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COMPETITION POLICY, DEVELOPMENT AND DEVELOPING COUNTRIES

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Foreword

This paper on Competition Policy, Development and Developing Countries was prepared for the South Centre, Geneva, by Prof. Ajit Singh and Rahul Dhumale. Prof. Ajit Singh gave a seminar on Competition Policy at ICRIER on November 26, 1999 and raised many pertinent issues on competition policy and its implications in the context of the multilateral trade negotiations within the WTO framework. In view of the importance of this topic, we are reproducing this paper with permission of Prof. Singh for wider dissemination.

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Director & Chief Executive
ICRIER

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PREFACE

The South Centre, with funding support from UNDP TCDC Unit, has established a pilot project to monitor and analyse the work of WTO from the perspective of developing countries. Recognizing the limited human and financial resources available to the project, it focuses on selected issues in the WTO identified by a number of developing countries as deserving priority attention. It is hoped that the project will lead to more systematic and longer term activities by the South Centre on WTO issues.

An important objective of the project is to respond, to the extent possible within the limited resources, to the needs of developing country negotiators in the WTO for concise and timely analytical inputs on selected key issues under negotiation in that organization. The publication of analytical *cum* policy papers under the T.R.A.D.E. working paper series is an attempt to achieve this objective. These working papers will comprise brief analyses of chosen topics from the perspective of developing countries rather than exhaustive treatises on each and every aspect of the issue.

It is hoped that the T.R.A.D.E. working paper series will be found useful by developing country officials involved in WTO discussions and negotiations, in Geneva as well as in the capitals.

South Centre, November 1999

List of Abbreviations

DRAM	Dynamic Random Access Memory
FDI	Foreign direct investment
FTC	Federal Trade Commission
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
MAI	Multilateral Agreement on Investment
MITI	Ministry of International Trade and Industry (Japan)
NICs	Newly industrializing countries
OECD	Organization for Economic Co-operation and Development
R&D	Research and development
SOEs	State-owned enterprises
TCDC	Technical Co-operation among Developing Countries
TNCs	Transnational corporations
TRIMs	Trade-related Investment Measures
TRIPs	Trade-related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization

FOREWORD

Competition policy has emerged as a major issue on the global trade agenda due to the pressure by major developed countries who consider that in an increasingly liberalized world economy the issue of competition should be addressed at the international level and appropriate agreements and rules be negotiated.

This, however, is hardly a new matter on the international agenda. Indeed, the subject has been dealt with in the UN at least since 1964 when UNCTAD was established. Such issues as restrictive business practices and a code of conduct for transnational corporations have been studied in depth and discussed by member states for decades with a view to adopting international instruments on these matters. The broad objective was to elaborate an international framework that would regulate the practices and check the power of large corporations, such that their actions and presence in the South would be more supportive of national development efforts.

This earlier emphasis has been largely forgotten. Today concern is focused more on how to promote globally the goals and objectives of major corporations from the North. And whereas in the earlier period the developed countries were at best ready to discuss voluntary codes of conduct, now when the onus is on developing countries to adapt their national policies to the needs of others, international agreements pressed for by the North are supposed to be binding and enforced by multilateral disciplines. This fundamental shift is but one reflection of the lopsided power relations between the North and the South.

As in other areas of international trade and trade related matters, the advanced industrial countries are seeking what they refer to as “level playing fields”, so that their corporations can have free and open access to developing countries. The firms in the latter countries, however, are relatively small with relatively little experience and, unlike the large established foreign firms with a world-wide presence, do not have the same access to finance and lack the less tangible but critical assets such as brand recognition or global marketing networks. The establishment of “level playing fields” would prohibit developing countries both from taking measures to shield their firms and industries from competition from massive foreign corporations and from pursuing measures to promote the growth of strong domestic corporations.

Much as in the case of the OECD proposal for a Multilateral Agreement on Investment (MAI), which it was hoped would be extended to embrace developing countries but which was aborted in the OECD, discussions on competition policy give little consideration to the specificities and differences in levels of development among countries of the South, and among developed and developing countries.

The global strategies and expansion of major corporations are beginning to have a marked influence on the nature of competition in the world market. The recent spate of mega mergers and acquisitions mainly among larger corporations based in the North is increasing the degree of market concentration and hence raises serious questions concerning the nature of global competition. Such trends are making it even more difficult for developing countries and their firms to exist as economically autonomous entities in the world economy.

TNCs drive many of the major policy initiatives of developed countries in the world arena, including those intended to put in place new global regimes to regulate the world economy and national economies of the developing countries. But although they are powerful actors on the global scene, TNCs themselves are not considered to have duties and obligations and are kept beyond the jurisdiction of the international community, as opposition from the North prevents issues regarding TNCs from featuring on the international economic and development agendas.

This working paper attempts to shed some light on the inadequacies of the approaches to competition policy advocated by the North, and which are reflected in WTO and increasingly in the UN as well. The paper illustrates that in-depth academic analysis of the subject of competition policy, when taking into account development priorities and analysing the situation in an integrated and balanced manner, arrives at a set of policy conclusions and approaches which differ substantially from those currently pressed for in the WTO arena.

This analysis provides yet one more example of the vital importance for developing countries of overcoming dependence on North-based studies and analyses, and of organizing their own analyses with a view to preparing their views and positions in international debates and negotiations such as those taking place in WTO.

SUMMARY

This paper provides a briefing for developing countries to apprise them of the main issues which are relevant for development and social welfare in relation to the present and prospective discussions on competition policy in the WTO, UNCTAD, OECD and other fora. Although this is the immediate backdrop for an examination of competition policy in relation to economic development, the topic is urgent and important in its own right, because of important new developments in the world economy and because of significant structural changes within developing countries themselves.

The main analytical conclusions for developing countries which emerge from the theoretical and empirical analysis of competition policy and economic development in this paper may be summarized as follows:

1) It is important for developing countries to have a competition policy which is designed to take appropriate account of their level of development and the long term objective of sustained economic growth. This is in part due to the potential effects of the international merger movement and also because of privatization, deregulation and liberalization which have occurred in the domestic economies of most developing countries.

2) A distinction is made in this analysis, between, on the one hand, countries at low levels of development and with meagre institutional capacity and, on the other, semi-industrial countries with greater institutional capabilities. The paper concludes that the types of competition policies adopted by the US and the UK are not appropriate for either group of developing countries.

3) If the concerns of developing countries with respect to competition policy are to be addressed seriously, this paper suggests that the concepts used in the current WTO/OECD/UNCTAD discourse on the subject need to be replaced with new concepts. Specifically, in considering competition policy from a developmental perspective, the paper reaches the following analytical conclusions:

   - emphasis should be placed on dynamic rather than static efficiency as the main objective of competition policy for developing countries;
   - there should be a concept of ‘optimal degree of competition’ (rather than of maximum competition) to promote long term growth of productivity;
   - there should be a related concept of ‘optimal combination of competition and co-operation’ between firms so that developing countries can achieve fast long term economic growth;
   - the critical need to maintain the private sector’s propensity to invest at high levels requires a steady growth of profits; for this to occur there is

need for government co-ordination of investment decisions which in turn requires close co-operation between government and business;

- there should be recognition of the concept of ‘simulated competition’, which involves contests among those seeking state support and which can be as powerful as real market competition;
- there should be recognition of the importance for developing countries of industrial policy and hence the need for coherence between industrial and competition policies.

However, the paper suggests that the concepts or principles outlined above appear ‘new’ only in relation to the current discussions on competition policy and economic development in the international agencies mentioned earlier. These concepts are fully grounded in modern economic analysis and a number of them are in fact implicit in WTO Agreements themselves but in which they have in fact been used to the advantage of developed countries. It is argued here that these same principles are also crucial for competition policy in developing countries in order to promote their economic development.

For developing countries, the paper recommends they should institute domestic competition policies suited to their stage of development.

The paper also recommends the establishment of an international competition authority, to prevent restrictive business practices and competition-reducing actions of large multinationals which are acquiring even greater market power as a consequence of the current huge wave of mergers and takeovers, both national and international.

I. WTO, COMPETITION POLICY AND DEVELOPMENT

The Declaration of the WTO Ministerial Conference held in Singapore in December 1996 stated in paragraph 20:

> " … we also agree to:
>
> … establish a working group to study issues raised by Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework.
>
> In the conduct of the work of the working group[s], we encourage cooperation … to make the best use of available resources and to ensure that the development dimension is taken fully into account. … It is clearly understood that future negotiations, if any, regarding multilateral disciplines in these areas, will take place only after an explicit consensus decision is taken among WTO Members regarding such negotiations."[1]

The General Council of the WTO established a Working Group in April 1997 on the Interaction Between Trade and Competition Policy under the chairmanship of Professor Frédéric Jenny, a French expert on industrial organization. The non-paper by the chair, "Checklist of Issues Suggested for Study", called for particular attention to the "development dimension" in the Working Group's discussion on these issues: "It was widely recognised that the Working Group's work programme should be open, non-prejudicial and capable of evolution as the work proceeds. It was also emphasized that all elements should be permeated by the development dimension."[2]

Although the WTO Working Group has made notable progress on its mandate, and there has been much useful work carried out at UNCTAD and other fora, it is, to put it mildly, rather anomalous that it is precisely the developmental dimension which is missing from the interim documentation released by the international agencies.[3] A serious policy analysis of competition policy and economic development, it will be argued here, requires fresh concepts and new definitions. An analysis of these issues, which are of vital importance to developing countries, within the traditional WTO framework will be highly prejudicial to the South's development needs.

The order of discussion of the various topics in this paper and the construction of its central argument is as follows:

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1 The full text of paragraph 20 of the Singapore Ministerial Declaration (INT/MIN(96)/DEC) is contained in Annex I of WTO (1999).

2 WTO (1998) Annex I, p.51.

3 WTO (1999). The final report of the WTO working group not only provides information on the activities of this group itself but also reports on the work which has been carried out in relation to competition policy for developing countries at UNCTAD, OECD, and the World Bank.

Firstly, it is suggested here that although many developing countries may not have needed a competition policy[4] before, most require it today, regardless of whether or not the subject is discussed at the next or future WTO ministerial meetings. This is in part due to the potential welfare-reducing effects of the current merger wave that is sweeping the world economy. Further significant structural changes within developing countries themselves also underline the need for competition policy.

Secondly, it is argued that many developing countries cannot aspire to have the kind of competition policies which advanced countries implement. More importantly it is suggested that it is not, in any case, in the interest of developing countries to do so. Competition policies for advanced countries are shown not to be appropriate for the stage of development of most developing countries.

Thirdly, the paper outlines the kind of competition policies which would best serve the interests of developing countries. Policies will be required both at the national and the international level. It will be suggested that the formulation of national competition policies in developing countries requires rather different economic concepts than those which are normally applied in advanced countries.

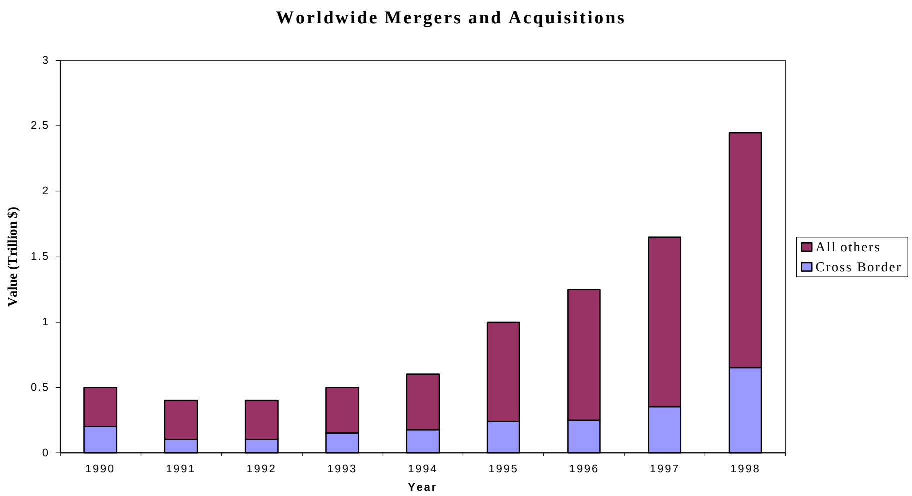
Fourthly, it will be argued that these new economic concepts are thoroughly grounded in modern economic analysis as well as being supported by a large body of empirical evidence. It will however be suggested that many of these concepts are "new" only in relation to the current studies and discussions on the subject at WTO, UNCTAD and other international fora; indeed some of them are implicit in the existing WTO Agreements.

Finally, the paper sets out the implications of the above analysis for developing countries.

[4] For the purpose of this paper, competition policy is defined as a body of laws, administrative rules and case law which are employed to deter restrictive business practices so as to maintain fair competition. Competition policy also includes rules and regulations governing mergers and acquisitions.

II. The Global Merger Wave

One of the most important reasons why some kind of competition policy for developing countries has become imperative is the gigantic merger wave which has gripped the world economy in the 1990s. As the chart below shows, between 1990 and 1998 the value of worldwide mergers and acquisitions rose nearly fivefold. Most of this merger activity took place within the US. Data reported in the Financial Times (FT, October 25, 1999) and not reproduced here suggests that of the total worldwide merger activity of nearly $2.5 trillion, almost $1.6 trillion represented takeovers and mergers within the United States; much of the remaining activity occurred in other industrial countries.



Source: *Economist,* January 1999.

A significant characteristic of the present merger wave is the large incidence of cross border takeovers and mergers. This type of merger activity has become progressively important with the increasing integration of the world financial markets over the last two decades.[5] However, most of the cross border amalgamations also take place among the industrial countries themselves. Nevertheless, during this decade, a considerable proportion of foreign direct investment (FDI) by industrial country firms in developing countries has taken the form of acquisition of existing enterprises rather than green field investment. UNCTAD (1999) data suggests that if China (which among developing countries has not only been the largest recipient of FDI, but most of this investment has also been green field) is excluded, the share of mergers and acquisitions in the accumulated FDI rises from 22 per cent during 1988 to 1991 to an average of 72 per cent in the time span 1992 to 1997.

5 For comparison with previous merger waves, see the discussion in Singh, 1993; Hughes, 1992 and Hughes and Singh, 1980.

Periodic waves of mergers have been an integral part of the capitalist development since its inception.[6] Mergers and acquisitions represent an important mechanism for reorganization and restructuring of a market economy.[7] Many of the leading corporations in the world today are the products of mergers affected in previous merger waves. Economic theory suggests that mergers can have both positive and negative effects on welfare. At the simplest level, the former may take the form of synergy among the amalgamating firms, and/or economies of scale which improve efficiency and reduce costs of production; the latter may arise from increased monopoly power of the merged firms which may be welfare reducing.[8]

Both in the US and UK one of the most important and the largest merger movements occurred a hundred years ago, during the 1890s. Although rigorous empirical work has not yet been done on the subject, back-of-the-envelope calculations suggest that the merger boom of the 1990s, taking into account the effects of factors such as the growth in the size of the economy and the rate of inflation may be the biggest ever recorded notably in the US.[9] This wave has already resulted in increased concentration in a wide range of industries including aerospace, defence equipment, power equipment, home machinery, automobile and automobile components, pharmaceuticals, soft drinks, snack foods, chemical fertilizers, retailing, accountancy and financial services (Nolan,1998).[10]

The merger boom of the 1990s is of course not entirely an exogenous or autonomous event. As indicated earlier, it is in part caused by liberalization and globalization, closer integration of world markets through finance and trade, and the creation of the European single market, among other factors. Firms are jockeying for strategic advantages in the new environment through mergers, acquisitions, and other kinds of tie-ups.[11] However, once some large takeovers have occurred in a particular industry, this creates an oligopolistic disequilibrium in the sense that the market shares of leading firms are disturbed. As a consequence, other giants are obliged to follow in order to maintain their share in the world market. In this sense, evidence suggests many mergers in the present wave are defensive, but that does not stop their overall effect in a number of cases from being welfare-reducing due to potential reduction in competition as outlined above.

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6 Evidence suggests that mergers are not randomly distributed over time but occur in waves. See, for example, Golbe and White, 1988.

7 For the differences between mergers and acquisitions (or takeovers) and their implications, see Singh, 1971.

8 It is important, however, to remember that not all mergers necessarily lead to increased monopoly power; even when they do, they are not always welfare reducing. Some of these points will be elaborated in the following sections. (See further Scherer and Ross, 1992; Singh, 1992a, 1992b).

9 For an analysis of the relative magnitude of previous merger waves, see Golbe and White, 1988; Singh, 1993; Hughes and Singh, 1980.

10 The above discussion has been concerned only with mergers, but other kinds of tie-ups and co-operative arrangements between firms can have similar anti-competitive effects. Often a case-by-case investigation is needed to determine the size of such effects. However, the observations in footnote 8 remain relevant.

11 Co-operation between firms can take various form with mergers and acquisitions representing one end of the spectrum in which two or more firms are amalgamated together into a single legal entity. Other kinds of inter-firm co-operation may involve joint ventures, technology sharing agreements, and outright cartels. Some forms of co-operation may be benign, e.g., technology sharing, while others (e.g. cartels) are not, and may reduce social welfare more than full scale mergers between firms.

2.1 Competition policy implications for developing countries

Whether the mergers take place in the US or Europe or through cross border takeovers in developing countries themselves, there are serious competition policy concerns for developing countries. If the largest producers in, say, the US automobile industry merge, this may not only lead to anti-competitive behaviour in the US but also similar or worse behaviour in developing countries (e.g. cartelization of markets, increased barriers to entry). The US has long had a competition policy which provides it with a defence against such welfare-reducing consequences of mergers.

In the famous example of the Boeing-McDonnell Douglas takeover case, although both companies were located in the US, the European Community objected to the merger on account of its potentially competition-reducing effects in Europe.[12] The Community was able to extract important concessions from Boeing before the merger was approved. It is also now commonplace for jurisdictions in other industrial countries to scrutinize separately all large proposed mergers for their effects on competition even if they occur abroad.[13]

Leaving aside perhaps China, India, Brazil, and the small number of relatively advanced newly industrializing countries (NICs), the vast majority of developing countries will find it difficult to stop anti-competitive behaviour by the local subsidiaries of merging large corporations in industrial countries. These corporations may behave competitively within industrial countries because of the effective competition regulations of the latter but may indulge in anti-competitive practices in developing countries. A Ghana or a Tanzania is likely to find it difficult to prove, let alone punish, predation or collusive pricing by large industrial country corporations.

Recently, US anti-trust authorities imposed a fine of US$700 million on the leading European producers of vitamins for creating a cartel to charge high prices to consumers. If such cartels can operate in the US with all its regulatory machinery and its extra-territorial reach, the task of adequately policing such abuses is likely to be beyond the capacity of most developing countries' competition authorities. These considerations suggest that the huge current international merger movement, even though it is largely occurring in advanced countries, has potentially serious adverse implications for developing countries. Therefore, the latter not only need competition policies in their own countries but also international and South-South co-operation. They need to involve the international community in co-operative action against potentially anti-competitive practices of the mammoth corporations which are emerging in industrial countries as a consequence of the current merger wave.

2.2 Level playing fields

The analysis of the international merger wave also suggests another area of concern for the more advanced developing countries. This relates to the question of unequal competition between large multinational and big domestic corporations in these countries. Even the largest developing country corporations tend to be much smaller than the industrial

[12] See further Khemani, 1998; WTO, 1997.

[13] See further Jenny, 1999 and Fox, 1999.

country multinationals. The large merger wave of the 1990s is likely to make this disparity even bigger. By means of worldwide mergers and tie-ups, the advanced country corporations are able to integrate their international operations. This may be a source of genuine technical economies of scale, but evidence indicates that in most industries average cost curves are L-shaped, that is to say, after a threshold size which is relatively small and which most of these giant corporations would already have achieved even before mergers, costs do not fall as the size of the firm increases. The economies which nevertheless the multinationals are able to achieve through integration are those relating to bulk buying of inputs, reduced cost of capital due to large size as well as economies achieved in advertising and other marketing activities on a large scale. To the extent that these economies depend on the market power of the multinational in relation to inputs, the cost saving measures are not necessarily welfare enhancing; furthermore, these "pecuniary economies" create barriers to entry which make the markets less contestable.[14]

During the last 50 years, Japan, as well as many NICs in Asia and Latin America, have been able to foster the development of big businesses to the advantage of these countries' overall economic development. This has usually been achieved through various kinds of state support. These large domestic corporations, which are privately owned, have often been the leaders in the diffusion of new technologies and the adaptation of imported technologies to domestic circumstances.[15] However, in the current, new international economic environment these firms are likely to be handicapped in three significant ways:

1) through the limiting of state aid as part of WTO disciplines;

2) through the increased size and market power both in the product and input markets of large multinationals;

3) through increased barriers to entry and contestability which the merger boom creates.

In these circumstances, it will be much more difficult than before for large developing country corporations to become even national let alone international players.

It is normal for multinationals to complain that there is not a level playing field between themselves and national corporations which are government supported; hence, the multinationals' demand for "national treatment". However, the actual situation is often quite the opposite: the playing fields are tilted in favour of multinationals who invariably have considerable market power. Liberalization and globalization, together with the international merger movement, are making these fields more unequal even from the perspective of *large* developing country corporations.

[14] For a comprehensive discussion of the economies of scale and of scope, and of multiplant economies of scale, see Scherer and Ross, 1990.

[15] See further Amsden, 1989 and Singh, 1995a.

III. PRIVATIZATION, DEREGULATION AND COMPETITION POLICY

Many of the same ideological, political, and economic forces of liberalization and globalization which have led to the current gigantic merger wave in the industrial countries have also been responsible for fundamental changes in the organization of economic activity in developing countries around the world. In the 1980s, and particularly during the 1990s, many developing countries have been undergoing far reaching market oriented reforms leading to considerable diminution in the direct role of the state in economic activity. This has resulted in widespread privatization, deregulation, and internal and external financial liberalization.

The timing and extent of these liberalization measures has varied between countries. In relation, specifically to privatization, the pattern was set by the programme of privatization of larger state-owned enterprises (SOEs) beginning in the 1980s in the UK under the conservative government led by Mrs. Thatcher. This was followed not only by many advanced countries, but also by the vast majority developing countries. Leaving aside transition economies where there has been mass privatization, the leading developing countries each with privatization proceeds worth more than US$1 billion between 1990-1997 were Argentina (proceeds of $27.9 billion), Brazil ($34.3 billion), Colombia ($5 billion), India ($7.1 billion), Indonesia ($5.2 billion), Malaysia ($10 billion), Mexico ($30.5 billion), Pakistan ($2 billion), Peru ($7.5 billion), Singapore ($1.9 billion), South Africa ($2.5 billion), Turkey ($3.6 billion), Thailand ($3.6 billion), and Venezuela ($5.9 billion).[16]

Considerable privatization also took place in African countries. However, in view of the smaller size of their economies and their lower level of development, in absolute terms the proceeds from privatization during the same period were substantially lower for these countries, other than South Africa. Nevertheless, privatization proceeds amounted to US$ 864 million in Ghana, $227 million in Kenya, $197 million in Zimbabwe, $140 million in Tanzania, $730 million in Nigeria, and $412 million in Zambia. In general, according to *WDR* (1999), the lower the level of per capita income, the lower the extent of privatization.

Privatization was ostensibly undertaken for a number of reasons including improving economic efficiency, reducing the drain on government resources caused by public sector losses, raising revenues for the government and to help pay off the foreign debt by raising foreign exchange through the sale of public assets to foreign multinationals. In most developing countries, privatizations were strongly encouraged if not required under structural adjustment programmes of the international financial institutions. It is generally recognized that, rather than efficiency reasons, the main motive for privatization in many countries was to achieve a relaxation of the hard budget constraints which the international financial institutions enforced as part of their conditionality. There have been few studies of the effects of privatization on economic efficiency in developing countries. However, a number of studies have been carried out for developed countries, particularly the UK, which indicate that it is not ownership *per se* which is the main determinant of economic performance, but rather the degree of competition in the market.

[16] *World Development Indicators*, (1999)

In this overall context, it is not difficult to see why the need for competition policy becomes crucial. Further, many of the privatized companies were natural monopolies under state ownership. Privatizing them does not necessarily lead to greater social welfare since it simply involves replacing the public monopoly with a private one. The former may in fact be preferable to the latter from a social welfare perspective, as there may be some consideration given to the public purpose in the former's activities. The presence of a large state sector is probably an important reason why many developing countries have not until now felt it necessary to have a competition policy. However, in the new privatized domestic economic environment, competition and regulatory policies become essential. Moreover, as Stiglitz points out, external liberalization cannot substitute for a competition policy if liberalized imports and exports become subject to domestic monopolistic restrictions (Stiglitz, 1999).

Khemani calls attention to another aspect of privatization via foreign takeovers which affects many developing countries. He reports cases where foreign acquiring firms, normally multinational enterprises, demand that governments erect barriers to entry or permit certain pricing practices. He notes: “Often developing and emerging market economies facing hard budget constraints or rising deficits, and/or are in desperate need of foreign investment, may have no choice but to cave in to such demands” (Khemani, 1999 p.105).

IV. Competition Policies in Advanced Economies: A Model for Developing Countries?

The argument so far has suggested that the new internal and external environment facing developing countries makes it necessary for them to have competition policies. The important question, and the one which is central to this paper, is what kind of policies would be appropriate for developing countries. Should developing countries simply follow the advanced countries in their competition policies and enact legislation accordingly? To answer this question it is necessary first to consider what kind of competition policy the advanced countries follow. Here, the significant point is that there are major differences among them in the policies that they pursue, their underlying philosophies, their legislative practices, and their modes of implementation.[17]

The US which has long experience in competition policy -- the first US legislation was passed nearly a hundred years ago in response to the merger movement at the turn of the 19th century (referred to earlier) -- takes a so-called structural approach to this issue. Competition is regarded as being a good thing in itself and anti-trust laws (including Federal Trade Commission (FTC) rulings and Supreme Court judgements) attempt to discourage anti-competitive practices. The spirit of this view is well captured in the epigram: the purpose of competition policy is to advance the competitive process rather than to protect the competitors. The WTO report notes, “A guiding principle that is often referred to by competition agencies and tribunals or courts is that ‘competition law protects competition, not competitors’ ” (WTO, 1997, p. 44).

Competition policy in the UK and in Western Europe has traditionally been based on a rather different philosophy. It does not regard competition as an end in itself, but a means to an end. This leads to a trade-off approach -- encroachments on competition are acceptable if they are adequately counterbalanced by benefits to the community. Thus, in the simplest case, mergers between two large firms in the same industry -- which by the traditional US anti-trust policy would be ruled out *per se* -- may be permitted under traditional UK competition laws, if it can be shown that the welfare reducing effect of increased market power resulting from the merger is more than matched by gains to society, as a consequence of reduced costs of production because of economies of scale and/or because of synergy.

This leads in practice to a case-by-case approach to mergers rather than the promulgation of *per se* structural rules as has historically been the case in the US. Singh (1993) has noted that there has been some convergence of competition policies in the US and the UK in the 1980s and the 1990s. The US authorities, partly due to increased international competition, started to give greater importance to the so-called “economies of scale defense” for mergers than they used to do before. Regulators in the UK, on the other hand, have started giving much greater weight to the effects of mergers or of other

[17] For a fuller discussion of competition policy in advanced countries see Scherer, 1994; Hughes, 1992; Waverman, 1995; Amsden and Singh, 1994. For the section on competition policy in Japan, this paper draws from Amsden and Singh, 1994.

kinds of corporate behaviour on competition *per se* than to other considerations (such as regional impact) in the calculation of net social gain.

Among industrial countries, Japan has its own approach to competition policy questions. Following the end of World War II, the US occupation authorities in Japan enacted US type anti-trust laws in part to punish the large Japanese firms -- the *zaibatsu* -- who were thought to have been responsible for aiding and abetting Japan's aggression and war effort. However, as Professors Richard Caves of Harvard University and Professor Uekusa of Tokyo University, leading students of Japanese industrial organization, point out, the US-imposed laws had no domestic constituency in the country.[18] The laws therefore soon fell into disuse for this as well as other strategic cold war-related considerations. Although the *zaibatsu* disbanded, they soon re-emerged in the form of a looser association of companies called *keiretsu*. Moreover, competition policy in Japan became subservient to the country's vigorous industrial policy. Professor Okimoto explains the philosophy behind the Japanese approach to the subject:

> "…the Japanese government takes a more pragmatic approach to anti-trust enforcement, one that makes allowances for national goals such as industrial catch-up. It takes into account other collective values and extenuating circumstances in weighing enforcement decisions against the letter and spirit of anti-trust laws. Included here are such considerations as economies of scale, enhanced efficiency, optimal use of scarce resources, international competitiveness, heightened productivity, business cycle stabilization, industrial orderliness, price stabilization and economic security" (Okimoto, 1989, p. 12-13).

Competition policy in Japan has thus evolved over time, as indeed has industrial policy.[19] This has been particularly true since Japan joined the OECD and began to implement trade and financial liberalization measures. The evolution of Japanese competition policy in the 1970s and the 1980s is interesting but not as relevant to developing countries as the competition policy practised by Japan between 1950 and 1973. This is because, at the beginning of the period, Japan was very much like a developing country with low levels of industrialization and economic development. Indeed, its industrialization prospects at the time were thought to be altogether precarious.[20] How Japan, starting from such low levels, caught up with the West is clearly a story of great interest to developing countries. As seen below, the theory and practice of competition policy during the Japanese catch-up process in the 1950s and 1960s is particularly instructive for such economies.

To sum up, this brief review of the different approaches to competition policy in the US, UK and Japan suggests that the most appropriate model from the perspective of economic development may be that of Japan during 1950-1973. This period will therefore be examined more closely below.

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[18] Caves and Uekusa, 1976.

[19] See Singh, 1998; Tsuru, 1993; Johnson, Tyson et al. 1989.

[20] World Bank, 1991.

V. ECONOMIC THEORY, COMPETITION POLICY AND DEVELOPMENT

Before moving to the discussion of Japan's competition policy in the period 1950-1973, it is useful to consider what insights are provided by economic theory to the question of competition policies for countries at different levels of development.

Recent advances in economic theory, particularly agency theory, transaction cost theory, and information theory, have greatly enriched our understanding of how competition and competition policy may work in various spheres of an economy and in different economies. Thus, a leading authority on the theory of industrial organization has recently observed:

> "Competition is an unambiguously good thing in the first-best world of economists. That world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, a benevolent court system to enforce contracts, and a benevolent government providing lump sum transfers to achieve any desirable redistribution. *Because developing countries are so far from this ideal world, it is not always the case that competition should be encouraged in these countries*" (italics added) (Laffont, 1998, p.237).

This author provides a number of examples to support his contention. All of these involve what economists call the theory of the "second best." The latter asserts that, if any one of the assumptions required for the validity of the fundamental theorems of welfare economics cannot be met, restricted rather than unrestricted competition may be a superior strategy. Laffont draws particular attention to the "demonization" by many economists (including those at the World Bank) of cross subsidization of different groups by large public utilities. However, he points out that in developing countries, where, in practice, taxes cannot be collected from the wealthy for re-distribution, it may be a good strategy for the government to require public utilities in these countries to subsidize poor consumers in the countryside at the expense of richer residents in the city.

Laffont suggests that even if competition policy of the kind followed by advanced countries such as the US or the UK were appropriate for poor African countries, they are a long way from having the institutional capacity to implement such policies. The implementation of a comprehensive competition policy requires a strong state which many developing countries at low levels of industrialization do not have. Therefore, at the very least, for such countries there will need to be far fewer and simpler competition rules which are capable of being enforced. Clearly it would be unfair, if not absurd, to subject a Sierra Leone to the same competition policy disciplines as the US.

We now turn to the consideration of the case of the semi-industrial countries, many of which are now fairly advanced in industrial development, e.g., Korea, India, Brazil, Mexico. These countries have reasonably strong states with competent government machinery. However, economic theory suggests that, even for these economies, the US and UK types of competition policies may be inappropriate. A very important reason for this conclusion is that the essential focus of competition policy in advanced countries such as the US is the promotion of allocative efficiency and reduced prices for consumers (WTO, 1997). However, from the standpoint of economic development, this perspective is too narrow and static. In order to raise their people's standard of living, a central objective of developing countries must necessarily be the promotion of long term growth of productivity. The pursuit of this objective of dynamic rather than static efficiency requires, among other things, high rates of investment. In a private enterprise economy, this necessitates encouragement of entrepreneurs' propensity to invest. However, the private sector's 'animal spirits' are likely to be dampened if, as a result of competition, profits became too low, even if only temporarily.

This suggests that unfettered competition may not be appropriate for a developing economy. Economic theory as well as experience indicate that, in the real world of incomplete and missing markets, unfettered competition may lead to price wars and ruinous rivalry and therefore may be inimical to future investment: from this perspective, too much competition can be as harmful as too little. What is required by developing economies is an optimal degree of competition which would entail sufficient rivalry to reduce inefficiency in the corporate use of resources at the microeconomic level, but not so much competition that it would deter the propensity to invest. This central analytical point is altogether ignored in competition policy discourse in countries such as the US where the concept of optimal degree of competition is simply assumed to be maximum competition, that is, the more competition the better.[21]

It is useful in this context to reflect on the operation of competition policy in Japan in the period 1950-1973. The Japanese economy achieved historically unprecedented growth during this time span: its manufacturing production rose at a phenomenal rate of about 13 per cent a year, GDP at 10 per cent a year, and its share in world exports of manufacture rose by a huge 10 percentage points (Singh, 1998). A central role in this spectacular economic advance was played by the very high rates of savings and investment in the Japanese economy. As noted earlier, the competition policy was subordinated to industrial policy, an essential concern of which was to maintain the private sector's high propensity to invest. For this purpose, the Japanese government's Ministry of International Trade and Industry (MITI) frequently imposed restrictions on product market competition. Amsden and Singh (1994) note: "It (MITI) encouraged a variety of cartel arrangements in a wide range of industries -- export and import cartels, cartels to combat depression or excessive competition, rationalization cartels, etc. … . Similarly, believing that large scale enterprises were required for promotion of technical change and for Japanese firms to compete effectively with their western counterparts, MITI encouraged mergers between leading firms in key industries" (Amsden and Singh, 1994, p. 944).

The Korean government broadly followed the Japanese strategy of economic development. It also had a strong industrial policy which, as in the case of Japan, dominated competition policy. The government helped create the mammoth corporations, the *chaebol*, which went on to capture world markets. Korea was unequivocally an industrially backward country in the 1950s. Its per capita manufacturing

[21] See earlier discussion of philosophy of US competition policy which finds virtue in competition itself rather than to examine its effects.

output in 1955 was US$ 8 compared to US$ 7 in India and US$ 56 in Mexico. During the last four decades Korea has managed to transform itself into an industrial and technologically sophisticated economy. It is the world's leading country in electronic memory chip (DRAM) technology. Until the recent financial crisis, it was expected to become the fourth largest producer of automobiles in the world by the year 2000.

As a result of lax enforcement of competition policy, Korea has one of the highest levels of industrial concentration in the world. However, the giant conglomerates compete with each other fiercely. A significant part of the competition has been of the non-market variety in which the *chaebol* have competed for government support. The latter has been given in return for meeting specified performance targets for exports, new product development, and technological change. In the market place, the *chaebol* competed for market share, as that determined their subsequent investment allocations in a particular industry. As in Japan between 1950-1973, the Korean government until recently has purposefully co-ordinated industrial investments by competing *chaebol*, so as to prevent overcapacity and too much competition (Chang, 1994).

The policies adopted by these East Asian countries find endorsement in the new developments in economic theory. Essentially, modern economic theory suggests that dynamic efficiency is best promoted by a combination of co-operation and competition between firms rather than by maximum or unfettered competition(Graham and Richardson, 1997).

It has been suggested by some scholars and high US government officials that the recent financial crisis in Asia demonstrates the failure of state-directed capitalism of the Asian countries. However, a careful analysis of these issues indicates that the crisis was caused not by too much state direction but rather by too little. Overinvestment by the *chaebol* in Korea or the property bubble in Thailand were caused essentially by the fact that these countries were pursuing capital account liberalization in the immediate period before the crisis. Korea had become a member of the OECD in the early 1990s and in fact had abolished its planning agency. Neither industrial overinvestment by the *chaebol* nor excessive investment in the property sector in Thailand would have occurred had the governments co-ordinated investment activity as before.[22]

[22] For various interpretations of the Asian financial crisis see Singh, 1998b, 1999a; Singh and Weisse, 1999; Radelet and Sachs, 1998; US Council of Economic Advisors, 1999; IMF, 1998; World Bank, 1999.

VI. ANALYTICAL CONCLUSIONS AND IMPLICATIONS

6.1 Analytical conclusions

The main analytical conclusions for developing countries which emerge from the theoretical and empirical analysis of competition policy and economic development, as well as from the earlier discussion of the new developments in the international economy and their implications for competition policy, may be summarized as follows:

1) Developing countries do need a competition policy in the wake of the international merger movement as well as because of privatization, deregulation and liberalization which have occurred in their domestic economies.

2) In examining this issue, a distinction was made between countries at low levels of development and with meagre institutional capacity and semi-industrial countries with greater institutional capabilities. In neither case were the US and UK types of competition policy found to be appropriate.

3) To address seriously the concerns of developing countries with respect to competition policy, this paper has suggested new economic concepts in place of those used in the current WTO discourse on the subject. Specifically, the paper has called attention to the following points:

    - the need to emphasize dynamic rather than static efficiency as the main purpose of competition policy from the perspective of economic development;
    - the concept of ‘optimal degree of competition’ (as opposed to maximum competition) to promote long term growth of productivity;
    - the related concept of optimal combination of competition and co-operation to achieve fast long term economic growth;
    - the critical significance of maintaining the private sector’s propensity to invest at high levels and hence the need for a steady growth of profits; the latter in turn necessitates government co-ordination of investment decisions so as to prevent over-capacity and falling profits;
    - the concept of simulated competition, i.e., contests, for state support which can be as powerful as real market competition;
    - the crucial importance of industrial policy to achieve the structural changes required for economic development; this in turn requires coherence between industrial and competition policies.

It is clear from this analysis that, in order to give effect to the stated desire in the Singapore WTO Ministerial Declaration of December 1996, “to ensure that the development dimension is fully taken into account”, it would not be enough to simply suggest that all that developing countries need is a longer time frame to be able to implement the US or UK type of competition policy. The special and different circumstances of developing countries and their developmental needs require a creative application of the new concepts above to competition policy questions.

The concepts introduced in this paper are not only relevant to competition policy in relation to economic development but also have important developmental implications for a number of different areas of the WTO Agreements, including those on TRIPs, TRIMs, and on Subsidies and Countervailing Measures. However, in view of their complexity, each of these subjects merits a full paper. Further, since a number of these topics are being dealt with in other parts of the work programme of the South Centre, these are not discussed here in any detail. Nevertheless, some brief remarks need to be made on some of the topics to indicate the wider application of the analysis presented in this paper.

First of all, it is important to appreciate that the concepts outlined above are only "new" in relation to the present WTO, UNCTAD and OECD studies and working groups on the subject: at another level, the validity of the concepts is not only accepted by modern economics but also implicitly recognized in various parts of the WTO Agreements themselves. For example, the underlying economic justification for the TRIPs Agreement is to be found in the concept of dynamic efficiency. Restrictions on competition are accepted under the Agreement in order to promote technical change and long-term economic growth. However, since most patents are held by advanced country corporations and individuals, the Agreement promotes the dynamic efficiency of developed rather than developing countries.[23]

Similarly, the notion of industrial policy is implicit in the Agreement on Subsidies and Countervailing Measures which does not prohibit government grants to private firms to promote R&D, or subsidies granted to disadvantaged regions, or those relating to new environmental laws. This rule again favours industrial policy requirements of advanced countries; many of the subsidies of interest from the perspective of industrial policy in developing countries are ruled out, for example, prohibited subsidies include those contingent on export performance, or those given for the use of domestic in preference to imported products.[24]

Thus, those who are uncomfortable with new concepts may wish to note that essentially what this paper has done is to make explicit certain economic principles which are already implicit in WTO Agreements. These have been used in the Agreements to the advantage of advanced countries but they can be applied just as well to the question of competition policy from the perspective of developing countries.

The broad analytical framework of this paper also has implications for some other important areas of WTO agreements to which it may be useful to draw attention. To take

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[23] For a fuller discussion of competition policy in relation to the TRIPs Agreement see Dumont and Holmes, 1999; Correa, 1999.

[24] The Agreement does recognise the interests of developing countries to some extent by allowing an extension of the time period for its implementation by different groups of countries. For example, least developed countries and other WTO members with GNP per capita of less than US$1,000 are exempted from the prohibitions on certain subsidies (such as export subsidies) until export competitiveness is achieved (defined as the attainment of a share of 3.25 per cent of world trade in a product for two consecutive years). Other prohibited subsidies must, however, be eliminated by these countries within a period of five years (eight years for LDCs) from the entry into the force of the WTO Agreement. See further Singh, 1996.

first the question of anti-dumping and countervailing duties, these have been used by advanced countries as a straight forward protectionist device, as is increasingly recognized (Stiglitz, 1999). A recent study of US anti-dumping cases suggests that, if these had been subject to the equivalent US competition policy standard of predation, more than 90 per cent of them would have failed.[25]

Should developing countries favour the abolition of anti-dumping measures because these are often used unfairly against their products? The answer to this question is not simple, as is indicated by the fact that a number of developing countries are also using this device, often against the products of other developing countries. In the past, under GATT, developing countries were able to use the balance of payments clause to support their infant industry policies. Under the WTO, however, there has been considerable erosion of this "balance of payments defense". In view of the fact that developing countries will require, for some considerable period, protection for their successive new industries as they expand their industrial base, they may have to resort to anti-dumping and countervailing measures for this purpose. Section C, Article XVIII of GATT, permitted developing countries to impose restrictions and protect infant industries. However, because the use of this provision required payment of compensation, since 1967 no developing country has invoked this article. Instead many developing countries used Section B (protection for balance of payments reasons) which did not require compensation, to achieve in effect the same result. Therefore, unless developing countries are provided with an alternative instrument for protection, it will not be in their developmental interest to seek the abolition of anti-dumping and countervailing measures.

Turning to the Agreement on TRIMs, the analysis in this paper suggests that it deprives developing countries of important industrial policy instruments which have proved useful for economic development. Some of these on the prohibited list such as local content requirements have been widely used by the highly successful East Asian countries during the last three decades. Further Correa (1999) suggests that some TRIMs were also used to control horizontal as well as vertical restrictive business practices of multinational corporations. He criticizes the prohibition of such measures under the TRIMs Agreement as this withholds from developing countries important instruments to counteract anti-competitive practices. Developing countries should therefore seek to revise this Agreement when it comes up for review as part of the in-built WTO agenda.

6.2 Implications for developing countries

There is an immediate difficulty in discussing the implications for developing countries of these analytical conclusions. Since the experience of many developing countries is that even a seemingly non-prejudicial discussion of a sensitive subject such as competition policy can subsequently, under advanced country pressure, lead to full-blown negotiations, in practice many countries will quite rightly take a tactical approach to this question. They may therefore simply wish to terminate discussions on the subject altogether in the WTO and other fora in order to maintain their freedom of manoeuvre.

[25] Reported in Stiglitz, 1999.

These tactical and practical considerations are fully understandable and so will not be commented upon here. These are matters of judgement for those directly involved in WTO diplomatic activities.

However, in any substantive discussion of competition policy, either in the WTO or in other fora, it would be useful to draw attention to the implications of the foregoing analysis which to some may seem obvious. Firstly, developing country representatives should point out that the issue of competition policy has hardly received any serious attention at all from the perspective of economic development in any of the fora where these issues are being considered. Secondly, for this purpose, the need to examine these matters in terms of new concepts of the kind outlined here should be stressed. This in turn requires developing country representatives to themselves gain an understanding of why the discourse on competition policy entirely in terms of the traditional WTO framework of market access, national treatment, transparency etc. is prejudicial to their developmental interests.

To provide a simple illustration, it may be perfectly legitimate for a developing country competition authority to allow large domestic firms to merge so that they can go some way toward competing on more equal terms with multinationals from abroad. Even if the amalgamating national firms are on the horizontal part of the L-shaped static cost curve, bigger size may still promote dynamic efficiency for the reason that firms need to achieve a minimum threshold size to finance their own R&D activities. The competition authority may therefore quite reasonably deny national treatment to the multinationals and prohibit their merger activity (because they are already large enough to achieve either static or dynamic economies of scale in this sense). In these circumstances, a violation of the doctrine of national treatment is likely to be beneficial both to economic development and to competition.[26]

Thirdly, a clear message of this paper is that developing countries require special treatment in the sense of being allowed to pursue competition policies which are appropriate to their stage of development. There should certainly be no multilateral disciplines of the WTO type obliging developing countries to have universal competition policies or indeed any competition policy at all if they do not think that the cost/benefit analysis of such a policy is worth their while. As indicated by the analysis of the paper, it would be advisable for most developing countries to institute a competition policy appropriate to their needs. But, as suggested earlier, enforcement of the competition policy does require a strong state which many developing countries may not have. In these circumstances, a competition policy could simply lead to more corruption and rent-seeking.[27]

Fourthly, even with appropriate domestic competition polices which meet the development test, developing countries would still require international co-operation to cope with the anti-competitive consequences of large international mergers, cartels, etc. The best solution would be the establishment of an international competition authority,

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[26] As far as we are aware, there are no agreements as yet which specify national treatment of firms in relation to merger activity. What is being suggested here is that developing countries should resist any moves in that direction.

[27]In practice, however, most countries do have some form of a competition policy, although this may be implicit rather than explicit. Without some generally accepted rules governing fair competition, economies and societies will experience a number of difficulties. (See further Graham and Richardson, 1997.)

having proper representation of the South in its governance and not dominated by the North. The international competition authority would be charged with maintaining fair competition in the world economy and keeping the markets contestable by ensuring that the barriers-to-entry to late industrializers are kept at low levels. It would have the authority to scrutinize mega mergers, to prohibit them if necessary and, in any case, to deter the mega firms from abusing their dominant positions. For good administrative and practical reasons, references to the competition authority would only be permissible in case of anti-competitive behaviour by corporations above a certain size. The size criterion would normally keep even most large developing country corporations outside the direct purview of the competition authority, but, nevertheless, the latter would recognize the special needs of developing countries as indicated in this paper.

However, such a legally enforceable international agreement will take some time to construct in view of the differences between developed and developing countries and significantly between the developed countries themselves on this subject. This is not to deny that there has been some useful international co-operation in this area between different groups of countries during the last two decades, but it has been quite limited. Following discussions of restrictive business practices by large multinationals in developing countries at UNCTAD II, New Delhi, 1968, and UNCTAD IV, Nairobi, 1976, the U.N. General Assembly in December 1980 adopted by Resolution 35/63 a “Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.” The “Set” is fairly comprehensive in scope and covers a wide range of restrictive business practices by multinationals, including the abuse of their dominant positions whether achieved through mergers and acquisitions or joint ventures. However, the Set is not legally binding and has therefore not been helpful to developing countries. (See further, Correa, 1999.)[28]

What is being suggested here is a legally binding rather than a voluntary international agreement for a global competition policy authority. Until such time as an agreement materializes, developing countries, especially small ones, would do well to begin to co-operate with each other through regional pacts and other arrangements, in order to restrain these restrictive business practices and influence the outcome of merger activities in advanced countries.

[28] Similarly in 1986, the OECD, the organization of developed countries, issued guidelines concerning restrictive business practices by multinationals. Under the guidelines, which again were advisory rather than legally enforceable, multinational enterprises were enjoined to refrain from a wide range of anti-competitive activities including abuses of intellectual property rights, predatory behaviour, competition reducing acquisitions, etc. (See further, OECD 1986; Scherer, 1994).

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