop and this will have an impact on the wider economy. The recent history in some Latin American economies indicates that neglect of the social side of an economy's development can endanger the ability to achieve efficiency gains from economic reforms. An efficiently operating and successful economy would seem a prerequisite for satisfactory social policies, however, experience suggests that the opposite is equally true.

[1] See Stiglitz (1999).

[2] Each Pareto optimal point is associated with a particular allocation of resources, to move from one allocation to another requires the use of lump sum taxes and transfers, leaving the "market" to determine prices. In practice, governments for a variety of reasons will be involved in the setting of marginal taxes and transfers which have implications for prices.

3.1.5 It is our view that these theoretical and practical issues do not negate the benefits of competition but rather confirm that the benefits will not arise unless other government policies operate in a complementary manner.

3.1.6 For example, in Mexico, the FCC exclusively applies competition law with sector-specific laws being applied by regulatory authorities. However, the FCC has an important role in implementation of price cap regulations and in the allocation of licences and permits. This recognises the authority and independence of the FCC and its expertise in determining market power and the existence of effective competition. The commission has contributed to the privatisation of the railways and satellites, the regulations to implement Civil Aviation and Airports Laws, regulations on Satellite Communications and the Local Telephony Rules. The FCC also participates in inter-ministerial committees such as the Privatisation Commission, and Consulting Committee for the Opening of Local Telephone Services. Additionally, the FCC also co-ordinated with the Foreign Trade Commission and the National Standardisation Commission, facilitating greater co-ordination on competition policy matters connected with industrial development, trade, consumer protection and environmental policy.

3.1.7 In Korea, the Chairman of the KFTC is also the Head of the Economic Regulatory Reform Committee, comprising 5 Government ministries - Finance and Economy, Ministry of Trade, Industry and Energy, Ministry of Government Administration, Ministry of Legislation and Office of the Prime Minister.

The Chairman of the KFTC has the right to present opinions at Cabinet meetings and economic ministers meetings. Areas which have been changed due to such intervention include:

- medical and pharmaceutical items subject to the application of the “Standard Resale price system” were drastically reduced;
- regulations relating to limits on distance between gas stations were alleviated;
- regulations relating to the liquor industry either abolished or eased;
- in the construction sector, the maximum amount of subcontracting for a business is determined by performance in the previous year. Thus, companies are deprived of the opportunity to land bigger contracts than in the previous year. The Commission objected to this on the grounds of competition.

3.1.8 In contrast, in the Philippines which does not yet have a competition commission, the telecommunications privatisation programme was not overseen by an independent body but was handled by the Office of Transport and Communication, under the President’s Office. With regards to connection standards, many companies were laggards and did not comply fully with the law. A competition authority backed by a competition law would have perhaps been able to influence the privatisation process to ensure that all the available benefits were obtained.

3.2 Objectives of competition law

3.2.1 A somewhat sterile debate has arisen over the objectives of competition law. Some commentators seek to draw a distinction between laws that have as their objective a "narrow concept of economic efficiency" and those which seek to operate in the "broad public interest". The application of competition law cannot operate in a political vacuum. Thus, the apparent purity of economic efficiency will be compromised by the need to relate it to other government policies. Some differences between economies exist over where this compromise takes place, either within the competition authority and within the scope of the law, as typically found within the public interest model or outside of the law and authority by the government (or another ministry).

3.2.2 In the broader public interest approach, it is possible for economic analysis to be used to consider non-efficiency aspects of the public interest, for example, employment effects or income distribution effects. If this wider analysis takes place within the competition authority, it can be balanced alongside the competition effects in an open and transparent manner. As such, the process of considering the "public interest" may in fact be more transparent and open than if the competition authority merely had a responsibility for economic efficiency and politicians had responsibility for broader public interest issues.

3.2.3 Some critics take the view that competition authorities might lack the skills to carry out a broad public interest assessment. Additionally, it might be reasonably argued that it is an unfair burden upon non-elected officials within a competition authority to consider the essentially political issues which comprise the broader public interest. Additionally, such responsibilities may compromise the independence of the competition authority by exposing it to the political pressures associated with the public interest.

3.2.4 Whilst, in our view, the disadvantages of the public interest model are overstated, our belief is that it would be wrong to be overly prescriptive in suggesting that one model is always generally better. Experience of many economies suggests that the culture and legal forms of each individual economy will determine the institutions and institutional structure that work best in that context. All that matters is that competition objectives, however defined, are pursued in an open and transparent manner and thus subject to the normal checks and balances inherent within the political and legal structure of the economy in question.

3.2.5 In what follows, we will interpret competition law objectives as being driven by economic efficiency whilst recognising that, in many economies, the objectives will be wider. Economic efficiency is almost invariably adjusted for issues of income distribution. Strict application of economic efficiency would make no distinction between producer and consumer surplus. However, in practice, most competition authorities attach a lesser weight to producer surplus. This might be because they regard consumer surplus as accruing only to domestic consumers whereas a proportion of profits (producer surplus) will "leak" overseas. Often the weighting is applied implicitly, for example, firms which claim that cost savings (increased producer surplus) will arise from a merger or agreement are often required to demonstrate or guarantee, how the cost savings are to be passed to consumers by way of lower prices. All this shows is that even those economies that follow the "economic efficiency" model will typically take on board some aspects of the broader public interest within the application of their competition laws. For the purpose of the discussion which follows, we take the objectives of competition law as being overall economic efficiency whilst recognising that this, in practice, involves aspects of income distribution.

3.3 Framework for competition law

3.3.1 The scope of this project requires us to assess the influence of competition law upon other factors. To do this, we need to outline the form which competition law might in practice take. For this purpose, we take as a benchmark the framework recently published by The World Bank and OECD[3]. This is set out briefly in Annex 2. Annex 3 shows, in summary, how competition laws in the sample economies match this framework.

[3] World Bank/OECD (1999). The framework also usefully covers in detail the objectives of competition policy as well as many other topics. David Elliott, one of the authors of this report, was part of the World Bank/OECD team that produced the competition law framework.

Chapter 4

<u>Are competition laws essential to achieve competition policy objectives, particularly given open economies?</u>

4.1 Competition and trade policies as substitutes or complements – theory

4.1.1 The issue here is whether competition law and liberal trade policies are complements or substitutes. The reforms undertaken in the transition economies involved the implementation of a liberal trade regime in the belief that this would expose domestic firms to more competitive pressure than could reasonably be expected from existing domestic rivalry. The view implies a degree of substitution between competition policy and trade liberalisation and follows from standard neo-classical trade theory.

4.1.2 The alternative view that trade liberalisation and competition law are complements has been advanced by many commentators. For example, the NAFTA trade agreement specifically acknowledges that a non-discriminatory and effective competition law has a role to play in generating the gains from liberalised trade.

4.1.3 Some economies have taken the view that liberalising trade will create incentives for existing domestic firms to seek to erect new barriers to competitors to preserve their existing position. Given this, a strong competition policy, perhaps with an emphasis upon trade aspects, is required again to ensure the gains from trade do arise. This view is perhaps best illustrated by the parallel development of the European Common Market and its associated competition law, which has concentrated on cases involving market access and the creation of a "common market".

4.1.4 Whether liberalised trade policy and competition policy are complements or substitutes can be examined at both a theoretical and at an empirical level. The rational for tariff policy is that to some extent tariffs serve to protect domestic firms by raising the prices of imported products. Thus, the removal of a tariff would in theory lead to lower import prices and increased competition for domestic producers[4]. Standard neo-classical trade theory leads to the result that the extent to which domestic prices are raised by the tariff depends on the slopes of the various supply and demand curves. At the most simplistic level, the more inelastic demand, the greater the effect on price from removing the tariff. This gives the pleasing result that trade liberalisation has the greater effect where the market is least competitive. Hence, trade liberalisation is seen as a direct substitute for competition policy[5].

4.1.5 Clearly, the extent to which trade and competition policy are substitutes will vary with the nature of the product. Tradable goods with low transport costs are more likely to generate a substitution effect than goods which are more difficult to trade such as services, which are often location specific. Also, tariff changes themselves may be ineffective if substantial non-tariff barriers remain. Additionally, access to a market might be highly dependent upon access to the distribution and retail network. Vertical agreements and other contractual relationships between domestic producers and distributors or retailers may well limit the ability of importers to compete[6]. All this serves to weaken the strength and general applicability of the substitution between trade and competition policy derived from standard neo-classical trade theory.

4.1.6 However, once we move away from the standard neo-classical models and allow for strategic behaviour on the part of either domestic or foreign firms then the substitution case is further weakened. Strategic behaviour by domestic firms is the main cause of concern for those whose argue that trade and competition policies are complementary. In this approach, the state of

[4] We take liberalised trade policies to mean any policy directed at tariff or non-tariff barriers, which lowers the cost of market access for importers.
[5] For a survey of these simply models, see Hazledine (1991).
[6] See also Klemperer (1995) who provides some additional theoretical reasons why import prices will be insensitive to exchange rates and tariffs based upon a consideration of switching costs.

domestic rivalry or collusion is seen as being determined by the extent of trade policy, and not as being exogenous as in the competitive model.

4.1.7 It would seem reasonable to presume that a liberalised trade policy would have a destabilising effect on domestic cartels both by reducing the possibility of "monopoly profit" from the cartelisation and reducing the ability to detect cheating[7]. This view is supported by studies[8] within the EU which found that several industries that had successfully obtained anti-dumping duties were subsequently found to be operating a cartel. An alternative theoretical proposition is that trade protection allows potentially collusive domestic firms to earn high profits without incurring the costs necessary to maintain a collusive agreement. Removal of trade protection via liberalisation thus increases the incentive for the firms to formally collude to maintain their profitability.

4.1.8 Extending the strategic behaviour to both foreign and domestic firms further weakens the effect of trade liberalisation upon competition. Clearly, the impact of trade liberalisation is limited to the extent that potential importers are members of an international cartel but beyond this we can examine models of the interaction between domestic and importing firms. For example, if the product in question is subject to bilateral trade between two economies. In this case, the importing firm's reaction to trade liberalisation (say a tariff cut) will be tempered by the reaction it expects from importers into its own domestic market. An aggressive response in a foreign market (to the incumbent domestic firms) may well trigger an aggressive response in one's own market by the same firms. The nature of the strategic behaviour assumed would determine the effect that any theoretical model generates. Nevertheless, such models do allow us to calibrate the likely effects given the assumed underlying behaviour.

4.1.9 For example, we might assume that foreign and domestic firms compete in a homogenous Cournot oligopoly framework[9]. Then, the elasticity of domestic price with respect to changes in the costs of importing firms (the latter can be interpreted as a tariff change)[10] is low. For example, given an import market share of say 20% and a ratio of marginal cost for the foreign firm to price of 0.6, a 20% reduction in tariffs will reduce domestic prices by only 2.4%. Thus, the extent to which trade and competition policy can be viewed as substitutes would in this model appear very weak.

4.1.10 Not all competition policy has a direct effect on entry barriers and, hence, price, and some authors have examined the effects on the incentives to merger, which arise from trade liberalisation. Ross[11] has argued that liberalising trade reduces the incentive to merger since the gains can no longer be internalised i.e. they spillover to the newly entering foreign firms. For example, if a merger allowed domestic firms to charge higher prices, this would also allow importers to obtain higher prices than if the merger had not taken place. Equally, one might argue that a response by domestic firms to a liberal trade regime would be to reduce the level of domestic competition, via merger, so as to leave the extent of competition, which would now include imports, unchanged.

4.1.11 Neven and Seabright[12] consider a somewhat stylised theoretical model in which two foreign and two domestic firms compete in a Cournot fashion. Marginal costs are similar for both domestic and foreign firms, both falling as production or capacity rises, but at all levels of output foreign firms have a higher (constant) level of marginal cost. This constant difference is interpreted as the trade cost or tariff. Neven and Seabright find that the incentives to merger are high when the marginal costs of the merged firm (which can be any two of the four firms) is close to that of

[7] i.e. changes in market share and sales levels could be wrongly attributed to increased sales by importers rather than to a member of the cartel gaining sales by selling at a lower price than agreed by the cartel.
[8] See Messerlin (1990).
[9] The Cournot model of strategic oligopolistic behaviour requires each firm to select its profit maximising output given its expectations (conjectures) about the aggregate output of its rivals. See OECD (1993) for a relatively non-technical explanation of other forms of strategic behaviour and their application to international trade.
[10] See Dornbush (1987). His original result is cast in terms of exchange rate rather than import price but the read over to the effect of a tariff cut is clear.
[11] Ross (1988)
[12] Neven and Seabright (1997)

domestic firms and trade costs are "high". The incentive falls as trade costs falls. Neven and Seabright conclude that trade liberalisation may not necessarily increase merger activity.

4.1.12 At the macro-economic level[13], some strong arguments exist for trade and competition policy being complements. All the weight of the evidence shows that monopolists, or more correctly firms who do not operate in a competitive market, have both high prices and higher costs[14]. Simple welfare economics shows that the effects of high costs are likely to be substantially larger than the traditional welfare losses from high prices. If a lack of domestic competition is present in an economy which is then subject to trade liberalisation, it then becomes an issue about how the macro-economy adjusts to the exposure of high cost domestic firms to international competition. If the domestic firms fail to raise their efficiency, then the currency is likely to depreciate, offsetting the effects of trade liberalisation. In Mexico, for example, it has been argued that the impact of the tariff reductions that arose from the NAFTA agreement was more than eroded by currency depreciation. Competition policy which increases domestic rivalry which in turn provides incentives to lower costs can thus be seen as important to the success of any trade liberalisation measures.

4.1.13 In conclusion, the theoretical discussion perhaps cannot fully resolve the issue of whether trade policy and competition policy are substitutes or complements, although a stronger case would appear to exist for the latter. The substitution models rely on a form of strategic behaviour that is competitive (typically Cournot) and, as such, presume a substitution effect. In the formal models, the difference between trade and competition policy being seen as either substitutes or complements turns very much on the strategic behaviour assumed by both domestic and foreign firms. Much of the theoretical discussion would seem to start from an assumption about what this strategic behaviour might be and, as such, is of limited use in distinguishing the opposing viewpoints. However, some guidance would seem to emerge. The theoretical models that assume the substitution hypothesis would suggest that the substitution effect is, in practice, likely to be weak. We also know that a large proportion of goods and services are non-tradable. Thus we can conclude that the substitution effect, if it exists, is likely to be limited in both scale and scope.

4.2 Competition and trade policies as substitutes or complements – evidence

4.2.1 Much of the empirical evidence arises from research into the liberalisation of trade between the US and Canada or from the creation of the European Common Market. Hazledine (1991) surveys the former and concludes that a tariff cut will not be fully reflected in changes in domestic prices and that a linkage appears to exist only where the domestic market is highly concentrated. A significant problem with the US and Canadian studies is that both economies had an extensive competition law which was rigorously enforced for many years prior to the reduction of tariff barriers between them.

4.2.2 The studies based upon the experience of the Common Market are of more direct relevance. Many of the economies which originally formed the EEC (now EU) had either no competition law or law that was applied very weakly, the exception being West Germany. This formed the background to the gradual erosion of internal tariff barriers between the economies of the Common Market and the development and application of community wide competition law.[15] Yamawaki, Sleuwaegen and Weiss (1989) have studied the formative years of the EU. They examined the change in prices that arose in West Germany between 1955/57 and 1969/71. Price changes were found to be determined in part by changes in domestic concentration but not changes in wider EU concentration[16]. They acknowledge some difficulties over their concentration

[13] The important issue of how the effectiveness of fiscal and monetary policy are influenced by imperfect competition is beyond the scope of this paper, see Dixon and Rankin (1994) for a survey of this topic. Other important papers on macro-economics and competition policy are Barry and O'Toole (1998) and van Bergeuk, Haffner and Waasdorp (1993).

[14] For a survey of the relevant theoretical and empirical literature, see Nickel (1996) and UNCTAD (1997).

[15] In practice, currently to become a member or associate member of the EU one of the de facto entrance requirements is a domestic competition policy.

[16] Changes in EU concentration being measured as the difference between the EU-wide 4 four firm concentration ratio in 1978 and the domestic concentration ration in 1963.

measures and that internal EU tariffs were not fully reduced until 1968 but argue that the results show that liberalisation had little short-term effect.

4.2.3 Additionally, they considered the changes in price cost margins between 1963 and 1978 for 5 EU economies.[17] Broadly, the results show that increases in EU-wide concentration were related to increases in the price cost margins whilst rises in the share of imports in sales reduced price cost margins. Changes in domestic concentration were not significant over this longer period. They interpret the result as evidence that as the internal Common Market became increasingly liberalised the oligopolistic interdependence between firms grew over time and that this offset the effect of increased trade. Their results would seem to confirm[18] the need for complementary competition law enforcement despite the lowering of tariff barriers and the need to apply this law to both domestic and importing firms.

4.2.4 Nickel[19] (1996) finds that both increased domestic competition and increased import competition are significantly related to productivity growth for UK firms. This relationship between efficiency and competition is confirmed in many other studies, for example, Scherer (1965) and Caves et al (1992) and Caves (1989) for a survey. Both Scherer and Caves argue that domestic competition provides a greater spur to efficiency than foreign competition. Most notably this last thought has been echoed in the much cited work of Porter[20] (1990) who argues that competition among domestic firms was often found to have a relatively more beneficial effect than foreign competition because of the more intense rivalry which exists between domestic firms. The latter arises from their common (domestic) conditions of operation.

4.2.5 Apparently, at odds with this large body of research results is the often-referenced work of MacDonald (1994) on US firms. He finds that productivity growth is related to high levels of initial concentration and that increased import competition had raised productivity growth in highly concentrated industries during the period between 1975 and 1987. Macdonald's work would seem to suffer from statistical[21] and conceptual problems. If competition were a driving force for efficiency, then one would expect that those firms, who are less competitive and have been for some time, would have the greatest potential for efficiency gains. Thus, one would expect a relationship between the initial concentration level and subsequent changes in productivity but the relationship would not be a causal one. Viewed in this light, Macdonald does not appear to contradict the broad thrust of other work in this area.

4.2.6 Specific studies in the context of developing economies yield less uniform conclusions. Rugayah[22] (1996) in a study of Malaysian manufacturing industry finds that the price cost margin is greater the higher the level of concentration, the higher the share of imports in sales and the greater the extent of foreign investment. This suggest that importers and foreign investors are attracted by profitable markets but do not seek to undercut domestic prices. Again, some support is given for the view that given the nature of oligopolistic competition,[23] imports are not to be seen as substitutes and thus competition and trade liberalisation should be seen as complements.

4.2.7 Gan and Tham (1977) consider market structure and price cost margins in Malaysia. They find that price cost margins increase as a) the average rate of (effective) tariff protection rises, b) the ratio of exports to industry sales rises and c) the extent to which industries were closed to investment.[24] The higher the level of foreign investment in an industry the lower the price cost margins. Price cost margins were not related to their measure of "concentration". However, the

[17] Study based upon 47 industries in each of France, West Germany, Belgium, Italy and the Netherlands.
[18] The result would also seem to confirm the approach of some of the theoretical models discussed earlier.
[19] Nickell (1996) also provides a survey of additional empirical work not reported here all which support the line taken in this paragraph.
[20] Both Caves and Porter include Japan and Korea within their sample economies.
[21] If one works back from his estimated equation to an underlying production function , that production function does not seem tenable.
[22] This article also provides a summary of structure, conduct, and performance models applied to developing economies.
[23] Most of the industries in Rugayah's sample are highly concentrated.
[24] For the period covered by the study 1968-1971, the Malaysian government controlled private investment and effectively prevented entry into certain industries.

measure was based upon the share of the largest 8 plants (rather than the share of the largest 8 firms) in total sales and cannot be interpreted as a measure of market dominance.

4.2.8 House (1973) in a study of Kenya also used a plant based measure of "concentration". He finds price cost margins increase when this measure of concentration increases. Price cost margins were lower the greater the proportion of exports in total output.

4.2.9 Chou (1986) in a detailed study of the Chinese Taipei manufacturing sector found price cost margins increased as both concentration and the share of publicly owned firms in each industry increased. The share of imports in total sales and the number of foreign owned firms (as a % of all firms in the industry) both served to reduce price cost margins. Chou also considered the determinants of exports. The share of exports in total industry sales was not related to either concentration or profitability. It was positively related to the extent of foreign direct investment and negatively related to the capital labour ratio and the percentage of skilled workers.

4.2.10 Dutz and Hayri (1998) explore the determinants of growth for developing economies. Their research seeks to explain real GNP growth for over 100 economies between 1986 and 1995. Their procedure was to estimate standard growth models across the sample and, then, to examine the relationship between the residuals[25] of the growth regressions and a variety of competition measures. They find that in the basic growth model that trade liberalisation leads to higher of growth. At the next stage of their analysis, they find that structural measures of competition i.e. measures of market dominance and overall concentration, do not provide any additional explanation. Conversely, measures relating to the existence of competition law and the qualitative effectiveness of anti-trust policy are significant contributors to growth. They conclude that for "most economies a strong link between competition and growth exists" after controlling for the effects of trade liberalisation and other factors. This suggests that competition law has a strong complementary role in stimulating growth beyond the liberalisation of trade. However, the analysis of a sub-sample of the "Asian tiger economies" shows that the wider results do not hold for this group. Some difficulties arise in interpreting this result since of the sample Asian economies only one, Korea, has competition law. The extent to which the other economies in the sub-sample are "competitive" would seem to have been picked up by other variables in their analysis.

4.2.11 We have not considered the impact of competition law upon other areas of competition policy such as privatisation and deregulation. We briefly touch upon the privatisation issue in footnote 38 below. As for deregulation, many examples exist of how deregulatory measures designed to stimulate competition have proved ineffective and have subsequently required action based upon competition law. The evidence suggests that competition law and broader competition policy in these areas are strong complements, the success of each depends upon the other. However, this subject area contains a large literature and to adequately reflect that important literature, beyond the brief comments above, would require a separate paper.

4.3 Some case examples of the complementary effects of competition laws on trade policy

4.3.1 In Japan, it has long been recognised that trade liberalisation *per se* will be insufficient. Domestic companies will have a strategic incentive to seek to overcome the import competition offered by liberalisation. In such cases, competition law may play a role of enhancing free trade and, thus, reduce the price of goods in the importing country. Specific case examples from Japan include:

- Soda Ash - the JFTC passed a recommendation decision ordering 4 Japanese companies not to decide upon the total quantity of natural soda ash, the price of imports, the allocation rates among companies or the trading partners for import. After the decision, the market for soda ash changed in the following way:
  - an increase in the quantity imported by as much as 8 times in the following 4 years;
  - significant changes in market shares among the soda ash manufacturers;
  - significant variation amongst importers in the increase in the quantity of their imports and the number of trading partners; and

[25] i.e that element of GNP growth which remained unexplained by their standard model.

- rapid and drastic drops in the price of soda ash.

- Soy Bean - a Japanese chemical company licensed its know-how for production of epoxidised soy bean oil to a Chinese Taipei company. In a secret memo, the Japanese company restricted the Chinese Taipei company from exporting the licensed products to Japan even after the contract expired. The JFTC found this to be illegal and ordered the firm to eliminate the restriction in Oct 1995.

4.3.2 More generally, the JFTC have published guidelines in respect of parallel imports. The JFTC have published the "Guidelines concerning distribution systems and business practices" in order to identify anti-competitive practices of Japanese sole import distribution agents, which seek to pressure exporters not to sell products to Japanese parallel importers. In cases such as the Hungarian porcelain (1996), German pianos (1996) and US ice-cream (1997), the JFTC judged that actions taken by the sole import distribution agents in Japan to block parallel imports were violating the Anti-Monopoly Act. As a result, barriers to parallel imports were eliminated.

4.3.3 Similarly in Mexico, the FCC has demonstrated that it will act against monopolistic practices in domestic markets that inhibit the access of foreign companies. For example, in 1995 it fined two manufacturers of domestic appliances for inducing retailers not to sell domestic appliances produced outside the NAFTA area, thus especially impacting upon two Korean exporters. In turn, the FCC received a complaint from a Mexican firm that a US competitor dominating the US market had engaged in a loyalty programme with retailers, thus negatively affecting the Mexican firm's exports.

4.3.4 Other examples exist in Latin America in which anti-competitive practices have sought to prevent trade. In Colombia the leading brewer has allegedly geographic market sharing agreements with existing and potential competitors in neighbouring economies and has acquired all the breweries in Ecuador. Also in Colombia, a leading US biscuit manufacturer found it difficult to enter the market due to exclusive distribution clauses between the dominant local producer and major retailers. Instead, the US firm has had to enter into licensing and joint market arrangements with the dominant firm.

4.3.5 We note that in many economies the importation and marketing of many products remain with state designated monopolies. Given this, any trade liberalisation is likely to be ineffective without the complementary introduction of domestic competition.

4.3.6 Whilst restraints upon distribution have in several cases arisen in reaction to trade liberalisation, we would not wish to give the impression that vertical restraints of this type are always anti-competitive. Most competition authorities treat the assessment of vertical restraints under a rule of reason. That is, each case is assessed individually by considering both the possible harm caused to competition and any benefits which might arise.

Chapter 5

How the introduction of competition laws will affect the international competitiveness of domestic firms

5.1 Introduction

5.1.1 It is not the purpose of this section to explore the merits of government policies directed at improving competitiveness. We take policies directed at improving competitiveness as given and merely seek to consider the impact of the application of competition law on the objectives of these policies.

5.1.2 The debate in this area has little or no underlying theory. Given this, we start from an examination of how some critics have perceived the likely impact of competition law and then consider the empirical relevance of these assertions.

5.2 Competition law as a danger to competitiveness

5.2.1 The underlying position of those who see competition law as a danger to competitiveness is that firms need to be large enough to compete in international markets and any such law would hinder the creation of large firms. Competition law is also seen by these critics to limit the ability of domestic firms to become internationally competitive because it makes it difficult to co-ordinate their business policies and strategies with domestic rivals by agreement. Equally a law directed at the control of mergers would also hinder strategic amalgamations necessary to obtain international competitiveness. Additionally the risks, uncertainties and lower profit rates associated with a competitive domestic market would prevent domestic firms from engaging in sufficient R&D, innovation and improvements in product quality.

5.2.2 The key issues that seem to emerge from these concerns are:

a) the role of economies of scale, minimum efficient scale and optimal number of firms for competitiveness;
b) the relationship between size and efficiency;
c) the role of agreements, particularly export agreements in export success;
d) the evidence on mergers and efficiency; and
e) the evidence on the relationship between R&D and innovation with firm size.

5.3 Sources of competitiveness

5.3.1 Some general observations are perhaps appropriate before considering each of the above issues in detail. Many of the issues relate to a perceived cost advantage in respect of competitiveness that arises from size per se. Two points are relevant here. Firstly recent research[26] (on OECD economies) suggests that cost differences are perhaps less important in determining competitiveness than would appear from a consideration of standard international trade theory. This research indicates that industries which had the largest increases in global competitiveness also showed the greatest increase in the sensitivity of relative labour costs to their share of exports. However the underlying trend in competitiveness was mainly determined by factors such as the quality of the labour force, an economy's education system and the structure of corporate governance. Competition law will have less impact on those factors, which appear to determine underlying competitiveness.

5.3.2 Secondly, competition law, in theory and if correctly applied[27], has no bias against size or dominance per se but only against the abuse of that dominance. That said, a law designed to examine and prohibit anti-competitive mergers is by its nature concerned with the expected effects arising from mergers. Such law is predicated upon the belief that dominance in a given market will

[26] Carlin, Glyn and van Reenen (1997)
[27] We consider below in the section on the risks of competition law the dangers of incorrect application.

create problems for competition and harm to welfare. The expected effects arising from a given merger will, to an extent, be influenced by this general belief.

5.4 The role of economies of scale, minimum efficient scale and optimal number of firms for competitiveness

5.4.1 Critics of competition law have argued that because of the need to lower costs for competitiveness, plants have to be of at least minimum efficient scale (mes). Thus a relatively small domestic market will support only one or a few mes plants and a "natural monopoly" or oligopoly could exist. In such circumstances competition law that effectively prevented the emergence of such structures would by definition harm competitiveness. However one needs to consider the market in which firms actually or potentially operate. This could be wider than just the domestic market. The total demand might well support several plants of mes size. Whilst the size and ability to develop export markets will always be problematic it nevertheless is reasonable for many tradeable goods to consider mes in the context of a market larger than just domestic demand[28]. Such considerations lead to the view that a policy designed to prevent domestic dominance, by one or a few firms, need not necessarily harm the ability of those firms to achieve an efficient scale of production.

5.4.2 The empirical[29] work on mes suggests that it is generally small when compared to market size and that the penalties from operating at less than mes do not become significant until plant size is relatively small[30]. Additionally Scherer and others (1975) [31] find that when considered across economies actual plant size is strongly related to national market size. Given that mes is "small" this result cannot follow from economies all striving to be as near as possible (to avoid the cost penalty of less than mes) to some very large mes. Essentially it suggests that actual plant sizes are not driven by mes but by a random process. Given this, one should be cautious about much of the empirical work which shows a relationship between "mes" and concentration. The "mes" in much empirical work is based upon the actual distribution of plant sizes. For example Rugayah (1996) uses a measure based upon the average size of the largest plants which supply 50% of industry output. All that such work tells us is that a correlation exists between large plants and concentration, which is in itself a statistical truism.

5.4.3 Of more interest Scherer (1975) found that actual plant size relative to mes increases significantly with an industry's access to export markets. This result suggests that where the national market might provide a barrier to obtaining mes, export opportunities have in practice been exploited to ensure scale economies are obtained. Equally it could be seen as further support for a random process determining plant sizes.

5.4.4 Many other researchers[32] have found that exports in an industry are concentrated in the largest plants. This might be because of the need to access exports to achieve economies of scale. This research result has typically been found in the US and Western European economies but given that mes is likely to be small relative to the domestic market size in these economies the argument seems unlikely. It is more likely that significant fixed costs and risks are associated with exporting which give rise to higher optimal firm sizes in export industries[33]. Of course we would expect to

[28] What we are suggesting is that the standard anti-trust analysis to define the "relevant market" is carried out.
[29] See Scherer et al (1975) for the most thorough study on mes. The research considers plant operation in 12 industries across 6 large industrial nations. Detailed engineering estimates were made of the cost curves.
[30] What we are saying is that cost curves are near "L" shaped and that over a large range of outputs unit costs do not change significantly. This result follows principally from the work of Scherer et al. Using different techniques Elliott and Gleed (1982) found for the vast majority of industries in the UK that the ranges of plant sizes operating in each industry (after excluding the smallest sized plants) were consistent with a common and constant cost curve.
[31] Also Eastman and Stykolt (1967) and Pryor (1972)
[32] See Caves (1989) and references therein
[33] This is the rationale for export credit insurance in which the government or a large insurance company is more able to pool risks than a single exporter. Joint export sales agents can achieve the combining of fixed costs.

find large firms to be associated with larger export levels simply because of the same random process which gives the large plant - market size relationship noted above.

5.4.5 In addition to economies of scale at the plant level the possibility of economies of scope at the firm level cannot be excluded. Thus explicit merger or other agreement between firms might allow for a reduction in common overhead costs and or allow for economies of specialisation. Whilst one cannot deny the possibility that such economies could exist their empirical relevance is not proven[34]. (We take this up later in the section 5.7 on mergers)

5.4.6 To date we have discussed, somewhat imprecisely, large plants and large firms and their role in competitiveness in the context of the implicit effects of a structural competition law designed to limit the creation of dominance. Thus the answer to the question of what might we lose in competitiveness, by limiting the creation of large plants and large firms, appears to be not much of significance.

5.4.7 However much competition law and its application is directed at creating the opportunities for entry and it is reasonable to ask in the context of competitiveness, whether excessive entry is a possibility. It is possible to postulate for a small economy that many industries will be characterised by relatively few firms and that industrial concentration will be high. We can assume that in such oligopolistic markets firms recognise their mutual interdependence and in doing so achieve a non-collusive equilibrium[35] with prices higher and output lower than would arise under a more competitive structure.

5.4.8 If economies of scale are not significant then entry will reduce the price cost margins and raise overall output. However if scale economies are important then entry will reduce the output of individual firms and cause costs to rise due to the loss of economies of scale. The overall welfare depends upon the shape of both the cost and demand curves and the extent of interdependence. Nevertheless the model bears some resemblance to the situation in many small economies where it is alleged that the oligopolistic nature of the market encourages both inefficient small-scale entry and the loss of economies of scale by the larger firms. Competition laws in these economies, by encouraging entry, will it is alleged, have adverse effects for both welfare and competitiveness.

5.4.9 Clearly this result is dependent on significant economies of scale being lost from the individual incumbent firm's loss of sales in the domestic market which, it is presumed, cannot be achieved by sales in other markets i.e. exports. Given the empirical results reported above these assumptions would not seem to have any general support. Aside from this, the models of Weisacker and Perry ignore the dynamic effects of increased competition leading to increases in efficiency, which we consider in the section below.

5.4.10 We see the observed plant distributions of large exporting plants co-existing with small, perhaps below mes (and hence higher cost) plants as evidence of a wider lack of competition. The large plants can perhaps by collusion, that might be either formal or tacit, maintain higher prices in the domestic market relative to those in export markets. The dominance of the large plants might be supported by regulatory barriers to large-scale entry or specific subsidies for large exporters. In these circumstances the monopoly profits derived from the domestic market by the larger firms may well allow export prices to be lower than they otherwise would be.[36] The effect is that the export share of the larger firms will be higher (than under more competitive domestic conditions) but this is not a reflection of any genuine competitiveness but the un-competitive nature of the domestic market. The application of competition law in such a scenario, by reducing entry barriers and stimulating entry and thus applying pressure upon costs, is likely to increase competitiveness rather than reduce it.

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[34] It has proved rather difficult to test for economies of scope since a detailed cost function needs to be estimated. Some applications have arisen in public utility industries where detailed cost data has been made available; nevertheless the evidence here is inconclusive.

[35] Specifically we assume that a Cournot non-co-operative equilibrium is achieved. This section draws upon the work of von Weisacker (1980) and Perry (1984).

[36] Note we are not saying that price differences between domestic and export markets are evidence of any abuse. Such price differences may well be optimal given the respective demand and cost conditions.

5.5 The relationship between size[37] and efficiency

5.5.1 Technical efficiency is seen as a major determinant of costs and hence of competitiveness. The concern relating to the application of competition law is that it may prevent the creation and maintenance of large firms, which if a link exists between firm size and efficiency will have an effect upon competitiveness. Caves (1989), Nickel (1996) and Unctad (1997) provide detailed surveys of the empirical work on the relationship between firm size and efficiency. We have considered this work and the conclusion that emerges from the studies is that no positive link can be found between firm size and efficiency. Equally the research broadly confirms that a lack of competition reduces technical efficiency. Most of the research work reported in these surveys relates to large industrial nations[38].

5.5.2 Meller (1976) concluded that for Chile, public sector protectionism contributes to inefficiency in Chilean manufacturing industry. Tybout et al (1991) attempted to assess the technical efficiency effects of trade reforms in Chile. They find that industries that were subject to the largest reductions in tariff protection between 1967 and 1979 experienced relatively large improvements in productivity. Similarly Lee (1986) in his study of Korea industries concludes that productivity levels fall as the rate of effective protection rises. An Unctad report[39] concluded that in Korea the government promoted the development of large conglomerates as a means of achieving economies of scale in mature heavy industries. Such high concentration led to losses in efficiency, including through lack of flexibility, the stifling of the growth of supplier networks and over concentration of innovation effort.

5.5.3 A more recent paper by Jonings and Repkin (1998) finds a positive relationship between technical efficiency and both firm size and profitability in Romania and Bulgaria. Some doubts must exist about the validity of this result. The analysis is based upon estimated production functions within broad industry groups and as such we cannot be sure that product variation is not responsible for apparent efficiency differences in capital and labour use. Many other studies have shown that for the transition economies the main driver of firm performance has been ownership. Privately and externally owned firms perform better than worker owned firms and public sector firms. Jonings and Repkin make no allowance for this in their work.

5.5.4 In summary the body of evidence finds no relationship between size and technical efficiency but one between efficiency and competition. Given this the evidence does not support fears that the application of competition law would reduce efficiency, indeed the evidence supports the converse view.

5.6 The role of agreements, particularly export agreements in export success.

5.6.1 Competition law would typically prohibit[40] agreements on price and market sharing arrangements that effect the domestic market. This would again typically include cartels involving imported goods and services. Agreements covering other behaviour for example, joint ventures in respect of R&D, would be subject to a rule of reason. That is they would be subject to an economic test to see if any restrictions to competition were outweighed by improvements to efficiency or technical progress[41]. Domestic competition law would catch agreements between domestic firms, with or without the agreement of importers, to limit imports. Export agreements covering the explicit collusion on price and market sharing by domestic firms in solely export markets might be allowed. Export agreements can also take the form of a quantitative restriction on the volume of exports to a particular economy or region. These are often known as voluntary export restraints.

[37] The previous section dealt with firm size relative to market size here we deal with size per se.
[38] A large body of research exists showing the effects of privatisation on efficiency. For smaller developing economies gains in efficiency appear to accrue from privatisation per se, whereas for the large industrial nations the efficiency gains appear more strongly related to the subsequent introduction of competition to the previously public owned statutory monopolies. On the former see Galal and Shirley (1994), Chisari, Estache and Romero (1997) and Guasch and Spiller (1998). See Newbury (1997) for evidence of the latter.
[39] Unctad (1986)
[40] See Annex 2 for the listing of cartel agreements which would generally be prohibited
[41] Again it would be usual to expect consumers to receive a share of these improvements

Domestic agreements

5.6.2 Horizontal agreements[42] between solely domestic firms to limit price competition and/or share markets are well known in their effects. Many studies have confirmed that they result in prices that are higher than would be the case with competition. Of course such agreements may well allow for price discrimination between home and export markets to be practised[43], such that the profits from excessively high prices on the domestic market effectively support lower prices in export markets and create an apparent advantage for competitiveness. Thus a law directed against such agreements could be perceived as having a detrimental effect on competitiveness.

5.6.3 Firstly we would argue that such a view is a mistaken interpretation of competitiveness, one that is not based upon any real cost and price advantages but merely reflects market power in the home market. Additionally such agreements will have a detrimental effect upon efficiency and hence the genuine competitiveness of domestic firms. At the theoretical level one would expect the existence of such agreements and associated high domestic prices to encourage inefficient and excess entry into domestic industry. Research in this area is quite conclusive. Elliott and Gribbin (1977) found that prior to the introduction of cartel law in the UK[44] over 50% of manufacturing industry were covered by agreements on price and market share. The cartelised industries were characterised by excess capacity, with a few large firms and a tail of inefficient smaller firms existing under the "high price umbrella". The removal of the cartels led to a reduction in capacity and efficiency improvements as well as the more obvious effect of reductions in price[45]. Given this it is to be expected that competition law directed at domestic price and market sharing agreements is likely to have beneficial effects upon competitiveness rather than the reverse.

5.6.4 Not all horizontal agreements involve price or market sharing or other prohibited terms. Competitors may integrate their operations to achieve greater efficiency, and the result may be pro-competitive on balance. Agreements of this type could include joint ventures, joint R&D, and the setting of common standards that benefit consumers (health and safety). These agreements would be subject to a rule of reason examination by the competition authority. As a general rule the nearer the focus of such agreements are to the final purchaser the more likely are they to harm competition. Thus for example a joint R&D operation which imposed no constraints on the individual parties on the use of the output of the R&D would be viewed favourably[46]. In contrast a joint selling arrangement would be more likely to be prohibited[47]. In these terms the existence of competition law applied to such agreements would only have an adverse effect upon competitiveness if the law prevented or deterred the making of beneficial agreements. This might arise because the law has been incorrectly applied or if it is costly for firms to seek clearance for such agreements[48].

5.6.5 The latter seems unlikely. The existence of de minimis rules which effectively exempt small agreements[49] suggests that recognition is paid to costs incurred, by both the competition authorities and firms, from the application of competition law. Thus the costs are regarded as outweighing the benefits in such small markets. However de minimis rules are not usually set by the application of formal cost benefit analysis. What little work has been done in this area[50] suggests that de minimis levels can be set at fairly low market sizes for the application of competition law in the area of dominant firms and mergers, certainly lower than the levels common in the UK and the rest of Europe. Whilst one should be very cautious in reading these conclusions

[42] We touch upon the effects of vertical agreements in the section on vertical mergers below
[43] Note we are not suggesting that geographic price discrimination is non-optimal. In many cases price discrimination can increase economic efficiency.
[44] The UK law was introduced in 1956 but did not become effective until 1959, the 50% figure relates to 1958.
[45] See Swan et al (1974)
[46] See Geroski (1993) for a discussion of policy towards R&D joint ventures.
[47] We consider here only domestic joint selling arrangements.
[48] We assume that the law is such that any significant agreement requires clearance. Without clearance the agreement would not be legally (under contract law) binding between the parties.
[49] Agreements involving small firms with small market shares measured over the relevant market.
[50] See Morrison and Elliott et al (1996).

over to the application of law to agreements it would seem reasonable to suggest that the market share de minimis for non-cartel agreements set out in Annex 2 is unlikely to be too low. Recent research into the application of Article 85 by the European Commission[51] suggests that the Commission have examined and even prohibited many agreements that were harmless in competition terms. However this conclusion seems to derive from the faults in the approach and analysis of the Commission rather than an incorrectly set de minimis levels.

Depression and rationalisation agreements

5.6.6 Horizontal agreements of this type are essentially designed to eliminate spare or inefficient capacity following a fall in demand or rapid technological change. These agreements may be short term or involve permanent change via merger[52]. Whilst such agreements purport to be driven by a desire to seek efficiency our general presumption is that this is best achieved by virtue of the market process. However in many instances this can involve highly localised social costs in terms of unemployment and it is unrealistic to expect labour markets, in terms of retraining and mobility, to work with sufficient speed to avoid these problems. Thus overall policy objectives may justify rationalisation agreements in some circumstances.

5.6.7 Nevertheless the mere existence of such agreements does suggest that collusion between the remaining firms is highly likely or at the very least the forum for discussing such arrangements provides a focal point for collusion. Thus the anti-competitive effects go potentially beyond the pure reduction in competitors, which is likely to arise from such agreements and mergers.

5.6.8 It is not our remit to discuss the merits of industrial policy in this area. However, our belief is that it would be more advantageous to seek to alleviate the social costs of change rather than to seek to control such change by managing the structure of industry. We recognise that the latter route is one often chosen but this will raise competition concerns, which must be examined within the context of competition law.

5.6.9 It is arguable that competition law can be applied too vigorously in depression circumstances. Neven et al (1998) question some of the recent high profile cartel cases brought by the European Commission. They observe that Polypropylene, Flat Glass, PVC, Wood Pulp and Welded Steel were all industries characterised by large excess capacity in which co-ordination may have been necessary to avoid cycles of entry and exit. Given the existence of large fixed costs such cycles are by their nature costly to society. The Commission is however hostile to accepting arguments for crisis cartels and this known hostility may have been a factor in the firms seeking to co-ordinate in a private and illegal manner. It would have been preferable if the firms concerned had felt able to have a rational ex ante examination of the case for such cartels with the Commission. Nevertheless such a discussion would have weakened the stance against price cartels and possibly the general deterrent effect of the law.

5.6.10 Hostility to the acceptance of crisis cartels is well founded. The UK experience merits particular attention. During the depression of the 1930's the UK government actively encouraged[53] the setting up of domestic and international cartels. These cartels were an extensive feature of the UK economy and were applied in both slow growing and fast growing industries. However 10 years after the Restrictive Trade Practices law was passed in 1956, which effectively made cartels illegal, differential growth rates were still observed between the industries which were previously cartelised and those that were not. The cartelised industries grew more slowly throughout the two post war decades despite the macro-economic conditions at the time being favourable for growth. The "crisis" which stimulated the cartels had long since passed but the institutionalised culture of cartelisation lived on leading to slow growth, even amongst those industries which were traditionally faster growing.

5.6.11 Japanese experience on depression and rationalisation agreements provides further useful background. The Japanese Government introduced in 1953 exemptions for certain types of cartel from the application of the Antimonopoly Act. These exemptions were used as a tool to protect

[51] See Neven, Papandropoulos and Seabright (1998).
[52] By the term merger we mean all forms of merger and acquisition which involve the transfer of control.
[53] See Gribbin (1978) and Elliott and Gribbin (1977).

relevant industries mainly in the 1960's and 1970's. However the exemption system for depression cartels was hardly used during the 1980's despite economic growth being slower. The system for rationalisation cartels has not been used since 1982. The inactivity in using these exemptions systems was caused by the fact that economic globalisation has been providing more opportunities for imports and thereby reducing the effectiveness of any domestic cartels in Japan. Against this background, a bill to abolish exemption systems for cartels is now under discussion in the Diet (as of 15 May 1999). The Japanese Government has "a belief a) that cartels would hinder the vitalisation of industries by allowing firms that have no competitiveness to remain in the market place, b) that cartels would negatively affect user industries and consumers, and c) that cartels would give rise to moral hazard among competitors. It is interesting to note that Japan used to have time-limited laws that allowed crisis cartels concerning the capacity of firms in specific industries. The idea behind these laws was to protect the industry that was in a critical condition. However due to changes in the business environment, mentioned above, Japan recognises that protecting an industry that has lost competitiveness no longer provides overall benefit to the Japanese economy. As a result Japan has turned its policy from one which allowed crisis cartels to supporting restructuring efforts of firms which are consistent with the Antimonopoly Act."[54]

5.6.12 No presumption either for or against crisis cartels and other rationalisation agreements or mergers would seem appropriate. They should not be exempt from examination under the competition law, indeed any per se exemption is likely to have harmful rather than beneficial effects upon competitiveness in the long term. As a first best solution we would propose that all such arrangements should be subject to the competition law, as it would allow for the relevant costs and benefits to be considered. We recognise that the stimulus for such rationalisation will not always arise from private firms and will sometimes be led by governments. In the latter circumstances it remains important that a mechanism exists for "competition" considerations to be given due weight in government decisions on industrial policy.

Export agreements

5.6.13 Export cartels[55] in general enjoy considerable freedom from the application of competition laws in the exporting economies. This arises from the belief that the anti-competitive effects arise only in foreign markets and that benefit accrues to domestic firms in the cartel. The cartels may be purely national in that they include the firms of one economy alone or international by including the exporters of more than one economy. In what follows we do not consider in depth the effects of export cartels and voluntary export restraints (VER's) upon the importing economy. Nor do we consider the differences between export cartels and VER's. For an excellent summary of the theoretical background and empirical evidence relating to export cartels and VER's see OECD (1993). A key point, which emerges from the OECD survey, is that no general presumption exists that an export cartel or VER will increase the profits of the firms in the exporting economy. The concerns we address here are with the effects of such agreements upon domestic competition in the exporting economy and go beyond those considered in the OECD survey.

5.6.14 Typically cartels which include any effect on the domestic economy would be prohibited under domestic cartel law. The pure export cartel, whether national or international is not usually prohibited.[56] There has been little incentive, and often unclear legal basis under domestic competition law, for the responsible competition authority to address export cartels. This arises from the belief that export cartels have little adverse effects upon the market of the exporting economy. However much evidence exists to show that the consumers and producers in many economies have suffered at the hands of pure export and international cartels.[57] This arises both from the high price of imports and the monopoly rents which can accrue to domestic producers in economies facing such cartels. Evidence exists that international cartels also adopt predatory tactics against competition from producers in the importing or third party economies[58].

[54] Communication from the Government of Japan.
[55] i.e. agreements between firms on prices to be charged or on market sharing in overseas markets. Other agreements not involving price or market sharing fall outside our definition of "cartel".
[56] For example the US, UK, EU, Canada, Japan and Mexico all in effect exclude pure export cartels.
[57] See American Bar Association (1991) and OECD (1993).
[58] An often-quoted example relates to the international cartel in heavy electrical equipment. See Jenny (1997) for other examples.

5.6.15 Despite these harmful effects it is to be expected that developing economies, and economies in the process of implementing competition law, will see little reason to adopt a different approach to export cartels than that which is common in the major industrial economies. We consider below the effect which an exemption from competition law for export cartels might have upon domestic competitiveness.

5.6.16 In terms of the purely national cartel an export cartel could arise from a need to pool resources to overcome the fixed costs and risks of exporting. The cartel might take the form of an export sales joint venture. The evidence presented above on firm size and exports suggests that fixed costs could provide a valid rationale for such an agreement. However the risks of exporting could be met by a third party insurer and does not seem to need an agreement between exporters.

5.6.17 If the domestic firms in the export cartel have no market power globally then they will be price takers on the international market and any export agreement between them would be in the form of (foreign) market sharing. Without any specific or formal mechanism this will probably limit the rivalry between them, particularly if exports are a significant proportion of domestic production. Thus in the long term we can expect a decline in competitiveness in industries which have such agreements.

5.6.18 However if the domestic firms have market power internationally then the effect of an export cartel would be to reduce total output. Whilst the profits of the cartel firms may well rise the effect will be to reduce employment and the demand for factors from other suppliers in the home economy[59]. It is far from clear that in those circumstances allowing such cartels increases welfare. Additionally the efficiency effects noted in the previous paragraph would also arise.

5.6.19 Notwithstanding these possible effects an overriding concern is that the mere existence of an export cartel provides a focal point for the co-ordination of behaviour on the domestic market. It seems unlikely that firms would meet to discuss costs and prices on export markets without a spill over onto domestic circumstances. Strong links between export and domestic cartels have been found. Gribbin (1978) describes how the UK government in the 1930's made its acceptance of domestic cartels and the granting of a tariff barrier conditional upon the UK firms negotiating export cartels with overseas competitors. In the US cases in which an export cartel has been associated with an illegal domestic cartel have arisen in animal feed and citric acid. Thus again it is seen that the possibility exists for a lessening of competition in the domestic market with adverse effects upon efficiency and competitiveness.

5.6.20 One additional effect is that the knowledge of an export agreement may lead to a retaliatory response by the economies exported to. Thus a risk emerges of "beggar-thy-neighbour" policies which ultimately harm all economies.

5.6.21 International export cartels will have all of the detriments of the purely domestic export cartel with the additional effect that potential competition in the domestic market from imports (from other cartel members) will almost certainly be limited. Again we can hypothesise a detrimental effect upon competitiveness.

5.6.22 Thus a competition law which excludes the possibility of considering export cartels could have a negative effect upon competitiveness. At the very least export cartels should be brought within the coverage of domestic competition law so that their supposed benefits can be subject to a rule of reason test. In the same way that economies have recognised the benefits from reciprocal trade liberalisation it is to be hoped that they will recognise the benefits of co-ordinated action against export cartels.

5.7 Mergers and efficiency

5.7.1 Competition law, by way of laws to control anti-competitive mergers, is seen as possibly preventing gains to competitiveness that arise from size effects and co-ordination. Competition law

[59] Without a formal general equilibrium model it is not certain that total employment would fall, however the result we quote in the text is more likely.

in this light is seen as preventing beneficial horizontal mergers that would give rise to economies of scale and scope and/or preventing the effective rationalisation of domestic industry to meet global competition. Secondly competition law might be seen to prevent beneficial vertical mergers and agreements. Lastly competition law might prevent the formation of large conglomerate firms which would have the size and resources necessary to compete on global markets. We consider each of these possible effects in turn.

5.7.2 Competition law in respect of mergers would typically follow a rule of reason approach; the relevant market would be defined and each merger would then be examined for possible anti-competitive detriments and any offsetting benefits. In this context it is important to note that a large firm in a small domestic market may not be dominant if the appropriately defined relevant market is actually a larger region or even global. Merger law should contain a de minimis provision such that the large proportion of mergers between small firms or mergers that raise no competition issues are exempt. Thus only the largest and significant mergers, in competition terms, would be subject to the competition law. The existence of such a competition law and its application[60] will deter or prevent some mergers that give rise to benefits. Either because the parties themselves do not believe that they can make a case that the benefits outweigh the anti-competitive effects or if the competition authorities reach this conclusion.

Horizontal mergers

5.7.3 By horizontal mergers we mean mergers between firms which are actual or potential competitors. Thus any merger between such firms has the potential to lessen competition. We have discussed above the literature on plant and firm size upon efficiency and it remains the conclusion that the need to be "big", relative to the size of the domestic market, so as to reap economies of scale and scope is at best likely to be overstated.

5.7.4 The empirical research on the effects of mergers is very instructive in this area. A horizontal merger should in theory lessen competition or at least leave it unchanged and possibly reduce costs. Thus profitability should increase[61] for these two reasons. If profitability does not increase or remains unaltered following a merger, then we can assert that cost increases outweighed any gains in market power. What an extensive 30 years of research has found time and time again in different economies and over different time periods is that mergers do not increase profitability[62]. If anything mergers are usually associated with a small but significant decline in profits. The only gainers from mergers appear to be the shareholders of acquired firms.

5.7.5 Thus horizontal mergers in general do not appear to be associated with efficiency gains. From this we conclude that the existence of competition law in this area is unlikely to deter mergers which give rise to efficiency gains and hence competitiveness. For mergers, which are subject to examination by the competition authorities, our presumption is that a full investigation of the costs and benefits will take place. This implies that procedures[63] exist for taking into account any perceived benefits to competitiveness and the impact they might have upon domestic welfare. These benefits would be considered against the possible detriment to welfare arising from any anti-competitive effects. In those circumstances mergers which on balance are favourable to welfare would be allowed and thus we do not see an adverse impact arising from correctly applied competition law.

[60] We assume here the law is applied correctly, we take up below the problems that arise from incorrect application.
[61] Typically this research has to construct a counterfactual, i.e. construct what the profitability of the merging firms would have been without the merger, against which to measure actual profitability.
[62] Many surveys of the empirical work on mergers are available; an accessible source is Bishop and Kay (1993). A more recent survey can be found in Collett (1996).
[63] Whatever the form of the competition law, the balancing might take place within the competition law if its objectives are defined in terms of the broad public interest or elsewhere within government.

Vertical mergers

5.7.6 Vertical mergers (and agreements) can be seen as a particular method of achieving vertical integration and as such are capable of providing savings in costs[64] and hence improvements in competitiveness. Nevertheless anti-competitive effects can arise and it cannot be assumed that mergers motivated by private gains to the firms will necessarily give rise to wider efficiency gains to society. Typically one can think of vertical mergers (and agreements) as having an impact on competition by denying (horizontal) rivals access to key inputs or distribution outlets.

5.7.7 Such anti-competitive concerns are perhaps greater in smaller economies or economies with a tradition of a tight relationship between manufacturers and the distribution/retail sector (i.e. Japan). Access to distribution will be a key element in enabling competition, be it domestic or via imports, to emerge, particularly where the economy is characterised by dominant firms. If such competition is prevented or limited by vertical mergers then an adverse effect upon domestic efficiency and competitiveness is likely. Dutz and Suthiwart-Narueput (1995) explore these issues in some depth. It is clear from their work and other examples that the benefits of trade liberalisation in opening up domestic markets to competition have often been limited or prevented by the forward integration of domestic firms into distribution.

5.7.8 One aspect neglected by Dutz and Suthiwart-Narueput is the effort by overseas firms to acquire dominance via the acquisition of domestic distribution (either by merger or exclusive dealing requirements) and subsequent squeezing out of domestic firms. This appears to have arisen in the context of products that have an associated world "brand name"[65]. This type of foreign investment via acquisition is equally capable of generating anti-competitive effects, as could purely domestic vertical integration.

5.7.9 Given this we would expect vertical mergers, above a de minimis threshold and particularly if involving firms with a dominant position at one or more levels in the chain of production and distribution, to be subject to examination by the competition authority. Thus in the same way as horizontal mergers a balancing of the costs and benefits (see para 5.7.5 above) would take place. In this context the existence of competition law per se should not have an adverse effect upon competitiveness. Indeed by ensuring competitive conditions and access to markets prevail we would expect competitiveness to be increased.

Conglomerate mergers

5.7.10 Many economies with a relatively small market sector or in the process of transition towards a market economy have taken a lenient view towards the development of large conglomerates. Indeed in some economies policy has been to actively encourage such conglomerates. The arguments for such conglomerates are somewhat loosely based around the thoughts that conglomerates can create efficient portfolios and diversify risk and that their size provides for efficiency and innovation benefits. Thus conglomerates in this view are seen to aid growth and competitiveness and that the existence and application of competition law could threaten this.

5.7.11 The discussion above has highlighted that size per se seems to confer little if any benefits for efficiency and we consider below the relationship between size and innovation. The arguments for conglomerates would seem to rest upon market failures elsewhere. In particular that capital markets are weak and poorly developed and that entrepreneurial talent is scarce.

5.7.12 The risk based case for a conglomerate has two aspects[66]. The conglomerate by combining activities which are not perfectly (positively) correlated will achieve a lower level of risk than the two separate activities. Also because it has a lower level of risk its cost of capital will be lower in

[64] See any standard industrial organisation textbook such as Waterson (1990) for a discussion of vertical integration.
[65] Cases involving cigarettes and soft drinks in Kenya.
[66] Additionally a risk to managers of firms exists, which because of their limited ability to diversify, their success is tied to the firms success, provides an incentive to conglomeracy. However this does not seem an issue for public policy.

raising external finance. However these conditions hold only if shareholders in general cannot diversify their risk via the stockmarket and that banks and suppliers of lending cannot also diversify their portfolio. In many small economies stockmarkets will be thin but shareholders and banks might be able to diversify globally. However global capital markets may not operate efficiently and bias might exist against firms from smaller economies. If this were significant it would provide some justification for a policy encouraging conglomeracy.

5.7.13 We recognise from both domestic and international considerations that a risk argument based upon capital market failure is reasonable. However dangers exist in this line of thought. If the justification for conglomeracy is based upon a thin capital market then the existence of large conglomerates, particularly those linked to banks,[67] will ensure that the domestic capital market continues to remain thin and unrepresentative. The more that the large conglomerates can lock up finance and take capital allocation decisions without reference to an external benchmark the more the capital market will remain short of funding and operate at non-optimal levels. This will clearly create a substantial barrier to the creation and expansion of other domestic firms and have an effect upon maintenance and development of competitive markets[68].

5.7.14 The empirical evidence[69] on conglomerate mergers is perhaps not quite as strong as that relating to horizontal mergers, in that diversified merger is generally unsuccessful but less so than other forms of merger. Some researchers have found no evidence of a risk reducing effect from mergers.[70] Of perhaps more relevance to APEC economies was the conclusion by Reid (1968) that conglomerate mergers were pursued for managerial motives. Indeed the main rationale for conglomerate mergers may well lie with the political power and influence that large firms, and their owners, can command.

5.7.15 It is of interest that the Chaebol in Korea were in part built upon a policy of granting preferential credit terms to large firms. We have referred above to the subsequent efficiency problems associated with these Chaebol. Equally the provision of cheap credit may have led to a higher debt equity ratio than would have been warranted in more competitive conditions. The high debt equity ratio of Korean and to a lesser extent firms in Indonesia and Thailand seems a major contributor to the current economic crisis[71].

5.7.16 Conglomerate mergers may well confer benefits upon a small economy however many of the benefits depend upon inefficiencies in capital markets. That suggests the appropriate policy response is not to promote conglomerate mergers but to address, as far as possible, the underlying capital market failure. Conglomerate mergers can, again given this market failure, create competition problems and hence detriment to competitiveness. Again we see an effectively applied competition law as providing the means by which the various pros and cons of conglomerate mergers, and indeed the existence of few large diversified firms within an economy, can be assessed. Such a process should not in itself harm competitiveness.

5.8 The relationship between R&D, innovation and firm size

5.8.1 Innovation is a costly and risky activity and firms need to perceive some potential return in order to invest the necessary resources. Given this it is often argued that some sort of market dominance is required for innovation to occur; if markets are too competitive, profits would be competed away, and firms would have little incentive to innovate. Equally large firms are thought more likely to innovate, as it is easier for them to fund such efforts and to reap the rewards. Thus competitiveness arises from the ability of firms which are large and/or have market power to

[67] We are thinking of the FIGS in Russia, the Chaebol in South Korea and the Grupos in Latin America

[68] Conglomerate mergers can create other competition problems but these in the main arise from the existence of market power in at least one of the markets in which the conglomerate operates and is thus a problem of dominance rather than conglomeracy.

[69] See Hay and Morris (1991)

[70] See Haugen and Langetieg (1975)

[71] See Claessens, Djankov and Ferri (1999)

indulge in greater innovation. Given this it is argued that the application of competition law can make markets "too competitive" in the sense that a sub-optimal level of innovation takes place.[72]

5.8.2 Equally it has been argued[73] that competitive pressures act to increase the incentives which firms have to create new products and lower cost production processes. Much evidence exists to suggest that firms that do not face strong competitive pressure enjoy their monopoly rent as excessive costs. Indeed as discussed earlier no positive relationship exists between efficiency and size and or market power.

5.8.3 The theoretical literature in this area is both large and often conflicting. Some general points can be made. The large uncertainty surrounding R&D investment suggests that external funding is unlikely, thus R&D funding will be mainly from retained profits (perhaps enhanced by government subsidy). A large R&D effort may also be mo re productive than a small one since it would allow the pooling of risks from projects undertaken simultaneously and perhaps more speculative projects to be undertaken. All this suggests that some size advantages arise in carrying out R&D. Again, as in the case of conglomerate mergers imperfections in capital markets may confer size advantages in respect of R&D expenditures.

5.8.4 In terms of the exploitation of that R&D Arrow (1962) has shown that a firm within a competitive industry has a greater incentive (can achieve a greater private gain) than a monopolist to innovate. One firm within the competitive industry is assumed to licence its innovation to the others, so in the Arrow model it exploits its monopoly on information. The model can be extended to a patent holder outside the industry and again the incentive is greater with competition. This model is recognised as being too simplistic but it does have the merit of guarding one against the more intuitive suggestion that monopoly provides the greatest incentive.

5.8.5 More recent work on the theory[74] suggests that the relationships are complex. Market structure is in part created by the strategic R&D game played between firms over time. The nature of the "game" determines the incentives and it becomes difficult to distinguish in the models results in terms of market structure and incentives from a particular assumption about behaviour. Thus the simple models and interpretations of empirical work that take market structure as given may be a misleading guide to the returns to innovation. Structure and behaviour, including R&D strategy, would seem to be determined jointly together with the returns to innovation.

5.8.6 At the theoretical level the game theory models provide some general support for the view that greater market power (up to a point) leads to higher R&D. Also incumbents with market power are the most likely to innovate. At a simplistic level it has been argued that some market power is helpful for R&D to provide the profit incentive to engage in R&D. Too much market power, however, acts as a disincentive for such activity.

5.8.7 Equally a large empirical literature exist in this area of which surveys can be found in Cohen and Levin (1989) and Symeonidis (1996). Three main results would seem to emerge. Little evidence is found to support the contention that R&D intensity increases with market power or firm size. In some industries it may do so but in most no relationship is found. What seem to distinguish industries are different appropriability conditions and diversification opportunities[75]. No support is found to suggest that innovative activity in the form of patents is related to market structure. Lastly innovative activity would appear to be related to the technological characteristics of the industry and not market power.

5.8.9 Of perhaps equal importance to smaller economies and those in transition to a full market economy is the rate at which technological improvements are diffused within the economy. The performance of an industry will often depend upon improvements made elsewhere. This could be other industries, independent research institutes or technology transfer from other economies. It

[72] One point to note is that the literature nearly always assumes that more innovation is per se good or more correctly the expenditure of resources directed at innovation is always a good thing. We do not address the issue of optimal investment in R&D here.
[73] See Arrow (1962)
[74] See surveys in Hay and Morris (1991) and Reinganum (1989)
[75] See Pavitt et al (1987)

thus may be optimal for smaller economies to ensure that their industries are capable of fully exploiting improvements made elsewhere rather than seeking to generate their own via expensive and risky R&D expenditure. Both the theoretical and empirical literature appear to suggest that large firms, or firms already carrying out R&D are likely to be the first to take up and successfully use innovations made elsewhere. However market power may not be conducive to diffusion. If the monopolist can maintain its entry barrier without investing in new products and technologies it has less incentive to do so than a competitive industry in which each firm has only the stark choice of being minimum cost or dying. However if the monopolist perceives the innovation as threatening its monopoly i.e. reducing the entry barriers, then it has an incentive to innovate first and gain a first mover advantage.

5.8.10 The empirical evidence on diffusion is not large and is limited to case studies of a single invention in a particular industry. The relationship between size and diffusion is perhaps more consistent than any between market power and diffusion. However in the context of the latter the OECD (1996) present some powerful data which shows the average rate of diffusion in terms of the monthly growth in cellular mobile telephone subscribers per 1000 inhabitants in OECD economies. The average growth rate for those economies with a monopoly supplier was less than 1%, for economies with duopoly suppliers 1.7% and for economies with open competition almost 3%.

5.8.11 Thus in conclusion no advantages from size or market power for innovation would appear to exist despite some theoretical support for the proposition. For the diffusion of innovations, size of itself does seem to be an advantage but having a position of market power possibly hinders diffusion. However given the nature of the essentially anecdotal evidence strong conclusions are not valid here. That said we find no support for the contention that the application of competition law applied to either mergers or the abuse of dominant positions would in itself harm innovation and hence competitiveness. A case by case approach should allow for the respective costs and benefits to be considered without bias.

Chapter 6

How the enactment of competition laws will affect the ability to compete for foreign investment vis-à-vis developing economies that have not enacted competition laws.

6.1 Introduction

6.1.1 Foreign direct investment (FDI) will be motivated and directed at particular economies by many factors[76]. Not least the market size, openness and growth prospects of an economy. These factors are broadly related to the extent of competition within an economy[77]. The factors that influence it may differ by the extent to which FDI is directed primarily at serving the domestic market or is designed to be an export platform.

6.2 FDI aimed at the domestic market

6.2.1 If high prices and profits are seen as a signal which stimulates entry then it could be argued that the existence of an actively applied competition law would be a deterrent to FDI since such entry opportunities would not exist. In a static world with an applied competition policy that achieved perfect contestability this might be the case. However these assumptions are so extreme as to have no practical relevance.

6.2.2 If the competition law does not discriminate between firms and their economy of origin then it would prevent domestic firms erecting barriers or denying market access to overseas firms. In that sense competition law can be seen as encouraging FDI by providing a level playing field.

6.2.3 Also foreign investors will themselves be subject to the competition law thus ensuring that they behave competitively. This will help create a more favourable climate for FDI within the economy. Equally these investors will be familiar with an environment in which a competition law operates and will recognise the benefits that arise to them from operating in such an environment. Given this, as long as they can be sure that the law will be operated in a non-discriminatory manner and is correctly applied then the law itself will not deter FDI.

6.2.4 Our own experience[78] suggests that this argument is perhaps not as straightforward as it first appears. Firms from economies such as the USA and UK appear to prefer to operate where clear rules exist and the roles of the regulator and the regulated are clearly defined. Such firms regard the existence of high quality regulation as reducing their "regulatory" risk and hence cost of capital. Reading over this experience would suggest that the existence of competition law would be an incentive for them to undertake FDI. Conversely firms from say France and Spain have had traditionally much closer day to day relationships with their regulators. They are familiar with operating in a less "arms length" manner than US or UK firms. They appear happier to take on the uncertainty of a vague regulatory framework, arguing that any problems can be resolved by close links with the regulator and Government[79]. Whilst we would not argue that the existence of a competition law would deter FDI by firms in France and Spain it may not prove an incentive to them.

6.2.5 We have seen it argued[80] that competition law might be interpreted by potential foreign investors as an additional "screening" mechanism and a bureaucratic hurdle they need to overcome. As such it may deter investors who would prefer economies with "less rules". Competition law can effect a FDI in three main ways:

a) if the foreign investor has agreements relating to the domestic market;
b) if the foreign investor is involved in a merger/take-over of a domestic firm; and
c) if the foreign investor abuses it's dominance in the domestic market.

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[76] See World Economic Forum (1997)
[77] Note the link with the work of Dutz and Hayri (1998), see paragraph 4.2.10 above.
[78] Of FDI into sectors which are to be regulated following privatisation.
[79] To the outsider this might look like regulatory capture and clearly a danger of this exists.
[80] WTO (1998)

6.2.6 In respect of (a) the foreign investor could have made anti-competitive agreements which significantly effect competition on the domestic market. For example an agreement in which the domestic market is "left" to local firms with the foreign investor concentrating upon exports. Such an agreement would be subject to the competition law. The law applying equally to both domestic firms and foreign investors. Such a law would typically be applied ex ante, given the risk of fines for ex post discovery. In that sense it could be seen as a barrier to FDI. However in these circumstances it would be reasonable to ask why the foreign investor requires agreements with domestic firms. An explanation might be that the domestic firms have control of particular resources that they will use as a barrier to the entrant unless concessions are made. Action on the underlying competition problem would in this case facilitate FDI rather than deter it.

6.2.7 In respect of (b) the competition law would be expected to include take-overs of domestic firms by foreign firms and for that law to be applied non-discriminatory. Again this would involve a form of ex-ante assessment of the costs and benefits of the merger. Nevertheless the law would typically only apply to mergers involving large domestic firms or domestic firms with significant market power. Such a form of FDI would be considered carefully by any economy whether it had a competition law or not. We cannot see competition law as applied in this case to be a significant deterrent to FDI unless the consequences of such a take-over would have adverse effects for the economy.

6.2.8 However the existence of merger control law has in many economies proved to be a temptation for governments to discriminate against take-overs by foreign firms on non-competition grounds. Legitimate reasons will exist for governments to seek to keep domestic control of strategic assets, perhaps say in the defence industry. It is fair to recognise that in some economies the merger laws have been used to discriminate against foreign firms. This is a genuine risk that arises not from the existence of competition law per se but from its inappropriate application.

6.2.9 The last broad class of action under competition law against a foreign investor concerns abuse of dominance. This would be ex-post entry and as we have argued above unlikely to be a deterrent and indeed the existence of competition law, if applied non-discriminatorily, may well improve the climate for FDI.

6.2.10 Notwithstanding the potential benefits of foreign acquisition (FDI by merger) the competition authorities should recognise that harm to consumers can arise from the favourable treatment of FDI (i.e. a promise to provide discriminatory treatment via for example quotas or tariffs from competing imports). The Polish, Czech and Hungarian authorities have been particularly active against such discrimination without apparent impact upon the flow of FDI. Moreover the award to foreign investors of special tax and financial incentives has competition consequences if such concessions are not available to all new market entrants and existing firms. Frischtak and Pittman argue that this discrimination in favour of FDI appears to be the situation recently encountered in Argentina, Brazil, the Philippines and Indonesia[81].

6.2.11 Thus the manner in which economies compete for FDI can have consequences for domestic competition and again it is important that the competition authority has input into the political decisions regarding FDI incentives.

6.3 FDI aimed at export markets

6.3.1 The majority of the arguments deployed for domestically focused FDI apply equally to FDI aimed at export markets. The key to success for the latter form of FDI will be directly related to the competitiveness of the domestic economy. As we have argued above the theory and evidence suggest a strong link between the application of competition law and external competitiveness.

[81] Frischtak and Pittman (1997)

6.4 Empirical evidence

6.4.1 Empirical evidence on the influence of competition law on FDI is thin. The Global Competitiveness Report (GCR)[82] shows that FDI flows to individual countries are strongly influenced by the degree of competitiveness[83].

6.4.2 The role of competition in determining FDI is not specifically considered within the GCR however the survey asked respondents to qualitatively assess the degree to which "anti-trust or anti-monopoly laws effectively promoted competition" in each country. We carried out a regression analysis of the determinants of FDI flows in 1995; the dependent variable was the ratio of FDI to GDP as a %. As independent variables we used the qualitative anti-trust variable described above, the rate of domestic corporation tax, a measure of the extent to which foreign investors are able to acquire domestic firms, a measure of flexibility in the labour market, the overall competitiveness index in the GCR and the ratio of GDP per capita.

6.4.3 Our results show that the greater the perceived strength of anti-trust policies the higher was the FDI/GDP ratio and the higher the level of corporation tax the lower the ratio. No other variables were a significant influence on the FDI/GDP ratio.[84] We do not regard this result at this stage as more than tentative support for the view that the existence of anti-trust law has a positive influence upon FDI flows. Further research in this area is merited.

6.4.4 The theoretical discussion and empirical evidence (admittedly fairly thin) both support the view that competition law will not deter FDI and indeed may help promote it.

[82] World Economic Forum (1997)

[83] Competitiveness is measured as a composite index based in part upon the qualitative response to a questionnaire survey of over 3000 business executives and in part upon statistical data of each economy. The index covers 53 economies at differing levels of development.

[84] The R^2 for the equation was 0.24; Jordan and the Ukraine were excluded since no information was available on tax rates, leaving 51 economies in the sample. The "t" values for "anti-trust" and "tax" were 1.9 and 2.8 respectively.

Chapter 7

<u>What social impact would competition law create?</u>

7.1 Distributional issues

7.1.1 As discussed earlier [paragraph 3.1.4] each distribution of income and factors of production is associated with a particular competitive and socially efficient equilibrium. By the term socially efficient we mean that no one individual could be made better off without making another worse off. All that theory in this respect tells us is that in moving from an economy characterised by a lack of competition and inefficiency to one which is competitive will improve the welfare of society as a whole. The theory tells us nothing about whether the society would approve of the new distribution, to do that one needs to impose a social welfare function.[85] More importantly, for our purposes here, economic theory tells us nothing about the process of going from one state to another. It is not the objective of competition law, based upon economic efficiency, to create a particular distribution of wealth however the application of competition law and the move towards a competitive equilibrium will have consequences for income distribution.[86]

7.1.2 In practice competition authorities will make decisions which impact upon distribution. They will typically give a greater weight to consumer surplus than producer surplus in the assessment of overall efficiency. More contentiously, competition authorities often seek to eliminate price discrimination between social groups or between geographic areas. Such price discrimination can be economically efficient[87] as well as evidence of an abuse of market power. Nevertheless many competition authorities would be uncomfortably in allowing price discrimination on efficiency grounds because it appears "unfair" that one consumer should pay more for the equivalent good than another. These distributional issues are secondary to the employment issues upon which we concentrate below.

7.2 Employment effects

7.2.1 If a sector of the economy faces a lack of competitive pressure it will have prices which are too high.[88] Additionally it will suffer from inefficiency[89] and its costs will invariably be higher than if it faced competition. The inefficiency will often manifest itself in terms of low labour productivity. This might be because the monopoly rents have been partially passed to labour as high wages or excessive employment. Most economists accept that the largest welfare loss in monopoly arises from inefficiency. Thus whilst one might expect that in moving from monopoly to competition, output and hence employment would rise, this is typically offset by the competitive pressure to lower costs and increase labour productivity, giving rise to an overall fall in employment in the sector.

7.2.2 In a general equilibrium framework we need to consider the employment effects arising elsewhere in the economy given the increased competition in the particular sector. The lower prices arising from competition will stimu late demand in other sectors, either directly if the output of the now competitive sector is an input to that sector or indirectly from the "income effect" of the lower price to consumers. Whether this stimulation of demand and hence employment indeed does arise depends upon competitive conditions in other markets and rigidities in the labour market. The introduction of competition more broadly across sectors will be jointly reinforcing in raising demand, however if labour rigidities remain, offsetting gains to the sector loss in employment will not arise.

[85] Essentially a weighting by society of its desires to achieve various objectives.
[86] We do not cover here the consequences for income distribution arising from privatisation and deregulation. Some important work has been carried out in this area see Waddams-Price and Hancock (1998) for a study of the effects in the UK and Chisari, Estache and Romero (1997) for a study concerning Argentina.
[87] We are not thinking here of price discrimination justified by cost differences but by Ramsey pricing requirements to recover fixed costs.
[88] Higher than they would be in a competitive situation.
[89] See Caves (1989) and Nickell (1996).

7.2.3 Barry and O'Toole (1998) have examined this issue in the context of the small open economy of Ireland. They assume, not unreasonably, that the Irish economy is divided into two sectors, a traded competitive sector and a non-traded non-competitive sector. They find that by calibrating a simple model of the Irish economy that the introduction of competition into the non-traded sector raises aggregate employment.[90]

7.2.4 In a similar piece of work, again relying upon a general equilibrium model, Chisari et al (1997) find that the effects of utility privatisation in Argentina gave rise to an overall gain in employment despite the substantial job losses (improved labour productivity) in the privatised sectors.

7.2.5 Whilst this academic work provides considerable comfort that the competitive equilibrium will in practice raise overall employment it says nothing about the transition process. The first round job losses in the sectors in which competition is introduced can be substantial and are likely to be all the more so if the sectors lack of competition was due to government support and subsidies. Considerable social problems will be created from the loss of employment. It will be important for economies to introduce social measures, which are complementary to competition law, to overcome these short-term problems. Such policies should be directed at the rigidities in the labour market, which prevent redeployment in other sectors, for example training and measures to assist mobility.

7.2.6 However we recognise that the labour market will never work perfectly and also that the scale of the problem will be very large in some cases. For example in economies previously subject to central planning it is often found that little diversification of employment exists in a given area, in effect we often find single industry towns. Clearly when that industry becomes subject to competitive pressures the employment effect and second round effects on the region will be large. It is important in such cases that competition law and other competition and industrial policies seek to remove and attack all the entry barriers that might exist to setting up other industries in those areas. Nevertheless it is unrealistic to expect competition policy to solve sufficiently quickly the employment and other social problems which arise in these circumstances. Some form of social support will be necessary.

7.2.7 The introduction of competition law and competitive pressures more generally, present some interesting issues in terms of prices. Many economies have a history of price control, particularly in respect of staple foods. Often a new competition authority will be in part staffed from those who previously worked on price control. Society at large will perceive that the competition law and the competition authority have a duty to protect them from abusively high prices. The success of competition law derives from changing the culture of society as much, if not more so, than the strict application of the law and given this it is important to build political support for the law. Often deregulation and the introduction of competition will give rise to a general realignment of all prices, some will go up and some down. Competition does not work quickly and it is to be expected that dominant suppliers with high prices and high costs will exist for a period. This can often create social problems particularly if the burden of high prices falls upon the poorest in an economy.

7.2.8 We do not believe it is tenable for a competition authority to argue that it has no role in controlling high prices and to argue that its role solely concerns the removal of entry barriers that allow such high prices. To do so will only bring the law and the authority into disrepute. Given the expectations of society, and the general uncertainty that will surround a move towards greater competition, failure to acknowledge a responsibility for high prices risks social unrest.

7.2.9 Clearly we do not wish the law to become a means for price control nor do we wish to advocate that anything other than the main emphasis is to be placed upon removing entry barriers. However some circumstances will arise in which entry barriers cannot be removed (i.e. natural

[90] It is interesting to note that the thrust of their article is to argue in favour of the new and stronger competition law that had been introduced in Ireland.

monopoly) or in which entry is not feasible within a reasonable period of time. In those limited circumstances short-term price control maybe justified.[91].

7.2.10 Social issues do arise in the context of competition law but these issues can be minimised by the application of complementary social policies and by the judicious application of the law. Nevertheless the short-term social costs of transition to a more competitive economy can be highly significant. These costs may last for several years. However they will be insignificant when compared to the long-term costs to the economy of not being competitive. Thus whilst policies should be promoted to alleviate the social costs, those costs must be placed in perspective. We recognise that this may be difficult. The costs of transition to a more competitive economy are often immediate and carry political significance to those regarded as instigators of change. In contrast the benefits of a more competitive economy are longer term and less obvious. Every effort must be made to convince all sections of society that these long term benefits are real and significant. We return to the importance of advocating the benefits of competition in section 9.3 below.

[91] We are aware that the thoughts here may be unpalatable to some of our colleagues. We believe that their position mainly derives from a view that those economies new to competition policy do not have the ability and skills to apply the policy beyond a strict efficiency criterion. Some force may exist in this but it remains the case that whoever is responsible for applying the competition law will have to be first and foremost a political animal. As such they need to be able to apply discretion and work as effectively as possible within the prevailing political climate.

Chapter 8

What the limits and downside risks are of enacting a competition law within a society

8.1 Introduction

8.1.1 We have considered above the complementary role that competition law has with other key policy areas devoted to economic development. We have also stressed at the outset that competition law is to be seen as one aspect of a wider set of policies that are designed to increase competition in an economy. Our thesis is that if the law is framed and applied correctly then the benefits of such a law will outweigh any costs and that conflicts with other policies can be resolved in a way which confers the greatest benefit on the economy. Given that we concentrate in this section on the appropriate fra mework and application of the law.

8.2 Scope and framework of the law

8.2.1 Annex 2 sets out in detail a suggested framework for competition law. The framework covers horizontal and vertical agreements, mergers and abuse of dominance. Economies that are in the process of developing and implementing a competition law are often advised to concentrate on horizontal agreements and in particular cartel agreements. This is understandable since cartel agreements involving price fixing are regarded as per se harmful to society. In contrast, most other areas of competition law require the application of a rule of reason and the danger exists that misapplication of the law in these areas is liable to harm the market process rather than promote it. Whilst this general advice may have some merit for the transition economies it has less applicability to APEC economies.

8.2.2 For example if a cartel law is applied effectively it will encourage firms to merge and so internalise the cartel. The net effect is to create large firms that maintain all the inefficiencies previously contained within the cartel[92]. Thus we see a need for the simultaneous application of both cartel and merger law. A related example arose in the Philippines[93] where deregulation of the domestic shipping industry led within three years to the entry of new operators, improvements in capacity, service frequency and the introduction of new technology. However a subsequent merger of three large shipping companies, which led to a firm with 50% of the local market for seagoing freight and 65-75% of seagoing passengers, was cleared by the Securities and Exchange Commission without any consideration of the dangers to competition.

8.2.3 Equally many APEC economies are characterised by dominant firms (or a high degree of concentration) in many sectors of their economy. Moves to increase competition and open markets will almost certainly be met by a strategic response by those firms to maintain their dominant position. This might take the form of vertical agreements to hinder access[94] or a more obvious abuse of dominance such as predatory pricing. However in considering abuse of dominance, particularly in markets newly opened to entry it will become necessary to distinguish between what constitutes a legitimate response to entry and what constitutes abuse. We do not pretend that such tasks are easy but it does seem to us that competition law for the APEC economies must be framed and applied simultaneously in the three key areas if it is to be successful.

8.2.4 Equally competition law should apply to all sectors of the economy. Exemptions should be kept to a minimum. Public owned industries should not be exempt from competition law in the areas in which their activities impinge upon the competitive position of private sector firms. We see the core activities of the publicly owned sector being regulated or controlled by the Government (either directly or via sector specific regulators), with the fringe activities being subject to competition law. More generally privatised firms should lose any exemption from competition law that they may have had previously as a public sector firm. Such firms will typically be in a

[92] This broadly reflects what happened in the UK where a cartel law was introduced some 9 years prior to laws allowing for the control of mergers, see Elliott and Gribbin (1977)
[93] See Cruz (1997)
[94] See Dutz and Suthiwart-Narueput (1995)

dominant position and will have every incentive to maintain that position by anti-competitive means. The competition authority will have a role to play in the privatisation process. This role may or may not be formally contained within the law. However it is important that the authority is involved, consulted and stresses the importance of competition in the privatisation process. It may be possible to introduce competition, by removing entry barriers or restructuring at the time of privatisation.[95]

8.2.5 If the competition law is limited in its scope and applicability a significant downside risk arises that it will lose credibility. The law, and those who apply it, should have a high status within government and competition objectives will need to be treated equally alongside other policies. In our experience, failure to do this will result in a failure to create competitive markets and the resulting benefits to society.

8.3 Application of the law

8.3.1 Competition law by its nature carries a presumption that the introduction and maintenance of competition in markets is a good thing. As argued above, free and competitive markets will provide for static and dynamic efficiency. However free i.e. unregulated, markets do sometimes fail. They may fail for three main reasons:

a) market power;
b) externalities; and
c) problems of asymmetric information.

8.3.2 Each area raises issues for the application of competition law. Some obviously call for the application of pro-competition measures whilst others call for limitations on the level of competition. In much of the earlier discussion we have stressed that little or no risk arises from correctly applied law. A rule of reason approach, which correctly balances costs and benefits, should not harm competitiveness or the ability to attract FDI. The downside risk from competition law could arise from the universal pursuit of "competition" as a goal[96] and may result in inefficient market solutions in some circumstances. Our intention is to provide illustrative examples of the problems that may arise rather than a comprehensive survey of all possibilities.

Market power

8.3.3 Competition is not always desirable nor is it, in the absence of government intervention, always feasible. The taxonomy below provides a framework to explore this in more detail.

		IS COMPETITION DESIRABLE?	
IS COMPETITION FEASIBLE?		YES	NO
	YES	TYPICAL CASE	CREAM SKIMMIMNG
	NO	ENTRY BARRIERS	NATURAL MONOPOLY

8.3.4 In terms of the taxonomy where competition is both desirable and feasible no action on behalf of the competition authority is usually required. Conversely where entry barriers exist and competition is desirable but not feasible action using the competition law is fully justified. However the boundaries between what constitutes behaviour by an incumbent to exclude entrants and what constitutes allowable competitive behaviour (the yes-yes box) are blurred in practice. Given this the law may be incorrectly applied to cases in which competition is both feasible and desirable.

[95] For a detailed approach on restructuring for privatisation see van Siclen (1993)
[96] We recognise that competition law may have as its objective "efficiency", however because of the strong links this is almost invariably interpreted as an objective to preserve and maintain competition or the "competitive process".

8.3.5 Our experience suggests that the likelihood of such a downside risk is slight. Competition authorities are naturally and correctly cautious of interfering in the market mechanism The difficulties over the boundaries of behaviour that may or may not constitute an entry barrier or a pro-competitive response are typically found in complicated vertical restraint cases and predation cases. Careful analysis following "best" practice should help classify if the case requires action by the competition authority. However given the nature of such cases the issues may still remain carefully balanced and inappropriate action may result. We believe the risk of this is slight, particularly if a cautious approach in this area is followed.

Competition feasible but not desirable

8.3.6 Of more difficulty for the application of competition law are cases in which competition is not desirable but it is feasible. To expect competition, or to take action to try and force competition in such cases would be socially harmful. A simple example might be where economies of scale or scope dictate that a dominant position (or high concentration) is most efficient[97]. As indicated above we believe the economies of scale case is often overstated and need not apply even in small economies providing that exports allow for economies of scale and scope to be obtained[98].

8.3.7 A more difficult case could involve an industry (or firm) in which joint fixed costs are the norm and in which marginal costs are low. In such circumstances the optimal pricing structure[99] will involve some products making higher profits than others with elements of cross subsidy. Competition and entry which is directed solely at the most profitable lines of business may in these circumstances be harmful as it destroys the sustainability of the "efficient" pricing structure. This form of cream skimming or destructive competition is clearly undesirable. However the industries in which we find the necessary underlying conditions are usually network based and more often than not have evolved to a close oligopoly or near monopoly. The risk in such cases is that the law may be applied because the authority feels "competition " is not working well enough given the high concentration or that fringe entrants (possibly cream skimmers) complain about practices seeking to drive them out i.e. predation.

8.3.8 Equally a danger exists that the competition authority will come under pressure to approve or ignore entry barriers set up by such industries (or government). To do so would ignore the dynamic benefits (downward pressure on costs and stimulus for innovation) that entry would bring. Whilst we acknowledge the risks, which both the simple and more complex cases above suggest, the competition authority should nevertheless be allowed to investigate such cases. The burden of proof in arguing for entry barriers and limitations on competition should always be with others.

Externalities

8.3.9 Externalities are a standard source of market failure. We highlight the difficulties that might arise under competition law in this context. For example financial institutions may well set up rules by agreement[100] which require firms to maintain a particular degree of capital adequacy or to provide evidence of an initial capital base. Such rules clearly constitute an entry barrier and limit competition within the industry. However the rules would appear necessary to counter a possible negative externality amongst depositors. If all depositors were simultaneously uncertain about the ability of the financial institutions to pay back their assets, then it is unlikely that those institutions could meet the "run" on their assets and the system would fail. The capital adequacy rules are necessary to provide a degree of reassurance to the individual depositor and hence prevent the externality arising.

8.3.10 In these circumstances competition law which was applied against such an entry barrier would be harmful to society. We would expect such agreements to be assessed by a rule of reason, with those proposing such barriers to clearly link them to benefits for society. Whilst we see a slight risk that "beneficial" rules which prevent entry and competition might be eliminated by the

[97] The excess entry arguments of von Weisacker (1980) and Perry (1984)
[98] The experience of very small European economies bears this out.
[99] i.e. the (Ramsey) pricing structure which benefits society the most
[100] The agreement may be self-regulatory or involve the government but the expectation is that it will fall within competition law.

competition authority, the risk does not amount to an argument for the rules not to be considered within the context of competition law.

Information problems [101]

8.3.11 As an example here we take insurance markets. These are prone to information problems. Consumers who are high risk can move from insurance company to insurance company and impose "adverse selection" problems on the companies. The result being that low risk consumer's pay more than they otherwise would if the companies could identify and charge higher prices to high-risk consumers[102]. In such circumstances the interests of insurance companies and of consumers are both best served by an agreement between the insurance companies to exchange information about the claims profile of individual customers. Such an agreement has the potential to be anti-competitive and as such would be considered by competition law. The agreement would be very close to an exchange about information on costs and as such could facilitate collusion on rates. Equally the incumbent insurance companies have an incentive to exchange the information amongst themselves but not to new entrants who might take business from them. The competition authority in applying competition law has a delicate balancing act in considering such agreements and risks do exist that it can damage consumer interest by preventing a sufficient exchange of information.

Natural monopoly

8.3.12 In this case competition is neither desirable nor feasible. Typically duplication of the assets is regarded as socially wasteful and competition is seen to provide no benefits. Price regulation, as in utility regulation[103], would then be required to safeguard consumers. Regulations and licences that prevent or limit entry often accompany this. However this position rests upon a static view of what the product is and the least cost way to produce it. We know from experience that regulators face difficulties in gaining sufficient information to control costs and allowing entry, albeit "inefficient" may be the best way to reduce costs. These reductions in costs may well exceed the costs imposed by a loss of scale and scope and that may themselves in time be overcome by an overall growth in demand[104]. Equally the nature of the product may change so dramatically that the idea of "natural monopoly" becomes redundant. The rapid rise of the mobile phone industry illustrates this.

8.3.13 We have sought to highlight the risks that could arise from the incorrect application of competition law. We do not think these risks are large and certainly of insufficient significance to make a case against having competition law. The risks apply both to economies with a long experience of competition law and those new to competition law, although we acknowledge they are greater in the latter case given relative inexperience. The risks are inevitable in any law which requires judgement and in which very clear rules cannot be laid down in advance about every possible aspect of anti-competitive behaviour. Some, very little in practice, rules can be proscribed. This is both a strength and risk of competition law. We consider in the next section how the risks associated with competition law can be minimised.

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[101] For a detailed survey of information issues see Stiglitz (1989)

[102] Such cases are further complicated by the fact that for social reason the government may not wish to see discrimination on tariffs i.e. the poor maybe more "risky."

[103] We do not rule out the very remote possibility that in exceptional circumstances where entry is impossible a non-utility monopoly firm might be subject to price regulation.

[104] I.e. natural monopoly may become natural duopoly or natural oligopoly as a market grows.

Chapter 9

The difficulties in obtaining support for the enactment of competition law within a society

9.1 Introduction

9.1.1 The difficulties in obtaining support for competition law should not be underestimated. For example Joskow, Schmalensee and Tsukanova (1994) regard the lack of public support in Russia for competition policy as being due in part to the perception that not only is there incompetent and corrupt management of the liberalisation/privatisation programme but that it is also unaccompanied by effective law enforcement. In cartel cases judges are often unwilling to infer a conspiracy from indirect and contradictory evidence; some legal systems may not support an inference of conspiracy without a written agreement in evidence, this seems the case in Russia.

9.1.2 Equally in environments where competition is not yet regarded as an instrument of sustainable development, the problem is compounded by absence of political will to sue well-connected individuals and firms, often political contributors to the dominant party. In these milieus, practices that facilitate cartel formation (such as business associations' price lists found in Brazil, Malaysia, Indonesia and a number of other economies), if not explicitly condoned, do not provoke sanctions[105].

9.2 Concerns arising from existence of competition law

9.2.1 The points above reflect concerns about the application of the law but more general concerns arise from the existence of competition law per se. The particular concerns which have been expressed to us by some APEC economies include:

a) a potential fear of undue bureaucratic control of the market mechanism and concern from other agencies over loss of policy control;
b) competition is highly interventionist and very costly to the public and consumer. Over-regulation and unnecessary intervention by the Government would only stifle investment and business activities;
c) competition legislation would increase the costs of doing business;
d) competition legislation would be too general i.e. framed to ban behaviour which was anti-competitive rather than define specific practices and in that sense it would be unenforceable or too specific in terms of a per se prohibition approach so as to discourage investment;
e) vertical and horizontal agreements can be economically efficient and justifiable. Competition law applied against such agreements could thus be counter productive and
f) competition law may undermine the ability of business to adapt quickly to market changes and prevent development in certain industry sectors where mergers and acquisitions are common commercial practices and do not give rise to any anti-competitive implications.

9.2.2 Most of these concerns appear to arise from an incomplete understanding of competition law and how it is applied together with a reading over of the "worst practice" of some competition authorities in developed economies. Above all these concerns stress the need for advocacy and explanation of the role and scope of competition policy. We return to the advocacy issue below but first address briefly the concerns.

9.2.3 Competition law and policy should only apply to areas of actual or potential market failure and thus it is not in conflict with the effective operation of the market mechanism. A competition authority will typically generate greater benefits for the economy than its costs of operation[106]. Far

[105] see Alexander and Petri (1996) and Simandjuntak (1995)

[106] See Morrison and Elliott et al (1996)

from stifling business and investment a competitive environment in which firms could have a degree of certainty that they would not be subject to anti-competitive practices would lower the cost of capital and have a positive impact on investment. The regulatory cost would fall in the main upon those firms that seek to distort the competitive process. We accept that competition law will require the application of a rule of reason with little in the way of per se rules. Thus, it is argued the law increases uncertainty in that it is difficult for businesses to assess in advance what might be viewed as anti-competitive. This uncertainty can be addressed by the competition law being accompanied by guidance on how it is to be applied. Again this forms part of the advocacy role. A competitive economy in which anti-competitive entry barriers are removed will allow for businesses to respond more quickly to the need for change than one in which entry barriers are prevalent. Whilst it is true that many entry barriers are due to government regulation it is equally true that firms in a dominant position have every incentive to erect strategic barriers. The cases we described earlier of the strategic response to trade liberalisation illustrate this graphically.

9.2.4 Despite what we would argue are the overwhelming benefits of competition law it is the case that in many economies that have introduced such law the results have been disappointing. This has been due to a variety of reasons however; one common feature seems to have been a lack of popular support for, and awareness of the law. Those economies that have been notably successful in introducing such law do appear to have followed a strategy directed at initially publicising their activities and seeking broad support within society. It is fair to say that many of us involved in initial wave of reform in Eastern Europe saw the key problems then as ensuring that the laws were correctly drafted and that academic training in "market" economics was provided. With hindsight we can appreciate that these are necessary conditions for success but in themselves are not sufficient.

9.3 Difficulties in introducing competition law

9.3.1 Those economies, particularly developing economies, which are "late comers" to the introduction of competition law, face broadly a common list of difficulties[107]:

a) political and bureaucratic resistance;
b) a bad reputation for the public sector, excessive bureaucracy, corruption and a lack of transparency;
c) inadequate judicial systems;
d) weak professional and consumer groups; and
e) a lack of resources and professional expertise within the competition authority.

9.3.2 We do not elaborate on these difficulties here[108] but on their solutions. Our experience suggests that in addressing these problems it is important to focus on three broad areas:

a) clarity within society about the aims and objectives of competition law;
b) advocacy of those aims across all sections of society and
c) developing confidence in the ability and institutional strength of the competition authority.

To an extent these areas are related, clarity aids advocacy and advocacy is an important aspect of building confidence.

Clarity within society about the aims and objectives of competition law.

9.3.3 It is important that both consumers and producers are clear about what competition law can and cannot do. As part of this process it will be necessary to educate both groups about the law. For consumers a danger exists that the expectations for competition law are too high. Equally in countries in which the non-government sector has been traditionally dominated by a few conglomerates a distrust of the "market system" is to be expected. Similarly within the producer sector tensions exist in opposite directions. Those with a position of economic and often political power will seek to prevent the enactment of such laws in order to preserve their position. Others

[107] We do not wish to imply that all economies without a competition law have these characteristics, but many have some.
[108] See chapter 10

will see competition law as presenting and opening up a range of opportunities. However again a danger exists within this latter group in that they mistakenly see the law as aimed at "protecting" competitors rather than protecting the competitive process. Additionally because competition law is typically accompanied by a reduction in government involvement in the economy, resistance is to be expected from those areas of government most closely affected. Competition law enshrines principles of economic democracy however like any move towards democracy it will be seen as a threat by some and an opportunity by others.

9.3.4 Given the above an obvious need exists to present the objectives of the law in "lay" rather than legal terms[109]. We see this as part of the advocacy role discussed below. Clarity about the aims will require the existence of other laws, both to reassure society about real concerns that can arise and to define the role of competition law. For example laws in the following areas:

a) contract law;
b) protection of IPR's;
c) regulation of particular sectors i.e. financial services, utilities;
d) corruption, corporate governance, etc;
e) stock exchange rules on disclosure; and
f) consumer protection.

9.3.5 The latter is of particular importance. It has often been argued that the competition law and the competition authority should have no role to play in consumer protection.[110] In this view a new competition authority is likely to be inexperienced and have little resources. Thus spreading its responsibilities wider will deflect it from its main task of promoting competition and perhaps expose it to pressure from particular interest groups. Against this consumer protection will often involve issues of information and empowering consumers with the ability to choose effectively amongst suppliers. As such the exercise of consumer choice is a vital element in competition between suppliers. Mostly consumer protection and the application of competition law work together. Occasionally they will conflict[111], however in our view both policies are stronger for being carried out within one institution. We recognise that others may not share this view.

9.3.6 Additionally, and perhaps of more relevance the consumer protection role provides a mechanism for the competition authority to appeal directly to consumers. It enables it to publicise both itself and pro-competitive actions that have a clear consumer benefit. Having a single institution for the application of consumer and competition law will strengthen the ability to advocate the cause of competition and assist in raising the profile of the competition agency.

Advocacy

9.3.7 Success in establishing a competition law will depend upon the skill and resources used in gaining the confidence and support of society. Advocacy of the benefits, in general and as a result of actions in particular from applying the law, are central to this. The authority should not hesitate to publicise successful cases. Indeed the recipe for success might well be said to choose the initial cases with a view to the publicity benefit that might be obtained. Thus the application of the law should initially be focused upon cases with little political opposition but with a high and direct consumer benefit.[112]

9.3.8 Both consumers and producers will need to be assured that the law will be applied without discrimination. As part of building that confidence the law will need to enshrine the independence[113] of the authority and its head. The competition authority should become the focal

[109] We do not develop the form in which this might done. Our own experience suggests each audience needs to be targeted separately.
[110] See Stockman (1993) for example.
[111] For example the capital adequacy rules discussed above, see paragraph 8.3.9 could be interpreted as consumer protection policy which creates an anti-competitive entry barrier.
[112] The clearest example of this approach is in Peru, where the competition authority took as one of its earliest cases a price cartel amongst chicken producers.
[113] We do not mean by this that the competition authority cannot be part of government, the appropriate institutional arrangements vary with each economy.

point for consideration of potentially anti-competitive actions both by private firms and government. Advocacy should initially be directed at specific interest groups such as consumer protection bodies and trade or wider business associations. The former needs to be educated that competition is the best protection for consumers. The latter present a more diverse audience and much of that which follows is directed at this group, who will in the nature of things have both economic and political power.

9.3.9 Producers will find reassurance if the authority has a structure and method of operation that they are familiar with, rather than being like a traditional government department. Thus the competition law might include provisions for the treatment of cases within certain time periods, or these might be public (non-statutory) targets for the authority. The aim is to create and demonstrate that a professional and business like culture exists. Complaints will be treated seriously in a timely and non-discriminatory manner.

9.3.10 Advocacy goes beyond informing society what the law can and has done. It acts also as a preventive measure. A test case against a particular form of behaviour can have a ripple effect throughout the economy. Equally a successful case can be used as a precedent to force changes in behaviour without the need to use valuable resources. As an example the UK law on cartels was introduced in 1956. Following a highly publicised test case in early 1959 over 2000 cartels agreements were subsequently voluntarily abandoned[114].

9.3.11 Advocacy will not only be about the competition authority informing society about the benefits of competition law but also about being seen to apply the law correctly. Transparency and adherence to due process are central in developing the confidence of all groups of society. Transparency enables the competition authority to build up a reputation for both the quality and impartiality of its work. It enables the authority to avoid being "captured" by a particular interest group. The law should not only require for the publication of decisions but the detailed reasoning behind the decisions. Due process is equally important to building business confidence and ensuring non-discrimination.

9.3.12 With the competition law essentially being applied using a rule of reason it will be important to issue guidance. Such guidance[115] has a role in informing society in more detail than the "law" about, for example, what is and is not to be judged as anti-competitive behaviour and how the evidence will be assessed in reaching a conclusion and the procedures to be adopted. Equally such guidance forms an aspect of the "internal procedures" manual for the competition authority. We take the view that issuing such guidance should be statutory obligation on the competition authority[116]and we would expect any deviations in particular cases to be justified. Of course developments in theoretical and applied economics might suggest variations to such guidance, as would experience and legal precedent.

9.3.13 In addition the competition authority should play a role in advocating competition principles more broadly within government (see paragraphs 3.1.6 and 3.1.7).

Institutional strengthening

9.3.13 Self evidently the competition authority needs to attract and retain high quality staff. The attraction of the competition authority will be enhanced by its profile and reputation within society and hence feed off the advocacy role. The independence, transparency and regard for due process all serve to create an attractive working environment for the high quality economists and lawyers required. However the retention of such staff will prove in practice quite difficult, particularly in the context of a growing private sector which will have the ability to pay higher wages than the

[114] See Elliott and Gribbin (1973)
[115] For example we might think of guidance on how the relevant market is to be defined or allegations of predatory pricing assessed.
[116] The new competition law to be introduced in the UK in March 2000 has made the issuing of guidance a statutory duty.

public sector. Many new competition authorities have suffered from high staff turnover that has weakened them[117].

9.3.14 Such a high staff turnover can in part be countered by building links with universities. The universities should be seen as sources of both technical advice and of new graduates. However this will require that the universities teach the appropriate economics and law courses. More importantly the consequences of staff turnover can in part be addressed by training both provided internally and by external advisers.

Internal training

9.3.15 The guidance manuals (see paragraph 9.3.12) would provide new staff with access to the approach to be adopted. These should be supported by case histories so that the collective memory of the authority is available. The guidance manuals and case histories also help in offsetting the effects of high staff turnover. The authority should seek to create a climate in which new ideas and approaches can be discussed openly and diffused widely amongst its staff.

External training

9.3.16 Formal training provided by outside experts, such as OECD, World Bank, Unctad and PwC needs to be carefully structured. At one level it must be cognisant of the latest advances in economic theory in the relevant areas but above all it must be directed at obtaining the best practical solution to cases. Many new competition authorities initially receive a somewhat "academic" training in the relevant law and economics but what they lack is the subsequent confidence to apply these tools in practice. Our experience suggests that the most effective training is case based, preferably from actual cases in the particular economies. Nevertheless such training should not be seen as a one-off exercise. It needs to be supported by internal training, repeating and developing upon previous external training, and by continuous support from the external trainers. New competition authorities, by definition, lack experience and they need to be able to consult experienced practitioners as a sounding board for the approach they are considering in a particular case. The external consultant should not take or vet decisions but provide support in ensuring those relevant arguments, both for and against have been addressed.

9.3.17 A key area for training is the judiciary or administrative tribunal that is required to reach the decision on cases.[118] In several countries we have seen reluctance in applying competition law because of the fear on behalf of the competition authority of losing cases. This fear stems from a lack of experience in the judiciary of competition cases and of their difficulty in dealing, not with issues of law per se but with cases that require economic judgement[119]. A vicious circle is created in which the courts never gain experience and cases are never sent. Whilst this is an exaggeration it has been a factor constraining the application of competition law in many countries. Training of the judiciary is of equal importance to that of the competition authority. External trainers who can prepare the evidence on both sides of a particular case are best to conduct this. The external trainers will have experience of acting as expert witnesses and can thus present both sides of the case and in effect "role play" a trial for the court to judge.

9.4 The experience of Brazil

9.4.1 The experience of Brazil provides an instructive example of the early stages of a competition authority[120]. The Minister of Justice in Brazil first sought to introduce competition law in 1945. Eventually in 1951 criminal law came into being which provide for penal sanctions for breaches of certain restrictive practices. However no tradition of prosecuting white collar crime

[117] Even in an economy such as the UK the "quality" of professional staff in the competition authorities fluctuates over time, whilst that of the non-professional staff has always been low.
[118] Different systems will have different structures; the competition authority may itself take the decisions with the judiciary or specialist tribunal acting as an appeal court.
[119] Our view is that the ordinary courts cannot be expected to deal fully effectively with competition cases, they require a specialist court/judges although we recognise that in many jurisdictions ordinary courts do deal with competition cases.
[120] See description of Brazil draws upon Malard (1996) and Oliveira (1998)

existed and the law was little enforced. Later in 1962 and again in 1967 changes to the law were made to increase its coverage. In 1990 a new law was passed recognising that the previous law had been inadequate. Institutional changes were made to enforce the law more vigorously. A Secretariat was created under within the Ministry of Justice to investigate practices and submit them for trial to CADE, the former competition body. Neither the new law nor the novel institutions were successful in changing the pattern of competition law enforcement. In 1994 a further law was passed incorporating a third body, one of the Secretariats of the Ministry of Finance, into the enforcement system. Enforcement was not improved and all three bodies lacked suitable experts.

9.4.2 Brazil had a culture of price control and the sectors chosen by the competition authority for investigation seem to be those which appeared not to co-operate with government policy to curb inflation or disobey price regulation. Thus from 1992 to 1994 the Secretariat opened 211 investigations[121] charging companies with excessive profits and only 71 cartel investigations, when it was widely known that firms still used the common price lists ruling during the period when price control was enforced. None of the investigations had by 1996 reached the adjudicative stage.

9.4.3 In the light of the earlier problems the authority, under a new head, subsequently adopted a three-stage approach. Stage one involved an extensive and ongoing programme of competition advocacy, an attack on horizontal cartels and external technical assistance. Essentially the initial aim was to get the authority back on course, inform society of what it could and could not do, choose its cases carefully to achieve the biggest payback (both politically and in terms of actual benefit) and to improve the technical skills of the authority via external assistance. The second stage was to address merger control and vertical agreements. It appears, that perhaps in an effort to correct its earlier failings, the authority lost some political support by attempting to tackle mergers for which the defence was based upon a need for international competitiveness[122]. As argued earlier the sequential approach to the control of cartels and mergers has dangers. In the third stage, which it is currently entering, it sees increased co-operation with the specific regulatory agencies. Broadly the policy has been to set clear objectives within a gradualist approach. A clear management culture based upon targets and transparency has been established. A strong emphasis has been placed upon training and links with universities. However the overriding theme is of the importance of advocacy and education. To an extent Brazil is building upon the experience of Poland and Peru in this latter respect.

9.4.4 If nothing else the Brazilian case demonstrates the difficulties in finding the correct balance to maximise support at any given time. Having a competition law is in itself of little use[123]. The current success of the authority owes much to the reputation for independence that it has now established and the shift of emphasis to advocacy. Whilst this may have brought it into conflict with other parts of government the authority is now highly respected and has attracted high quality staff.

9.4.5 We recognise that the process of obtaining support for competition law and its application is difficult. Support for the law is merely the first stage. Continuing efforts and resources have to be made to ensure that the competition authority gains support in its work. Some valuable lessons have been learnt on what is required for this. Competition authorities must devote time and resources to advocating the cause of competition and their role and success in achieving this.

9.5 Law and Institutional Structure

9.5.1 We conclude this chapter with a few observations drawn from our wider experience on the nature of the law and institutions to successfully implement competition law. Broadly two forms of law are available; the prohibition model as favoured in the EU and much of Eastern Europe or the administrative model. In the prohibition model the law attempts to say what is likely to be anti-competitive leaving the Courts to enforce the law and set precedent by case law. Under the

[121] The pharmaceutical industry was the subject of 107 investigations, many alleging making up products to circumvent price control.
[122] See Fristak and Pittman (1997)
[123] Argentina first had a competition law in 1919 and the current law established in 1980 set up a Competition Commission. For many years the Commission has remained very small and largely inactive.

administrative model more discretion is left to the competition authority to both enforce the law and to set the precedent, perhaps by published guidelines.

9.5.2 For example, a prohibition system in which cartels and monopoly abuse are subject to legal penalties (fines and perhaps imprisonment) would seem to require a tradition of an independent judiciary. Such a system could require specialist courts or be administered by the "ordinary courts". We would favour the former but recognise that in many countries ordinary courts carry out this task. In contrast the pure administrative model has an anti-trust authority countering anti-competitive issues by powers to alter behaviour and perhaps structure but not to levy fines or impose imprisonment. It is important that in such a system the anti-trust authority or the tribunal which takes the decisions is independent of government and other influences.

9.5.3 Clearly the distinction between the models can become blurred in practice. It is often the case that an anti-trust authority will have powers to levy fines within a prohibition system. However such decisions will be potentially subject to appeal to a specialist or ordinary court of law. Both models have been tried amongst economies newly introducing competition law. As a general conclusion the prohibition model has not worked as well as it does in those economies with a long tradition of anti-trust law. This stems from the fact that only a limited number of per se rules can be specified and that most competition issues need to be based upon a case by case assessment. A judiciary without the relevant experience clearly will have difficulty administering such law particularly where no case law exists. Drawing upon case law as it relates to other economies and conditions may not be useful. To overcome this some economies i.e. New Zealand and the UK have a tradition of appointing lay assessors, usually economists, to assist the Courts in reaching their decisions. The administrative model is more reliant on political support and where this has existed i.e. Poland and Ukraine it has worked tolerably well but in other countries such as Belarus where such support is lacking the competition authority has failed to establish itself.

9.5.4 It is our view that no unique model exists for all economies. The mix of institutions and people has to be tailored to the particular economy. No system will work effectively without suitably qualified people and the necessary political support. However the appropriate system for a given economy can make much difference. For example the court based system in Russia led to problems because of the lack of experience of a market economy and training in the necessary economic concepts for the judiciary. In contrast Poland's successful administrative system was led initially by dynamic and well informed people. The authority took early action and created a good reputation that set off a virtuous circle. Its advocacy role reinforced its success and it has continued to attract good staff and political support[124].

9.5.5 The political conditions and the nature of the institutions determine the nature of competition enhancing policies that can be pursued. The table below illustrates the broad relationships that seem to emerge.

Conditions	Institution	Policy Emphasis
Independent and expert	**Specialist courts**	**Prohibition of cartels,**
Political will, but no independent courts/tribunals	**Ministries, with co-ordinating mechanism**	**Introducing competition upon privatisation, through external trade, through de-regulation and lower entry barriers based upon government regulations**
Political will and tradition of independent tribunals	**Anti-trust authority**	**Case -by-case approach to mergers, monopolies and cartels**
No political will	**None**	**No progress likely until highest level of government convinced of need for competition or coerced by conditionality or desire to join WTO etc**

[124] For an assessment of the early experience of competition law in Poland, Hungary, Slovakia and the Czech Republic see Fingelton, Fox, Neven and Seabright (1995).

Role of advisers and international agencies in building support and institutions

9.5.6 Experience suggests that external advisers have helped greatly in the process of building support. They can advise on the best system given the circumstances of the particular economy. For example many economies which are seeking closer links with the EU are being "encouraged" to adopt the EU prohibition system of competition law. Indeed for the reasons outlined above, for many economies this is likely to be inappropriate. Clearly advisers can help in the drafting of law and regulatory structures. Too often countries seek to draft elaborate laws that are difficult for business to understand and for the competition authority to apply. The Kenyan competition law is an example of this. Repeatedly changing the law, as in the Brazilian case, can also be counterproductive. External advisers can assist in developing law that is simple, clear and effective to apply and likely to be robust to changing circumstances.

9.5.7 Advisers can assist with institution building, in terms of assessing priorities and the development of suitable organisational, management and accounting structures. As discussed above they can play a key role in providing the correct type of training and in developing methodologies and guidelines appropriate to the particular economy. Finally advisers can play an important role in initial advocacy, by informing the business community about the processes involved in competition law and the benefits to be obtained. Equally, external advice can be sought by companies in the form of competition audits to ensure that their current practices are not anti-competitive. Our experience suggests that external advisers in a variety of ways can do much to develop a competitive culture within an economy. Such a culture cannot be obtained by competition law alone, both business and government has to understand that it is in their mutual self-interest to promote and develop such a culture.

Chapter 10

Other factors influencing the implementation of competition law and moves toward increased competition within an economy

10.1 Introduction

10.1.1 The previous section concentrated upon the need to build support for the implementation of the law and the creation of appropriate institutional structures. In this section we develop that theme by looking broadly at the factors which more generally assist the move towards the creation of a competitive economy. We consider this mainly in the context of 4 case study economies: Mexico, The Republic of South Korea, The Philippines and Malaysia. For this work we use two main sources: the Global Competitiveness Report for 1997[125] and the APEC individual action plans for these economies. The former allows us to identify the competitive weaknesses in these economies and the action plans allow us to assess the extent to which they are being addressed. Annex 1 presents the basic data, Table 1 shows broad macro-economic indicators for the case study and a sample of other APEC economies. Table 2 identifies a more detailed list of factors taken from the Global Competitiveness Report (GCR). It should be stressed that the GCR is based upon a questionnaire sent to business executives in each country and as such reflects the perceptions of the respondents.

10.2 Macro-economic issues

10.2.1 The recent macro-economic downturn is not conducive to generating a climate that is favourable toward greater openness in trade and competition. Notwithstanding the arguments above that greater competition will increase competitiveness and efficiency, many economies will be pre-occupied with the problems arising from the Asian crisis. As can be seen from Table 1 in Annex 1 the crisis has had a significant impact. In these circumstances it could be difficult for our case study economies to proceed further with either strengthening their competition law or introducing such law. Whilst it is undoubtedly true that the introduction of competition law would assist the recovery it could add in the short term a significant cost in terms of increased unemployment upon an already high level.

10.2.2 From Table 2 it can be seen that income inequality is perceived to have increased in all economies except Chinese Taipei and Japan. Again this is not helpful in creating a climate conducive to a more competitive economy particularly given the fact that the little evidence which exists suggests that de-regulation has resulted in greater income inequality[126].

10.3 Trade barriers

10.3.1 The data in Table 2 suggest that the level of tariffs is not on balance seen as an impediment to the ability to import materials and equipment in any of the APEC sample economies. Nevertheless support for this view was below average in Korea, Malaysia, Australia, China, Thailand and Japan. Given that many APEC economies are highly concentrated the ability of new competitive firms to grow may well depend upon the availability of imported resources and as such import tariffs will clearly impede this.

10.3.2 Mexico, Malaysia, Korea and the Philippines have all lowered the overall level of tariffs in recent years. We note that Korea has unilaterally reduced its tariffs on 182 raw materials and semi-finished goods.

10.3.3 Japanese executives see non-tariff barriers as an important barrier to entering the Japanese market. This suggests that despite the efforts of the Japanese Fair Trade Commission (see

[125] World Economic Forum (1997)

[126] see Waddams-Price and Hancock (1998) and Chisari, Estache and Romero (1997). Both these studies show that all consumer groups have gained from de-regulation but that the richest groups in society have gained most.

paragraphs 4.3.1 to 4.3.2) important obstacles to imports remain. We note that the survey suggests this may also be a factor in the 4 case study economies as well as again in Australia, China and Thailand. Korea plans to terminate its import substitution programme in mid 1999.

10.4 Openness of the economy[127]

10.4.1 Foreign investment is an important element in changing the structure of an economy. It provides a key source of new technology and competition to existing firms. For economies with capital constraints and dominant domestic firms it may provide the most important source of new competition. Cross border ventures would seem less easy to negotiate in most of the sample APEC economies than in other economies in the World. Foreign investors also find APEC markets (with the exception of Hong Kong) less easy to enter by acquisition than other economies. Korea appears more difficult in this respect than other APEC economies. APEC economies vary in the significance of FDI as a source of new technology. We note from its Action Plan that Korea has reduced the number of sectors with restrictions upon FDI. Cross border mergers and acquisitions are also said to be liberalised and the Action Plan records Korea's commitment to enhancing market openness for foreign investment. We also note that the Action Plans for Mexico and Malaysia both seek to relax restrictions on foreign investment.

10.4.2 The openness of government procurement to foreign firms appears to be a problem in Korea and Japan. The Korean Action Plan contains no proposals to liberalise government procurement.

10.5 State owned firms

10.5.1 State owned firms appear to have a dominant role in Singapore, Chinese Taipei and China. It is important that such firms are not exempt from competition law where applicable, or from competition from private firms, except where this would be inefficient i.e. for reasons of natural monopoly.

10.5.2 The existence of a large public sector suggests that privatisation is likely to be an important issue. We have seen above (i.e. Korea paragraph 3.1.7) the essential role which competition authorities have in the privatisation process. The competition authority is best placed to seek to ensure that privatisations are conducted in a way that increases competition rather than just merely transfers the ownership of assets from public to private hands. Without competition law and a competition authority it will be difficult to ensure that privatisations take account of competition considerations.

10.5.3 It is of interest that the Korean competition law excludes the activities of government agencies from its coverage whereas in contrast in Mexico no general exclusions exist for state, federal or municipal agencies.

10.6 Government regulations and bureaucracy

10.6.1 The efficient functioning of a market economy requires that firms are free to enter and exit industries. Government regulations are in many economies the most importance source of entry barriers. Not only do the regulations in themselves hinder entry they also typically provide a means for existing firms to prevent entry by potential competitors. Existing firms can do this either directly by objecting to potential new entrants, for example perhaps the wording of the regulation requires new firms to establish a "need" before they are granted a licence, or by exerting political pressure on those who grant licences. Equally lengthy and time-consuming bureaucratic processes can impede the efficient functioning of markets.

10.6.2 We note that such regulations and bureaucracy has been identified by business executives as a feature in several APEC economies and serves to diminish competition.

10.6.3 Korea and Mexico both have programmes for the review of regulations that involve input from the competition authority. The Korean Action Plan provides a commitment to review all

[127] In this section and subsequent sections we draw mainly upon Table 3 in Annex 1

regulations. Mexico is seeking to speed its administrative processes by setting deadlines for responses. The business application will be automatically granted if these deadlines are not met by the authorities.

10.7 Quality of regulation

10.7.1 From Table 2 it appears that Korea and Thailand are perceived as having government policies that are not impartial and transparent. Also in Thailand the regulations are seen as being imprecise and the civil service as not being independent of political pressure. This latter problem also occurs in Mexico, Korea, Philippines, Chinese Taipei and Malaysia. In most APEC economies the public sector is regarded as being less competent than the private sector.

10.7.2 These issues are capable of being addressed by the broad advocacy proposals we have set out above. The survey evidence suggests that such advocacy has a role and is needed both in economies that currently have competition law and those that do not.

10.8 Finance

10.8.1 In any competitive economy it will be important that new and existing firms are able to obtain finance to enter new markets. Such finance should be available on non-discriminatory terms. Problems in respect of the availability of venture capital[128] appear to exist in Mexico and Japan. More generally the banks in several APEC countries perhaps treat small firms less favourable than in other economies. These financial issues suggest that a degree of bias may exist in favour of existing firms, particularly large firms, which will hinder markets being fully competitive. We note that legal reforms have been introduced in Mexico, which reduce the cost of borrowing.

10.8.2 It appears that the Chaebol and other large firms in Korea were granted credit on favourable terms and we might conjecture that this would have led to a higher debt equity ratio than would have been sustainable under non-discriminatory and free market determined interest rates. These high debt equity ratios have made the adjustment required by the current financial crisis more severe.

10.9 Management and corporate control

10.9.1 The efficiency of firms will depend in part on the quality of management. Only China recognises any deficiencies in this respect. However the management of firms may not be sufficiently motivated by profit considerations to generate efficiency and external influences via an effective "market" in management is perhaps required. To an extent this will arise from a market in corporate control, inefficient management is disciplined by take-over and or by corporate boards exercising control.

10.9.2 We note that in Mexico, the Philippines, Thailand and Japan hostile take-overs do not seem to offer a means of control. This is perhaps less of a problem in Mexico and the Philippines which seem to have above average corporate control, however this is not the case in Japan and Thailand. In Malaysia and Chinese Taipei whilst hostile take-overs do arise the corporate control market may not operate efficiently due to insider trading.

10.10 Social welfare

10.10.1 We have discussed above the need for social welfare to alleviate any short-term unemployment induced by competitive changes in the economy. However we did stress the need for other policies to improve flexibility in product and labour markets to avoid longer-term employment problems. We note that alone amongst the APEC economies Australia is regarded as having social policies that do not aid labour flexibility.

[128] n.b. the survey was conducted prior to the current financial crisis in Asia.

10.11 Market dominance and anti-monopoly policy

10.11.1 Market dominance by a few companies is perceived to be a problem in several APEC economies. Such dominance poses particular issues for the introduction of greater competition. Clearly existing dominant firms have an incentive to behave anti-competitively towards new and potential entrants and as such the competition law and authority must be capable of acting swiftly and effectively against such practices. However dominant firms will often have first mover advantages that require little or no action on their behalf to maintain. A competition law, which is expressly designed to address only behaviour[129] and not structure, might be insufficient where such dominance is common. Whilst we do not advocate a structuralist approach to competition policy it is important that powers do exist to order divestment in cases where the dominant structure is itself regarded as harmful to the objectives of the law.

10.11.2 Of course most competition law provides for structural remedies in respect of mergers and as we have argued merger control law is an essential part of any competition law. This is important in economies with an existing structure of dominance. Equally and particularly in such economies, competition authorities should make a structural input, i.e. seek to create competitive structures, where privatisations are being considered.

10.11.3 Whilst it is of interest that anti-monopoly policy in Korea is possibly regarded as less effective than that in other countries we note that plans to improve merger control and reduce exemptions from the law exist. Korea also has a system in which “market dominating” enterprises face higher fines for abuse than other firms do. This may go some way to reducing the incentives that we observe above.

10.12 Legal and political system

10.12.1 Irregular payments to facilitate business seem to be a feature in some APEC economies and suggest a need for strengthening the application of the law in this respect. Also it would also appear difficult for private businesses to obtain impartial redress against the government in some economies

10.13 Summary

10.13.1 We have highlighted a range of issues that will hinder the effectiveness of competition law alone in generating a more competitive economy. Some of these problems are being addressed within the Action Plans of the individual economies. The issues we have identified are relevant to both economies with and without a competition law. To a large extent the issues identified serve to reiterate one of our main themes, which is that competition policy must be viewed as part of a range of policies designed to increase competition and it is important that these policies are operated in a complementary manner.

[129] For example the law in Argentina "targets behaviour not market structures, it deals with consequences not causes" from OECD (1998) Argentine Annual Report 1997.

Annex 1

Table 1

Macro-economic indicators

Indicators	Economies											
	Mex	Kor	Phi	Mal	Sin	Aus	Nzl	Cta	Hk	Chi	Tha	Jpn
Real GDP growth 1998 %	4.6	-6.5	-1.6	-6.0	0.3	3.6	-0.7	4.6	-5.2	7.8	-8	-3.0
Inflation 1998 %	15.9	7.5	10.0	5.2	-0.3	0.8	1.6	1.8	2.8	-0.5	8.8	0.4
Growth in real exports 1998 %	6.6	13.9	-7.6	2.0	-4.4	-1.0	0.4	4.3	-4.5	2.0	5.5	-1.7
FDI as % of GDP 1998	1.6	0.4	1.3	5*	8	1.5*	0.32	1.16	1.47^	0.86	1.9	0.19
Unemployment 1998 %	2.7	7	7.9*	2.5*	2.4*	8.7*	6.7*	2.7	5.5	3*	4	4.6

Sources: EIU World Outlook 1999, OECD
^ = 1995, * = 1997

Table 2

Subjective factors which assist implementation of competition law and greater competition within an economy

FACTORS	ECONOMIES											
	Mex	Kor	Phi	Mal	Sin	Aus	Nzl	Cta	Hk	Chn	Tha	Jpn
Income gap between top 20% and bottom 20% has declined in last 5 years	**D**	**D**	**D**	**D**	**D**	**D**	**D**	A	**D**	**D**	**D**	A
The level of tariffs is not an impediment to the ability to import materials and equipment	A	**A**	A	**A**	A	**A**	A	A	A	**A**	**A**	**A**
Non tariff barriers are not important	**A**	**A**	**A**	**A**	A	**A**	A	A	A	**A**	**A**	**D**
Cross border ventures can be negotiated easily	**A**	**A**	**A**	**A**	A	**A**	A	**A**	A	**A**	A	**A**
FDI is an important source of new technology	A	**A**	A	A	A	A	A	A	**A**	**A**	**A**	**A**
Foreign investors are free to acquire control of domestic firms	**A**	**A/D**	**A**	**A**	**A**	**A**	**A**	**A**	A	**A**	**A**	**A**
Public sector contracts are open to foreign bidders	**A**	**D**	**A**	**A**	A	A	A	**A**	A	**A**	**A**	**D**
State owned/controlled firms do not have a dominant role	**A**	A	A	**D**	**D**	A	A	**D**	A	**D**	A	A
Government regulations do not impose a heavy burden on firms	**D**	**D**	A	A	A	**D**	A	**D**	A	A	**D**	**D**
State interference in private business is minimal	**A**	**A**	A	A	A	**A**	A	**A**	A	A	A	**A**
Senior management of your company spends less than 30% of its time dealing with government bureaucracy	**A**	**A**	**A**	**A**	A	A	A	**A**	A	**D**	**A**	A
On average public sector personnel are more competent than those in the private sector	**D**	**D**	**D**	**D**	A	**D**	**D**	**D**	**D**	A	**D**	A
Government economic policies are impartial and transparent	**A**	**D**	A	**A**	A	A	A	A	A	A	**D**	**A**
Government regulations are precise and fully enforced	**A**	**A**	**A**	A	A	A	A	**A**	A	**A**	**D**	A
The civil service is independent from political pressure	**D**	**D**	**D**	**D**	A	A	A	**D**	A	A	**D**	A
Tax evasion is minimal	**D**	**D**	A	A	A	A	A	**A**	A	**D**	**D**	A
Venture capital is readily available for new firm development	**D**	**A**	**A**	A	A	**A**	A	A	A	A	**A**	**D**
Banks treat small and large firms equally	**A**	**A**	A	**A**	A	**A**	A	**A**	A	**A**	**A**	**A**
Hostile take-overs by share purchase is something managers have to take into account	**D**	A	**D**	A	A	A	A	A	A	A	**D**	**D**
Insider trading is not common	**A**	**A**	A	**D**	A	A	A	**D**	A	**A**	**D**	A
Quality of management world class	**A**	**A**	A	**A**	A	**A**	A	A	A	D	**A**	A
Corporate boards are highly effective at monitoring management performance	A	**D**	A	A	A	A	A	A	A	**A**	**A**	**A**

Table 2 (cont.)

Subjective factors which assist implementation of competition law and greater competition within an economy

FACTORS	ECONOMIES											
	Mex	Kor	Phi	Mal	Sin	Aus	Nzl	Cta	Hk	Chn	Tha	Jpn
Unemployment insurance makes a good trade off between social protection and work incentives	A	A	**A**	A	A	**D**	**A**	**A**	A	A	A	A
Social welfare system has preserved labour market flexibility	A	A	A	A	A	**D**	A	**A**	A	A	A	A
Market dominance by a few companies is not common	**D**	**D**	**D**	A	A	**D**	**D**	A	A	A	**D**	A
Anti-trust or anti-monopoly policy effectively promotes competition	A	**A**	**A**	**D**	A	A	A	A	**A/D**	A	**D**	A
Irregular payments are not common in business or official transactions	**A**	**A**	**A**	**A**	A	A	A	**A**	A	**A**	**D**	A
Additional payments to avoid regulations have decreased in the last 5 years	A	**A**	**A**	A	A	A	A	A	A	**A**	**D**	A
Legal system is effective in enforcing commercial contracts	**A**	**A**	**A**	A	A	A	A	**A**	A	**A**	**A**	A
Private business can readily obtain impartial action in the courts against breaches of trust by the government	**A**	**A**	**D**	A	A	A	A	**A**	A	**A**	**A**	**A**
More democratic political institutions would lower the cost of doing business	**A**	**A**	A	**A**	**A**	A	A	**A**	A	**A**	**A**	**A**
Organised crime does not impose significant costs on firms	**A/D**	A	**D**	A	A	A	A	**A**	A	**A**	**A**	A

Notes: Business executives in each country were asked to rank their response to each question on a scale of 1 to 7. Where the average score for the country exceeds 3.5 we regard that as agreeing with the statement and signify that with A, a score less than 3.5 is shown by D (dark shading) and a score of 3.5 as A/D. To an extent that comparative performance between countries is also of interest we also highlight (light shading) scores over 3.5 which are below the median of other countries. N.B. this is reversed for the penultimate statement.

Source: The information is taken from the Global Competitiveness Report for 1997 and is based upon a questionnaire sent to 3000 business executives, as such it represents their perception of conditions in their own country. The survey covers 53 countries in total.

Annex 2

A Framework for the Design and Implementation of Competition Law and Policy[130]

1. Objectives and Scope of Competition Law

1.1 We have discussed above in section 3.2 the differing approaches to defining the objectives of competition law. The suggested approach of the World Bank and OECD is to regard competition law as being intended to maintain and enhance competition in order to promote consumer welfare. Competition law is an essential part of the economic constitution of a free market economy. It should as much as possible, apply to all market transactions and to all entities engaged in commercial transactions irrespective of ownership or legal form. All exceptions to the application of the law should be explicitly identified in pertinent legislation.

2. Definitions

2.1 The competition law should define common terms that are used in law and that are needed to interpret its provisions consistently.

3. Abuse of dominant position

3.1 In many countries, the position of a firm is not dominant unless the share of the relevant market exceeds 35%. In some countries' law a market share of 65% or 70% creates a presumption of dominance that the firm must rebut. Many think it is better practice to place the burden of proving dominance on the competition agency.

3.2 The provision should employ a general legal standard: a "significant limitation of competition". In economic terms this standard typically refers to restrictions that would permit a price increase above what would prevail in a competitive market. It is not possible to legally define a "significant" limitation of competition, however, as the size of an anti-competitive price increase can vary across jurisdictions.

3.3 The laws of some countries also list specific types of conduct, such as predatory pricing, tying or exclusive dealing, that can constitute an abuse of dominance. Such provisions are more common in countries that employ a civil code legal system as opposed to a common law system. It is difficult to define such conduct, however, or to be sufficiently inclusive of potentially abusive conduct.

Restrictive Agreements

4.1 Certain types of horizontal agreements, collectively described as cartel agreements, are subject to greater control than other types. In many countries, this distinction is not found in the law itself, but in enforcement practice or regulations. Countries that are first adopting competition laws are better off making the distinction explicitly in law, however, to provide clarity within society about the aims and objectives of competition law.

4.2 Not all horizontal agreements are cartel agreements, however, as competitors may integrate to achieve economic efficiency. This may be pro-competitive on balance. These agreements should be subject to a more lenient legal standard and distinguished from cartel agreements in the competition law.

4.3 Finally, some horizontal and vertical agreements may be harmful to competition in some sense, but may generate efficiencies that make them beneficial on balance. It is helpful if the law sets forth the standards to govern this analysis.

[130] This annex is based upon the framework published by the World Bank and OECD 1999

5. Mergers and Acquisitions

5.1 A competition statute's merger provisions should be permissive. In particular, there is no need for systematic review and approval of all mergers. Mergers should be allowed unless the competition authorities can prove that they will significantly limit competition. Requiring notification of all mergers would unduly burden the authorities and impose unrealistic costs and delays on the merging parties. Only large mergers, which are most likely to pose a threat to competition, should be subject to pre-merger notification requirements.

5.2 The same competition test should be applicable to all mergers, whether or not notification is required. The competition office should thus have the power to order the dissolution of smaller, not notified mergers. To eliminate the uncertainty of possible dissolution, merging firms should be permitted to make voluntary notifications.

6. Unfair competition

6.1 To reduce the risk of the competition authority arbitrating what are really private disputes, the law should provide for enforcement through private actions. Every effort should be made to ensure that the unfair competition provisions are as clear as possible. Note that the countries could address this issue in their general consumer protection laws instead of the competition statute.

7. Organisational and Enforcement Matters

Specialised courts and rights of appeal

7.1. Because the judiciaries in transition and developing economies are inexperience in dealing with free market problems, it may be advisable to set up specialised courts to hear competition cases. Concentrating these cases before specially trained judges should speed up the acquisition of expertise and produce more consistent, predictable decisions. The composition of the court could be tailored to the requirements of competition cases. For example, at least one economist could be included in each tribunal.

Private enforcement

7.2 In some countries, private actions for redress of injury resulting from violations of competition law may be instituted before an appropriate court or tribunal. This may have two benefits: they supplement and reinforce public enforcement of the competition law, and they free the competition authority from having to obtain redress on behalf of private parties.

Relationships between the competition office and other government bodies

7.3 Independence from other parts of government is essential to the proper functioning of the competition office. Decisions of the office may affect the interests of entrenched businesses that may have a strong influence on government ministries. The competition office should be free from the political influence of these interests, but should also have the power to participate in government decisions directly impacting competition.

Prohibition and remedial orders

7.4 The competition law should empower the competition agency to prohibit anti-competitive conduct or redress the harm from it.

Fines and Penalties

7.5 The competition office should have the authority to impose fines for cartel agreements, serious or repeated abuse of dominance, non-cartel agreements and unfair competition and to ensure compliance with merger notification requirements and competition office decisions. To deter cartel agreements, fines must be considerably larger than the excess profits that firms anticipate earning through their illegal behaviour.

7.6 Some countries have found that the deterrent effect of penalties is enhanced considerably if the anti-competitive acts are characterised as criminal and if individuals as well as enterprises are liable.

Interim injunctions

7.7 The power to obtain interim injunctions is frequently necessary to preserve the status quo pending investigation. They are particularly useful in merger cases and in cases involving other types of conduct in which prohibition orders rather than fines are relied on to eliminate or prevent anti-competitive practices.

Enforcement guidelines and advance rulings

7.8 Parties subject to the law should be helped to comply with it and to plan their activities accordingly. Much of this assistance could come through the publication of enforcement guidelines articulating how the competition office will interpret and apply the law. In addition, while protecting confidentiality, the competition office should be required to publish all prohibition orders and decisions imposing sanctions with the supporting reasons. There is also a need for a process whereby parties can obtain advance rulings from the competition office concerning planned courses of action.

Investigative powers

7.9 To ensure sufficient investigative capability, the competition office should be able to require that the parties under investigation and third parties product documents, written answers to questions and oral testimony. In addition, the competition office should have the power to search the premises of subjects of an investigation and to take away evidence.

7.10 Such broad investigative powers should be subject to strict procedural safeguards. In most countries, searches can be conducted only after authorisation by a court or tribunal. The competition office should be required to permit any party submitting evidence to have reasonable access to that evidence and it should be required to return the evidence after the investigation and subsequent enforcement proceedings. These powers should be reinforced with severe fines for wilful destruction or with-holding of evidence or persistent refusal to supply requested information in a timely fashion.

Table 1

Suggested provisions to formulate Competition Law

Issue	Suggested Provisions
Scope of Competition Law	
	This law is intended to maintain and enhance competition in order ultimately to enhance consumer welfare
Article 1	*1. This law shall be enforceable on the whole territory of the Republic of [ ] and applies to all areas of commercial economic activity. The law shall be applicable to all matters specified in [sections of the law containing the prohibitions of restrictive agreements, abuse of dominance and merger review], having substantial effects in the Republic of [ ] including those that result from acts done outside of the Republic of [ ].*
Article 2	*2. This law does not derogate from the direct enjoyment of the privileges and protections conferred by other laws protecting intellectual property, including inventions, industrial models, trademarks and copyrights. It does apply to the use of such property in such a manner as to cause the anti-competitive effects prohibited herein.* *3. This Law shall apply neither to the combinations or activities or workers or employees nor to agreements or arrangements between two or more employers when such combinations, activities, agreements or arrangements are designed solely to facilitate collective bargaining in respect of conditions of employment.*
Definitions	
Competition	*The process by which economic agents acting independently in a market limit each other's ability to control the conditions prevailing in that market.*
Firm	*Any natural or legal person, governmental body, partnership or association in any form engaged directly or indirectly in economic activity. Two firms, one of which is controlled by the other, shall be treated as one firm. Two or more firms that are controlled by a single firm shall be treated as one firm. The competition office shall adopt a regulation setting out what constitutes control.*
Good	*All property, tangible and intangible, and services*
Market	*A collection of goods among which buyers are or would be willing to substitute, and a specific territory which could extend beyond the borders of the Republic of [ ], in which are located sellers among which buyers are or would be willing to substitute.*

Abuse of Dominant Position	
Article 3 – abuse of a dominant position	1. *A firm has a dominant position if, acting on its own, it can profitably and materially restrain or reduce competition in a market for a significant period of time. The position of the firm is not dominant unless its share of the relevant market exceeds 35%. A firm having a market share exceeding 35% may or may not be found to be dominant depending on the economic situation in that market, including the firm's market share, competing firms' market shares and their abilities to expand those shares, and the potential for new entry into the market.* 2. *Actions of a dominant firm – including creating obstacles to the entry of competing firms or to the expansion of existing competitors or eliminating competing firms from the market – that have or may probably have as their result a significant limitation of competition are prohibited.* 3. *Section 2 of this article does not prohibit actions by a firm that create obstacles to the entry of new firms or reduce the competitiveness of existing firms solely by increasing the efficiency of the firm taking those actions or that pass benefits of greater efficiency on to consumers.*
Article 4 – power to break up a firm abusing its dominant position	1. *When a firm has abused its dominant position and no other remedy under this law or under an applicable regulatory statute would be likely to rectify the situation or prevent recurrence of the abuse, the competition office may reorganise or divide the firm provided there is a reasonable likelihood that the resulting entity or entities would be economically viable.* 2. *The power to reorganise or divide contained in this article shall be exercised in a manner designed to minimise any increases in costs of providing a good.*

Restrictive Agreements *Article 5 – prohibited agreements between firms*	 1. *An agreement, concluded in any form including by concerted practice, between competing firms (including firms that could easily become competitors) is prohibited if such an agreement has or would likely have as its principal effect:* • *Fixing or setting prices, tariffs, discounts, surcharges or any other charges;* • *Fixing or setting the quantity of output;* • *Fixing or setting prices at auctions or in any other form of bidding, except for joint bids, so identified on their face to the party soliciting the bids;* • *Dividing the market, whether by territory, by volume of sales or purchases, by type of goods sold, by customers or sellers, or by other means;* • *Eliminating from the market actual or potential sellers or purchasers; or* • *Refusing to conclude contracts with actual or potential sellers or purchasers.* 2. *An agreement other than those enumerated in section 1 or this article, concluded in any form including concerted practice, is prohibited if it has or would likely have as its result a significant limitation of competition:* • *An agreement among competing firms, including firms that could easily become competitors, other than those agreements enumerated in section 1 of this article, cannot be found to significantly limit competition unless the shares of the firms participating in the agreement collectively exceed 20% of a market affected by the agreement.* • *An agreement solely among non-competing firms cannot be found to significantly limit competition unless:* • *At least one of the parties holds a dominant position in a market affected by the agreement; or* • *The limitation of competition results from the fact that similar agreements are widespread in a market affected by the agreement.*
	3. *An agreement prohibited under section 2 of this article is nonetheless legal if it has brought about or is likely to bring about gains in real as opposed to mere pecuniary efficiencies that are greater than or more than offset the effects of any limitation on competition that result or are likely to result from the agreement.* *The burden of proof under this section lies with the parties seeking the exemption, and includes demonstrating that if the agreement were not implemented it is not likely that the relevant efficiency gains would be realised by means that would limit competition to a lesser degree than the agreement.*
Mergers and Acquisitions *Article 6 – Review of concentrations* *Definition*	 1. *"Concentration" – shall be deemed to arise when:* • *Two or more previously independent firms merge, amalgamate, or combine the whole or a part of their businesses; or*

Control Notification Regulations regarding concentrations Permitted and prohibited concentrations	• *One or more natural or legal persons already controlling at least one firm acquire, whether by purchase or securities or assets, by contract or by other means, direct or indirect control or the whole or parts of one or more other firms.* 2. *"Control" – for the purpose of this article, control is defined as the ability to materially influence a firm, in particular through:* • *Ownership or the right to use all of part of the assets of an undertaking; or* • *Rights or contracts that confer decisive influence on the composition, voting, or decisions of the organs of a firm.* 3 *When an agreement or public bid will produce a concentration larger than the minimum size as provided in the regulations issued in pursuant to section 7 of this article, the parties to the agreement or bid are prohibited from consummating such concentration until [ ] days after providing notification to the competition office, in the form and containing the information specified in regulations issued pursuant to section 7.* 4. *Before the expiration of the [ ] day period referred to in section 3 of this article, the competition office may issue a written request for further information. The issuance of such a request has the effect of extending the period within which the concentration may not be consummated for an additional [ ] days beginning on the day after substantially all of the requested information is supplied to the competition office.* 5. *Parties to an agreement or public bid not subject to the notification requirement in section 3 of this article may voluntarily notify, and, if they do so, be subject to the same procedures, restrictions and rights as are applied to cases of compulsory notification.* 6. *If, before consummation of a concentration, the competition office determines that such concentration is prohibited by section 8 of this article and does not qualify for exemption under section 9 of this article, the competition office may:* • *Prohibit consummation of the concentration;* • *Prohibit consummation of the concentration unless and until it is modified by changes specified by the competition office;* • *Prohibit consummation of the concentration unless and until the pertinent party or parties enter into legally enforceable agreements specified by the competition office.* 7. *The competition shall from time to time adopt and publish regulations stipulating:* • *The minimum size or sizes or concentrations subject to the notification requirement in section 3 of this article;* • *The information that must be supplied for notified concentrations;* • *Exceptions or exemptions from the notification requirement of section 3 for specified types of concentrations;* • *Other rules relating to the notification procedures in sections 3, 4 and 5 of this article.* 8. *Concentrations that will probably lead to a significant limitation of competition are prohibited.* 9. *Concentrations prohibited under section 8 of this article shall nonetheless be free from prohibition by the competition office if the parties establish that either:*

	a) The concentration has brought about or is likely to bring about gains in real as opposed to merely pecuniary efficiencies that are greater than or more than offset the effects of any limitation on competition that result or are likely to result from the concentration; or *b) One of the parties to the concentration is faced with actual or imminent financial failure, and the concentration represents the least anti-competitive among the known alternative uses for the failing firm's assets.* *The burden of proof under this section lies with the parties seeking the exemption.* *A party seeking to rely on the exemption specified 9a, must demonstrate that if the concentration were not consummated it is not likely that the efficiency gains would be realised by means that would limit competition to a lesser degree than the concentration.* *A party seeking to rely on the exception specified in 9b, must:* • *Demonstrate that reasonable steps have been taken within the recent past to identify alternative purchasers for the failing firm's assets;* • *Fully describe the results of that search.* *10. The competition office may determine, within three years after consummation that either a non-notified concentration or a notified concentration in which the provisions of sections 3-5 of this article are not fully complied with, has led or will probably lead to a significant limitation of competition and does not qualify for either of the two exemptions set out in section 9 of this article. If it so determines, the competition office may:* • *Undo the concentration by dissolving the constituent elements;* • *Require other modifications of the concentration, including sale of a portion of its operations or assets;* • *Require the surviving firm or firms to enter into legally enforceable agreements specified by the competition office and designed to reduce or eliminate the competition-limiting effects of the concentration.* *11. Notifiable concentrations that the competition office determines are prohibited by section 8 of this article and do not qualify for exemption under section 9 may subsequently by authorised by a published decision of the Government of [ ] for overriding reasons of public policy involving a unique and significant contribution to the general welfare of the citizens of [ ].*
Unfair competition *Article 7 – prohibition of unfair competition*	 *Unfair competition is prohibited, including:* *1. The distribution of false or misleading information that is capable of harming the business interests of another firm;* *2. The distribution of false or misleading information to consumers, including distribution of information lacking a reasonable basis, related to the price, character, method or place of production, properties, suitability for use, or quality of goods;* *3. False or misleading comparison of goods in the process of advertising;* *4. Fraudulent use of another's trademark, firm name or product labelling or packaging;* 5. *Unauthorised receipt, use or dissemination of confidential*

	scientific, technical, production, business or trade information.
Organisational and enforcement matters *Article 8 – Independence of the competition office*	 1. *The competition office is under the authority of the (President of [ ]) and receives its budget directly from and reports directly to the (legislature of [ ])* 2. *The [head] of the competition office is appointed by the (President of [ ]) for a renewable term of [a minimum of three] years and can only be removed by a [vote of the legislature] for patent inability to discharge his functions.*
Article 9 – Representatives and interventions by the competition office	1. *The competition office shall have the right to make submissions to state administrative authorities engaged in designing or administering legislation or regulations that could affect competition in any market in [the Republic of] . When hearings are held with regard to the adoption or administration of such laws or regulations, the competition office shall have the right to intervene in such proceedings.* 2. *The competition office shall have the right to publish the submissions and interventions referred to in section 1 of this Article provided that confidential information is not divulged.*
Article 10 - Interim injunctions	1. *The head of the competition office may apply to [appropriate court or tribunal] for an order to suspend business practices under investigation by the competition office or the consummation of concentrations. Before making the order, the [court or tribunal] shall be satisfied that the proposed measures are urgently required to avoid serious, imminent and irreparable harm to the economic interests of the Republic of [ ], as expressed in this act. When the effectiveness of the order would not be prejudiced, the [court or tribunal] shall permit the firms that would be subject to the order to present their views regarding the proposed orders.* 2. *Within three days of the issuance of an order by the [court or tribunal] pursuant to this Article, the competition office shall deliver the order to the parties subject to it, together with reasons for the order and notice of the right to appeal.* 3. *All orders made under this article lose effect twenty-one days after they are issued, unless renewed by express decision of the [court or tribunal]* 4. *Orders issued under this section may be appealed to the [pertinent appeal court] but do not lose their effect pending the outcome of the appeal.*
Article 11 – Advance rulings	1. *Parties may apply to the competition office for advance rulings, binding on that office, regarding eligibility for exemptions from the prohibitions of articles [relating to restrictive agreements and abuse of dominant position]. If it chooses to grant an advance ruling, the competition office may include in it specified conditions and requirements. The advance ruling shall by its terms exist for a specified period of time.* 2. *The parties may renew advance rulings upon application. An advance ruling may be revoked or modified if:* • *A significant change in circumstance has occurred since the ruling;* • *The applicant has infringed on a condition or a requirement specified in the ruling;* • *The decision to grant the ruling was materially*

	influenced by inaccurate, fraudulent or misleading evidence; or • *The applicant abused the exemption granted to it.* *3. The competition office shall arrange for publication of its advance rulings, omitting any confidential information. It may arrange similar publication of all other decisions taken under this act, again omitting any confidential information.*
Article 12 – confidentiality and conflict of interest rules	*1. Officials of the competition office, as well as their agents and consultants, shall maintain the confidentiality of all business, commercial or official information of which they become aware during the course of their official activities, except that which is otherwise public. Disclosure of such confidential information may occur in the course of administrative or judicial proceedings arising under this act, or otherwise permitted by [the court or tribunal].* 2. *All members of the competition office shall inform the head of the competition office of any position held or activity carried out in an economic field by the member, including all agents thereof. The head of the competition office shall take all necessary steps to ensure there is no conflict of interest arising from such positions or activities, including requiring that such positions be resigned or activities ceased.*

Annex 3

Competition Laws in South Korea, Malaysia, Mexico and The Philippines

1 In order to understand the progress APEC economies have made in implementing competition law, we have taken a sample of 4 APEC economies to assess how their competition law matches up to the framework outlined in Annexe 2. We have studied the laws of South Korea, Malaysia, Mexico and The Philippines.

2. Korea

2.1 The table below shows that the Korean Fair Trade Act matches the suggested framework to a great extent. The key difference is the treatment of designated large business groups, which have specific exemptions from the concentration provisions. Recent revisions have served to tighten the restrictions on these groups, however, including the banning of cross-debt guarantees by affiliates of the same large business group. The Act also includes some additional provisions including specific restrictions on the activities of trade associations, restrictions on re-sale price maintenance and restrictions on the conclusion of unreasonable international contracts.

3. Malaysia

3.1 In Malaysia, there is not a specific Act on competition. Subsequently, there is no administrative authority to oversee or administer any competition rules or regulations, including the monitoring of Restrictive Business Practices, abuses within the market or possible cartel actions. Therefore such activities are not per se illegal and no specific documented records of such practices are collated, while they are known to exist. However, there are currently 30 laws which regulate certain activities of enterprises and which protect consumer interests. Under these laws, a consumer or trader may seek redress through the appropriate Ministry, public agency or via the Civil Courts. A Consumer Protection Law has recently been introduced in Parliament. Under this law, a Tribunal will be established to settle consumers' complaints involving transactions of not more than RM10,000. Other laws include the Companies Act 1965, the Control of Supplies Act 1961, the Trade Descriptions Act 1972, the Food Act 1983, the Direct Sales Act 1993 etc.

3.2 Competition areas of particular concern in Malaysia are with regard to Restrictive Business Practices such as collusive tendering, market allocation or quota refusal to supply, cartel price fixing, predatory pricing etc, which are strongly suspected but which existing laws cannot completely prohibit or control. Other areas of particular concern are with regard to issues of market power arising from corporate mergers, take-overs, and restructuring activities or enterprises.

4. Mexico

4.1 The Federal Law on Economic Competition entered into force in June 1993. The Law regulates Article 28 of the Constitution regarding economic competition, monopolies and free market participation. Its main objective is to protect the process of competition in the Mexican market and to enhance economic efficiency through the prevention and elimination of monopolies, monopolistic practices and other restraints to the efficient operation of markets. As seen in the table, the current law matches the suggested framework relatively well, covering the key areas of abuse of dominant position, restrictive agreements, and concentration. In line with our recommendations, the Commission also aim to pursue a greater advocacy role in future to promote understanding of the Law's objectives, and issue a periodic gazette containing the Commissions resolutions and criteria, providing further transparency.

5. Philippines

5.1 The Philippines does not have a comprehensive anti-trust legislation, although it has statutes prohibiting unfair trade practices. The basic statute that prohibits unfair trade practices, monopolies and combinations in restraint of trade is the Law on Monopolies and Combinations. The Law deters any person, firm or entity from monopolising or attempting to monopolise, or from taking part in any conspiracy or combination in the form of trust in restraint of trade or commerce or from restraining free market competition. Other competition related laws include the Corporate Code of the Philippines, which provides for rules regarding mergers and consolidations, the Price Act which defines and identifies illegal acts of price manipulation and the Consumer Act which provides for consumer product quality and safety standards. Enforcement of these laws is vested in numerous agencies.

5.2 By 2000, it plans to review existing laws on competition with the end of improving the competitive environment. To this end, they will endeavour to enact an anti-trust, anti-monopoly law including the establishment of a Fair Trade Commission to enforce competition laws.

Table 1

How Competition Laws in South Korea, Malaysia, Mexico and The Philippines match the framework set out in Annex 2

	South Korea	Malaysia	Mexico	Philippines
Objective of law	Act aimed at encouraging fair and free competition, thereby stimulating creative business activities and protecting consumers as well as promoting a balanced development of the national economy		Single objective of the law is to protect the process of competition in the Mexican market and to enhance economic efficiency.	
Scope of Competition law	The Act does not apply to agriculture, fishery, forestry and mining sectors nor to regulated industries, public enterprises and government agencies	Not applicable	The law applies to all sectors of economic activity. All economic agents are subject to the law including entities of the federal, state or municipal administration.	Not applicable
Definition	Alternative definitions are used, including enterprise, business group, trade association, resale price maintenance, given area of trade			
Article 3 - Abuse of a dominant position	A market-dominant enterprise is defined as one which holds 50% or greater share of the market		Monopolies are prohibited, as are monopolistic practices. Market dominance is determined by the possibilities of substitutes, distribution costs, costs and probability of customers seeking other markets, entry barriers, existence and power of competitors etc	
Clause 2 - Actions of a dominant firm	Includes unreasonable control of the sale of goods, interfering with business activities of other firms, threats to restrain competition		Includes RPM, tied sales, price discrimination, exclusive dealing, refusal to deal. All subject to a rule of reason approach.	
Article 4 - Power to break up a firm abusing its dominant position	The KFTC is empowered to demand corrective measures and impose surcharges of up to 3% of revenue.		The Commission may impose the following penalties: Order of suspension, rectification, elimination of the practice Fines of up to 225,000 times the minimum general wage prevailing in the Federal District.	
Article 5 – Prohibited agreements between firms	Prohibited agreements include price fixing, quantity fixing, restrictions in production, hinder or restrict the establishment or expansion of facilities, hinder the activities of other firms. The KFTC is empowered to order corrective measures and impose surcharges.		Price fixing, output restriction, market division, bid-rigging, vertical market division, resale price maintenance, tied sales, exclusive dealing, refusal to deal, boycott.	

Mergers and Acquisitions *Article 6 – Review of concentrations Definition*	4 definitions of concentration are given		A merger or acquisition of control, or any other act whereby companies, partnerships, shares, equity, trusts, assets in general are concentrated among suppliers, competitors, customers or any other economic agent. The commission shall contest and penalise those concentrations whose purpose of effect is to diminish, impair or impede competition and free market participation, regarding equal, similar or substantially related goods and services.	
Control *Notification*	Ownership or the right to use all of part of the assets of an undertaking Corporations whose total amount of assets or revenue meet the criteria shall file a report with the KFTC within 30 days of after the date of execution of a business combination. No enterprise that has filed a report shall register a merger, perform the obligations under the agreement or subscribe to shares until 30 days after filing. The KFTC can shorten this period or extend to a maximum of 60 days		The commission must be notified of concentrations before carried out if they meet certain criteria. Notice shall be given in writing. The commission may request additional information within 20 days of notification that must be submitted by the parties within 15 days. The Commission shall have 45 calendar days after acquiring notification to issue a decision. This can be extended for up to 60 more days.	
Permitted and prohibited concentrations	Every year the KFTC designates certain monopolistic enterprises as Market-dominating. When such enterprises engage in abusive acts they are subject to more severe penalties than ordinary enterprises. For such market-dominating enterprises additional prohibitions include holding companies, cross-capital investment, limits on debt-guarantees for affiliates, restrictions on voting rights for finance and insurance companies The KFTC is empowered to order corrective measures and impose surcharges.		Permitted concentrations include those that have received a favourable ruling, except when such ruling was obtained on the basis of false information, and those that do not require pre-notification, a year after being carried out. For the purpose of the law, faculties exercised exclusively by the state in some strategic sectors do not constitute monopolies	
Article 7 – prohibition of unfair competition	Unfair competition is prohibited including: 1. Unreasonably refuse to transact with or discriminate against a certain partner 2. Unreasonably engage in activities designed to eliminate competitors		Included under the provisions regarding monopolistic practices. Deceptive or misleading advertising or representations are not included in the law. These are included in the Federal Law of	

	3. Unreasonably induce or coerce competitors to deal with oneself 4. Unreasonably take advantage of bargaining power 5. Use adverts or make false representations which may deceive or mislead consumers The KFTC is empowered to order corrective measures or to impose surcharges.		Consumer Protection	
Organisational and enforcement matters *Article 8 – Independence of the competition office*	Yes – established under the jurisdiction of the Prime Minister to independently achieve the purposes of the Fair Trade Act		Yes – The Federal Competition Commission is an administrative entity of the Secretariat of Commerce and Industrial Promotion. It shall be technically and operationally autonomous… It should be free to issue its own decisions. The Commissioners shall be appointed to serve for renewable periods of 10 years, and may only be removed from office for serious reasons that have been duly justified.	
Article 9 – Representatives and interventions by the competition office	The Chairman of the KFTC may attend and take the floor at Cabinet meetings			
Article 10 – Interim injunctions				
Article 11 – Advance rulings				
Article 12 – Conflict of interest rules and confidentiality	No Commissioner of government official shall divulge trade secrets of Enterprises or Trade Association, obtained in the course of carrying out their duties.		The information and documents obtained by the Commission in connection with its investigations, as well as those submitted to it, are strictly confidential	

Annex 4

Historical Development of Competition Laws

1 Australia

1.1 Australia's competition laws are primarily contained in the *Trade Practices Act 1974*. Part IV of the Act sets out 'competitive conduct rules' that prohibit anti-competitive agreements (e.g. collusive price fixing), misuse of substantial market power, exclusive dealing, resale price maintenance and anti-competitive acquisitions.

1.2 An independent regulator, the Australian Competition and Consumer Commission (ACCC), undertakes compliance and education activities, and enforces the law by pursuing court action. The ACCC may seek injunctions, divestiture or monetary penalties of up to $AU10 million for corporations and $AU500,000 for individuals for breaches of the Part IV provisions. Individuals and corporations may also take private court action for breaches of the provisions of the Act, and remedies include damages, injunctions (in most cases) and other orders.

1.3 The competition laws were greatly enhanced following adoption of the 1993 Hilmer Committee recommendations and development of the National Competition Policy, agreed to in 1995 by Federal, State and Territory governments. Key features of the new laws are:

a) universal application of the competitive conduct rules to all sectors of the Australian economy, including government business activities and the unincorporated sector (eg, the professions);
b) mechanisms for providing access to essential services provided by means of significant infrastructure facilities; and
c) prices oversight of State and Territory government businesses with a high degree of market power through the *Prices Surveillance Act 1983*.

1.4 Australia's competition laws apply to all forms of business and all industry sectors. They fit within a National Competition Policy framework that involves many other initiatives such as review of anti-competitive regulation and the application of a competitive neutrality policy to government businesses.

1.5 Special Aspects of Australia's Competition Laws

1.5.1 Not all anti-competitive conduct is prohibited under the Act. Exemptions apply to:

a) matters specified in and specifically authorised by other legislation or regulations;
b) agreements about terms and conditions of employment;
c) employment, partnership and sale of business agreements containing restrictive covenants;
d) agreements for the export of goods;
e) agreements dealing with standards; and
f) licences and assignments of intellectual property.

The Government is currently considering the merits of exempting many of these arrangements.

1.5.2 Conduct that would otherwise breach the Act may also be permitted by virtue of authorisation and notification procedures in Part VII of the Act. The ACCC may authorise (i.e. grant immunity from legal proceedings for) anti-competitive conduct that has overriding public benefits. Certain conduct (exclusive dealing) may also be granted immunity if notification of this conduct is given to the ACCC in certain circumstances.

1.5.3 There are also special arrangements for certain industries, such as the electricity industry. In 1998, following the development of a number of State-electricity markets, the National Electricity Market was implemented to:

a) reduce competition in the wholesale supply and purchase of electricity;
b) create an open access regime providing for non-discriminatory access to electricity networks; and
c) create a transparent and nationally consistent legal and regulatory framework.

1.5.4 The National Electricity Code defines rules for wholesale electricity trading and access to electricity networks and was authorised by the ACCC and accepted as an 'Access Code' under the Act. The ACCC, in granting authorisation for the Code, accepted that the Code would bring about significant public benefits in the form of greater efficiencies, lower input costs for other industries, lower prices and better service delivery to end users.

1.5.5 There are also limited exemptions in the Act from prohibitions against anti-competitive agreements and exclusive dealing for international liner cargo shipping conferences (unincorporated associations of ocean carriers carrying on multiple businesses which include liner cargo shipping). However, these agreements must be registered and the Minister may remove the exemption.

1.5.6 There are special rules for competitive conduct within the Australian telecommunications industry, which apply in addition to the other competition laws, and which are designed to assist open market access to both telecommunications infrastructure and service provision.

1.6 Background Summary – the Development of Australia's Competition Laws

1.6.1 Australia first enacted competition laws in 1906 with the passing of the *Australian Industries Preservation Act 1906*, which prohibited monopoly and restraints of trade. Due to early strict judicial interpretation and Constitutional limitations, this, and subsequent legislation, was not entirely successful until the enactment of the *Trade Practices Act 1974*, which provided a comprehensive regime for business competition and regulation.

1.6.2 Underlying Australia's commitment to maintaining effective and transparent competition laws, in addition to ongoing changes, there have been a number of substantial reviews and amendments to the Act.

a) The Act was reviewed in 1976 and major amendments were made in 1977, including introduction of prohibitions on secondary boycotts.
b) There were further substantial amendments in 1986, including provisions to regulate anti-competitive mergers that occurred overseas.
c) In 1992, amendments were introduced, amongst other things, to increase penalties for contravention of rules against anti-competitive conduct.
d) The *Competition Policy Reform Act 1995* introduced major changes to Australia's competition laws, and adopted many of the Hilmer Committee recommendations, such as universal application of the competitive conduct rules to all sectors of the Australian economy (e.g., government business activities and the unincorporated sector) and the introduction of a generic access regime for significant infrastructure services.
e) In 1997, competitive conduct and access provisions dealing specifically with the telecommunications market were introduced.

2 Hong Kong, China

2.1 Objectives/Guiding Principles of Hong Kong, China's Competition Policy

2.1.1 Hong Kong, China believes that competition is best nurtured and sustained by allowing the free play of market forces, and keeping intervention to the minimum. The Government will not interfere with market forces simply on the basis of the number of operators, scale of operations, or normal commercial constraints faced by new entrants. Action will only be taken on competition restraints when market imperfections or distortions limit market accessibility or market contestability, and impair economic efficiency or free trade, to the detriment of the overall interests of Hong Kong, China.

2.1.2 Hong Kong, China is committed to competition as a means to enhance economic efficiency and the free flow of trade, thereby also benefiting consumer welfare. However, for such a small and externally-oriented economy, the government does not see a need to enact an all-embracing competition law. Hong Kong, China's competition regime is based on a Competition Policy Statement which sets out the government's competition policy objectives, and offers pointers to facilitate compliance with the policy. All government entities, public and private-sector bodies are encouraged to adhere to the following pro-competition principles for the purpose of enhancing economic efficiency and free trade:

a) maximising reliance on, and minimising interference with, the market mechanism;
b) maintaining a level-playing field;
c) minimising uncertainty and fostering confidence in the system's fairness and predictability by:
    (i) consistent application of policies;
    (ii) transparent and accountable operations; and
    (iii) adherence to equitable and non-discriminatory standards and practices.

2.1.3 Hong Kong, China places emphasis on striking a balance between competition policy considerations on the one hand, and other policy considerations such as prudential supervisions, service reliability, social service commitments, and safety. The government also recognises the importance of promoting the complementarity between competition and other public policies using competition principles as a common reference point.

2.3 Implementation of Hong Kong, China's Competition Policy

2.3.1 While Hong Kong, China does not have a comprehensive competition law, the government does not rule out the need to take sector-specific administrative or legislative measures if they are justified. For example, in the broadcasting sector, there are pro-competition clauses in all broadcasting licenses. The Government has also put in place a package of measures to liberalise the regulatory regime of satellite broadcasting and facilitate new comers in the market. Hong Kong, China has also conducted a comprehensive Review of the Television Policy in 1998 and decided to liberalise the television market and further enhance competition safeguards in the market through a series of measures.

2.3.2 In the telecommunication sector, pro-competition clauses are incorporated in licenses. The government conducted a Review of Fixed Telecommunications in 1998 and decided to further enhance competition in the local fixed telecommunications network services market. The Telecommunication (Amendment) Bill was introduced into the Legislative Council in May 1999 to strengthen the regulatory framework and enhance competition safeguards.

2.4 Recent Developments

2.4.1 In response to a report on "Competition Policy: The Key to Hong Kong's Future Economic Success" issued by the Consumer Council, the Government agreed in November 1997 to adopt a more proactive, transparent and comprehensive competition policy. This involves:

a) establishing a high-level Competition Policy Advisory Group (COMPAG) to vet existing government policies and practices to ensure they are not anti-competitive. COMPAG, set up in December 1997, may also review other competition policy matters as appropriate;
b) issuing a policy statement on the objectives of and guiding principles on promoting competition (COMPAG promulgated the Policy Statement in May 1998);
c) requiring all bureaux to give due regard to the competition angle in setting new policies or reviewing existing policies;
d) requesting all bureaux and departments to submit new initiatives for promoting competition;
e) requesting the Trade Practices Division of the Consumer Council to continue to monitor and review trade practices in sectors prone to "unfair trading activities; and
f) requesting the Consumer Council to assist and encourage trade associations to establish codes of conduct for promoting competition.

3 Japan

3.1 Development of the Anti-Monopoly Act

3.1.1 The Anti-Monopoly Act was passed on 31 March 1947 and promulgated on 14 April 1947. Based on the provisions of the Anti-Monopoly Act, the Fair Trade Commission of Japan (JFTC) was inaugurated as the agency responsible for the enforcement of the Act.

3.1.2 Article 1 of the Anti-Monopoly Act states that the objectives of the Act are to promote free and fair competition, to stimulate the creative initiative of entrepreneurs, to encourage business activities, to heighten the level of employment and people's real income, and to promote the democratic development of the national economy as well as to assure the interests of consumers in general. The fact that this Act was designed to build up a system of fair and free competition was made clear from the beginning.

3.1.3 In February 1953, the JFTC made public a summary of the revision of the Anti-Monopoly Act, showing the basic direction in which the revision was to take form. The main items were:

a) that cartels would be permitted if there was a need to cope with a business depression or to rationalize corporate organizations or activities; and
b) that provisions were to be established to allow resale price maintenance in certain circumstances.

3.1.4 These amendments reflected increasing requests from business circles after Japan had regained political power in 1951. However, the JFTC managed to maintain its position that cartels should be prohibited in principle. It did not accept the business community’s extreme proposals to allow cartels in principle and to regulate them only when they were harmful. Based on this summary, an amendment was passed on 6 August 1953 and promulgated on 1 September on which day it went into immediate effect.

3.1.5 In 1973, the first oil shock shook Japan. Businesses large and small tried to absorb the resulting cost increases of almost all commodities by forming cartels. In 1973, the JFTC issued 67 decisions against cartel activities, which was a record number for the JFTC. In February 1974, the JFTC made a public accusation to the Public Prosecutors Office of 12 oil wholesalers and 15 of their directors, who were found by the JFTC to have fixed their prices. This was, in effect, the first criminal accusation for participating in cartels.

3.1.6 In addition, during this period large companies were forming mergers and pursuing acquisitions in a vigorous manner. Large companies extended their influence on other companies by means of stockholdings. Under these circumstances, serious problems occurred from the viewpoint of competition policy. The first was the problem of “controlled prices”, meaning that prices did not reflect the supply-demand relationship and were downwardly inelastic. The then-Act, as is common with other competition laws in many economies, was not designed to address this situation itself. The second problem was “parallel price increases”, meaning price increases in a specific market at almost the same rate during the same period. This type of corporate behavior was recognized to stem from interdependent relationships of firms in an oligopolistic market and was difficult to address under the then-Act, either. The third problem was cartels. Oligopolization of a market not only makes cartels easier to conduct, but also more difficult to detect by the competition authority.

3.1.7 To cope with the situation, the Anti-Monopoly Act was further amended in 1977. The main provisions of the amended Act called for the following:

a) surcharges to be levied on entities that participated in cartels that may affect prices;
b) measures to deal with a monopolistic situations in markets;
c) reporting requirements on parallel price increases; and

d) restrictions on the total amount of stockholdings allowed by a large non-financial company, and the strengthening of restrictions on the stockholding rate by financial companies.

3.1.8 While vigorously enforcing the amended Act of 1977, the JFTC began creating guidelines under the Anti-Monopoly Act, recognizing that preventing violations against the Act was another key for effective competition policy. A wide range of guidelines under the Anti-Monopoly Act were made. Some examples of areas covered by guidelines include: activities of trade associations, mergers and acquisitions, distribution systems, and business practices.

3.1.9 The JFTC also prioritized the vigorous application of the Anti-Monopoly Act to the distribution sectors. It conducted fact-finding surveys on trade practices in industries such as home electrical appliances, publications, department stores and supermarkets, and cosmetics. These surveys revealed anticompetitive practices including coercion of trading conditions preferable to large distributors which might constitute the abuse of dominant bargaining positions. The JFTC guided the relevant industries to stop participating in these trade practices.

3.1.10 After Japan had successfully surmounted the second oil crisis, trade frictions with other countries became even more serious. Around the mid-1980s, allegations of possible anti-competitive practices by Japanese firms and trade associations were raised by the US at the Japan-US trade negotiations. During the MOSS (Market Oriented Sector Selective) talks between Japan and the US which started in 1985, and also during the SII (Structural Impediments Initiative) talks which began in 1989, issues relating to the competition problems were taken up. In concluding the SII talks, the Japanese side announced its intention to:

a) increase the number of JFTC investigators;
b) adopt formal remedial measures, particularly in such fields as price-fixing cartels, bid-rigging, etc.;
c) increase transparency in enforcing the Anti-Monopoly Act by disclosing the identities of the persons involved; and
d) increase the surcharge rate.

3.1.11 All of these measures have been put into effect since then.

3.1.12 For instance, the JFTC announced its policy in June 1990 to actively seek the imposing of criminal penalties for pernicious and important cases believed to have wide-ranging impact on the lives of the Japanese. The Anti-Monopoly Act was amended, in April 1991, to quadruple in principle the rates for calculating surcharges. Furthermore, in December 1992, another amended version of the Antimonopoly Act calling for harsher criminal penalties was established.

3.1.13 The enforcement records of the JFTC in the1990s have shown significant increases in legal action in all aspects of the Anti-Monopoly Act violations. For example, the JFTC levied the amount of 11.2 billion yen against sales quantity and price cartels committed by cement manufacturers. After 1991, the amount of surcharge orders increased year by year--5.6 billion yen in 1994, 6.4 billion in 1995 and 7.4 billion in 1996.

3.1.14 Subsequent to 1989, the number of personnel of the JFTC--mainly in the investigation sections--has steadily increased. As for the organizational structure of the JFTC, the General Secretariat was strengthened in June 1996 with the establishment of the Special Investigation Department among others.

3.2 Deregulation efforts and exemption reviews

3.2.1 During the 1990s, the JFTC has been reinforcing the advocacy of deregulation and the review of exemptions from the Anti-Monopoly Act.

3.2.2 First, the JFTC has been conducting surveys and studies on problems with Japan's regulations and making reports on the possible directions of reform from the viewpoint of competition policy. The JFTC has made public the report and repeatedly urged relevant agencies to review those regulations. In addition, the JFTC often organizes study groups of academics and other experts in order to examine regulations for specific industries. The industries analyzed by the JFTC and its study groups includes transportation (domestic air freight for passengers, trucks, shipping), distribution (large-scale retailers, distributors of liquor, cigarette and rice), electricity, gas, telecommunications, financial services and so forth. The JFTC has contributed to promoting the review process made by regulatory agencies. The advocacy role of the JFTC on deregulation is clearly stated as one of the important elements in the revised Three-Year Programme for Promoting Deregulation made in March 1999.

3.2.3 Second, the exemptions to the Anti-Monopoly Act have been reduced in scope. In 1997, 35 exemptions under 20 laws were abolished or curtailed, including import cartels and port-related cartels. In June 1999, a bill was passed in the Diet with the objective of repealing or limiting the scope of exemptions (i.e., repealing depression and rationalization cartels that were allowed under the provisions of the Anti-Monopoly Act and limiting in scope other cartels permitted under other laws) and of making strict the procedures in granting an exemption provided by other laws. Although these exemptions were introduced and utilized as a tool to protect relevant industries mainly in 1960's and 1970's, the system of depression cartels, for example, was hardly utilized in the latter half of 1980's of lower economic growth, and there was no application for authorization of depression cartels in this decade of long depression. The system of rationalizing cartels has not been utilized since 1982. The inactivity in utilizing those systems was caused by the fact that economic globalization has been increasing opportunities for imports and, thereby, reducing the effectiveness of domestic cartels in the Japanese market. In this respect, a bill was passed to abolish exemption systems.

4 Korea

4.1 In 1980, the "Monopoly Regulation and Fair Trade Act" (hereinafter, the Fair Trade Act or FTA) was enacted with a view to facilitating the transformation of the nation's economic structure into a market economy in which price assumes a crucial role.

4.1.2 The purpose of this Act is to encourage fair competition by prohibiting the abuse of market-dominant positions, excessive concentration of economic power, and regulating improper concerted acts and unfair business practices, thereby stimulating creative business activities in the marketplace.

4.1.3 Through this, effective tools have been provided to the efforts to resolve problems resulting from past government-led growth strategies, such as ill-functioning markets, worsening inefficiency, and the monopolization of commodities markets, to name a few.

4.1.4 An amendment of the Fair Trade Act in 1986 prohibited affiliated companies of a business group from making cross capital investments.

4.1.5 In 1998, an amendment to the FTA was made which banned chaebol-affiliates from making new cross debt guarantees, and lifted the ceiling on the allowed amount of capital investment.

4.1.6 An amendment in 1999 enlarged the scope of the Fair Trade Act to cover all enterprises and introduced *per se* illegality as to hard core cartels, further strengthening the enforcement of the competition law.

4.1.7 In 1984, the "Fair Subcontract Transactions Act" was enacted for the purpose of ensuring fair subcontracting.

4.1.8 The purpose of this Act is to promote the sound development of the national economy by establishing a fair and even playing field for contractors and subcontractors to enjoy balanced development on an equal footing in a mutually complementary manner.

4.1.9 In 1990, as a part of government efforts to strengthen competition policy, the authority for making rules measures was transferred from the Economic Planning Board to the Chairman of Korea Fair Trade Commission (hereinafter, KFTC), enabling the competition agency to carry out competition policy independently.

4.1.10 In an amendment in 1994, the status of KFTC was elevated to an independent administrative agency under the Prime Minister, and its functions and resources were substantially enlarged.

4.1.11 The "Act on Comprehensive Ban of Cartels" was legislated to abolish the 20 cartels which had been exempt under the 18 individual laws.

4.1.12 Exemptions and exceptions to Korea's competition laws are solely based upon statutes. Pursuant to Article 58 of the Fair Trade Act, businesses or trade associations engaging in legitimate activities that are authorized or mandated by other statutes are exempted from the application of the Fair Trade Act.

4.1.13 However, activities based on the discretionary instructions of a regulatory agency, without the authority expressly stated in a statute, are not exempted from the application of the Fair Trade Act.

4.1.14 The Fair Trade Act applies equally to all businesses, regardless of whether they are public or private, and there are no special or exclusionary provisions for public enterprises.

4.1.15 However, the application of competition law is limited to certain aspects of public enterprises that are controlled by the relevant regulatory agencies. For example, most public enterprises are monopolistic enterprises; hence, the governing administrative agency may often control the prices, such as those for electric power, telephone and gas.

4.1.16 If a public enterprise is a market-dominant business and precludes its competitor by refusing to supply facilities, such practices may be regulated pursuant to the Fair Trade Act.

4.2 Small-and-medium Enterprises (SMEs)

4.2.1 The KFTC believes that one of the most important prerequisites to protecting SMEs is establishing fair competition in the market. Therefore, the Fair Trade Act contains provisions that are unique to the competition law of Korea - prohibition of unfair assistance between *chaebol* subsidiaries and limit on debt guarantees.

4.2.2 Article 60 of the Fair Trade Act exempts cooperatives, composed of small-sized enterprises, from application of the competition law, under the condition that they meet statutory requirements. Even if a cooperative were to fulfil all the requirements, the Fair Trade Act would apply nonetheless if the activities of the cooperative constituted unfair business practices or had the effect of unfairly raising prices by substantially limiting competition.

5 Malaysia

5.1 Malaysia at the moment has no specific legislation on competition, anti-trust, anti-monopoly, fair trading or the like. The intention to have such a law was first stated in 1993 and efforts have been undertaken by the Ministry of Domestic Trade and Consumer Affairs to draft a competition or trade practices law which is now in a draft form. The related Bill has not been tabled in Parliament yet, as the benefits and implications on the overall economy in having such a law are still under study.

5.2 Nevertheless, Malaysia has always been a supporter of competition policies and principles and always strives to improve further the competition environment in the economy. Economic reforms and structural adjustment plans have been adopted, involving deregulation of processes and procedures, divestiture of State monopolies and privatisation of government entities and services, in parallel with the elimination of subsidies and the liberalisation of prices and investment policies, as well as the dismantling of trade restraints, particularly tariffs and non-tariffs and the opening up of the economy to international trade competition.

5.3 Various measures have and are being implemented to enhance competition. These include the privatisation of a number of government services and agencies. The government has also encouraged the private sector to participate in the provision of tertiary and technical education. In addition, the government encourages more private sector participation in the health care sector through the privatisation of health services. Competition in the energy sector has been improved by encouraging the participation of independent power producers in power supply. The government introduced more liberal policy in the telecommunication and multimedia sectors by encouraging participation of foreign companies to promote competition in this sector. The vendor development programme, rural industrial programme and entrepreneur development programme have also been implemented to improve competition in the long run. The continuation of liberalisation of tariff, trade and investment is also a measure to enhance further the competition environment.

5.4 When reviewing the prices of goods and services in general, it is believed that some price rigidities and unethical or restrictive business practices (RBP's) do occur in Malaysia. In particular, RBP's such as collusive, tendering, market allocation or quota, refusal to supply, cartel price fixing, predatory pricing, transfer pricing, etc are suspected but the existing laws cannot effectively prohibit or control these practices, which include the abuse of market power by dominant enterprises.

5.5 The benefits of having a competition law as opposed to adopting competition policies by merely maintaining competitiveness without introducing a competition law, shall be carefully weighed in terms of the developmental needs of the nation. Effective measures will always be instituted in order to ensure a positive and sustained economic growth with equity ie where all parties are able to share in the fruits of the growth fairly.

6 Mexico

6.1 The Federal Law on Economic Competition (FLEC) was enacted on 23 June 1993. At the same time, the Federal Competition Commission was created as the agency in charge of enforcing the law. The principle objective of this antitrust statute is to protect the process of competition in the Mexican market, and enhance economic efficiency.

6.2 Principal Provisions of the Statute

6.2.1 The Federal Competition Commission was designed to function as an autonomous and decentralised administrative body of the executive branch within the Mexican Secretariat of Commerce (Secretaria de Comercio y Fomento Industrial). The Commission is empowered to:

a) conduct investigations of competition violations initiated at the request of interested parties or by the Commission itself;
b) issue administrative rulings and assess penalties for violations (and for contempt of the Commission);
c) render advisory opinions regarding competition policy questions; and
d) participate in the negotiation of international agreements regarding competition policy.

6.2.2 This antitrust statute consists of 39 articles that establishes economic and legal regulations for all economic agents in Mexico. This includes all government agencies or entities, individuals, private companies, state owned companies or companies with government participation, associations, professional organisations, trusts and the like. Articles 1 and 3 of the FLEC state the general application of Mexico's antitrust policy:

6.2.3 Article 1: This law regulates Article 28 of the Constitution regarding economic competition, monopolies and free market participation. Its observance is binding in the entire Republic and applies to all sectors of economic activity.

6.2.4 Article 3: All economic agents are subject to the provisions of this law, whether they are individuals or corporations, agencies or entities of the federal state, municipal, public administrations, associations, professional groups, trusts or any other form of participation in economic activities.

6.3 Restrictive Agreements

6.3.1 The fourth paragraph of Article 28 of the Federal Constitution reserves several areas of economic activity managed by the state, considered to be "strategic areas". Such strategic areas include: mail, telegraphs, and radiotelegraphs; the coinage of currency and the issue of paper bills by one single bank controlled by the Federal Government; hydrocarbons; basic petrochemicals; radioactive minerals and the production of nuclear energy; electricity; and activities expressly set forth in the laws issued by the Congress of the Union. Under the new FLEC these particular areas are not considered to be monopolies. Nevertheless, any state enterprise is subject to FLEC outside of the strategic sectors.

6.4 Dominant positions/monopolies

6.4.1 The FLEC prohibits all absolute monopolistic practices, referred to as "per se" practices. According to the law, agreements among competitors to fix prices or quality, rig public bidding, divide distribution of goods or services, or allocate market shares violates Article 9 of the statute, regardless of the size of the agent involved, or the characteristics of the market.

6.5 Relative Monopolistic Practices

6.5.1 Relative Monopolistic Practices are evaluated under a rule of reason approach to determine whether they have pro or anti-competitive effects in the market. The principal relative practices considered in the FLEC are the following:

a) vertical market division;
b) vertical price maintenance;
c) tied sales;
d) exclusive dealing;
e) refusal to deal; and
f) others with similar consequences in the market.

6.6 Merger control

6.6.1 The law's approach is basically preventive. There is a pre-merger notification procedure to aid the Commission in detecting anti-competitive mergers. This procedure gives a maximum period for investigation and deliberation of 45 days. The FLEC establishes in Article 20 that the Commission must be notified of all "concentrations" involving firms under the following conditions:

a) If the value of a single transaction or series of transactions amounts to over 12 million times the minimum general wage prevailing in the Federal District (US$44.17 million);
b) If a single transaction or series of transactions implies accumulation of 35 percent or more of the assets or shares of an economic agent, whose assets or sales amount to more than 12 million times the minimal general wage prevailing in the Federal District (US$44.17 million); or
c) If two or more economic agents take part in the transaction, and their assets or annual income volume of sales, jointly or separately, total more than 48 million time the minimum general ways prevailing in the Federal District (US$176.68 million), and such transaction implies an addition accumulation of assets or capital stock in excess of 4.8 million times the minimum general wage prevailing in the Federal District (US$17.66 million).

7 New Zealand

7.1 New Zealand's current competition laws were enacted in 1986, but there have been a variety of such laws since 1905. Between 1958 and 1986 the trade practices law was based primarily on United Kingdom legislation. This type of legislation was formalistic, consisting of lists of practices which could be investigated, and generally only preventing those considered contrary to the public interest. A change of approach was made with the enactment of the Commerce Act 1986.

7.2 Objectives of the legislation

7.2.1 The Commerce Act 1986 was enacted at the same time as a number of measures designed to increase the competitiveness and efficiency of the New Zealand economy by reducing Government control and direct regulation of business activity. The Commerce Act was seen as a necessary accompaniment to the market reforms, as it ensured that private firms did not replace the previous government regulation with anti-competitive behaviour. The Act was needed to:

a) Define the rules by which business were to operate in the newly deregulated, open economy;

b) Deter the possible spread of restrictive practices and mergers by firms wishing to reduce the new competition; and
c) Provide a basis for the regulation of corporatised and privatised utilities.

7.2.2 In this environment it was intended that the Commerce Act would promote competition thorough legislation which:

a) prohibits the establishment or operation of business arrangements which reduce competition;
b) prohibits firms from using market power for anti-competitive purposes;
c) provides for the scrutiny of mergers and take-overs to prevent undesirable acquisitions of market power; and
d) provides for price control in markets where there is an absence of competition.

7.2.3 The Act has the stated objective to "promote competition in markets within New Zealand". A key feature of this law is its narrow focus on a single well-defined objective - the promotion of competition as a means of increasing efficiency.

7.2.4 The Act was largely modelled on the Australian Trade Practices Act. The enactment of the 1986 Act represented a radical change in competition law in New Zealand moving from an abuse control to a prohibition law modelled on the Australian Act, which, in turn was clearly modelled on US antitrust law.

7.2.5 New Zealand's approach, like Australia, is to focus on the behaviour of industries rather than their structure, and recognises in some cases an efficient industry structure may imply fewer competitors.

7.3 Scope of the application of the legislation

7.3.1 Liable Persons

7.3.1.1 Section 3(1A) provides that the Commerce Act applies to markets in New Zealand for goods or services. Penalties, damages, or injunctions may be sought against persons who contravene the decisions relating to restrictive trade practices and business acquisitions.

7.3.1.2 Penalties, damages, or injections may also be sought against those persons who aid, abet, counsel, induce or attempt to induce, or conspire with, or are in any way, directly or indirectly, knowingly concerned in or party to a contravention by another person.

7.3.2 Exemptions

7.3.2.1 Application to the Crown is limited to instances where the Crown engages in trade, except that the Crown shall not be liable to pay a pecuniary penalty and shall not be liable to be prosecuted for an offence under the Act.

7.3.2.2 Practices which are specifically authorised by other statutes or by orders in council are exempted from the trade practices prohibitions of Part II of the Commerce Act. In addition, there are exemptions for agreements restricting competition between partners; agreements between interconnected companies; agreements to protect the goodwill of a business being sold; agreements to comply with product quality standards; agreements relating to remuneration, conditions of employment, hours of work, or working conditions of employees; agreements relating exclusively to exports from New Zealand; and actions undertaken by groups of consumers.

7.3.2.3 Further exemptions apply to provisions relating exclusively to the carriage of goods to and from New Zealand by sea, and to conduct in accordance with a statutory intellectual property right.

7.3.3 Enforcement machinery

7.3.3.1 Enforcement of competition law is the responsibility of the Commerce Commission. Approvals may be sought from the Commission in relation to anticompetitive conduct or business acquisitions. The Commission may clear acquisitions that do not create or strengthen a dominant position in a market. It may authorise anticompetitive business acquisitions and some types of trade practices if the public benefits outweigh the anticompetitive detriment.

7.3.4 Closer Economic Relations with Australia

7.3.4.1 There is legislation providing for cooperation between the Commerce Commission and the Australian Trade Practices Commission in relation to the investigation of anticompetitive conduct occurring in one country and affecting a market for goods in the other country.

7.3.4.2 Under sections 98H(2) and 99A of the Commerce Act the two Commissions may receive information and documents on behalf of each other.

7.3.4.3 The Evidence Act 1908, the Judicature Act 1908, and the Reciprocal Enforcement of Judgments Act 1934 have been amended to allow the courts in each country to assist the other in hearing cases relating to anticompetitive practices.

8 Philippines

8.1 The most basic, if not the oldest, of the Philippines legislation that addresses anti-competitive behavior is provided by the Philippine Constitution which states: "The State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed."

8.1.1 Article 186 of the Revised Penal Code of 1932 (Republic Act No. 3815) defines and penalizes monopolies and combinations in restraint of trade and provides penalties thereof.

8.1.2 The Consumer Act of 1932 (Republic Act 7394) provides for consumer product quality and safety standards.

8.1.3 The Corporation Code of the Philippines (1980) provides for the rules regarding mergers and consolidations, and the acquisition of all or substantially all the assets or shares of stock of corporations, which are particularly relevant in evaluating vertical or horizontal cartels or arrangements.

8.1.4 The Revised Securities Act (1982) complements the Corporation Code. This Act proscribes manipulation of security prices and insider trading.

8.1.5 Consumer welfare and protection is also an important field for laws on anti-competitive behavior. The most important legislation in this regard is the Price Act of 1991 (Republic Act 7581) which defines and identifies illegal acts of price manipulation such as hoarding, profiteering and cartels.

8.1.6 The present laws have proven to be inadequate or ineffective to stave off the ill effects of anti-competitive structures and behavior in the market. Despite the considerable number of laws and their varied nature, competition has not been fully established in all sectors of the economy, nor has existing competition in other sectors of the market been enhanced. These laws have hardly been used or implemented, as may been seen in the lack of cases litigated in court.

9 Singapore

9.1 Singapore does not maintain competition laws but depends on its free and open market to ensure a competitive environment in the domestic economy. For services which the Government has traditionally been the sole provider, the Singapore Government has commenced a programme of corporatisation and privatisation to subject the provisions of such services to competition and market discipline.

10 Chinese Taipei

10.1 Chinese Taipei's economy has grown considerably since the 1970s. This rapid growth triggered drastic changes to the socio-economic structure, which the original economic order and regulations could no longer adequately address. In order to deal with these changes and to reflect international trends, the Ministry of Economic Affairs (MOEA) was instructed by the Executive Yuan in 1980 to study the establishment of a set of competition laws, the Fair Trade Law.

10.2 With a mandate to maintain trade order, ensure fair competition, promote economic prosperity and market order and protect consumer interests, the Fair Trade Law was intended to complement government economic development policies of liberalization, internationalization and institutionalization, in the pursuit of a competitive market-oriented economy. It was to be based on international examples and experiences.

10.3 The draft law was completed by the MOEA in 1985 and submitted to the Executive Yuan. It was referred to the Legislative Yuan a year later for the required three readings prior to promulgation, beginning a 5-year deliberation of the draft law.

10.4 A series of public hearings were also organised, involving scholars, experts, business representatives and the general public, to gather public opinion on the draft law. Since the Fair Trade Law would have major impact on local business operations, much care was taken in the deliberation process of the draft law.

10.5 After the decade long policy debate, the Fair Trade Law was promulgated on 4 February 1991. Enforcement began a year later with the establishment of the Fair Trade Commission.

10.6 The Fair Trade Law covers a wide range of antitrust and unfair competition concerns. The antitrust component of the Law regulates monopolies, mergers and concerted actions. The Law, in general, permits the existence of monopolies, as long as they do not abuse their market power. Mergers involving parties reaching a certain sales volume or market shares must apply to the Commission for approval. The Commission in principle forbids concerted actions but allows for exceptions which require the Commission's prior approval. The unfair competition component of the Law prohibits unfair competition which includes resale price maintenance, various other types of vertical constraints, acts which are likely to impede fair competition, false and deceptive advertising, commerce disparagement, multi-level sales and any other practices which are deceptive or grossly unfair.

10.7 The Fair Trade Law was amended on 5 February 1999 to increase penalties, enhance the ability of the Fair Trade Commission, require that cases are dealt with through administrative channels before the judicial system is resorted to, and incorporate more stringent rules on multi-level sales.

11 Thailand

11.1. Overview

11.1.1 The revolution of Anti-Monopoly Law in Thailand began with the enactment of the Anti-Profiteering Act of 1947. This Act was aimed primarily at protecting consumers from excessive product prices. There were no provisions in this act to prohibit monopolies or competition restraints. Later, as the economy expanded, this Act proved to be insufficient to effectively protect consumers from unfair trade practices and rapid price increase. Hence, the Price Fixing and Anti-Monopoly Act of 1979 was enacted to replace the Anti-Profiteering Act. The Price Fixing and Anti-Monopoly Act of 1979 was later replaced by two separate Acts: the Price of Goods and Services Act of 1999, and the Business Competition Act of 1999.

11.2 Development of Competition Law in Thailand

11.2.1 The Price Fixing and Anti-Monopoly Act of 1979 contained two components: consumer protection provisions, and anti-monopoly provisions. While the part of the Act relating to price fixing was effectively enforced, the anti-monopoly section was seldom enforced.

11.2.2 As the economy expanded, this Act became incompatible with Thailand's economic conditions. The law was no longer able to efficiently protect consumers, or prevent abuses of monopoly power. This resulted in the enactment of the Business Competition Act of 1999.

11.3 The Business Competition Act of 1999

11.3.1 The objective of the Business Competition Act of 1999 is to promote free and fair competition among businesses. The provisions of the Act focus on business conduct control. The Act accepts that some firms will have high levels of market power. However, the use of such market power to harm other firms, or the economy as a whole, is prohibited.

11.3.2 The Act attempts to protect competition through the following means:

a) It prohibits businesses with dominant positions from abusing their market power by:
   i) setting unfair prices for goods and services through resale price maintenance, predatory pricing and price discrimination,
   ii) setting unfair trading conditions, directly or indirectly, to customers in order to restrict customers' normal business practices,
   iii) limiting the supply of goods and services to create a shortage, and
   iv) intervening in other businesses without proper reason.

b) Any mergers that may create monopolistic power or reduce competition are prohibited, unless those mergers get permission from the Committee on Business Competition.

c) Entrepreneurs are prohibited from conspiring and colluding with other entrepreneurs in order to create monopolistic power, or reduce competition.

12 United States

12.1 Description of the U.S. Antitrust Laws

12.1.1 The United States has a long history of antitrust enforcement. The U.S. Congress enacted the first U.S. federal antitrust law -- the Sherman Act -- in 1890. Almost 25 years later, in 1914, the U.S. Congress enacted the Clayton Act and the Federal Trade Commission Act - at which point the primary U.S. antitrust laws were in place.[131] The Sherman Act contains broad bans -- with both criminal and civil penalties -- on price-fixing agreements, monopolization and other unreasonable restraints on trade. Section 1 of the Sherman Act states that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal." Sherman Act § 2 makes it unlawful to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations." The broad prohibitions of the Sherman Act have been read into section 5 of the FTC Act.

12.1.2 The Clayton Act prohibits mergers and certain other forms of conduct the effect of which may be anticompetitive. Specifically, Clayton Act § 7 prohibits mergers and acquisitions "in any line of commerce or in any activity affecting commerce in any section of the country, [where] the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly . . ." Mergers and acquisitions may also be challenged under sections 1 and 2 of the Sherman Act and section 5 of the FTC Act.

12.1.3 These statutes are phrased in terms of broad prohibitions. The determination as to the kind of conduct that constitutes an "unreasonable restraint of trade" or the kind of merger "the effect of which may be substantially to lessen competition" has been delineated over the past 100 years by court decisions in specific cases. During the course of this judicial process, certain kinds of conduct have come to be recognized as being so economically harmful as to obviate the need for an in-depth search for anticompetitive effects. Such practices, *i.e.*, price-fixing, bid rigging, agreements to limit output, as well as horizontal agreements allocating customers or territories, have been designated as *per se* antitrust offences. Prosecution of such violations requires proving that the relevant conduct occurred -- no proof of competitive effect is needed. Such *per se* violations are also the only antitrust law violations that are prosecuted criminally.

12.1.4 Criminal violations of the Sherman Act by corporate defendants are punishable by fines of up to $10 million or double the gross amount gained from violation of the law or loss by the victim(s). Sherman Act violations by individuals are punishable by fines of up to $350,000, and up to three years imprisonment. The Department has recently requested Congress to increase the fine for corporations to a maximum of $100 million. This increase has been requested to ensure that antitrust penalties are not written off as a mere minor cost of doing business.

12.2 State and Private Enforcement

12.2.1 One interesting feature of U.S. antitrust enforcement is the fact that in the United States, nearly all 50 states and the District of Columbia also have some form of antitrust law which is enforceable in their state courts. State antitrust statutes vary, as do the remedies for violations thereof. State antitrust laws are enforced by state attorneys general in state courts. When investigating the same transaction, state and federal authorities make every effort to coordinate their approaches.

12.2.2 State attorneys general may also, subject to a number of limitations, bring an action on behalf of natural persons residing within the state for injuries sustained as a result of any violation of the Sherman Act.[132] Damages recovered by states in these actions are trebled.

12.2.3 Private antitrust actions are also an important feature of the federal antitrust enforcement regime. Because the resources of government agencies are limited, private plaintiffs may, in effect, serve to supplement government enforcement. While enforcement of the FTC Act is reserved to the Federal Trade Commission, private actions under the Sherman or Clayton Acts for the recovery of damages may be brought by any individual or entity "injured in its business or property by reason

[131] For a more complete discussion of the history of the U.S. antitrust laws, see, e.g., Hans Thorelli, *The Federal Antitrust Policy* (1955); Rudolph J. Peritz, *Competition Policy in America, 1888-1992* (1996); Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law* 1 - 113 (rev. ed. 1997).

[132] 15 U.S.C. §15c(a)(1)(1994).

of anything forbidden in the antitrust laws."[133] Private actions seeking an injunction under the Sherman or Clayton Acts may be brought by any individual or entity "threatened [with] loss or damage by a violation of the antitrust laws."[134] Despite the broad statutory language, however, a private plaintiff must meet requirements demonstrating he was indeed "injured," that the injury was to his "business or property," and that the injury was the type of injury that the antitrust laws were intended to redress. If, in a case brought by the government, a defendant is adjudged to have violated either the Sherman or the Clayton Act, a private plaintiff may use that judgment as *prima facie* evidence in a subsequent action for damages, and ask the court for an award of three times the amount of any damages proven. The U.S. Government can also sue for treble damages to recover for injury to its business or property resulting from an antitrust violation.

12.3 Exemptions and Exceptions to the Federal Antitrust Laws

12.3.1 No major economic sector is completely exempt from the federal antitrust laws. Over time, however, some sectors and some types of conduct have been granted partial exemptions. Some of these exemptions have been in the form of Congressionally enacted legislation, while others have been judicially created. Sectors which have some form of exemption from the antitrust laws include:

- Agriculture: certain activities of qualified agricultural cooperatives are exempt from the antitrust laws;
- Energy: the energy sector is generally subject to the antitrust laws, with limited exceptions;
- Securities industry: the antitrust laws are generally applicable to the securities industry, but implied antitrust immunity has been found in some cases by the courts for certain activity regulated by the Securities and Exchange Commission;
- Insurance: the business of insurance is not subject to antitrust laws to the extent that it is regulated under state law and does not constitute a boycott. McCarran-Ferguson Act, 15 U.S.C. secs. 1011-15.
- Transportation: The Surface Transportation Board has the authority to exempt certain types of activity by railroads and motor carriers from the antitrust laws. Under a narrow set of circumstances, the Department of Transportation can grant immunity from the antitrust laws for certain activity by air carriers involving their international operations. The Shipping Act of 1984, 46 U.S.C. secs. 1701-20, allows the Federal Maritime Commission to regulate shipping and grant antitrust immunity.
- Newspapers: under the Newspaper Preservation Act, newspapers "joint operating arrangements," in which formerly competing newspapers merge their commercial operations while keeping their news and editorial functions under separate ownership and control, may be exempted from the antitrust laws if the Attorney General concludes, after a public notice and comment period, that all or all but one of the newspapers was in danger of financial failure. This is a more lenient test than the generally applicable 'failing company" test under which otherwise anticompetitive mergers may be permitted. Apart from this specific exemption, the newspaper business remains fully subject to the antitrust laws.

12.3.2 While no private industry is completely exempt from application of the federal antitrust laws, certain governmental entities do enjoy various forms of antitrust immunity. The federal government, its agencies and instrumentalities are immune from suit under the antitrust laws. Under the "state action doctrine," each of the 50 states, when acting in its sovereign capacity, is also exempt from operation of the antitrust laws. This exemption extends to private or quasi-private entities who operate pursuant to a "clearly articulated and affirmatively expressed" state policy, and whose conduct is "actively supervised" by the state itself. See California Retail Liquor Dealers Ass'n v. Medcal Aluminum, Inc., 445 U.S. 97 (1980).

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[133] 15 U.S.C. §15(a) (1994).

[134] 15 U.S.C. §26.

12.3.3 Local municipalities and their instrumentalities are immune from antitrust damage actions, but are not immune from suits for injunctive relief.[135]

[135]For a more complete discussion of exemptions and exceptions to the U.S. antitrust laws, see *Antitrust and Market Access: The Scope and Coverage of Competition Laws and Implications for Trade*, at 169-179, OECD (1996).

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