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Competition Policy In A Globalising And Liberalising World Economy

Introduction

As a general rule of thumb consumers gain from healthy competition between firms for their custom. However, competition is not a naturally occuring phenomenon. The natural instinct of a firm is to maximise its market position and to gain a dominant share of a market. To counter this tendency rules and regulations need to be developed to ensure that competition is maintained.

Since 1990s many developing countries including India undertook economic reforms which advocated a market economy as against the control and command economy practiced until then. A central element in many such reform programmes has therefore been price liberalisation measures. In India for example, where price and distribution controls had insulated firms from competition and made them sloppy, benefits were noticed from price liberalisation in sectors such as cement.

On the contrary, in the process of reforms, anti-trust legal provisions were diluted in India which spurred a spate of mergers, amalgamations and strategic business alliances leading to oligopolistic market situations. This clearly has the potential for harming consumer welfare.

Integration into the global economy can also lead to similar situations beyond the capacity of most countries to control their ill-effects. This Briefing Paper examines the need for both a strengthened domestic competition policy and an international competition policy which is imperative for all countries in this age of globalising and liberalising world economy.

What is competition?

There are a number of models of competition in basic economic theory. Each of the models is an "ideal type" and so unlikely to be found in real markets. However, the theory does set the parameters for behaviour and give indications for policy.

For what is termed "perfect competition" a number of conditions are needed. Firstly, there must be a very large number of buyers and sellers for a product or service. Secondly, there must be perfect information flows to enable both buyers and sellers to make choices. Thirdly, there must be perfect mobility of all the players in the market (both buyers and sellers) to enable both buyers to find and interact with sellers and vice versa. Fourthly, each producer must make identical products. Finally, there must be free entry and exit to the market. This means that a firm must be able to establish itself without cost. There are two results of this structure, firstly that there is only one price, that defined by the balance of supply and demand and that secondly, all producers are termed "price takers". That is no firm can set a price other than that dictated by the market.

Models of competition	Perfect competition	Monopolisitic competition	Oligopolistic competition	Monopoly
Number of buyers	very large	very large	very large	very large
Number of sellers	very large	large	very few	one
Nature of products	identical	large differences	large differences	large differences
Barriers to entry and exit	none	none	large	very large

At the other extreme is monopoly, where a single firm dominates the market. In reality a monopoly is defined as existing where a single supplier controls a majority, or a very large share, of a market. Barriers to entry are usually enormous in those sectors that are monopolies. Such barriers can be cost-based (the costs of setting up an aircraft industry are huge), or based on ownership of patents or legal rules (for example, nationalised industries). In this case the monopoly is a price maker and can fix the price and allow demand to determine output, or set output and allow demand to set the price.

In between the two extremes lie oligopoly and monopolistic competition. An oligopolistic market occurs when there are a very small number of firms operating. Firms in such a market tend to produce large numbers of branded goods and compete on non-price terms (such as brand loyalty) and reinforce this with high advertising budgets. Each firm depends on the actions of the other firms and has to take a close look at what other firms are doing in the market before it takes any actions. Many OECD markets for soaps and washing materials exhibit an oligopoly structure.

Monopolistic or workable competition, which sounds like a contradiction in terms, shares the characteristics of perfect competition and monopoly. Barriers to entry are very low, or non-existent and there are a large number of suppliers and consumers. However, there is a high degree of differentiation in the products offered and each supplier has a monopoly on the supply of their particular product. This high degree of differentiation is usually achieved through branding and reinforced through advertising. The personal computer market in many OECD countries shows tendencies toward this model.

In Poland, the Antimonopoly Office has had to deal with numerous cases of abuses of dominant position by natural monopolies, particularly water works, electricity, gas and sewage services, as well as telecommunication networks. The Office has undertaken steps to elaborate legal regulations of such sectors by setting up enforcement agencies and training their staff.

In Sri Lanka, the competition law provides for establishment of the Fair Trading Commission like in many developed countries, to promote and inter alia ensure protection of consumer interest, including incentives to producers for a fair rate of return on the capital, resource allocation among different sectors, control of inflation and other objectives of public policy.

The legacy of colonialism, state control and export-led development policies, left Kenya with a hybrid approach to competition policy. This is evident in the titles of the laws that were used to enforce competition. The forerunner of the Restrictive Trade Practices, Monopolies and Price Control Act, 1988, was the Price Control Act, 1956. The emphasis on price control is central to the Kenyan law, but peripheral to most other competition law systems.

An exception exists in Australia, where the competition law, Trade Practices Act, 1974, and the Price Surveillance Act, 1983 are administered by one authority: Australian Consumer & Competition Commission. In spite of its limiting title, the PSA is actually used to expose unwarranted price increases or unhealthy market manipulations.

What is competition policy?

In practice competition law and policy acts to reinforce competitive behaviour within the existing structure of competition in a market. In general it will only act if there are clear abuses of competition on the part of a particular firm, or group of firms, that harm the operation of the market.

Domestic competition problems
Black and white cases

- **Tied selling:** forcing a buyer to purchase more quantity than they want, or the full range of products in a particular class or even other products which they don't want.
- **Resale price maintenance (RPM):** the supplier dictates the price that the seller can charge.
- **Exclusive dealing:** creating local monopolies agreeing to divide markets into regions (product or geographic).
- **Reciprocal exclusivity:** the seller agrees to only sell the goods of the single supplier.
- **Refusal to deal:** forcing a purchaser to act under instruction from the supplier under threat of the withdrawal of products or services. This usually occurs when there are limited options for a purchaser for alternative supply.
- **Differential pricing:** a supplier charges different prices to different sellers on a basis other than quality or quantity ordered.
- **Predatory pricing:** the charging of differential prices with the aim of driving a competitor out of business.
- **Cartel:** a group of firms acting together to gain a dominant market position.

In 1991, the first year of economic reforms, corporate India announced 71 mergers and acquisitions. By 1994, the number swelled to 324 and by 1995, it was roughly 412. In certain cases the marriages were beneficial as either the taken over company was sick or the managements decided to promote internal group efficiency. However, in most cases it had the potential to be harmful to consumers' interest, as the emerged entities acquired more than a majority share of the market. For example, Unilever's Indian subsidiary, Hindustan Lever Ltd acquired an Indian soap manufacturer, TOMCO Ltd in 1991. This led to HLL controlling a 77 p.c. share of the soaps market and 90 p.c. share of the detergents market. Under nearly all developed country competition laws, such a marriage could not have been consummated.

A number of countries, particularly developing countries, also faced problems on the ability of that country to export goods or compete more effectively in the region. This also became a consideration in development of their competition and merger law. In Egypt, it was reported that foreign firms demanded protection against dumped imports from Japan as a price for continuing operations in the country.

In South Korea, horizontal unreasonable concerted activities are prohibited unless registered with and approved by the Economic Planning Board. The Board will consider whether they lead to a substantial restriction of competition in any particular sector against the public interest. Thus, when six major petroleum refiners collaborated in restricting sales, the Fair Trade Commission of Korea fined them US$ 3 million.

In recent cases, the European Commission took action against 15 European shipping firms for operating cartels and market sharing arrangements on routes between France and central African countries. In December 1994, the EC imposed record fines of approximately US$ 290 million on 33 European cement manufacturers, one international cement association and eight national manufacturers that had colluded over a period of 10 years to rig Europe's cement market.

'Consumer welfare vs economic welfare'

The aim of competition policy and laws is not as straightforward as might be assumed. Although economic theory tells us that competition and therefore strong competition law is aimed at enhancing consumer welfare, we often see in practice other aims taking precedence. As the box below shows, competition law can be developed to enhance overall economic rather than consumer welfare. The difference between the two approaches can be enormous. Overall economic welfare places the welfare of the economy over basic consumer welfare.

In practical terms this can mean that a case of market dominance can be sanctioned if doing otherwise might jeopardise jobs, or restrain the company from competing on the global stage. For example, the Canadian government supported a proposed merger between a Canadian firm, de Havilland and a European firm, ATR, because de Havilland were likely to go out of business unless the merger went ahead. Canada defined de Havilland as an ailing industry and considered overall economic welfare gains to outweigh potential competition problems.

In recent years, Canada, the United States, the EEC, Italy and New Zealand have placed more emphasis on the economic efficieny goals. Several developing countries, including Colombia and Mexico, have done the same. But some countries, notably France, India, the UK and emerging economies in the former Soviet Bloc countries, design competition laws towards multiple objectives.

How has competition policy evolved

Laws and regulations affecting the behaviour of firms in their markets have been on the statute books in India for almost two millennia and in Europe for several centuries. The root of modern competition law, however, springs mostly from the late 19th and early 20th centuries. The reasons for the development and spread of competition policy since then involve a complex interplay of factors listed below.

Reasons for spread of competition policy

- Response to domestic pressure
- Policy imposition by occupation
- Response to external pressure
- Response to changing geo-politics
- Joining the club

Considerations in competition policy

- **Consumer welfare:** the estimation of the proposed or existing activity or situation on consumers.
- **Public interest:** includes consideration of employment effects and wider considerations such as the need to maintain corporate activities for cultural reasons, or other public interest arguments.
- **Overall aggregate welfare:** directed toward maintaining overall system welfare.
- **Producer welfare (industrial policy):** anti-competitive mergers and acquisitions are allowed and often encouraged, to enable the enlarged domestic corporation to be more 'competitive' on the global scale.
- **Response to outside pressure:** countries can pressure each other to more strictly enforce their own competition policy (e.g. US on Japan) or change their competition laws (e.g. US on Mexico) to bring them into line with their own expectations.
- **Need to regulate mergers:** the regulation of merger activity among corporations within their borders and across borders, where possible.

In the USA during the latter decades of the 19th century, the position of large corporations was under very strong attack from industrial workers and, most vociferously, small farmers. Large corporations were seen to be acting in unison to control markets and exploit consumers. The rebellion against these "trusts" formed the basis of what became the US Anti-Trust law. The strength of domestic outrage at corporate behaviour has also played a part in the development of competition laws in South Korea and Australia. It may be noted that Canada introduced anti-trust legislation even before the US.

The end of World War II and the occupation of Japan and Germany by Allied forces, marked the start of a period of growth for competition law. Prior to the end of the War, German and Japanese industrial law promoted the development of conglomerates and monopolies and built them into their military planning. The USA used the opportunity of the end of the War to re-write German and Japanese competition law to ensure that this situation did not reoccur. In 1951 Japan regained control of its legislative functions and promptly reformed many elements of the 1948 Anti-Monopoly Law.

The ability of large countries to impose their views on smaller countries has been a constant element of world politics. This situation is no less true for competition policy. During the post war period the USA signed a number of agreements with smaller countries, a condition of which was the development and enforcement of competition policies and laws. A major development since the mid-1980s has been the frequency with which competition issues crop up in trade disputes involving the USA. The most recent example involved the USA threatening Japan, just after the new GATT 1994 came into force, with sanctions for its closed market in automobiles and its spare parts. The USA perceived this situation to be as Japan's failings in domestic competition law enforcement.

A very important influence on the development of competition law has been the aftermath of the collapse of the Soviet Bloc. The collapse of the USSR and its satellite states speeded up the process of liberalisation that had been gaining momentum since the late 1970s. Many developing and transition countries, having seen the collapse of the central planning model, enacted sweeping reforms, removing regulations and encouraging foreign investment. In several East European countries, the counter effect of liberalisation has been a quick and sharp reduction in output from large public sector enterprises, without a corresponding increase in supply by other producers, leading to hyper inflation. This is due to macroeconomic imbalances too.

However, the rapidity of liberalisation created a number of problems for developing countries in their approach to competition. Many developing countries simply did not have the regulatory infrastructures to ensure that they did not replace publicly owned monopolies with private monopolies. This realisation prompted many developing countries to adopt competition laws during the last couple of decades.

To deflect criticism that the government's economic stabilisation programme, launched in December 1993, has benefited business rather than consumers, Brazil proposed tough measures to control price taking by companies in June 1994. The so-called "anti-trust" law included heavy fines or even jail for those found guilty of unjustified and excessive price increases. Companies or mergers/alliances between companies controlling more than 30 p.c. of the market will be deemed to be dominant and subject to special scrutiny and clearance.

An added condition for new market economies is the fact that all the major economic powers have some form of competition policy and law. The desire of many developing and transition economies to emulate their performance and sign economic co-operation agreements has led many to see the enactment of competition laws as a membership requirement. This has been enhanced by the inclusion of competition policy elements in many of the free trade agreements being negotiated between the EU and the Eastern European countries. A similar example exists under NAFTA, where the US ensured that Mexico has appropriate competition legislation.

The international challenge to competition law

The development and spread of competition laws and policies has run alongside globalisation and liberalisation of the world economy. The spread of this process of economic integration has posed a number of problems for competition authorities. As the box in next page shows, there are a number of activities that are a most direct challenge to the effective enforcement of competition law at the national level.

Cross-border mergers and acquisitions (M&As) pose a problem for national competition agencies. This is because, by their nature, they involve firms operating in more than one country and will have an effect on more than one country. This can lead to more than one competition agency being involved in evaluating the efficacy of a proposed M&A. For instance in the proposed merger between Wilkinson and Gillette, fourteen different agencies were involved in oversight proceedings, often operating under different rules and requiring different levels of confidentiality. This situation can also lead to different competition agencies arriving at different conclusions. The Canadian case mentioned above, involving de Havilland and ATR, also involved the EU. Canada passed the merger for economic welfare reasons, whereas the EU blocked the merger because of competition concerns.

Strategic business alliances also pose a threat to domestic competition law in that they are designed to foster co-operation between competing firms. Such co-operation can be designed to offset huge research costs and spread risk, or even strengthen marketing arrangements. However, there is also a potential for such agreements to step over the line between co-operation and cartelisation.

Industrial policy instruments are also highly prone to clash with domestic competition policies and

International competition problems and grey area measures

- **Cross-border mergers and acquisitions (M&As)** can be used to create monopoly positions where previously competition existed between firms.
- **Strategic business alliances:** co-operation between competing firms, for example, to develop products, conduct research, joint marketing etc.
- **Export cartels:** firms agree export prices, divide markets or take other group action in markets outside their own domestic markets.
- **Import cartels:** often created as a defensive response by firms that purchase the goods of export cartels.
- **Domestic cartels:** domestic cartels can limit market access for foreign firms.
- **International cartels:** joint action by corporations from more than one country, under which they agree to divide markets, set prices or divide up bids for projects.
- **Trade policy:** the use of anti-dumping law to restrict imports, the setting of import targets and setting quotas on exports.

undermine their impact. Many countries, such as Germany, explicitly exclude export cartels from the purview of competition law and a number encourage import cartels to counter other countries' export cartels. This creates a spiral of anti-competitive practice and anti-consumer results.

International cartels are the most stark challenge for national competition agencies. For example the oil cartel promoted by the Organisation of Petroleum Exporting Countries in 1971, by which oil prices doubled and quadrupled sending many economies into a spin. As the agreement is an international one, there is no one agency capable of dealing with the agreement on an international level. It is up to national agencies to co-operate or go it alone in trying to tackle the cartel. The USA, operates the controversial "effects doctrine" which allows it to act against firms outside the USA whose anti-competitive practices affect the US economy. Another solution has been the development of co-operative agreements between competition agencies. The most notable of these was the 1995 US-EU agreement.

One of the most controversial areas of conflict for national competition policy is the intrusion of trade policy into its sphere of influence. It is often said that the best form of competition policy is a liberal import policy. While this is superficially true, it is also fair to say that the record of many trade policy instruments has had the opposite effect on competition. Most prominent among these are anti-dumping law and import and export restrictive agreement.

Anti-dumping law aims to protect domestic producers from "unfair" competition from imports. In practice the definition of unfair has been stretched to the point of incredulity and it is largely used to unfairly protect domestic producers from competition. Similarly voluntary restraint agreements have sought to restrict trade in favour of domestic protection and have indirectly led to the cartelisation of what trade is allowed. These policies directly contradict the basic tenets of competition law.

Efforts towards international competition policy

A number of international bodies have responded to the many challenges faced by national competition agencies. The OECD began such work in 1960s, encouraging their member countries to at first, share information and experience, and then to co-operate on specific cases that involved more than one jurisdiction. The UNCTAD has also played a very important role in spreading competition policy to developing countries, by developing a set of principles for competition laws in 1980 and by offering technical assistance for developing countries to develop their own laws in this area.

However, the most recent "kid on the block" of international competition law, is perhaps the most influential. The Agreement on Trade-Related Investment Measures (TRIMs) of the Uruguay Round has mandated the members of the World Trade Organisation to look into the possibility of enhancing the scope of the agreement with measures on competition policy and its flip side, investment policy. It is to do this by the turn of the next century. The results oriented approach of the WTO makes it an ideal vehicle for the creation of a strong body of international competition regulations. However, it must realise that the work of the UNCTAD and OECD already lays down a solid basis for any future work. Besides, the EU competition law and practices offer a good framework for an international competition policy.

Would consumers benefit from international competition rules?

The potential for national competition law to benefit consumers is almost beyond question. The only problem occurs when aims other than consumer welfare are used in deciding cases. The challenges of globalisation have also thrown a challenge to competition law, and thus consumer welfare. That challenge must be met, and must be met at the right level. Those countries that currently co-operate on the enforcement of their competition laws ought to be congratulated and further such agreements should be encouraged. However, only a truly global set of regulations for the control of restrictive business behaviour will really be effective against global wrong doing.

Conclusions

A good competition policy is synonymous with an effective consumer protection policy, as it protects consumers from market place abuses. Both UNCTAD and the OECD have done a lot of work in this area and need to be involved and consulted in future work.

At the national level, competition law should:

- be directed at enhancing consumer welfare
- should be enforced by a single body with a consumer policy branch represented at executive level
- be responsible for anti-dumping laws and regulate all trade agreement restricting imports
- be included as a consideration in all industrial policy decisions

At the international level

- an agreement should be aimed for that deals with problems of international competition enforcement
- the WTO should begin informal negotiations aimed at identifying the main problems in the area
- the WTO should involve the UNCTAD and OECD specialists in this work
- any such work should be designed to enhance global consumer welfare
- any international competition agency should include an agency specifically designed to champion the consumer cause

Recommendations

It is therefore recommended that governments and the international community should develop appropriate competition policy and law as follows:

- **Harmonise, reform and strengthen national laws under a single agency and ensure their role in policy involving consumer and business representation**
- **Ensure independence of the competition authority by making such provisions in the law itself**
- **Ensure division of responsibilities like investigation, prosecution and adjudication and transparency in their functioning**
- **Develop basic principles of competition rules on the basis of which national parliaments can legislate mutually recognisable and harmonised domestic laws**
- **Develop basic principles of 'rules on rules' on cross-border competition issues alongwith international cooperation mechanisms under the WTO system, but on an arms length relationship**

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