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Competition and Development

THE POWER OF COMPETITIVE MARKETS

Susan Joekes and Phil Evans

INTERNATIONAL DEVELOPMENT RESEARCH CENTRE

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and Development

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THE POWER OF COMPETITIVE MARKETS

by Susan Joekes and Phil Evans

INTERNATIONAL DEVELOPMENT RESEARCH CENTRE
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Executive Summary

The Issue

The growth of privatization and international trade and investment, and the spread of bilateral and multilateral trade agreements have increased economic integration, affecting almost all nations of the world. This new reliance on private enterprise has brought about many changes in the economic structure and production capacity of developing countries. However, it has also made developing countries more vulnerable to new and harmful types of anticompetitive business practices.

Putting effective policies in place to ensure that businesses compete is a complex and difficult task. This book and its accompanying website demonstrate the importance of true and fair competition to sustainable development and an effective marketplace, touching on issues of globalization, consumer welfare, cartels and monopolies, and trade liberalization.

The Research

Much can be learned from the problems faced in developing countries and the steps that have been taken to overcome those problems.

Costa Rica: Consumer choice at the corner store

Benefits of competition policy are not always clear to the average consumer. But people in Costa Rica noticed when a competition authority ruling put a stop to a Coca Cola's bottler's anticompetitive practices. The highly visible case is helping to build political will to tighten the legislation.

South Africa: Equal opportunity to compete

Competition law in South Africa acknowledges that ensuring open, free, and competitive markets today requires addressing the injustices of the past. The law is exerting a subtle influence over the way in which South Africans do business.

Uzbekistan: Competition research improves services

Like migrant workers all over the world, Uzbek workers abroad send much of their earnings home to support their families and communities — and until recently paid fees as high as 10% to transfer the funds. Those fees are coming down thanks to competition, and recommended innovations are leading to more choices for consumers.

Egypt: Privatization alone is not enough

The privatization of state-owned companies attracted new players to Egypt's cement industry and generated export growth. But at the time, the market wasn't regulated to ensure fair play among businesses. New legislation is now helping to rid it of anticompetitive behaviour.

For more case studies and further details on the four noted above, visit **www.idrc.ca/in_focus_competition**.

The Lessons

The introduction and implementation of a competition law is fraught with problems. Political will is necessary every step of the way. Competition law will not be broadly accepted or fully enforced unless key leaders in government have adopted market principles as the underpinning of economic development. The following recommendations suggest practical strategies for introducing and enforcing a competition law.

1. **Enact legislation that is strong and supported** — Sound legal drafting is vital. The law must be designed to prevent opponents from undermining its aims.
2. **Appoint and encourage strong leadership** — Leading a competition authority — especially in its early years — requires determination, independence, and a tireless facility for public engagement.
3. **Recruit expert staff and renumerate them well** — New authorities need to hire lawyers with experience in competition, courtroom, and administrative law and procedure. Economists must be trained in industrial organization.
4. **Ensure that judges receive specialized training in competition law** — A few judges, strategically assigned to deal with competition cases, should be trained in the minutiae of law and economics.
5. **Recognize that not everyone will be your friend** — A coherent mapping exercise should be carried out to identify organizations that currently engage with the authority, and each should be surveyed to identify the degree to which it is friend or opponent of the authority.
6. **Build alliances with the beneficiaries of competition law** — Coalitions must be built between the competition authority and those who will benefit from predictable and lasting implementation of competition rules.

7. **Activate popular interest in competition questions** — Competition authorities should regularly brief media of all kinds, from mass-market newspapers and broadcasters to sector-specific journals and NGO newsletters.
8. **Build alliances with other government departments** — The competition authority should search out and foster coalitions with like-minded departments and agencies of government.
9. **Institute both leniency programs and tough fines** — Competition legislation should provide the authority with the power to be both lenient toward defectors from cartels and to punish the rest.
10. **Develop interagency cooperation and entrench competition provisions in trade agreements** — Intergovernmental cooperation against anticompetitive activities across borders is imperative.
11. **Monitor liberalized markets closely** — The entry of large foreign-owned companies into a developing-country market can significantly benefit the domestic economy. But the cost of these benefits may be losing local competitors and unfairly squeezing local suppliers who now confront a buyer with considerable market power.

Preface

On the web
THE ISSUE

This book is an introduction to competition and the laws and policies affecting competition in developing-country markets. Its focus is on the practical problems these countries face and the steps they have taken and can take to overcome them.

The last few decades have seen huge changes in the way developing countries manage their economies. Most governments have moved away from central planning toward supporting a market economy and allowing the growth of local, privately owned businesses. National economies have become more reliant on the capabilities of individual firms making their own decisions about the production of goods and services based on market signals. A wave of privatization across the globe has seen governments withdraw, in large part, from providing not only goods but also infrastructure and social services for their people.

These in-country changes have taken place at the same time as great changes have swept the global economy. Merchandise trade has become freer and more capital is available. Firms everywhere are encouraged to export while facing greater competition from both imports no longer subject to high tariffs and foreign firms that set up commercial operations locally. Moreover, firms based in developing countries are increasingly linked with businesses abroad through franchises, subcontracts, or long-term supply relations.

However, the market is never completely "free." Restraints can come from the state trying to protect its citizenry. Privatized utilities and network service providers are regulated to ensure good coverage and quality of service; banks are subject to prudential and other regulations to ensure stability and good performance; health service providers have to meet government-set standards of care and treatment; and producers of goods and services have to abide by quality, performance, and safety standards.

Another form of restraint arises within the market and is largely aimed at exploiting and overcharging consumers and governments. Private firms meet to agree on a price for products or services, agree not to compete with each other or to keep out newcomers, or, in the case of the largest firms, simply abuse their power in the marketplace. With globalization also comes the possibility that these restraints allow for transfers of income and profits abroad. Governments are not always blameless in this second form of restraint: poorly designed regulations, lack of oversight, opaque bidding practices, and downright corruption all interfere with competition.

A number of policies and laws exist to counter this latter form of restraint. Generally known as competition law and policy, they are also referred to as antitrust or antimonopoly rules. The different terminology depends largely on culture and tradition rather than the content of the laws and policies themselves.

This book is about anticompetitive practices in developing countries and the policies that governments and citizens can promote and practice to limit their impact. We provide the non-specialist reader with some background on the nature and meaning of competition and competition law and policy. We explore the special features and challenges for policy-making in developing countries in this area, taking into account the diversity of developing-country economic structures, circumstances, development paths, and political systems.

We attempt to convey three lessons: the importance of competition in the development process; the fact that individual countries can tailor and enforce competition law to suit their particular situation; and the importance of international cooperation in entrenching fair business practices and standards.

In Part 1, we provide a brief primer on trade and competition and outline the issues and particular challenges that developing countries face in an era of increasing globalization and international interdependence. In Part 2, we describe IDRC's involvement in supporting developing-country research in the area of competition law and policy. Part 3 contains a wealth of information that IDRC has garnered, lessons it has learned from the work it has supported, and advice for new economies seeking to promote competition and overcome abuses in their market systems. Finally, Part 4 provides practical strategies for introducing and enforcing a competition law. The text is supplemented by a glossary of terms pertaining to economics and competition as well as the abbreviations used in the book.

The bulk of the text is empirical. Gathering evidence is not straightforward in this or any other field. Evidence must be research-based, with careful documentation of experiences, an analysis of cause and effect, and an understanding of context, before any lessons can be drawn. This book presents a summation of the mass of new evidence gathered by IDRC-supported researchers in developing countries over the past 5 years, anchored in the wider literature in which developing-country experiences have received inadequate attention.

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11 February 2008

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Susan Joekes
Phil Evans

7 March 2008

Part 1

The Issues

On the web
THE ISSUE

Imagine an open-air market in a developing country — a busy, bustling, lively place. Customers move from one vendor to another, testing the produce, haggling over prices, seeking the best value for their money. The vendors extol the virtues of their produce, offering bargains in an effort to attract more customers. It's an age-old system based on open competition; vendors who offer the best value do the most business and the customers benefit.

Now imagine a market where all the poultry vendors sell their chickens at the same price, a price that always seems to be a little higher than last week, just like the price of sugar, which has gone up — again! To make matters worse, the bank charges a higher and higher commission to release the money that your family members send from their jobs overseas. Then there's the bus ride back to the village. There used to be several bus companies. Now there's only one, and the fare has doubled. But what can the consumer do if there's no competition?

Competition and the policies that help to underpin it are among the most important elements of modern regulation. Almost every government around the world relies on competition to deliver a more efficient economy and help drive economic growth. Most of those governments are also committed to developing the policy tool kit that lets them harness the process of competition and stop those who might seek to abuse it.

Competition is not necessarily a natural state for many markets. In some, such as gas, water, and electricity markets, the need for major infrastructure impedes competition. But in other services and goods markets, policies that promote competition can be used to encourage fair play among firms, to shed light on otherwise murky pricing and contracting practices, and to open up opportunities for small- and medium-sized enterprises to grow. Competition and the competition policy tool kit can also be used to eliminate corruption and rigged bidding processes and thus maximize the value of public expenditure.

What are competition and competition policy?

Before looking at competition policy, we first need to distinguish it from competition itself. Although this may appear a little contradictory, it is important if we are to identify what each policy area does and what it does not do. It is also important because of language. Many countries have in fact had what are now called competition policies for hundreds, if not thousands, of years. These market-regulating laws and rules were designed to ensure a form of fair play in the marketplace. Market rules have existed for as long as markets and long before what we now call the market economy.

Competition springs from interactions in the marketplace as rivalry between firms over consumers' or customers' money drives them to deliver higher quality and lower prices. This process of rivalry then impels each firm to look inward to ensure

Competitive markets

"Competitive markets are ones in which there are many firms operating; their ability to set prices is limited in that if they charge above the market price, they would lose their customers; information is widely available to producers and consumers; both entry and exit are relatively easy for actors [firms] in the market; externalities are limited; infrastructure is adequate; and contracts can be enforced and property rights protected. When these characteristics apply, economists infer that the market functions well as an institution and permits resources to be used efficiently and welfare [consumer and producer surplus] to be maximized." — Carlton and Perloff (1999)

that it is using all its resources as efficiently as possible. This reduces inefficient use of resources, cutting down waste, and, thereby, reducing costs. Competition is therefore a process, whereas competition policy is largely a curative when that process fails to work.

The end result of the process of competition is often referred to as "workable competition" (see box on p. 4). This is a shorthand phrase to describe the sort of market that we would expect to see with competition — while not perfect — working.

The first modern expressions of what we now call competition law started in North America with the *Canadian Combines Act* of 1889 and the (US) *Sherman Antitrust Act* of 1890. These laws resulted from a revolt of the rural and urban poor against the power of what were called the industrial trusts, which controlled large parts of commerce through collusion and abuse of their huge economic power. The laws were also passed to head off more populist and radical responses to an increasingly abusive form of industrial capitalism. The United States still calls its laws antitrust laws and the countries quickest to follow the North American lead were also heavily agricultural economies suffering under the yoke of a small number of very powerful firms.

Structure, conduct, and performance indicators for workable competition

Structure

- The number of traders is at least as large as economies of scale permit.
- There are no artificial barriers to entry and mobility.
- There are moderate and price-sensitive differences in the quality of the products offered.

Conduct

- Some uncertainty exists as to whether rival firms will try to increase sales and market share by lowering the prices of their products.
- Firms strive to attain their goals independently, without collusion.
- There are no unfair, exclusionary, predatory, or coercive tactics.
- Inefficient suppliers and customers are not shielded permanently.
- Sales promotion is informative, or at least not misleading.
- There is no persistent, harmful price discrimination.

Performance

- Firms' production and distribution operations are efficient and not wasteful of resources.
- Output levels and product quality (i.e., variety, durability, safety, reliability, etc.) is responsive to consumer demands.
- Profits are at levels just sufficient to reward investment, efficiency, and innovation.
- Prices encourage rational choice, guide markets toward equilibrium, and do not intensify cyclical instability.
- Opportunities for introducing technically superior new products and processes are exploited.
- Promotional expenses are not excessive.
- Success accrues to sellers who best serve consumer wants.

Adapted from Scherer and Ross (1993).

Timeline of competition laws

1889 — *Canadian Combines Act* passed (Canada)

1890 — *Sherman Antitrust Act* passed (United States)

1911 — Standard Oil and American Tobacco Co. split up using the *Sherman Act*

1914 — *Clayton Antitrust Act* passed (United States)

1915 — Federal Trade Commission formed (United States)

1957 — *Treaty of Rome* established (European Economic Community)

1976 — *Hart-Scott-Rodino Antitrust Improvement Act* (United States) investigated mergers for antitrust activities

1980 — United Nations Conference on Trade and Development (UNCTAD) adopted a set of policies to tackle restrictive business practices

1982 — American Telephone & Telegraph (United States) split up because of an antitrust suit filed in 1974

The origins of modern competition law were, thus, a response to abuse by firms. However, they were also framed by the need to ensure that the economy used its resources as efficiently as it could. Monopolies were seen as wasteful and as closing off opportunities for rival firms to sell their wares. The desire for efficiency and to promote entry and innovation have underpinned much of the efforts to inject more competition into economies ever since.

The proliferation of modern competition law only really occurred after World War II. Although, previously, many countries had some market-regulating rules (most European countries have had such laws since the Middle Ages), they tended to be biased in favour of the largest and most powerful firms and guilds and against the consumer and smaller players. One of the reasons for the increase in competition policy after World War II was the role that anticompetitive practices played in the run-up to the war itself. In both Germany and Japan, cartels were forced on the economy as part of war preparations. In the immediate aftermath of the war, the occupying powers broke up these cartels and wrote competition laws in both Japan and Germany. However, it was not until the formation of the European Economic Community that we really saw modern competition law take root in Europe.

The object of competition law is generally twofold: first, to ensure that anticompetitive behaviour and agreements are restricted with the object of, second, ensuring that normal market dynamics occur. Thus, competition policy is largely intended to cure abuses in the marketplace (cartels and barriers to rivalry) or to ensure that future abuses do not occur (by blocking mergers).

To complicate matters, competition policy includes things like advocacy and coordination with government departments that go beyond competition law. Competition law is the adoption of legislation to prohibit anticompetitive conduct by the private sector that reduces competition in markets. Competition law and policy are part of a tool kit that all governments need and most use to deal with the modern world economy. Other measures include trade, investment, and general government policies that affect competition within an industry or market. Some industries, particularly those that used to be run by the state or are "natural monopolies," have sector-specific regulation (i.e., a specific regulator keeps them in check and generally tries to introduce competition into the market gradually).

Competition law is used to address three main situations:

➛ **Anticompetitive agreements**, where two or more firms agree among themselves to fix prices, limit production, divide markets up geographically, or rig bids when tendering for government contracts.

Natural monopoly

Some industries have phenomenally high entry costs. For example, it is unlikely that a firm entering the market would build a new underground railway line, road system, or gas pipeline alongside an existing one, and few industries or countries would want to bear the costs, financial and social, of having two subways or pipelines. Once a firm has invested in facilities, it enjoys lower and lower marginal costs. It is thus said to have a degree of natural monopoly over some elements of its business. Such industries tend to be closely regulated to stop them from abusing their monopoly power by, for example, limiting access of rivals to an essential facility (like a pipeline or a port).

- **Abuses of dominance or exclusionary behaviour**, where one firm is so powerful it can act without thinking about its rivals or can act to exclude its rivals. Abuses of dominance or exclusionary behaviour can include predatory pricing (pricing below cost to drive competitors out of a market and then raising prices once they have gone), tying up distribution networks to exclude competitors from the market (not allowing distributors to carry competitors' products), and denying competitors access to essential facilities (stopping a shipping company landing goods at a dock).
- **Merger-control regulation**, where firms that want to merge are reviewed to ensure that their deal is not likely to reduce competition significantly. Merger-control regulation is aimed at ensuring that mergers do not lead to too much market concentration, which may lead to abusive behaviour. This type of law is unusual in that it is pre-emptive – economists would say *ex ante* – an authority can block a merger before it happens. Anticompetitive agreements and abuse of dominance controls are reactive (*ex post*) in that the events have already occurred.

As we shall see, national competition laws differ in scope and coverage. For example, several developing countries, including Peru and Jamaica, do not have merger control. Its relevance is questioned particularly for small economies where concentration is argued to be necessary to achieve economies of scale and competitiveness, both in domestic and export markets.

Why has competition policy become a controversial issue?

The last few decades have seen a surge in the process known as globalization. This term describes a number of trends. Among these are a growth in cross-border trade and commerce, an increase in the importance of private capital, an increase in foreign direct investment by multinational corporations, and deregulation or liberalization of previously state-owned or -controlled sectors. Competition has thus reached into a larger number of areas and countries than ever before, and the practices that can stifle that competition have become more visible, particularly where government monopoly has been replaced by private monopoly.

The 1980s saw the beginning of a wave of governments selling off — in full or partly — their utility, transport, telecoms, and sometimes health sectors to private firms or investors. The wave was triggered in the early 1980s by political and economic shifts in key developed countries, like the United States and the United Kingdom, that favoured private over state control of assets. The wave moved to large parts of the world, as a condition on loans from international financial institutions and as a wider shift toward private capital, hastened by the end of the Cold War and dissolution of the Soviet Union. A useful database of cases can be found on the Public Services International website (PSIRU n.d.).

This process of restructuring, triggered by greater exposure to globalization, has generally increased competition in domestic markets by dismantling the protective border barriers and restrictive investment rules that prevailed in the postwar years and by creating a domestic environment that facilitates foreign investment and trade. In the early 1980s, developing countries had started liberalizing their economies under International Monetary Fund–World Bank structural adjustment programs, which imposed these conditions for debt rescheduling. In 1994, trade liberalization was accelerated by the successful negotiation of the General Agreement on Tariffs and Trade, under which industrialized countries lowered tariffs considerably, particularly those on non-agricultural goods.

Competition law, in its role as curative to market ills, grew in prominence because countries feared losing the possible gains from liberalization to anticompetitive agreements or practices. During the 1990s, there was also increasing concern over the cross-border impact of international cartels. A number of enormously powerful and important international cartels were uncovered during this time and their impact on developing countries became more apparent.

Cartels

Cartels involve firms agreeing among themselves to limit production, divide markets, and fix prices. Of 40 cases of privately operated cartels prosecuted in the United States and Europe in the 1990s, 24 had lasted more than 4 years. The total annual worldwide turnover of just 20 of these cartels exceeded US$30 billion. There are three types of cartels: private international cartels, state-exempted export cartels, and state-organized cartels. Big international cartels are most common in intermediate (input) markets. The most damaging cartels existed in the vitamins, lysine, and graphite electrodes markets.

The link between trade and competition policies was explored several times, including during the Doha Round of World Trade Organization (WTO) negotiations, as one of what were called the "Singapore issues." Although the trade–competition link was never moved into the negotiations agenda itself, it is addressed in many regional trade agreements (RTAs).

Singapore issues

The first ministerial conference (the WTO's highest level decision-making body) took place in Singapore in 1996. At that meeting, a number of "trade-related" issues were raised by member states. These included the links between trade and competition policy and between trade and investment policy. The Working Group on Competition Policy enjoyed significant progress in sharing experiences in competition law among members (WTO 2001, 2003). But opposition to adding competition to the negotiations agenda gradually increased. Along with two other proposed items, the topic of competition was set aside from WTO deliberations after the Cancun Ministerial Conference of 2003.

In addition to improving efficiency and bringing new challenges to incumbent firms, competition can have other benefits that are politically contentious. As evidenced in the WTO, many interests are ranged against the introduction of effective competition policies. Anticompetitive behaviour entails a transfer of resources from consumers to the producers involved. In developing countries, the poorest are often effectively paying a tax to the richest. The intended benefits of trade reform, in terms of lower prices for consumers, are only forced through from the docks to the doorstep if liberalization is accompanied by competition policies. Competition law can also play a significant role in exposing government contract and deregulation processes and limiting "sweetheart" deals behind closed doors.

Challenges in introducing competition law

Competition policy can be an effective tool in reducing corruption, ensuring that consumers gain from liberalization and trade reform, and limiting the power of the largest corporations nationally, regionally, and globally. Thus, it is no surprise that it has many powerful enemies. The difficulty of overcoming entrenched opponents is often compounded by the fact that developing countries simply copy large parts of their laws and policies from developed countries without necessarily adapting them to local conditions. There are also significant challenges to setting up the right institutions to handle competition law and policy.

In developed countries, current laws have evolved significantly over time and are enforced by well-funded and -supported public bodies, whose key staff move in and out of the public sector and a well-resourced, private-sector legal and economics community. IDRC-funded research projects on competition law have been trying to address some of the problems that arise when developing countries adopt these policies in a "one size fits all" approach. Some of the key issues raised in that research point to the need to ensure that

- ➛ Actions against anticompetitive practices affecting development goals are given priority;
- ➛ Fines are a serious deterrent to infringement;
- ➛ The competition authority is properly funded;
- ➛ Merger policy is appropriate to the size and stage of development of the economy; and
- ➛ Dominance measures are appropriate to the size and stage of the economy.

In developing countries, competition law and policy face many challenges. Among the key ones are ensuring political and societal support, enforcing the laws with limited resources, and dealing with cross-border enforcement problems.

On the web
THE ISSUE

Ensuring support

Competition policy and law fall victim to the classic problem of reformers everywhere: those who do well under the existing rules will oppose change much more strongly than those who might gain from change. What is already a difficult task is further complicated by the fact that competition policies and laws are complex instruments with uncertain outcomes. The problems faced in all countries — and made more difficult in developing countries — include getting the law before legislative bodies, getting that law through legislative bodies, then ensuring that the authority charged with the task of enforcement has the resources needed to carry out the job. All stages require political and public support, and advocacy efforts should focus on gaining such support.

Living with scarcity

Lack of resources is a huge obstacle to successful implementation of competition law. The required resources are not just financial, but include institutional capacity, particularly skilled human resources, and wider societal capacity to engage with the reform process. Any country introducing a competition law will need judges and lawyers trained in competition law as well as skilled staff able to identify anticompetitive behaviour. Outside the immediate legal system, a country will also need journalists, consumer groups, and other non-governmental organizations (NGOs) who understand the law and its benefits and who can act as watchdogs.

Dealing with cross-border anticompetitive conduct

One of the greatest challenges facing enforcement agencies in developing countries is cross-border anticompetitive activity. Although cross-border activity has always been part of the world economy, increasing globalization has triggered an increasingly linked series of anticompetitive agreements. International cartels stretch across national borders and are seemingly invulnerable to the laws of a single country, even countries as powerful as the United States or entities such as the European Union.

In 1997 for example, according to a well-known study, developing countries imported US$81.1 billion in goods from industries that had seen a price-fixing conspiracy during the 1990s. These imports represented 6.7% of imports and 1.2% of gross domestic product (GDP) in developing countries. For the poorest developing countries, they represented an even larger proportion of trade — 8.8% of imports (Levenstein and Suslow 2001).

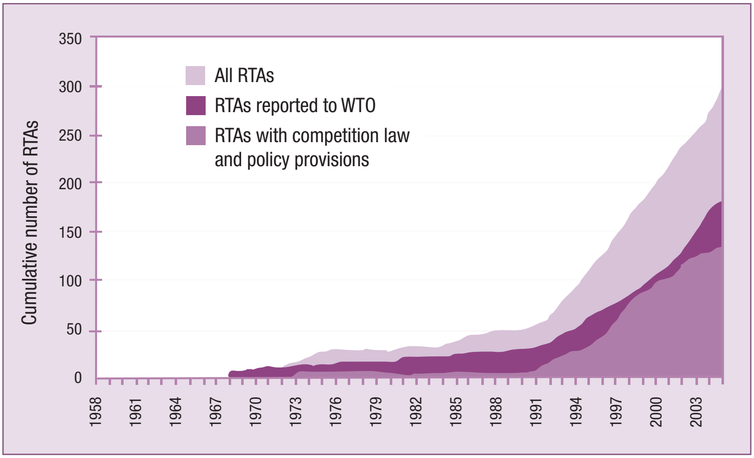
Competition authorities in industrialized countries, particularly the United States and those of the European Union, have been increasingly successful in uncovering and prosecuting international cartels. "Leniency programs" and increasing cooperation between large authorities were largely responsible for the successes. Many of the cartels that have been uncovered — such as the vitamin cartel (involving vitamins and all foods containing vitamin additives) and the lysine cartel (animal feed) — had a significant impact on the cost of basic foods in developing countries.

What is a leniency program?

Leniency programs are designed to reward the first cartel member who "blows the whistle" on fellow conspirators. Whoever tips off an agency and provides evidence of cartel activity will see their fine reduced or eliminated. For leniency programs to work, the competition authority must have a reputation for rigour and aggressive enforcement.

Developing countries face a number of problems in combating international cartels. For example, there is a lack of cooperation between developing- and developed-country authorities, and among developing-country authorities. Perversely, foreign firms may also be protected by the confidentiality laws of the country in which they have their home base. Of a more basic nature, developing countries may not wish to take on some of the largest corporations in the world for fear of retaliation. Some of these issues are being increasingly addressed in bilateral and regional trade negotiations (Figure 1) and have been included more generally in two sets of international guidelines — those of the United Nations Conference on Trade and Development (UNCTAD) and the Organisation for Economic Co-operation and Development (OECD).

Figure 1. Proportion of regional trade agreements (RTAs) with provisions related to competition law (Cernat 2005)



UNCTAD's set of mutually agreed equitable principles and rules for the control of restrictive business practices (UNCTAD 2000), or "the Set" as it is known, was negotiated during the 1970s and adopted in 1980 by the United Nations General Assembly. The non-enforceable objectives of the Set are to ensure that

- ➛ Restrictive business practices do not impede realization of the benefits of trade liberalization;
- ➛ Competition is protected in the market and concentration of capital and economic power are controlled;

- ➛ Social welfare is protected; and
- ➛ Disadvantages to trade and development resulting from restrictive business practices are eliminated.

The Set has been used by many developing countries as a guide to writing their own national laws. In any case, the rules are not binding on United Nations' member states.

Similarly, the OECD countries agreed on guidelines for multinational enterprises (OECD 2000a). These were first adopted in 1976, and revised in 2000, as part of *The OECD Declaration and Decisions on International Investment and Multinational Enterprises* (OECD 2000b). The guidelines include a competition section, which requires multinational enterprises to refrain from anti-competitive behaviour and to comply with all local competition laws. In 1998, the voluntary guidelines were supplemented by the *Recommendation of the Council Concerning Effective Action Against Hard Core Cartels* (OECD 1998), inspired by the increasing awareness of the existence of cartels and in recognition of the success of the United States Department of Justice's prosecution of international cartels.

During the late 1990s, discussions of the WTO's Working Group on the Interaction between Trade and Competition Policy led to a realization that most developing countries were uninformed about competition law and policy (WTO 2001, 2003). National efforts to improve understanding were given technical assistance by the WTO, UNCTAD, and the World Bank. The sum of all these efforts has been a vigorous debate about the kind of multilateral agreement that might be needed to enable developing countries to tackle egregious practices from abroad. However, this debate has cooled of late with the withdrawal of the WTO as a venue for a possible agreement.

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Part 2

The Approach

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THE RESEARCH

In 2002, IDRC began supporting research on competition policy in developing countries and feeding the findings into policy debates. The decision to enter this field was based on four factors that met all of IDRC's normal criteria for research investment:

- ➛ There was a strong theoretical case for a competition regime to enable the market economy to meet development objectives.
- ➛ There was a need for more information about national competition policies and challenges to implementation.
- ➛ Knowledge of the international aspects of private restraints on markets in the context of globalization was lacking.
- ➛ Important international forums existed for discussion of these issues.

IDRC is a publicly funded Canadian institution governed by an international board. It was founded in 1970 to support research by developing-country researchers that would address development problems. The research covers a large number of areas, including environment and natural resource management, information and communication technology, innovation and science, and social and economic policies. All research supported by IDRC is applied rather than “blue sky” science. It is specifically related to developing countries and informed by the countries’ own development goals and objectives. In the area of competition policy, IDRC’s research support is directed at improving research-based evidence on a number of issues related to the design and implementation of policies to promote and protect competition in developing-country markets.

IDRC has supported research on competition through its international economic relations programs. From the beginning, special attention has been paid to cross-border competition problems with particular reference to exposure to anticompetitive practices from abroad that comes with the liberalization of trade and investment. But, to be properly balanced, research also addresses domestically generated anticompetitive practices unrelated to the pressures of globalization. Anecdotal evidence suggests that such practices are widespread and may cause serious damage to poor people and to small or new firms and businesses.

Studies have been supported in many sectors and on many themes, in large and small countries in all parts of the developing world. Some bias toward Latin America and Africa at the expense of Asia reflects the few attempts that have been made in the latter region to implement economy-wide competition regimes. Research has covered analysis of problems related to anticompetitive conduct at all levels: local, domestic, regional, and international. It has also examined experiences in policy implementation and drawn potential lessons in policy development relating to legal provisions and cooperative arrangements and ranging from local-level measures to national and regional structures and multilateral negotiations.

IDRC has supported many different types of institutions — universities, international organizations, and non-governmental action-research and advocacy organizations — to do the research. University studies tend to focus on testing hypotheses, determining causes and effects, and improving analytical techniques. International organizations have special skills in synthesizing and publicizing research findings for policy audiences. NGOs are given IDRC support to enable them to use more research-based evidence in their advocacy activities, pressing for social and economic justice and, ideally, encouraging policymakers to pay attention to new issues.

IDRC believes that providing support for combinations of topics and policy-research actors and ensuring that their findings are included in policy debates is a good way to bring relevant, empirically verified material to the attention of policymakers as they design and implement policies for development. Research results are not the only factor affecting policy decisions, but they are essential to good policy-making. Policies must be informed by rigorous, research-based evidence if they are to be well designed in terms of their objectives. Once new policies are introduced, research also needs to be done to monitor and evaluate particular policy instruments and enable them to be fine-tuned to increase their effectiveness. But research funding is a low priority in developing countries. Thus, external support from IDRC or other donors can be disproportionately valuable to good policy formulation.

All this is true of the policy process in general. However, research is doubly important in the competition policy field, because competition law enforcement is a research-based function. Investigation of specific firm behaviour is the bread and butter of competition law enforcement, but studies of the structure and dynamics of relevant markets are also needed. A sophisticated set of conceptual tools and analytical techniques has been developed for this purpose. Great skill is needed by practitioners to apply these tools and techniques and decide what action to take to

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remedy various situations. Yet, most authorities in developing countries are new and underfunded. They have little or no resources for research and weak research capacity. Therefore, IDRC has also supported research by competition authorities themselves, in collaboration with a local research institute, as necessary. Moreover, support is given to allow them to share their findings with other authorities and help improve international understanding and coordination.

The following sections report empirical findings of IDRC research projects on competition policy and draw lessons from them to inform efforts at implementation and policy development.

Part 3

The Experience in Developing Countries

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THE RESEARCH

Although competition policy and law enforcement face challenges in all countries, the difficulties are exacerbated in developing countries. We will address these issues by posing a number of questions:

- ➛ Has enforcement of competition law benefited developing economies?
- ➛ How can competition law be tailored to meet the specific needs of an economy?
- ➛ What are the challenges in legislating and implementing competition law?
- ➛ How and why are stakeholders involved in the implementation process?
- ➛ How can competition authorities deal with cross-border anti-competitive conduct?

Has enforcement of competition law benefited developing economies?

Economic theorists have long predicted that great benefits must flow from the competitive process. In order to maintain their position in the market and keep rivals in check, firms must constantly improve, bringing in new equipment and products and improved production processes (through imitation or invention), seeking out cheaper suppliers or new customers, and improving management techniques and workers' skills. New firms come into the market and prosper if they perform well; less efficient firms become unprofitable and are forced out. These effects have been amply verified by empirical studies of the determinants of industrial growth (Easterly 2001; Baldwin 1998; Khemani 2007).

Competition policy and law, when they work well, help to foster an effective competitive process. Countries that have a record of effective competition law enforcement have experienced higher growth (Dutz and Hayri 2001). Companies have no reason to perform better if they do not face any competition. They are not under any pressure to do so. This is why private or state-owned monopolies and firms in highly concentrated industries perform poorly. In many cases, firms use their wealth and market power to secure political influence, which they use to gain protection from the inconveniences of competitive pressures, undermining the dynamism of the economy and the welfare of the country as a whole (Khemani 2007).

Introducing the competitive process in a country that previously operated under a different economic model is complex. A comparison of the former Soviet Union countries' transition from central planning to a market economy showed striking differences. Firms in countries with a better developed competitive infrastructure managed the transition much better than those with a poorly developed competitive infrastructure (Carlin et al. 2001a, b).

Competition law and policy can play an important role in the wider advancement of developing countries. By cracking down on exploitative or abusive market behaviour, competition law enforcement contributes to what can be termed "economic democracy." This term has two main facets. First, it refers to the empowerment of consumers and the enhancement of their welfare, as improving consumer choice and lowering consumer prices increase their economic power. Second, the term refers to benefits for firms. Not only do the prospects of firms that were targeted by anticompetitive activities improve with competition law enforcement, but the firms that carried out such practices themselves stand to gain as new pressures drive them to perform better. As a result, they may be able to enter new markets, at home or abroad. And as market entry barriers come down, entrepreneurship in general becomes more rewarding.

Competition policy enforcement can assist enterprises of all sizes. Small firms can be harmed, no less than individual consumers, by the actions of larger firms on which they rely for inputs. Sometimes they are harmed by the anticompetitive actions of other small firms; it is difficult but not impossible for a competition authority to correct actions of this sort. When market entry barriers are reduced and more enterprises, both large and small, flourish as a result, more individuals acquire a stake in the productive assets of the country.

For all these reasons, as David Lewis, Chairperson of the South African Competition Tribunal, pointed out in a speech to a 2006 IDRC meeting in Cape Town, economic democracy made real through competition law enforcement is a continuous process. By contrast, citizens in electoral democracies only occasionally express their political opinions through the ballot box.

The rest of this section reports evidence on these points from IDRC-supported research in developing countries.

Competition drives productivity gains

In Tanzania, the introduction of the *Fair Trade Practices Act* in 1994 had favourable effects on firm productivity, investment, and export performance. Interestingly, some firms that were sanctioned under the new law for anticompetitive practices improved their performance. Following the law, there was a reduction in market concentration in many industries, perhaps because new entrants were encouraged to commence operations and were able to sustain themselves in business as the climate became less accepting of the anticompetitive actions of incumbents. (Kahyarara 2004).

New entry spurs productivity gains

The encouragement of new firms can indeed make a significant contribution to productivity. A Korean study of plant-level data during 1990–1998 showed that higher entry and exit rates accounted for as much as 45% and 65% of productivity growth during cyclical upturns and downturns, respectively (Hahn 2000). In Jordan, Saif and Barakat (2005)showed that concentration does not lead to economies of scale, but increases profits and damages productivity. Firm productivity growth in the country declined over the period during which market concentration and barriers to entry were at their highest. Conversely, productivity tended to improve during transition periods when local firms struggled to compete against new market entrants.

In both South Africa and Egypt, following the withdrawal of the government from the steel and cement sectors respectively, new players joined the industry and existing players responded by increasing their profitability and productivity. Subsequently, problems became apparent in the ways that firms in those industries sought to maintain their positions and maintain high profits. Action under the competition law was taken in each case to ensure that the social benefits from competition were not undermined after the initial market opening (Roberts 2004; Ghoneim 2006).

Competition policy can stop bid rigging and help expose corruption

Competition law is part of a cluster of policies that aid good governance. Investors tend to be reassured by a stable regulatory environment. Competition law helps ensure that market entry and exit is possible and that an investor will not be subject to abusive government or company practices. When there is no competition law or political will to protect competition, there is regulatory capture, widespread formation of cartels, "bid rigging," (see box), tied selling, and predatory behaviour — and consumers pay more (Adhikari 2004). For example, in 1999, leading sugar firms in Nepal, facing competition from Brazilian imports, pressured the government to raise import tariffs to 40%. They argued that they were able to meet local demand but needed protection.

Bid rigging

When governments want to build a bridge or school or buy a fleet of buses, they attempt to get the best value by inviting companies to bid on the contract. The bidding process is both competitive and confidential. Governments go to great lengths to ensure that the winning bid really does represent the best value for the taxpayers' money, even employing complex game theory in their efforts to prevent collusion among prospective bidders. In many countries, there are stiff penalties — large fines and possible imprisonment — for "rigging" bids. In a perfect world, the competition would always be fair and the best bid would always win. But what if the bidding is fixed?

With millions or even billions of dollars at stake, ingenious and unscrupulous suppliers can find many ways to conspire to subvert the bidding process. In **bid rotation**, suppliers agree among themselves to take turns at being the lowest bidder. A similar scheme is **bid suppression**, in which some suppliers refrain from bidding so that a predetermined bid is accepted. In **complementary bidding**, some suppliers deliberately make unacceptable bids so that, again, the winner is predetermined. These and other techniques appear to be genuinely competitive, but in reality they conceal inflated prices and poor quality. Whether bid rigging occurs in contracts for government or the private sector, it is always anticompetitive, and the end result is poor use of public monies or high prices for the consumer.

After getting the tariff hike, however, they allegedly withdrew supply, raising prices still further. Consumers had to pay 29 rupees per kilogram instead of 20 rupees (the landed, post-tariff price in Nepal for imported Brazilian sugar).

In Korea, the competition commission uncovered bid rigging for key public construction projects (Hur 2004). Each project cost about 20 to 30 trillion won (US$21 to US$32 billion at current exchange rates). In response, the government set up permanent monitoring of bids, saving roughly 4 trillion won (US$4 billion).

Competition is often distorted by politicians engaging in corruption or favouritism. For example, in Nepal when the manufacturers of polythene pipes were charged with rigging bids, they claimed that they did so in response to pressure from public officials to share rents from their contracts (Adhikari 2004). A 2004 study cited several instances of alleged favouritism and bribery surrounding the granting of contracts in Belize and other countries of CARICOM, the Caribbean Community (Stewart 2004).

Competition law can broaden economic democracy

Consumer gains from enforcement of competition law can be very large. For example, the Korean Fair Trading Commission uncovered a cartel in student uniform manufacturing. The three firms involved controlled roughly 50% of the market and overcharged consumers by an estimated 60 billion won (about US$64 million). The cartel was halted and fined 11.5 billion won (Hur 2004).

In Uzbekistan, competition problems arose in the area of foreign remittances (APIC 2006). Many Uzbek families depend on the salaries of family members working outside the country. These remittances are largely spent on essential items, such as food and education. Western Union and Travelex had established dominance by signing a number of exclusivity deals with remittance agencies, leading to high charges. The Uzbek competition authority acted by controlling foreign remittance services, and the government responded by setting up its own foreign remittance provider through the national postal service.

In some countries economic wealth and market power are highly skewed in favour of a small number of private companies. These are often family controlled, with tight social interconnections among them and in many cases they have strong connections at the political level and with high-ranking public officials. Competition law can be used to combat the imbalance. The competition law of South Africa is notable in this regard. It contains provisions for black economic empowerment that are intended to partly rectify the overconcentration of wealth in the hands of a racially distinct elite under apartheid.

The South African economy under apartheid had a dual structure: the white population operated in a formal economy with a developed infrastructure, while the black population operated primarily in the informal sector. In 1994, the African National Congress government reviewed the existing competition law in light of the aim to dilute apartheid-era economic power. The resulting law included references to the encouragement of small- and medium-sized enterprises — viewed as a way to spread economic wealth and "to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons" (*Competition Act*, Government of South Africa 1998). In the judgement of the Chairperson of the Competition Tribunal, David Lewis, "it is wholly possible to [take account of] industrial and social policy considerations without compromising the core objectives of ... competition law and policy" (Lewis 2006).

Competition law helps secure gains from market opening

The reduction of barriers to trade and the removal of barriers to entry, both for foreign and domestic investment, is an important spur to competition. Some development analysts have argued that trade liberalization is perhaps the single most important measure that governments can use to this end.

In Morocco, 1995 WTO membership opened up some domestic markets through the abolition of import restrictions and subsidies. A study of Moroccan industry (Achy and Sekkat 2005) found that changes in output per worker were proportional to the degree of competition induced in each sector. Morocco has had a competition law since July 2000, but its enforcement had been limited. Perhaps for fear of disruptions to incumbent firms, the sectors that remained the most protected — food, apparel, and chemicals — were those with the largest employment shares. Achy and Sekkat argue, based on the positive response of firms in open sectors, that sheltering domestic firms from foreign competition was specifically damaging to industrial competitiveness.

Nevertheless, competition considerations suggest that liberalization is not always effective in raising productivity and increasing growth in previously protected markets. First, market conditions may not permit competitive processes to emerge. Foreign firms may benefit from subsidies in their home countries, giving them an unfair commercial advantage in developing-country markets. Conversely, consumers in local markets may have distinctive preferences so that foreign products are not a substitute for local ones. In Peru, consumers want meat from live poultry, not frozen imported products (Boza 2005). In the 1990s, domestic live poultry producers operated a cartel to coordinate output and prices through local industry associations. Since there was no effective foreign competition, the Peruvian competition authority intervened to dismantle the cartel.

Second, in the absence of domestic competition policy, firms can still exercise market power in damaging ways. Despite the removal of import tariffs or restrictions, they can prevent the entry of new foreign players or goods in the market, in the same way that they previously blocked domestic rivals. Or else new foreign entrants may be able to establish market dominance and abuse that new power with impunity. That was the case in Uzbekistan, where foreign money-transfer companies quickly consolidated their first-mover advantages (APIC 2006).

Third, if some firms are unable to compete against foreign rivals, the redeployment of their assets and workers into firms in other parts of the economy might not be possible. In a Peruvian case study, Boza (2005, p. 10) states that

> *Trade liberalization too frequently resulted in inefficient companies in the developing countries closing under pressure from more efficient international firms. While the elimination of inefficiency is economically a laudable goal, the projected transfer of resources from less productive uses to more productive uses did not occur due to a lack of capital and entrepreneurship. Thus, rather than creating new jobs, trade liberalization resulted in the destruction of many of the few jobs that existed.*

Boza points to general features of the competitive environment that often make liberalization much more damaging than predicted. Though perhaps not a factor in that case, the absence of a competition law, and the persistence of entry barriers to many markets, can be an important deterrent to entrepreneurship and the mobility of capital.

The opening of the cement market to private firms in Egypt provides a cautionary tale to illustrate the benefits and limitations of liberalization policies (Evenett 2006; Ghoneim 2006). Until 1999, the cement sector was government-controlled and -owned, and it operated far below capacity. Chronic undersupply forced the government to open the industry to private-sector participation. Both foreign and local investment was attracted into the sector and output in the sector grew immediately to meet domestic demand. Three new entrants alone provided almost 7.5 million additional metric tonnes of cement to the market. The new entrants adopted innovative distribution strategies and aggressive marketing techniques. Production of cement increased and became more efficient without a price increase. The productivity increases were so marked that domestic Egyptian cement suppliers soon had excess cement to offer on the international market, where they were competitive because of low capital and labour costs in Egypt. In March 2000, the average price of Egyptian cement was US$35.5 to US$55.7 per metric tonne compared with the world market price of US$39 to US$110 per metric tonne, giving the Egyptian producers a clear cost advantage. Starting in 2002, exports of cement by Egyptian producers grew rapidly.

However, this benign outcome did not last long. The growth of sales and low prices were soon curtailed. With no competition law in place to monitor anticompetitive practices, cement producers were able to raise prices sharply within a few years. Recently, a competition law has been introduced and certain firms in the sector are now being brought to court.

In conclusion, competition policies need to be applied diligently to realize the gains from market opening and minimize costs. Liberalization can promote competition but it is not a panacea. Market opening needs to be accompanied by the introduction of a strong competition law or by reinforcing the implementation of an existing law.

Mergers and acquisitions can be addressed effectively

Mergers and acquisitions have potential implications for competition because they reduce the number of market players. Merger review allows a competition authority to examine the positive and negative implications of any prospective merger and to identify an appropriate response. Some mergers may be allowed to go ahead, some can take place under certain conditions, and some are prohibited.

During the early 2000s, South African steel companies began to consolidate operations (Roberts 2004). Baldwins Steel was acquired by Trident Steel in 2000, Baldwins/Kulungile and Abkins became one entity, and Iscor Steel acquired Saldanha in 2002. The competition authority was called on to determine whether this market consolidation was a sign of anticompetitive behaviour. It decided that it was not and argued that concentration of the industry would enhance efficiency. Saldanha had been failing, but its acquisition by the unprofitable Iscor Steel allowed the merged entity to become profitable, as did the newly merged Trident Steel.

The special provisions of the South African competition law require black empowerment to be taken into account as a matter of public interest. Chabane (2003) looked at a merger between a large multinational company, Shell, and a subsidiary of a black empowerment holding company. The competition commission (the investigating body) argued that the merger would increase black ownership within the merged entity, but would put the existence of an independent empowerment firm at risk. It approved the merger on condition that the independent status of the subsidiary be retained in the new entity under joint control of Shell and the black-owned holding company. It also required that the subsidiary company's line of branded products be maintained. However, the tribunal that judged the case disagreed, arguing that the smaller firm was failing. It approved the merger unconditionally, stating that public interest objectives in terms of black economic empowerment were best served in this way.

How can competition law be tailored to meet the specific needs of an economy?

In developing countries, the competition law may have to address more objectives than elsewhere. As is always the case, proponents must draft legislation that will allow competition decisions to strike a balance among efficiency and the fair treatment of consumers. But they also need to take into account developmental considerations such as employment promotion and the growth of small- and medium-sized enterprises. Developing countries may also need to take particular notice of institutional capacity to enforce the law. For example, it might make sense for the law to emphasize prohibitions that are easy to investigate and enforce. Attention to abuse of dominance provisions could come later, because taking action in these cases rests on technically complex "rule of reason" procedures. Merger control would be left till last, if it is appropriate at all.

The need to tailor competition law to economies at different stages of development is often most clearly seen in the exceptional provisions in competition clauses of RTAs. In an IDRC study, Brusick and Clarke (2005) point to the text of the European Union–Egypt and European Union–Estonia RTAs, which allow for the exemption of various state aids and state monopolies. The authors noted the flexibility of Canada, the European Community, and the United States in allowing transitional periods, structural adjustments, and technical assistance for developing-country governments.

In any event, periodic review and revision of the law is called for as experience of cases and knowledge of competition issues in the economy build up over time.

Public interest considerations

South Africa is the most clear and celebrated example of a competition law that writes in national development objectives on a par with the classic aims of equity and efficiency. The preamble to the 1998 *Competition Act* expressly refers to the harms of the former apartheid regime and targets ownership by a greater number of South Africans as a policy objective. It states that development should be fostered through a competitive economy, balancing the interests of workers, owners, and consumers. Its general objectives are orthodox (efficiency, adaptability, and development of the economy), but it is unique in specifying other requirements:

- ➛ To promote employment and advance the social and economic welfare of South Africans;
- ➛ To expand opportunities for South African participation in world markets and recognize the role of foreign competition in the Republic;
- ➛ To ensure that small- and medium-sized enterprises have an equitable opportunity to participate in the economy; and
- ➛ To promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

In the case of mergers, the law specifies that the competition commission must take into account the effect of the merger on a particular industrial sector or region, on employment, on small businesses or firms controlled or owned by historically disadvantaged persons, and on the ability of national industries to compete in international markets. It also states that, to do its work, the commission may require input from those affected by public interest considerations.

There have been several cases where this public interest provision has been considered. In *DB Investments S.A. v. De Beers Consolidated Mines, Ltd* (2001–2002), parties agreed that conditions of employment would not be changed following the merger (Chetty 2005). In 2000, the finance minister blocked the Nedcor/Stanbic bank merger on the competition commission's recommendation that "the proposed transaction should be prohibited on the grounds that it will have significant social costs [primarily], potential abuse of market power in the retail banking market and potential job losses, which represents a net loss to society, which cannot be offset by any potential efficiency gains."

Heavy concentrations of wealth in one social or ethnic group are found in many countries. Groups disadvantaged by this situation may receive special consideration. For example, in Saint Lucia, taxi drivers are largely lower-income members of the black population. In contrast, white families control the tourism management sector and are keen to move into transportation. Although this might promote efficiencies, it could also lead to the displacement of the existing taxi drivers, with serious social repercussions. The problem could be addressed in law through an exemption for the sector, with the requirement to review the situation every 6 months, tied to a set of requirements for improving efficiency in the sector. Another approach would be to prohibit vertical integration in some sectors to ensure space for small entrepreneurs to enter the market or to prevent dominant players from crowding out small entrepreneurs.

Other developing countries' competition laws contain different types of special public interest provisions:

- ➛ Mexican competition law allows the government to fix prices on essential basic consumption goods.
- ➛ Costa Rican law allows import and export licenses to be restricted for up to six months at a time in the public interest.
- ➛ A draft Guatemalan law would force the competition authority to defer to efforts to coordinate supply and promote exports.

Small economy considerations

Small developing countries face some specific structural problems in relation to competition. Their economies tend to be very open, specialized in a few production lines, and highly dependent on importing what they do not produce.

On the production side, the domestic market may be too small to support more than one or two firms of minimum efficient size. When drafting a competition law, government officials or legislators may face pressure to relax the normal limitations on market concentration to allow efficiency gains. However, it is a misconception that competition law always seeks to prevent firms from growing so large that they achieve a dominant position. Competition law is directed against firms that abuse a dominant position, not against dominance in itself. The threshold for defining dominance, and thus consideration of possible abuse of dominance, is flexible and may be set higher in small economies (Gal 2001). In any event, in many lines of business, the domestic market in small- and even medium-sized economies is too small to allow even a single firm to attain minimum efficient size. Such producers have to sell their products abroad as well as at home. In small economies, accordingly, exporting is the norm. The purpose of the competition law in this connection is to ensure that internationally successful firms do not act anticompetitively and exploit consumers in their home country.

The import business in small economies typically contains many small firms that might club together to import in bulk at lower prices. On its face, this constitutes anticompetitive behaviour even though consumers may benefit. The situation is acknowledged in the United States Virgin Islands *Antimonopoly Law*, article 1505, for example, which specifically exempts "the establishment of formal agreements between small entrepreneurs engaged in the retail sale of the same or similar commodities for the purpose of bulk purchase of those commodities in order to meet in good faith, competition of businesses with substantially larger sales volumes." The law defines small entrepreneurs as merchants with gross receipts from all sources in any year not normally exceeding US$250 000 and with no more than 12 employees. In other settings, different thresholds might be appropriate.

Moreover, where import distribution is monopolized or cartelized, collaborative actions among rivals seeking to challenge the incumbents may be socially desirable. In many CARICOM countries, the import, wholesale, and retail sectors are tightly controlled by elite white groups that operate sole distributorships, interlocking directorates, and family ties across companies, making market entry difficult for the non-white population. Local, small, black businesses have an individualistic business culture and do not collaborate in bulk importing. In contrast, small firms owned by newly arrived families from Asian countries have managed to enter retail markets successfully. These groups import cooperatively in bulk and sell through individual outlets, agreeing on the selling price of the products and taking a significant market share. These actions would be allowable, within limits, on public interest grounds under a provision like that of the Virgin Islands law (Stewart 2004).

Dealing with small firms

The rationale for putting small firms within the scope of the competition law is that small firms can, of course, hold a local monopoly. There are obvious practical problems, however, for a public agency in pursuing small firms: the disproportionate expense to the authorities of taking action against perpetrators. For this reason, the law may set minimum firm-size thresholds for case examinations. But a threshold is not desirable if specific competition problems recur in local markets throughout the country and constitute, when added up, a nationally significant issue. The Peruvian competition authority, INDECOPI, tackled the problem in an innovative way. It set up a number of local chapters under a franchise arrangement with universities and NGOs interested in competition issues. This enabled some apparently small-scale, local cases to be pursued at the municipal level. They came to the notice of local authorities throughout the country, who could regulate to avoid similar practices within their own areas.

Dealing with informal production

In many developing countries, most enterprises are informal (i.e., largely outside bureaucratic purview because they are not registered and perhaps not paying income, sales, or property taxes). The large size of the informal sector is usually attributed to the existence of onerous regulations or anticompetitive behaviours that create barriers to entry to formal markets. Informal enterprises account for the vast majority of businesses, the majority of non-agricultural employment, and an important share of national output in developing countries. According to Oliveira (2006), the informal sector accounts for 60% of economic activity in Peru, 50% in Uruguay, and approximately 42% in Nigeria. Oliveira notes that this has important implications for competition enforcement. In markets prone to informality, data collection and the analysis of allegations of cartels and predatory pricing become more complex and expensive. The market power of dominant formal-sector firms may be overestimated.

Another problem is that in some regions, such as the Caribbean, the drug trade has infiltrated the informal sector. It is alleged that some retail businesses, such as car parts suppliers, are established to launder drug money. These markets are impervious to regulation because competition enforcers run serious personal risks if they try to investigate such cases.

Even identifying the boundary between formal and informal activity is problematic. For instance, “fronting” has developed in the Caribbean where a large, formal firm hires vendors to compete with the informal vendors by selling the firm’s goods outside the store on the pavement, giving the impression that they are part of the unregistered sector. This strategy takes back market share from the informal traders (Stewart 2004).

In general, the competition problem deriving from informal activity is that these firms may be able to undercut local formal businesses by evading payment of import duties, taxes, and charges. “Unfair” competition from informal enterprises is best dealt with through bureaucratic reform to improve incentives to firms to become formal and by good governance measures, rather than through competition enforcement.

Merger control regulation

Many developing countries argue that merger control is not appropriate for them because local firms cannot achieve international competitiveness without achieving economies of scale, which, in small economies, requires the creation of local monopolies or substantial market power. However, there is a case for merger control, particularly in the service sector, which may be especially vulnerable to abuse of dominance because foreign competition is often not an effective check.

Belize offers some useful lessons in this regard. Belize has a very small population (fewer than 300 000 people) but a very large land mass (22 995 km^2). Transport services are thus crucial. Until 2003, Belize’s main cross-country bus route had been served by seven companies. One company, Z-Line, undercut its rivals through predatory pricing and other tactics, then bought five of them outright. The only surviving competitor, Novel, then bought Z-Line, monopolized the route, and soon almost doubled fares. Travelers rioted. Merger control regulation could have prevented this monopolization of an essential public service (Stewart 2004).

When the competition law does include merger review provisions, the yardstick used to evaluate mergers may differ between large and small economies. It could be helpful to develop a set of criteria based on minimum efficiency scale considerations rather than simply prohibiting a merger if competition is substantially reduced in the market. Michal Gal (2001) therefore recommends that the threshold for merger notification normally be set higher in developing than in developed countries.

Exceptions and exemptions

Almost all competition laws contain some exceptions and exemptions. For example, the European Union provides a general exemption for agriculture. Exceptions may be written into the law itself or the authority may have the power to exempt firms on a case-specific basis. This explains the difference between "exceptions" included in the law and "exemptions" granted by administrative authorities.

An IDRC study showed that, in Thailand, state-owned enterprises are exempt from the competition law and have engaged in anti-competitive practices (Nkikomborirak 2004). Instead, the exemption could have been made temporary and linked to capacity building. Such an approach is called progressivity and is now broadly accepted in the international trade field.

Morocco allows for discretionary exemptions to improve the management of small- to medium-sized enterprises and the marketing of produce by farmers, providing such practices produce a "net public benefit" for which the burden of proof falls on firms (Achy and Sekkat 2005). Jordan exempts agreements of minor importance (where market share of firms does not exceed 10%), provided they do not involve price fixing or market-sharing agreements (Saif and Barakat 2005). The competition authority has discretion to allow exemption in cases where the competitiveness of enterprises, production and distribution processes, and consumer welfare benefit.

Some exemptions, which may be copied from developed-country legislation, make relatively little sense in developing countries. For example, Jamaica exempts agreements related to intellectual property, despite the fact that there is little or no local innovation involving industrial property rights (Stewart 2000). Exemptions may also sometimes be used inadvertently to protect large vested interests.

For these reasons, exceptions and exemptions should generally be accompanied by conditions:

- ➢ They should be openly arrived at (to prevent secret favours);
- ➢ They should be subject to scheduled periodic review; and
- ➢ They should reflect the best available knowledge of the market sector and the economy.

What are the challenges in legislating and implementing competition law?

As argued above, competition law and policy have many enemies, who are strident, and relatively few friends, who tend to be lukewarm. These problems come at all stages in the development of such laws. Drafting a bill and getting it through congress or parliament requires overcoming opposition from often powerful vested interests. The natural allies of competition law tend to be small- and medium-sized enterprises and consumer groups, which tend to be weak or non-existent in developing countries (Gal 2004).

For competition law to be effective, all parts of government have to accept that development strategies are underpinned by market principles (Gal 2004). Countries like Argentina, Brazil, Israel, and South Africa only saw competition law revised and implemented successfully after a process of market reform, while other countries, like South Korea, have had draft laws for decades without being able to legislate them. Even when a law is before the legislature, those opposed to it will attempt to water it down. In Mexico and Central America, notably in Honduras, draft laws have included restrictions in scope, relatively soft sanctions, many exclusions and exemptions, and other forms of limitation on the powers of the competition authorities.

Training of judges

A problem for many developing countries is a lack of skill in competition law among the judiciary. Jordan's competition law provides for one or more specialized judges, appointed by a judicial board, to preside over competition cases (Saif and Barakat 2005, p. 44). Major efforts to train judges have also been made in Costa Rica.

Strong leadership

IDRC case studies suggest that some authority heads have been key in putting the competition regime on a sound footing. George Lipimile in Zambia, David Lewis in South Africa, and Allan Fels in Australia all fall into this category. As Allan Fels argued, "In this organization, we're in show business ... show business first, law enforcement second" (Hawkins and Blazic 2002). An independent press is a great advantage in this respect. The media in Zambia followed George Lipimile so closely that his trips out of the country were reported, and a special column on competition issues was instituted in a major newspaper.

The cost of running an authority

The cost of maintaining a competition authority is often raised by developing countries as a reason not to institute competition laws. However, the initial set-up costs and regular maintenance charges have to be put into the context of the savings an authority can make. Clarke and Evenett (2003) compared the cost of running an authority with the saving it was responsible for in terms of stopping overcharges by just one cartel: the vitamins cartel (see Table 1, p. 42). The results show that the deterrent effect of the authority would have saved, for example, enough to pay the costs of three competition authorities in Colombia or six competition authorities in Mexico. More recent studies support this conclusion (Connor and Bolotova 2006).

Table 1. Cost of operating a competition authority compared with reduction in cost of vitamins due to its enforcement of anticartel law

Country	Cost of operating a competition authority (million US$/year)[a]	Reduction in cost of vitamins (million US$ /year)[b]	Reduction as % of cost
Zambia	0.13[c]	0.01	7.7
Tanzania	0.07[c]	0.02	28.6
Peru	10.05[d]	6.62	65.9
Kenya	0.26[c]	0.18	69.2
South Africa	8.76[c]	9.91	113.1
Colombia	5.47[d]	16.50	301.6
Mexico	9.70[e]	58.27	600.7
Venezuela	1.36[d]	12.13	891.9
Argentina	1.40[e]	23.94	1710.0
Brazil	1.15[d]	63.13	5489.6

Source: Clarke and Evenett (2003).
[a] Total cost of running the nation's competition authority. Data is latest available, always 1999 or later.
[b] Average annual cost in the 1990s.
[c] From Consumer Unity and Trust Society (India).
[d] According to the authority's website.
[e] From Hahn and Layne-Farrar (2002).

Adequate human resources

Competition law enforcement requires both legal and economic expertise. Yet attracting high-quality staff is very difficult. In most developing countries, particularly those where competition law is new, there are few professionals with expertise in competition law. Young authorities, such as those in Jamaica and some in Latin America, train staff only to lose them to the private sector or abroad. The CARICOM study suggests that good salaries, scholarships, and training should be tied to a requirement for a minimum number of years of service (Stewart 2004, p. 210).

The authority may be granted special status with independent terms and conditions of employment to allow it to offer better than normal government terms. INDECOPI in Peru did this and found that jobs were seen as prestigious and desirable by young professionals. Motivating and paying staff well are important challenges facing competition authorities. IDRC has initiated a high-profile project that gives research funds to competition authorities in developing countries to increase staff research skills and challenge them with new projects. The hope is that this project will reduce staff turnover and engage officers in building up knowledge of competition issues in their economies.

When in-house expertise is lacking, authorities can retain outside assistance or counsel in important cases. For example, in the 1995 wheat cartel case, INDECOPI formed an ad hoc investigatory task force with personnel from other institutions. Peru's Ministry of Economy and Finance seconded economists to the authority for the duration of the investigation.

Staff-development methods can include in-house training, sending staff on internships to more established authorities, and hosting seconded staff from those established authorities. Technical assistance is offered by international financial institutions, UNCTAD, the United States Agency for International Development, and other donors. In more recent years, the United States Department of Justice and Federal Trade Commission have seconded staff to young competition authorities in Eastern Europe and South Africa. Providing courses in competition law at local universities is important and international faculty can be brought in to participate in modules. Young competition authorities also need to build institutional memory by keeping careful records of cases and of approaches to investigation.

Adequate and independent financial resources

Without sufficient financial resources, an authority will be unable to function effectively. Ideally, operational revenue should be independent of politicians and ministries. For example, in El Salvador, Panama, and Honduras, the authority submits its own budget to congress. Some authorities can fund themselves using the fines they impose. However, this is generally considered inadvisable as the authority may be tempted to levy excessive fines — or be viewed as doing so.

Legal enforcement tools

In Jamaica, the *Fair Competition Act* gave both investigative and adjudicative responsibilities to commissioners (Stewart 2004). The Federal Trade Commission was taken to court for this reason on grounds of breach of natural justice and lost both the case and the subsequent appeal. The commission was paralyzed while it waited for legal reforms to enable it to pursue cases.

In Costa Rica (Sittenfield 2008), the law only allows business people (natural or legal) who are competing with each other to be prosecuted for forming a cartel. This ignores the role that chambers of commerce and business associations can and do play in the formation and execution of cartels.

A competition authority must have the power to initiate its own investigations; to request information from any public or private businessperson; and to enter business premises to collect information and seize documents, computer hard drives, and other evidence to help it uncover wrongdoing (i.e., carry out a "dawn raid"). In CARICOM, the competition commission cannot initiate an investigation on its own initiative, but only at the request of a member state or the regional body, the Council for Trade and Economic Development.

The Costa Rican law does not grant its competition authority the right to enter premises (Sittenfield 2008), severely hampering its ability to obtain vital information on cartel activities. As Sittenfield points out, in the early life of a competition regime, it is relatively easy to get information. In ignorance, cartels will carry on past practice, publicly announcing their agreement in the newspaper or recording the decision in the minutes of a business association. With time, they become more educated on competition law and start to cover up their agreements. Strong investigative power for the authority then becomes indispensable, and heavy sanctions for non-cooperation in investigations become necessary. George Lipimile in Zambia points out that he had difficulty getting information from Coca Cola manufacturers in his investigation of the company's Zambian subsidiary (Stewart 2004). The government then passed legislation allowing jail sentences for companies' CEOs for non-cooperation in an investigation, after which the company cooperated.

The Costa Rican study recommends that young authorities concentrate on tackling per se prohibition agreements. Per se prohibitions simply outlaw a certain type of agreement regardless of whether or not it has caused damage. The alternative "rule of reason" approach requires the authority to prepare a complex analysis of product and geographic markets to show that the agreement has adversely affected other agents in the economy. However, an authority must be careful to ensure that, in applying the per se rule, there should be a single, reasonable explanation of the situation. In Costa Rica, an investigation into a number of airlines supposedly using their monopsony power to reduce fees paid to travel agents was abandoned after it emerged that the lead airline in the market had publicized its reduction of agents' commissions months before (Sittenfield 2008). This opened up the possibility that other airlines had simply "followed the leader" rather than conspired to fix the fees.

The use of sanctions

Employing stiff sanctions for abuse of competition is an important weapon in any authority's armoury. Imposing fines that are sufficiently high to discourage further offenses is a key element of this. In several countries, including Peru, Mexico, Panama, and Costa Rica, the power to impose sanctions has been increased. Many countries have moved from setting fines as a fixed sum to setting them as a percentage of the yearly turnover (usually 10%)

or of the actual or potential profit from the anticompetitive conduct. This has not always been successful. In Costa Rica, it was not possible to apply the legal sanction — a 10% fine on sales or assets — because it would bankrupt a small firm. In other countries, authorities have some discretion and can impose a fine of up to 10% of sales or assets (Sittenfield 2008) although discretion poses the risk of corruption or political pressure.

In El Salvador, fines can be imposed, but if the company cooperates with the authority in eliminating the anticompetitive behaviour, the sanction will be removed. The rationale for this is that it is very difficult to get the evidence to prove cases and cooperation can achieve the same objective. Mexico has introduced the same provision in its revised law (Schatan and Rivera 2008).

How and why are stakeholders involved in the implementation process?

As argued above, parties opposed to competition measures are more organized and more politically active than those who may gain from a strong competition regime. Engaging with stakeholders for and against competition law and policy is important during the legislative phase and, perhaps, even more important once the authority begins to enforce the law. At this point, it can become extremely vulnerable. Businesses that feel themselves threatened will take more care to conceal anticompetitive acts (which puts greater demands on the authority's resources) and will seek to discredit and undermine the authority.

Establishing good relations with the business community is primarily intended to maximize voluntary compliance with competition law. Conversely, civil society organizations and the media can help the authority register and investigate complaints. However, this only works if they understand the principles, functions, and scope of application of competition law. Organizations of consumers, whether formal or not, are not automatically allies to competition law and policy. In societies undergoing significant economic change, introducing competition raises significant economic and social challenges, with established firms closing down and many jobs lost. In such cases, consumers and those who represent their interests can turn against competition authorities unless efforts are made to place such changes in context, point to benefits as well as costs of competition, and provide examples of other countries where the process of change has benefited consumers.

Of course, it is also incumbent on organizations that take a position on competition policy to educate themselves about the process of competition and the policy tool kit that can be used to harness it. Consumers' organizations should work with each other and with competition agencies to arrive at well-reasoned positions.

Other government departments and bodies are potential allies of the authority, but can also be hostile. Establishing working relations with other regulatory bodies, such as those covering utility sectors and financial services, is particularly important in terms of establishing ground rules for areas of joint competence and oversight.

The private sector

In 2002, interviews with businesspeople and government officials in 22 Common Market for Eastern and Southern Africa (COMESA) member states showed that there was a general lack of knowledge and understanding of competition law and policy (Lipimile 2004, p. 175). In some of the countries, citizens were not convinced that lack of competition law in the region constituted an economic problem worthy of their government's attention.

As the level of deterrence inspired by competition law depends on market actors' awareness of the law, this survey indicates a significant problem. However, there are a number of ways to counter this. Authority staff can take part in seminars and conferences explaining the need for the law and the fact that it is a normal feature in more developed economies. A competition regime sets clear standards of business conduct and keeps markets open to new entrants with superior levels of productivity. Competition law enforcement assists firms subject to anticompetitive acts by rivals and — although this argument may not have much immediate traction — even leads to performance improvements by perpetrators of such acts. In Peru, INDECOPI publicized legal reasoning and rulings to help explain the law and deter anticompetitive acts. By entering into mediation with offending companies rather than proceeding immediately to court, INDECOPI was able to disseminate its message about competitive conduct to key players.

The competition authority can engage with the private sector at two levels: with businesses, which can, through their conduct, have a substantial effect on the market; and with small- and medium-sized enterprises, which, along with consumers, are often victims of anticompetitive conduct. Different and targeted approaches are needed for these audiences.

Relations with other governmental bodies

If a competition authority is to be effective, all other government branches and agencies must understand why competition law is important and be aware of competition concerns. This is particularly important when government agencies draft laws or carry out privatization. However, the competition authority's need for understanding and support is complicated by the fact that other regulatory agencies and ministries usually have the same or higher standing. Its power to act or advise can thus be severely curtailed (Wilson 2006).

Outreach is important

The process of outreach to other government agencies and departments can also help the competition authority. For example, procurement officers and auditors may detect bid rigging and share the authority's interest in stopping such practices. Cooperation with like-minded departments often begins with information sharing about market situations and investigative methods (Sittenfield 2008, p. 11).

It is often important for a competition agency to involve itself with agencies overseeing markets with new and fast-changing technologies, such as telecommunications. The early adoption of competition principles in telecom regulation has ensured that the new technologies have led to more widely accessible service, lower prices, and newer, better products in that sector.

Early engagement is key

In countries with new competition powers, early engagement with government agencies is vital. For example, political intervention to control prices was common in Peru before the passing of competition legislation. When it launched its wheat cartel probe in 1995, the new competition agency, INDECOPI, met with all political and economic interests to explain the provision of the law that made the action illegal. The authority was then able to carry out its investigation without political interference (Boza 2005, pp. 36–37).

Local government can present problems

Municipal and other lower-level authorities are prone to regulatory capture, particularly in developing countries. National action is often necessary but difficult. In Peru, INDECOPI managed to set competitive standards to regulate the local taxi transport. It was able to gather evidence for the case from its local offices, in cooperation with local NGOs and academic institutions. The investigation related to a single municipality, but the case was noted and recommendations applied by local authorities facing similar problems.

Working with key ministries is a priority

Arguably the most important governmental relations that any competition authority has are with trade, industry, and finance ministries. The policy-making and regulatory mandates of these departments have a strong influence on business behaviour and market structure. However, competition considerations are often not a formal part of their mandate. IDRC research suggests that adopting competition principles will increase the ability of these departments to address their wider objectives. Such an overlap can provide the basis for constructive engagement between the authority and these important government departments.

In principle, the interests of the trade ministry and the competition authority are complementary: where trade barriers are overcome, anticompetitive practices can still prevent price reductions from reaching the domestic market. Exploitative and exclusionary practices in transportation and goods distribution often create bottlenecks in developing countries. Competition enforcement can help to ensure that the gains of trade are passed on to individual and business consumers.

Competition authorities must adopt a balanced approach with trade ministries, discerning instances where protection may be needed as opposed to those where inefficiencies need to be weeded out through increased competition from imports. As a Costa Rican example illustrates, the policies are not always aligned. Several domestic wooden pallet manufacturers jointly asked the trade minister to increase the tariff on imported pallets. In return, they promised to maintain an agreed maximum price of US$9.50 a unit. The ministry obliged by raising the tariff by 10%. A Costa Rican pallet importer complained to the competition commission, which found that the agreement to fix prices was illegal. The commission did not consider whether the ministry acted within its powers in raising the tariff, but rather stated that the ministry should not have used its powers to facilitate action proscribed by the competition law.

Special treatment for foreign investors

Different issues arise in the service sector. Here, trade liberalization is not concerned primarily with import taxes, but with domestic regulation and entry barriers. The authority's principal role here is to prevent anticompetitive market conduct by all participants. In most developing countries, governments have provided foreign service-sector investors with advantages such as tax holidays, exemptions from paying duties, site allocations, etc., that are not offered to local investors. Such discrimination sits uneasily with competition law provisions, although few countries have specific rules governing the exercise of government power in this area (Lipimile 2004, p. 180).

Privatization processes must be monitored

Developing-country privatization programs have often preceded the passing of competition law, often leading to state monopolies becoming private monopolies and undermining the development boost of the reform process (Lipimile 2004, p. 177). Disciplining the conduct of a newly created private monopoly is technically and politically demanding for any authority. Where the monopoly falls under the supervision of a sectoral regulator, the competition authority may not even be authorized to act. Privatization authorities should be obliged to consult with competition agencies when selling a state-owned company or they should be compelled to consider the implications in terms of competition.

Governments often look to industrial policy to reduce disruptions to business and employment from external shocks. In COMESA countries, for instance, it is commonly argued that local industries are not strong enough to withstand competition from incoming foreign companies (Lipimile 2004, p. 176). The Peruvian and CARICOM studies expressed the same concern. Industrial policy advocates sometimes argue that normal rules on collusive behaviour among domestic companies should be relaxed or that strong, dominant, "national champion" (domestic) firms should be allowed to emerge to compete more effectively with foreign rivals. These are politically tempting claims, particularly in smaller countries.

Competition advocates, in return, point to the universally observed slackness of innovation and poor record in cost-cutting by monopolies, along with their exploitation of consumers. In general, it is not clear why it is believed that a firm that grows only with special exemptions can compete in international markets.

The media play an important role

The many forms of media can be powerful allies in improving public awareness of competition law. An IDRC-supported study in Costa Rica revealed an extremely low level of awareness of the existence and functions of competition law, even among firms. The Jamaican Fair Trade Commission has a strategic approach to its public communications work and, as part of an IDRC research project on the pharmaceutical industry, the authority will publish at least two background articles in national newspapers and prepare a month-long radio series.

Educating the media is as important as using it as a communications outlet. The media can raise the level of public knowledge about competition law and can report on cases, enhancing the credibility of the authority. The media also function as watchdogs capable of sniffing out anticompetitive activity. Competition authorities routinely scrutinize media outputs for clues to possible anticompetitive conduct, particularly cartel activity. For example, a trade association may announce a price agreement or a company head may "innocently" refer to horizontal collaboration with competitors in a speech. Competition authorities can use media reports in their own investigations. For example, in a consumer protection case, television footage provided INDECOPI in Peru with compelling evidence demonstrating that racial discrimination was the sole reason why some consumers were refused entry to nightclubs in Lima.

A large database containing allegations of anticompetitive practice reported in the media in sub-Saharan African countries was the basis for a presentation at an IDRC-supported seminar (Evenett et al. 2006). The allegations covered all sectors and all countries of the region and a very broad range of anticompetitive acts — most related to domestic, not foreign, firms.

On the web
THE RESEARCH

Harnessing consumer organizations and NGOs

Consumer organizations and NGOs represent the "person in the street" and can be the ears and eyes of a competition authority with respect to concerted price hikes or anticompetitive behaviour of dominant firms. Consumer Unity and Trust Society of India, perhaps the best known NGO that is internationally active in the competition field, was founded to give voice to consumer complaints, but quickly saw the relevance of competition law. The Peruvian competition authority, INDECOPI, is unusual in that it has responsibilities to implement consumer protection, competition, and intellectual property laws. It is a case study in how to use consumer protection powers to gain public support and credibility for competition work.

Even without a competition law in place, consumer mobilization can have an effect. In 2001, consumers in Belize showed their strength in a dramatic fashion, forcing a dominant firm to stop abusive conduct. In December 2001, Belize Telecommunications Ltd raised tariffs, it argued, to cover the cost of purchasing an installed global system for mobile communications (US$60 million). Consumers were outraged at having to pay up-front for the system, without any indication that prices would fall after it had been paid for. They formed an association, obtained signatures from 65% of the population, and petitioned the government to take action. The government drew up a statutory instrument to stop the new rates, but this was blocked by a court action by Belize Telecommunications Ltd. In 2002, on appeal, the statutory instrument was upheld (Stewart 2004, p. 162). In the same year, a telecommunications act was passed that empowered the regulatory authority to control rates, protect consumer interests, and oversee the orderly development of the sector.

The research community

The research community in any country includes a wide range of people from universities, research institutes, NGOs, consulting firms, parts of the public sector, and indeed the authority itself. Researchers have much to offer competition authorities through studies that yield relevant empirical material and evidence-based analysis. Governments can request that donors support research into competition and other economic policy matters, whether as a free-standing item, within a technical assistance agreement, or as part of the activity plan for general budgetary support.

Competition authorities, on their own or in conjunction with a local research institution, can apply for research support from a new competition research facility established by IDRC. This started in 2005 as a project giving small grants to study competition issues in the distribution sector. Competition authorities from eight countries — Argentina, Armenia, Costa Rica, Jamaica, Malawi, Peru, Uzbekistan, and Zambia — were awarded grants in the first phase. In October 2007, the facility's mandate was broadened to consider proposals on any aspect of competition in the distribution, transport, and construction sectors.

The academic community can contribute to knowledge of competition matters through research, but its educative function is also valuable. Courses on competition law can be included in the economics and law syllabuses of universities. Direct collaboration between the authority and research institutes extends resources for analytical work and helps keep staff up to date.

Individual researchers can have a significant impact. For example, the principal researcher on an IDRC-supported project in Jordan formed an NGO, the Jordan Competition Association. The association organizes public meetings with other stakeholders (notably the private sector), makes submissions to political bodies, and prepares material on competition for the media.

How can competition authorities deal with cross-border anticompetitive conduct?

Since the end of World War II, markets have become increasingly open to foreign entry, a process that accelerated with the creation of the WTO in 1995. Although consumers have generally gained, transnational firms seeking to dominate markets in developing countries have also been strengthened. Lower borders have also made it easier for firms to organize an anticompetitive conspiracy in one location that takes effect in another.

In the late 1990s, investigations by the United States Department of Justice uncovered a string of high-profile international cartels of this kind. Many of them had been long-lived and had not collapsed under their own weight as economic theory predicts. They were well-organized, internally well-documented, and stretched across national boundaries. The conspirators planned their output and divided markets among themselves in jurisdictions in which competition law enforcement was lax or non-existent. They seemed deliberately to extract the most economic rent from jurisdictions in which competition law was weakly enforced, notably developing countries (Clarke and Evenett 2003). The study indicated that effective competition legislation and enforcement were deterrents to the cartel and resulted in less exploitation of national markets. This conclusion is broadly in line with those of Connor and Bolotova (2006), Suslow and Levenstein

(2002), and the theory of punitive deterrence originally developed by Landes (1983).

The publicity resulting from this and other high-profile cases encouraged developing-country competition authorities to look at subsidiaries of multinational enterprises located within their own jurisdictions. Many cartels were revealed. However, the relevant documents were normally located outside the local jurisdiction. The low level of cooperation among authorities and restrictions on sharing information limited follow-up action.

Although cartels are the most obvious and pernicious form of cross-border competition abuse, the ability of large firms to wield power across borders cannot be underestimated. Using market power in one economy to exploit a second is a concern for many small economies. Likewise the creation of significant market power through mergers is a concern in two areas:

- Where a foreign takeover of a local firm allows the new company to increase prices or reduce service in the market where it faces least competition, enabling it to cut prices where it does face stiff competition, distorting both markets; and
- Where an international merger may be cleared in the major developed jurisdictions, but may have significantly worse effects in a smaller developing economy.

In the latter case, that economy has little recourse to local action and cannot influence the decisions made in the developed economies. Some, who argue against having a merger policy, say that a policy of total trade and capital openness can insulate an economy from undue use of market power by allowing new entrants untrammelled opportunities to compete with anyone who gains market power domestically.

Jurisdiction issues

A key problem for any competition authority is that its power is limited to the country within which it is based. In practical terms, this means that the authority may find it difficult to prosecute cases where information is held outside the country or where the anticompetitive activity occurred elsewhere. At an IDRC-supported seminar, Tekdemir (2006) described how a cartel had been formed in the Turkish coal market. An investigation by the Turkish Competition Authority was prompted by consumer complaints that the price of coal had increased sharply. The investigation revealed that the increase was the result of price-fixing by several companies, two of which were headquartered overseas — one in Switzerland and the other in Austria. The domestic companies were fined for their part in the cartel, but the one foreign firm could not be fined.

The Swiss company involved in the cartel had no office in Turkey; the Austrian company closed its local office when the investigation began. Thus, the Turkish authority had to resort to diplomacy to gain access to the evidence. However, members of Turkey's own diplomatic service were unfamiliar with competition questions, did not fully understand the case or its significance, and were reluctant to spend time and energy on the prosecution. In addition, the governments of Switzerland and Austria gave Turkey only token assistance in pursuing their nationals.

The need for cooperation

The Turkish coal case also demonstrates what can happen when cooperation fails, particularly given the fact that Turkish officials believed they had the legal machinery for cooperation in place. Their government had a free trade agreement with the European Free Trade Association, which includes Switzerland, and the trade agreement includes explicit competition provisions. But the Swiss refused to help, arguing that Swiss law did not cover the matter.

Austria, likewise, refused meaningful cooperation, notwithstanding European Union law that Turkey believed should have been applied to the case by the Austrian authorities. Austrian officials contended that the European Union law did not require the action requested by Turkey and that domestic legal obligations to safeguard business confidentiality would be breached if information was shared between the European Union and Turkish competition authorities. Most competition laws explicitly authorize the authority to take action only if there is harm to domestic consumers. If harm is caused in another country by a multinational company, the government of the home country is under no legal obligation to take any action.

This case confirms three general propositions. First, a small or developing country can face challenges getting practical cooperation from authorities in developed countries. Second, developed-country governments may seek to protect their own companies against overseas competition investigations. Third, even full cooperation between authorities will not bear fruit unless authorities can share information on harm caused by domestic firms abroad.

Despite these problems, competition authorities in developing countries do have some limited means at their disposal for tackling the problem of international anticompetitive practices. One approach is to strengthen cooperation in RTAs. Another is to encourage informal cooperation between authorities facing similar abuses or being targeted by the same companies. A third is for partner countries to adopt "positive comity" provisions that allow transgressions of competition law carried out in one jurisdiction to be prosecuted in another, but these are rare and limited to industrialized countries.

In Uzbekistan, competition law has played a role in creating regulatory linkages with neighbouring countries (APIC 2006). The Uzbek government entered into discussions of cross-border issues with other competition authorities in the region as a means to harmonize treatment of particular sectors. Intergovernmental collaboration can be limited to the sharing of competition law information, experience, and advice in what is known as soft cooperation. In contrast, hard cooperation involves real enforcement by competition authorities working together to investigate, disrupt, and punish anticompetitive behaviour. It usually entails the exchange of data and information about specific cases, the conduct of dawn raids, and so on. However, developing-country experience is that industrialized countries are generally not willing to extend much cooperation to their competition authorities.

Costa Rica's prosecution of airline companies, noted earlier, also highlights the problems posed when evidence lies outside the prosecutor's jurisdiction. The Costa Rican competition authority had to rely on circumstantial evidence of collusion, leaving it with a weak case. As proceedings continued, rulings against some of the airlines were reversed. Equally unsatisfying was the later discovery that Panamanian officials had been prosecuting the same airlines for the same offences — neither government knowing of the other's parallel action (Sittenfield 2008).

Regional bodies can offer some solution to the cooperation problem. In the Andean Community, the competition laws adopted by the regional body are applicable in both Bolivia and Ecuador. In the case of anticompetitive practices occurring in either jurisdiction, the regional law provides a basis for cooperation. A similar arrangement could, in future, facilitate the prosecution of anticompetitive acts in COMESA member countries; it has been proposed that if a COMESA member does not have a competition law, the regional law would have effect. In CARICOM countries, a regional competition law has been accepted as part of the single-market undertaking, with a Community Competition Commission established to deal with cross-border issues. The law requires that member states cooperate with each other and with the commission on competition cases.

More generally, competition authorities try to overcome obstacles to cooperation by including competition provisions in RTAs. However, such an approach is hampered by the fact that these provisions tend to be written by trade negotiators rather than the competition authorities (Alvarez et al. 2005).

A more direct means of strengthening cooperation between competition authorities is through agency-to-agency agreements, such as the one signed between the United States and Brazil. Cooperation between Zambia and South Africa has been seen as the starting point for deeper recognition of anticompetitive behaviour taking place in each other's jurisdictions. Information and assessment reports are now routinely exchanged between the two authorities. In Argentina and Brazil, the competition provisions of the Southern Cone's common market (MERCOSUR) were insufficient to the needs of each authority, triggering an agency-to-agency agreement.

Young competition authorities have reported that the most effective cooperation they have received is informal (Stewart 2004). Getting to know individuals in mature agencies and building relations and trust constitute the most important course of action for a young authority. Therefore, senior staff should attend conferences, such as the International Competition Network annual conference, to achieve such exposure.

Part 4

Recommendations, Actions, and Tools

On the web
THE LESSONS

The introduction and implementation of a competition law is fraught with problems. Political will is necessary every step of the way. However, competition law will not be broadly accepted or fully enforced unless key leaders in government have adopted market principles as the underpinning of economic development.

The following 11 recommendations provide practical strategies for introducing and enforcing a competition law. They are grouped in three clusters: drafting the statute and setting up the competition authority, engaging public support, and contending with anticompetitive conduct that crosses national borders.

Drafting and implementing competition law

1. Enact legislation that is strong and supported

Sound legal drafting is vital. The law must be designed to prevent opponents from undermining its aims. Any exceptions or exemptions granted to industries or firms must be based on solid economic justification. They should be openly decided and scrutinized regularly with the expectation that they will eventually be terminated. As the APEC–OECD (n.d.) checklist of regulatory reform states, "When exclusions from competition law exist, they need to be narrowly targeted and no broader than necessary to achieve other legitimate public policy objectives that cannot be better served in other ways."

Developing countries must be able to apply the principles of flexibility and progressivity when developing their competition regimes. This may require special provisions to address market failures that lead to social injustices and interventions to protect the poor. The law may also need to be phased in over time.

Any competition law must

- ➛ **Adhere to basic legal principles:** The law must, at minimum, meet a country's constitutional requirements and standards of natural justice.
- ➛ **Endow the authority with powers of investigation, including search and seizure:** The authority must be able to initiate investigations. Investigatory powers should extend to regional competition authorities established by intergovernmental agreements. The law must provide for an appeal process.
- ➛ **Allow flexibility to set fines and other penalties:** The authority should have discretion in setting fines according to the size of the firms involved. Fines must be high enough to deter, but not so high as to bankrupt violators. Fines should be

based on a percentage of the company's annual turnover, with a range up to 10%.

External expertise should be sought to ensure that draft laws meet these criteria. This can be done at no cost through technical assistance or informal cooperation with mature agencies. Those developing the competition regime will need to engage in skilful coalition-building to fend off attacks by powerful vested interests.

Concessions granted to gain support should be temporary and subject to review. Central American states initially granted many concessions to get their laws onto the statute book, but a few years later were able to revise and strengthen them. A progressive approach allows the introduction of a competition regime in a limited way, with the option to extend and strengthen it after conducting a program of advocacy and education.

In a hostile environment, it may be useful to allow a moratorium of up to 2 years, during which stakeholders are educated and official opinions on firm conduct are provided without fines or sanctions being imposed. This allows stakeholders to become familiar with the law, inducing greater compliance and building technical expertise in the authority.

2. Appoint and encourage strong leadership

Leading a competition authority — especially in its early years — requires determination, independence, and a tireless facility for public engagement. Strong competition authority leaders in countries as diverse as Australia, South Africa, and Zambia have demonstrated the power of lively media relations and public engagement. Successful leaders secure an authority's reputation and build its legitimacy. Competence is crucial to sustainable leadership. Leadership appointments should be non-partisan, both in process and outcome. Leaders of competition authorities must be tenacious and discrete. They need to pick their early targets carefully, choosing cases they can win, that rely on available and convincing evidence, and that will attract popular interest and approval.

A new competition authority must be given media relations resources and training and should be encouraged to court the media to get its message across. Every new authority must have a well-connected, strong leader who can withstand the high levels of pressure that he or she will come under.

3. Recruit expert staff and remunerate them well

New authorities need to hire lawyers with experience in competition, courtroom, and administrative law and procedures, and they may have to retain outside counsel in difficult cases. Economists must be trained in industrial organization. All professionals should be paid well, and prestige should be built into the job. Staff should be trained through workshops, scholarships, internships with mature competition authorities, and secondments of foreign competition-law experts into the new organization.

The new authority should have the statutory power to develop its own budget and submit it for legislative approval. It is generally unwise to force an authority to subsist on the fines it levies, as this may also create a temptation to impose self-serving and excessive fines.

4. Ensure that judges receive specialized training in competition law

A few judges, strategically assigned to deal with competition cases, should be trained in the minutiae of competition law and economics. The cases will then be competently heard and decided, while more judges are exposed to the complexities of competition-law issues.

Engaging stakeholders

5. Recognize that not everyone will be your friend

Although outreach is important, not everyone that a competition authority wishes to engage with will share its enthusiasm for competition law and policy. Indeed, some may well be hostile to both what the authority wishes to do and the very existence of the authority. Even those who seem to be natural allies could initially be opposed to the authority and its works.

A coherent mapping exercise should be carried out to identify organizations that currently engage with the authority. Each should be surveyed to identify the degree to which it is a friend or opponent of the authority, in general or in specific instances. The likelihood of each organization being turned into an ally should be assessed and an action plan developed to identify the best strategy to increase the authority's allies.

6. Build alliances with the beneficiaries of competition law

Coalitions must be built between the competition authority and those who will benefit from predictable and lasting implementation of competition rules. Such groups can include consumer organizations, farm groups, labour unions, NGOs interested in good governance and economic justice, small businesses victimized by monopolists, and others.

There is a particular reason for using a mass media specialist to publicize the harms resulting from anticompetitive abuse and the benefits of rigorously enforcing the competition law. Journalists should be offered training by independent and expert advisers on the various aspects of competition law and policy. Whenever a case is decided, targeted background kits should be developed and media briefings held to help journalists cover the authority's work.

7. Activate popular interest in competition questions

Any competition authority should provide regular briefings for media of all kinds, from mass-market newspapers and broadcasters to sector-specific journals and NGO newsletters. Journalists should be briefed in legal and economic details. Competition authorities should consider establishing offices in outlying cities and regions, staging seminars, and giving speeches to specific audiences about the law and its significance. The authority's chief executive should be central in publicizing the authority's work.

Key members of authority staff should be media trained and put in contact with key media contacts. Working relations between key staff and key journalists should be encouraged.

8. Build alliances with other government departments

A competition authority should search out and foster coalitions with like-minded departments and agencies of government. The authority should not hold back from dealing with the anti-competitive outcomes of government actions. It should prosecute anticompetitive practices, even if they have been blessed — expressly or tacitly — by other government offices. Where it does not have authority to investigate, it should persuade sector regulators to stand against any abuses by newly privatized monopolists. Clear demarcation of responsibility and mechanisms for cooperation can limit conflict with other regulators.

Competition authorities should consider working with partner organizations in neighbouring countries or those with whom they have a twin or donor relationship to encourage dialogue between foreign authorities and local government departments. Efforts should be made to encourage important government departments to follow discussions at the World Bank, OECD, and other forums focused on regulatory reform.

Dealing with cross-border anticompetitive conduct

9. Institute both leniency programs and tough fines

In cracking cartels, a competition authority should use a leniency program in which the first cartel member to confess is provided with immunity from prosecution in return for cooperating in the investigation and surrendering all available evidence of wrongdoing. Competition legislation should provide the authority with the power both to be lenient with defectors from cartels and to punish the rest.

Competition authorities should follow best-practice guidelines in the design of leniency programs. However, a leniency program is only as effective as the punishment it is designed to avoid. If a leniency program is to work effectively, competition authorities must ensure that they have a series of strong enforcement tools and a reputation for using them.

10. Develop interagency cooperation and entrench competition provisions in trade agreements

Intergovernmental cooperation against anticompetitive activities across borders is imperative. Agency-to-agency arrangements between developing and developed countries can be useful. Informal cooperation and collaboration are very effective for young or small agencies. Travel funds should, therefore, be provided to enable staff to travel to meet other officials.

Competition provisions in RTAs should encourage information sharing among national competition authorities and facilitate investigative and prosecutorial cooperation.

The interaction between sectoral regulators, often found in energy and water markets, and competition regulators is enormously important. Sectoral regulators often have competition powers that overlap with the more general competition authority.

It is important that these organizations develop procedures to share the workload in specific areas. There are many examples of such procedures in developed countries that can act as guides for less-developed regimes.

11. Monitor liberalized markets closely

The entry of large foreign-owned companies into a developing-country market can bring sizeable benefits to the domestic economy. But the cost of these benefits may be losing local competitors and unfairly squeezing local suppliers who now confront a buyer with considerable market power. A competition authority must pay close attention to signs of possible abuse of market power, such as imposed conditions on suppliers, predation of smaller competitors, and the like. It may be necessary to impose heavy sanctions for non-cooperation in investigations to ensure that multinational enterprises surrender information.

Glossary of Terms and Abbreviations

The purpose of this short glossary is to help the casual reader focus on terms used in this book. Terms marked with * or ** have been drawn most significantly from the glossaries of the European Commission (2003) and OECD (Khemani and Shapiro, n.d.), respectively, although some have been abbreviated. Italicized terms are defined in the glossary of the European Commission (2003), and bold terms are defined elsewhere in this glossary.

Abuses of dominance* — Anticompetitive business practices (including improper exploitation of customers or exclusion of competitors) in which a firm in a dominant position may engage to maintain or increase its **market power**.

Anticompetitive agreements — A general classification of agreements between rival or potentially rival firms to limit *competition*. See **cartels**.

Anticompetitive conduct/practices — Any activity that is intended to limit *competition* or extract **rent**. The activity will involve an **anticompetitive agreement**, an **abuse of dominance**, or a **merger**.

Bid rigging* — A form of coordination between firms that interferes with a bidding process. For example, firms may agree on their bids in advance, deciding which will be the lowest bidder;

some may agree not to bid or bid high so that a predetermined bid will win.

CARICOM — Caribbean Community (and Common Market)

Cartels* — Arrangement(s) between competing firms designed to limit or eliminate *competition* between them, with the objective of increasing prices and profits of the participating companies and without producing any objective countervailing benefits. In practice, this is generally done by fixing prices, limiting output, sharing markets, allocating customers or territories, **bid rigging**, or a combination of these. Cartels are harmful to consumers and society as a whole because the participating companies charge higher prices (and earn higher profits) than they would in a competitive market.

COMESA — Common Market for Eastern and Southern Africa

Comity* — Principle applied in the field of *international cooperation* on competition policy. In negative comity, every country that is party to a cooperative agreement guarantees to take account of the important interests of the other parties of the agreement when applying its own competition law. In positive comity, a country may ask the other parties of the agreement to take appropriate measures, under their competition law, against anti-competitive behaviour taking place on their territory and affecting important interests of the requesting country.

Cost of capital — The cost of financing a project or firm expressed as an opportunity cost for an equivalent investment alternative. This typically requires judgements of risk of the project or firm: assessing what components will make up the capital (debt, share equity, etc.), and assessing the opportunity costs for those components in the market.

Dawn raid — A dawn raid occurs when a competition authority has the power to enter a firm's premises, copy and seize documents, copy or seize computer hard drives, and remove evidence to help it to uncover evidence of wrongdoing.

Deadweight loss – A deadweight loss is a loss of efficiency caused by an economy not producing at its most efficient level. Deadweight losses can be caused by the cost of anticompetitive behaviour or agreements, excessive taxation, or subsidy levels.

Economies of scale occur when the more a firm produces, the lower its long-run average unit cost of production becomes. Returns to scale exist where a firm lowers its short-run cost by simply increasing its output. See **Minimum efficient scale**.

GDP – gross domestic product: the total market value of all goods and services produced within a country in a given period of time (usually a calendar year).

Hard core restrictions* – Restrictions of *competition* by agreements or business practices, which are seen by most jurisdictions as being particularly serious and normally do not produce any beneficial effects. They almost always infringe competition law.

IDRC – International Development Research Centre

INDECOPI – Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual (Peruvian Competition Authority)

Market power* – Strength of a firm in a particular market. In basic economic terms, market power is the ability of firms to price above *marginal cost* and for this to be profitable. In competition analysis, market power is determined with the help of a structural analysis of the market, notably the calculation of *market shares*, which necessitates an examination of the availability of other producers of the same or of substitutable products (*substitutability*). An assessment of market power must also include an assessment of barriers to entry or growth (*entry barriers*) and of the rate of innovation. Furthermore, it may involve qualitative criteria, such as the financial resources, the **vertical integration** or the product range of the *undertaking* concerned.

MERCOSUR — Mercado Comun del Cono Sur (Southern Cone Common Market)

Merger** — An amalgamation or joining of two or more firms into an existing firm or to form a new firm. A merger is a method by which firms can increase their size and expand into existing or new economic activities and markets. A variety of motives exist for mergers: to increase economic efficiency, to acquire **market power**, to diversify, to expand into different geographic markets, to pursue financial and research and development synergies, etc. Mergers are classified into three types: horizontal, vertical, and conglomerate. Horizontal mergers are between firms that produce and sell the same products, i.e., between competing firms. If significant in size, these mergers can reduce competition in a market and are often reviewed by competition authorities. **Vertical integration** between firms operating at different stages of production usually increases economic efficiency, although they may sometimes have an anticompetitive effect. Conglomerate mergers are between firms in unrelated businesses.

Minimum efficient scale — The minimum size a firm can be for it to be productively efficient. In small economies, this can be very important if the market is too small to support more than one firm efficiently. If a market is smaller than the minimum efficient scale of a single firm, then that firm will be less efficient than rivals and will charge higher prices to consumers.

Monopoly/monopsony* — Market situation with a single supplier (monopolist) who, because of the absence of competition, holds an extreme form of **market power**. It is tantamount to the existence of a *dominant position*. Under monopoly, output is normally lower and prices higher than under competitive conditions. A monopolist may also be deemed to earn supranormal profits (i.e., profits that exceed the normal remuneration of the capital). A similar situation on the demand side of the market, i.e., with a single buyer, is called monopsony.

NGO — non-governmental organization

OECD — Organisation for Economic Co-operation and Development

Oligopoly* — A market structure with few sellers who realize their interdependence in making strategic decisions, for instance, on price, output, and quality. In an oligopoly, each firm is aware that its market behaviour will affect the other sellers and their market behaviour. As a result, each firm will take the possible reactions of the other players expressly into account. In competition cases, the term is often also used for situations where a few big sellers jointly dominate the competitive structure and a fringe of smaller sellers adapt to their behaviour. The big sellers are then referred to as the oligopolists. In certain circumstances, this situation may be considered to be collective (also joint or oligopolistic) dominance.

Per se prohibitions simply outlaw a certain type of agreement regardless of whether it has caused damage.

Productivity — The most common use of this term is the value of output per worker's hour. This is an example of factor-specific productivity (i.e., labour). Simply put, one is more productive if one produces more output for a given hour of work, but a worker may be more productive with a new, more expensive machine; labour productivity may rise with more investment in capital (another factor of production). Hence, in economic studies of competition, where the focus is on improvements in welfare caused by competition through innovation, efficiency, etc., the total factor productivity is used: the value of output as it exceeds the value of the input factors of production (traditionally land, labour, and capital).

Regulatory capture is the circumstance when a government regulatory agency (such as a competition authority), which is supposed to be acting in the public interest, becomes dominated by the vested interests of the incumbents in the industry that it oversees.

Rent — A firm (or group of firms acting anticompetitively) can extract rent when it has *market power* by restricting output, forcing consumers to pay more than they would otherwise pay in a competitive market. Rent generates economic profit (revenue less economic opportunity costs). Economic opportunity costs usually differ from explicit accounting costs. Most of this adjustment typically reflects the opportunity **cost of capital**.

RTA — regional trade agreement. In this book, RTAs encompass bilateral and multilateral free trade agreements and customs unions, irrespective of geography.

Rule of reason**— An evaluation of the procompetitive features of a restrictive business practice against its anticompetitive effects to decide whether the practice should be prohibited. Some market restrictions that may at first glance give rise to competition issues, may on further examination be found to have valid efficiency enhancing benefits. The opposite of the rule of reason approach is to declare certain business practices illegal, per se, (i.e., always illegal). For instance, price-fixing agreements and resale price maintenance agreements in some jurisdictions are illegal.

Tied selling* — Making the sale of one product conditional on the purchase of another product.

UNCTAD — United Nations Conference on Trade and Development

Vertical integration/restraint** — Relationship, ownership, or control of different stages of the production process, e.g., petroleum refiners, pipeline companies, and oil explorers. A vertical restraint is an agreement-setting conditions under which the firms within a production process may purchase, sell, or resell certain goods or services.

WTO — World Trade Organization

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