

Issues Note on Session II: Competition Policy and Regulation

**Changing Competition Policies in Developing Countries:
From Policies Protecting Companies Against Competition
to Policies Protecting Competition**

1. Post-war evidence in OECD countries suggests that countries operating competition policies have not been necessarily identical with champions in competition intensity. This view finds also support in developing countries which do not have a long history in adopting competition policies or even operating competition laws. Until the mid-eighties, only a dozen developing countries operated competition laws. By the time competition policies were designed in these countries, the majority like Brazil, India, Pakistan, Colombia, Venezuela and Ivory Coast still relied on import-substitution policies behind high tariff and non-tariff barriers. In addition, some of them maintained restrictive policies against foreign direct investment. Thus, these countries seem to have used competition laws to regulate instead of unleash competition. To put it more strongly, they used competition laws as a substitute rather than as a complement to market opening. In doing so, they ignored the fundamental principle that without open markets competition policies will not be efficient. The monopoly control policies of these countries were designed primarily to protect domestic companies against foreign companies instead of protecting consumers against companies. Others like the Republic of Korea, helped „national champions“ to penetrate into world markets by means of sector-specific industrial policies including access to concessional loans.

On the other hand, until recently, countries like Singapore and Malaysia with relatively unrestricted market access did not show need for competition laws. However, it would be misleading to argue that trade liberalisation can fully substitute for competition laws. For various reasons, such redundancy does not exist. For instance, the existence of natural, policy-induced or firm-induced market segmentation, technologically determined indivisibilities in output, high costs of market entry as well as the existence of a non-tradable sector escaping the direct effects from trade liberalisation may suggest competition policies to be efficiency-enhancing even if goods and service markets are relatively open.

2. The initial reluctance of developing countries to apply competition laws in a competition-enhancing way has a number of reasons:
 - a) Inward-oriented domestic policies had been promoted by means of subsidies and public equity shareholding which were feared to become obsolete with the enforcement of laws intensifying competition.
 - b) Many governments believed that market size in developing countries was too small to allow for workable competition so that atomistic competition was feared to lead to excess capacities and waste of resources [UNCTAD, 1995:10]. Seemingly, governments rated such losses lower compared to those arising from monopolistic conduct.
 - c) Governments had often established state-owned enterprises in the formal sector and had vested interests to maintain a strong governmental position both in trading and production in order to maintain control on the tax base.
 - d) Many governments were hostile against market economies and used competition policies as a public watchdog against allegedly „disorderly“ functioning markets.
 - e) Competition policies were embedded into policies to support domestically owned companies and to discriminate against foreign majority-owned companies (misperception of level playing field).

- f) Many developing countries had either restricted the outflow of investment earnings and/or had imposed high taxes upon the formal sector and thus had induced investors to apply „transfer pricing“ strategies (overinvoicing of imports and underinvoicing of exports, respectively) in order to circumvent restrictions. Policies against so-called restrictive business practices were targeted to identify and contain such strategies. De-restricting profit repatriation and broadening the tax base would have been the better response.
3. Since the mid-eighties, however, there has been a fundamental shift in the perception of markets in developing countries. In order to arrest a further spiral of internal and external monetary disequilibrium, stabilisation and adjustment policies were implemented to align domestic prices to world market prices. Policies toward foreign investment were liberalised, trade policies were derestricted and tax policies were rationalised. With the opening of the current and capital account, pure „watchdog“ tasks of competition policies against monopolistic suppliers circumventing domestic policy restrictions became largely redundant.
4. When import substitution policies were fading out, this was equivalent with the reduction of the implicit tax on exports. Hence, in the aftermath of policy shifts, many developing countries became successful exporters of non-traditional exports and soon faced contingent protection measures in industrialised countries' markets. Among these measures, anti-dumping procedures (ADPs) ranged prominently. Such procedures were often justified with the allegation that developing countries had no competition policies which would have been commensurate with those of OECD countries. Contingent protection measures, including countervailing duties and ADPs, therefore, induced many developing countries to either introduce competition policies or revise the old ones.

In most cases, competition laws have been modelled on those of the major OECD trading partners in order to avoid contingent protection measures based on allegations of unfair trade. As a result, Latin American countries have embarked

upon the antitrust regulations of the US and Canada while Central and Eastern European transformation countries' laws are oriented toward EU competition laws.

5. In few cases where regional integration arrangements between developing countries (and transformation countries) on the one hand, and OECD countries on the other hand, went beyond pure trade preferences (so-called deep integration), developing countries adjusted their competition policies to those of the OECD countries even if this did not imply to be exempted from contingent protection measures such as ADPs. The NAFTA, for instance, which contains identical provisions on competition policies to those of the Canada-Chile Free Trade Agreement (CCFTA), does not curtail the Parties' right to apply ADPs and countervailing measures. On the other hand, the CCFTA provides for the reciprocal exemption from the application of ADPs even though it addresses competition policies only in general terms [WTO, 1997: 85].
6. While in the past mainly four countries initiated AD-investigations (US, EU, Canada, Australia) against developing and transformation countries, today many developing countries have reciprocated by launching AD-investigations against other developing countries and OECD countries. To remain WTO-consistent, they are on the safer side if they can legitimate their decisions by underlining their reform efforts toward new or revised competition laws.
7. Why and in which direction should competition policies in developing countries differ from those in OECD countries? It is argued that while in general competition policies should be flexibly applied in order to account for public interest criteria such flexibility might be even more needed in developing countries just because of pursuit of developmental targets [UN, World Investment Report 1997: 131]. In this context, the analogy to the multilateral trading order with its various provisions for special and differential treatment in favour of developing countries (Arts. 12 and 18 GATT, Part IV GATT, Enabling Clause of 1979) is addressed, especially the infant industry argument which underlies Art. 18 GATT.

If the infant industry argument would be extended to competition laws, domestic monopolies in developing countries would enjoy legal legitimacy both against capital and goods inflows.

However, the infant industry argument is theoretically flawed for two reasons mainly. First, the case for externalities which cannot be internalised by companies in developing countries calls for compensating the companies for the positive externalities they produce but not for subsidising the production of goods. Second, it can also be rejected on empirical grounds since infant industry protection creates strong vested interests and political entitlements for permanent protection. The empirical evidence strongly supports the view that protecting infant industries in developing countries and so-called sunrise industries in developed countries implies high costs for the economy. Protection absorbs resources both of consumers and taxpayers without convincing evidence that positive externalities actually materialise.

8. Competition policies are sometimes not only seen as instruments for developmental targets but also treated as a vehicle to cater for the poor, i.e., as a vehicle for distributional targets. In this realm, it is argued that any sector producing goods for the poorest among the consumers should receive special attention with respect to its pricing strategies and eventually be scrutinised with respect to the legitimacy to raise prices [UNCTAD, 1995: 18]. Basic food and pharmaceuticals, as laid out in the Sri Lankan competition law, could represent such sectors. However, to leave the criteria for separating between basic and non-basic sectors to the state authorities is an invitation to politically motivated discrimination and abuse. It is as problematic as the adoption of so-called „ministerially approved cartels“ for overriding political reasons in the German law against restrictive business practices.
9. Unprecedented technological innovations in the IT sector and the trend toward mega-mergers have been engines to break into so-called natural monopolies. These monopolies are characterised by high sunk costs of market entry and

technically determined indivisibilities in output. In developing countries, such monopolies can be mainly found in public utilities like energy grids or telecommunications networks. The ongoing liberalisation of the telecom sector in East Asia with its strategic alliances shows how rapidly deregulation can be enforced in emerging markets if the market structures are strongly shaping.

10. Privatisation and relaxation of investment codes can on the one hand, help competition policies to act against restrictive business practices by opening new sectors to new suppliers but on the other hand, may require the pursuit of competition policies. The latter may hold because privatisation can impair competition if it is a foreign investor who acquires control of specific assets of the privatised company and subsequently restricts access to these assets to the detriment of new competitors. Furthermore, if privatisation can only be pursued by take-overs of or joint ventures with local companies already operating in the sector, competition authorities should be alerted. Concentration ratios could rise and competition could suffer if the latter is not enhanced from outside, neither through opening the current account (imports) nor the capital account (new foreign investors). Detrimental effects of privatisation and foreign investment upon competition could be contained if domestic investment regulations would explicitly confirm the recognition of the MFN and national treatment principles (as envisaged in the proposed MAI).

To sum up, recent history has seen a profound change in competition policies in developing countries from protecting companies against competition to protecting competition against companies. Both globalisation and regionalism supported by adjustment policies in developing countries have been instrumental to anchor competition policies as a competition-enhancing device. As a result, differences between competition policies in OECD countries and emerging countries have shrunk and will shrink further. For the poorer countries which continue to suffer from weak administrative capacities and a rudimentary stage in institution building, enforcing trade liberalisation may still be the most straightforward

strategy to help competition to increase. There are various avenues toward intensified competition in domestic markets. Public surveillance of companies' conduct in the market is only one of them.

Bibliography

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