Multilateral rules on competition policy: an overview of the debate

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Summary

Competition policy has become an important topic in the context of the global trade and capital liberalization processes of the past decade. The average tariff rate on imports has decreased substantially and various non-tariff restrictions have been abolished. Barriers to trade erected by private parties have hardly been tackled, however, although these business practices can distort trade and investment flows and lead to conflicts between countries. Competition policy deals with anti-competitive business practices (sometimes called restrictive business practices). Competition laws were first introduced in the United States and later in European countries. Latin American countries have only recently adopted competition laws.

The subject is complex and interdisciplinary. It combines the fields of international law, corporate law, industrial organization, innovation policy, transnational corporations, international trade and transport. Competition policy seeks to prevent companies from reducing the efficiency of market mechanisms. It is aimed at keeping firms from forming cartels or monopolies and from abusing a dominant market position and at ensuring that mergers and acquisitions and subjected to proper scrutiny. These practices often limit competition and take away incentives to excel, innovate, reduce prices and improve customer service. Anti-competitive practices may also act as trade barriers that distort trade and investment flows. They may reduce global welfare and lead to conflicts between countries. Hence, some sort of international agreement may be necessary to forestall or eliminate these new kinds of trade barriers.
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Such an agreement could, in addition, take the place of anti-dumping measures and thus avoid their detrimental effects.

The United States was the first country to introduce competition policies. The European Union has a supranational system of competition policies that regulate anti-competitive practices, mergers and acquisitions having transborder effects. Competition laws in Latin American countries are relatively new, and their structure and wording resemble those of Western countries. Enforcement activity in these countries has, however, been less than energetic.

There have been various unsuccessful attempts in the past to establish a multilateral agreement on competition policy. International organizations such as the Organization for Economic Cooperation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD) have studied and discussed the topic extensively. UNCTAD has been involved in many competition policy initiatives and has assisted developing countries with the introduction of suitable legislation. In addition, UNCTAD has made available a set of non-binding multilateral rules to control restrictive practices. OECD perceives competition policies as a step towards the creation of contestable markets at the international level. It recommends that all countries adopt competition policies and establish the required enforcement agencies. The OECD countries should cooperate to restrain anti-competitive practices that have effects on more than one country.

Currently, competition policies are being discussed in various international organizations. The World Trade Organization (WTO) has a working group that is studying the subject, and some countries even want to establish a multilateral agreement on competition rules. Furthermore, the OECD are also studying the topic and have published several proposals. In Latin America, discussion groups are taking place on the theme. Various subregional groups, including the Southern Common Market (MERCOSUR), Group of Three, the North American Free Trade Agreement (NAFTA) and the Asia-Pacific Economic Cooperation (APEC) have formed working groups that are examining questions related to competition policy. The topic is also included in the preparatory work for the creation of a Free Trade Area of the Americas (FTAA).

The United States does not support a new international agreement on competition policy. Instead, it advocates bilateral agreements whose scope would be confined to cooperation between national competition-policy enforcement agencies. Furthermore, the United States prefers to keep its domestic anti-dumping legislation. The European Union, on the other hand, is more enthusiastic about multilateral rules on competition policy. The European Union would also like other countries to make their courts accessible to foreign firms. The next step would be the adoption of common rules by all countries and international cooperation between enforcement agencies. The developing countries position on multilateral rules governing competition policy is more vague.

Before Latin American countries commit themselves to international agreements on competition policy, they should carefully study the issue as it relates to their development needs. On the one hand, it is in their own interest to adopt competition policies. However, there are a number of as yet unanswered questions concerning the impact of competition policies on foreign direct investment. Nevertheless, certain modifications can be made in the legislation to address those concerns. For instance, exemptions for certain practices and sectors might be given. The authority of the enforcement agency might even be extended to such an extent that it could act as a general promoter of economic liberalization. It is sometimes argued that developing countries should adopt more lenient policies in order to build large, competitive domestic enterprises. This probably has a negative overall welfare effect, however, and should be avoided. The final point made in this study is that multilateral negotiations are more in the interest of Latin American countries than bilateral agreements with industrialized countries.
This paper reviews the current debate on competition policy. It starts with an introduction to the subject, followed by a short survey of competition policy in the United States, Europe and Latin America. An overview of anti-competitive business practices is then provided. Subsequently, the paper examines the reasons for the adoption of multilateral rules on competition policy.

Chapter II describes the different domestic competition policies in the United States, Europe and Latin American countries. The following chapter deals with the rationale for multilateral rules on competition policy and reviews previous attempts to establish multilateral rules, as well as the work of UNCTAD and OECD on competition policies. The current discussions at WTO are outlined in chapter IV, with emphasis on the negotiating positions of the United States, the European Union and developing countries.

The paper closes with a discussion of issues that could be important to the formulation of a negotiating position for Latin American and Caribbean countries. It addresses questions such as (1) whether it is favourable or necessary for Latin American countries to adopt domestic competition laws, (2) whether these laws need a specific form (different from the laws in developed countries) to meet their development needs and (3) whether multilateral rules are in the interest of developing countries.
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I. Introduction

A. Historical background

The term competition policy has been used in a number of different senses. It is sometimes used in a broad sense to designate all policies that can increase competition and eliminate barriers to the operation of market forces. Such market obstacles can be created by either Governments or private agents. Box 1 provides an overview of some of the major policies and agreements that promote international competition. This includes agreements which limit the use of export subsidies that give domestic producers an unfair competitive advantage over their foreign competitors as well as agreements that reduce the risk of foreign investment, such as investment protection agreements and other agreements that do away with government-erected barriers to foreign firms. Many of these agreements are partially included in the framework of the World Trade Organization (WTO). For example, investment was dealt with in the Agreement on Trade Related Investment Measures (TRIMs) and intellectual property rights in the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). In this paper, however the term competition policy will be used only in reference to public policies whose purpose is to restrain private enterprises from acting in ways that distort market operations. This type of policy involves the enforcement of laws on anti-competitive modes of behaviour, such as those associated with cartels and vertical agreements. They also usually involve controls on mergers and acquisitions. In the United States, this policy is called antitrust law and in the European Union, competition policy. UNCTAD refers to this as the control of restrictive business practices.
This paper will also discuss anti-dumping measures. Some countries, such as the United States, use anti-dumping measures to deal with anti-competitive practices. Nonetheless, evidence shows that such mechanisms are often misused as a protectionist tool, with harmful effects on international trade. In this study we will argue that their replacement by another type of competition policy or agreement would be preferable.

Box 1

POLICIES TO PROMOTE INTERNATIONAL COMPETITION

- Agreements to facilitate and secure foreign investments;
- Agreements on subsidies;
- Introduction of competition in service sectors;
- Anti-dumping legislation;
- Elimination of government rules that act as entry barriers;
- Policies to protect intellectual property rights;
- Policies that prevent companies from applying restrictive business practices and that supervise mergers and acquisitions (competition policy).

Another confusing term that is frequently used and sometimes applied as a synonym for anti-competitive business behaviour or restrictive business practices is unfair competition (in Spanish, competencia desleal). This term includes other issues besides restrictive business practices. It is also used for metrology (weights and measures), misleading representation and advertising, counterfeiting of trademarks and infringement of intellectual property rights.

Competition policies have a long history. Some authors claim that the first actions against anti-competitive practices date as far back as the middle ages, when cartels, the so-called guilds, were formed in most European cities. A first prohibition of contracts that restrain trade can be traced to English common law of the early fifteenth century.\footnote{It was mainly a refusal by the courts to enforce such contracts. See \textit{Competition Policy Convergence: the Case of Export Cartels}, \newline\url{http://www.dfait-maeci.gc.ca/english/foreignp/dfait-1/94_03_e/s3.html}.
}

In the second half of the nineteenth century, the United States and Canada experienced a turbulent process of economic change. Railroads and steamships expanded the scope of many markets, and managerial innovations led to larger corporations and trusts. At the same time, agricultural prices fell as a consequence of monetary stringency associated with the gold standard. Farmers and small business owners discovered that they had to pay high prices for the inputs charged by the trusts while receiving lower prices for their own outputs. They subsequently lobbied for legislation to limit the trusts’ power (Scherer, 1990, p.12). Their movement was successful and led to the adoption of competition laws in Canada (1889) and the United States (1890).

In the United States the Sherman Act was the first law to prohibit most cartels and many vertical agreements. Two decades later, in 1914, the Clayton Act was adopted. This law contains guidelines on mergers and acquisitions. Significant case law has emerged since then through verdicts of the Supreme Court. In 1911 the Court ordered the break-up of Standard Oil into 33 regional companies. The oil company had been found guilty of acquiring and abusing a monopoly position (Scherer, 1990, pp. 450-451). Another famous case was the obligatory break-up of AT&T
into regional telephone companies in 1982. AT&T abused its monopolistic position to keep competitors out of the market (Scherer, 1990, pp. 462-464).

Many cartels were formed in Germany around the turn of this century. Cartels also expanded their economic importance in countries such as Austria, Switzerland, Italy, France, the Scandinavian countries and Japan. The cartels reached their peak during the great recession of the 1930s. After World War II the United States occupation forces imposed severe competition laws on Japan and Germany. In 1957 competition policies were included in the Treaty of Rome, which established the European Economic Community (the predecessor of the European Union). The aim was to remove and prevent barriers to trade erected by companies and state-owned enterprises. In addition, the treaty sought to encourage competition, efficiency, innovation and lower prices in order to optimize the functioning of the single European market.

Competitive laws were adopted only recently in a few developing countries. Since 1990, approximately 35 countries have adopted or renewed competition laws (Shyam Khemani, 1996, p. 1). In Latin America, Argentina and Mexico adopted competition laws in 1923 and 1917, respectively. Competition laws were introduced in Chile, Brazil and Colombia in the 1960s (Coate and others, 1993). Those laws were poorly enforced, however, because no enforcement agencies were created. As an alternative to competition policy, monopolies were often nationalized or regulated, for example through price controls and capacity licensing. Competition from foreign firms was curbed through high import tariffs and quantitative restrictions. Eventually, this combination led to a non-competitive, high-cost domestic industry (World Bank, 1994, p.1).

B. Restrictive business practices by corporations in closed economies

This section surveys the major restrictive business practices of corporations. Although these practices may affect both domestic and international markets, this section concentrates on domestic markets.

Compensation policy includes measures related to the behaviour of firms and those related to the structure of markets. The former are concerned with horizontal and vertical business agreements such as cartels or agreements with resellers; the latter are concerned with mergers and acquisitions.

1. Vertical agreements

Vertical agreements include a wide range of contracts between suppliers and resellers that reduce the effective functioning of the market mechanism and hinder new entry into the market. Most of these contracts are restrictive in nature, since they limit free price formation and competition. Restrictive contracts are prohibited, and participating enterprises can be fined. Not all vertical agreements are entirely restrictive in nature, however. Economists and lawyers are still studying the efficiency-enhancing effects of some vertical agreements, such as exclusive dealing.

A company or a group of companies may demand unreasonable conditions from its sellers and resellers, sometimes using the threat of boycott to enforce these demands. Sales conditions considered unreasonable include the following:

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2 See: Competition Policy Convergence: The Case of Export Cartels, op. cit.
• Reciprocal exclusivity, which prohibits a reseller from selling the products of competing firms (also called captive distributorship or exclusive dealing). In the United States these agreements are prohibited if the manufacturer has a large market share or if securing access to distributors is difficult for new entrants.

• Bounded sales, in which a company forces its resellers to hold or to purchase more than they find necessary.

• Tying, in which the sale of a given product is bound to other products, or even to a whole range of products (i.e., full-line forcing).

• Resale price maintenance by fixing consumer prices and retail margins.

• Prohibition of discounting.

• Predatory pricing, which involves selling goods at a very low price, to drive competitors out of the market, or selling inputs to competitors at excessive prices (UNCTAD, 1996a, pp.8-9).

Licenses and dealerships are forms of vertical agreements that may have positive welfare effects. These contracts can contain certain anti-competitive conditions, such as dividing product assignments, granting exclusive geographic territories, allocating production quotas or fixing the prices of patented products. The net effects of such conditions on welfare and technological progress are difficult to determine. Patent holders may derive higher benefits from licensing their patents on favourable terms. The rewards to technological innovation will therefore be higher and the incentive to technological innovation stronger.

2. Monopolies

A monopoly occurs when a single seller controls the sale of a product which has no close substitutes. If the market presents no threat of new entry, a monopolist can maximize its profits by raising prices and limiting output (see for instance Scherer, 1994, p.17). Moreover, a monopoly implies detrimental effects on welfare if the market is protected by entry barriers or government rules. Opinions differ on the impacts of monopolies. Economists associated with the influential Chicago School, for example, argue that a monopoly only exists when the firm has some superior firm-specific advantage that increases its efficiency. Hence, a competition policy that prohibits these monopolies may also prevent the most efficient market structure (Godek, 1993, pp. 4-9).

3. Dominant firms

Undesirable economic outcomes may result when one or a few firms dominate a market (i.e., they control a large market share). Dominant firms can influence the behaviour of other firms, set their prices above perfect competition levels and demand unreasonable conditions to its resellers, as can the monopolist.

The theoretical basis for this assertion is the dominant-firm price-leadership model (Hay and Morris, 1991). This model holds that the dominant firm acts as the price leader by setting the price for the market. The firm does this in accordance with maximizing its own profits subject to a demand constraint. The other producers in the industry are assumed to be followers or to form a small competitive fringe. The dominant firm can even restrict other firms’ choices through

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3 A license gives a firm (the licensee) the right to use a technology or produce or sell a product or brand, under specific conditions determined in the contract. The licensee is usually obligated to pay a royalty to the holder of the license (the licensor).
strategical behaviour, for example via threat strategies such as the threat of a price war, which could ruin competitors with fewer financial resources. The other firms are therefore forced to follow.

A dilemma for enforcers of competition policy is that firms with large market shares may raise welfare by exploiting economies of scales and other sources of efficiency (Scherer, 1990, pp. 438-439) and they sometimes have a better ability to innovate (Scherer, pp. 630-637). Their market power and their ability to raise prices have negative effects on short-term social welfare, however.4

4. Cartels and concerted behaviour

A cooperating group of companies can act as a monopolist or dominant firm. In a free market, firms may be willing to cooperate among themselves when colluding is more profitable than competing. Collusion can occur in a number of ways, including the establishment of a binding cartel, covert collusion, price leadership with threat and counter-threat strategies, and even merging with or acquiring direct competitors.

A cartel might also engage in horizontal restrictive business practices. For example, a cartel can fix prices or supply conditions among its members. It can allocate markets per area or per groups of customers, and it can set aside “combat funds” to eliminate outsiders, for example by systematically underbidding them. A cartel can also tender collusively (i.e., bid rigging). To accomplish this, a cartel can form a turn system in which all members join the tenders and submit a cover bid (i.e., a minimum bid above a competitive price). Each cartel member is then rewarded with a project (UNCTAD, 1996a, pp. 7-80).

Horizontal agreements include quantity agreements; price agreements (fixed by a standard formula or by a given ratio between competing, but non-identical products); agreements to eliminate price discounts, or uniform discounts; agreements on credit terms, extended to customers; bid rigging agreements; agreement not to reduce prices without notifying the other cartel members; agreements to buy up excess product offered at low prices; agreements to appoint a single sales agency to handle all sales of cartel members; customer allocation; territorial monopoly agreements; exchange of commercially sensitive information; and predatory agreements.

Cartels are usually, prohibited because of their negative welfare effects. Certain types of agreements between companies can be beneficial to society, however. In the case of research and development (R&D), for example, more research may be produced if two companies can share the risks and costs. Small companies may be unable to withstand the serious financial impact of an unsuccessful outcome. Although the overall effect of these joint ventures may be positive, the cooperation could (secretly) be extended to setting the price of the products developed.5

5. Mergers and acquisitions

When cartels are prohibited by law, companies can circumvent this prohibition by merging with or acquiring their competitors. In the end, this can have the same negative effects on social welfare as the formation of a cartel. Mergers and acquisitions are therefore usually controlled. Mergers might also have positive welfare effects, however. The post-merger company can lower its

4 Furthermore, if the assumption of a closed economy is dropped, the corporation is seen to operate in the world market. Firms with a dominant position in one country may be relatively small in a wider regional market or in the world market. For this reason, it has been argued that enforcers of competition policy should be more flexible.

5 Some cartels have transnational effects. These are international cartels (i.e., cartel members are based in different countries); import cartels (i.e., importers buy all imports together or have a common buying office); and export cartels (i.e., exporters form a cartel to sell their products abroad jointly).
costs per unit through economies of scale, better integration of production facilities, plant specialization and the rationalization of transportation, other services and distribution systems. The company may also achieve a general reduction in administrative and overhead costs (U.S. Department of Justice, 1982, p. 22). Enforcers of competition policy must weigh the positive and negative welfare effects of a proposed merger and then condone the merger, prohibit it altogether or allow it under well-defined conditions.

Three broad categories of mergers can be distinguished, each with different effects on social welfare: horizontal, vertical and conglomerate mergers. Horizontal mergers involve firms at the same stage of the production process. The positive effects of these mergers are generated from the increased scale and scope economies. The negative effects on social welfare are the increase in market power and the subsequent risk of abuse of the market position.

Vertical mergers occur between firms at different stages of the production process. These mergers can generate efficiency advantages. For example, an integrated company can avoid the output-restricting effects of upstream and downstream demands, and the proportionate use of complementary inputs may be subject to less distortion. However, a vertically integrated firm can increase its monopoly power over upstream inputs which it does not directly control, along with those that are acquired. This happens when two or more inputs are needed to produce a finished product. When the producer of an input acquires the end producer, the integrated firm may be able to control the demand of the other inputs and so extract rents from their producers. Additionally, the newly integrated firm may restrict supplies to other retail outlets supplied by the old intermediate firm.

In the case of a conglomerate merger, it is difficult to analyze the total effect of two firms merging across different markets. Aggregate concentration may change, affecting price and output and increasing the firm’s market power. Positive scale efficiencies may occur: the conglomerate firm can borrow capital for a lower interest rate and has a more efficient internal labor and capital market. Economies of scope might also be achieved through the joint production of different goods.

C. Restrictive Business Practices by Corporations in Open Economies

While business practices might originate in a specific country, their consequences may go beyond that country’s boundaries, affecting foreign companies and consumers. Enforcers of competition policy are often unable to enforce domestic laws against cross-border practices originating abroad. This gap results in reduced competition, reduced efficiency and potential conflicts between countries.

After governments have abolished impediments to trade and investment, companies could reinstate these to raise their profits. Some practices limit trade flows, working as barriers to entry into national markets. This reduces or eliminates the expected benefits of trade liberalization. The following business practices and horizontal and vertical agreements have the same effect as trade or investment barriers.

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6 Anti-competitive behaviour that has no direct negative effect on foreign markets may indirectly hurt foreign competitors. The extra rents earned by anti-competitive behaviour can be similar to subsidies for the enterprise in the domestic market. Firms can use the extra profits earned by their anti-competitive behaviour to improve their position vis-à-vis their foreign competitors. Firms can, for example, reinvest monopoly profits earned at home in R&D or capacity expansion, and so improve their comparative advantage in export markets. Or they can use the production capacity freed up by the restriction of domestic output for dumping the goods in a profitable export market.
1. Agreements which act as Entry Barriers

Some business agreements distort trade and investment as they block market access to new entrants (domestic as well as foreign) and also to imports. Companies might apply these measures as they seek further protection, especially after trade liberalization and tariff reductions.

(i) Reciprocal exclusivity. These agreements, which stipulate that a dealer is only allowed to sell one branch of products, can effectively block foreign imports, because there are insufficient retail outlets. This is often cited as one of the main barriers for entry into the Japanese market (Ito, 1992).

(ii) Collective exclusive trade agreements. These agreements are between national producers and their buyers. A group of retail outlets, whose market share is very high, makes an agreement with a group of national producers to sell only their products. Until recently, these cartels were popular in the Netherlands and Belgium.

(iii) Voluntarily export restraints. These include restrictive arrangements such as voluntary restraint agreements and orderly marketing agreements between private corporations.

(iv) National cartel. A national cartel can work as an entry barrier to foreign competitors by using (e.g., a common strategy to compete with the foreign entrant, (e.g., the threat of a price war, underbidding or a boycott of inputs).

Entry barriers have various effects on trade and investment patterns. They can impede trade directly by blocking market access for foreigners, and they maintain a geographical price-discrimination strategy. They also support local monopolies and cartels with detrimental effects on trade. Entry barriers are also detrimental to foreign direct investment (FDI) flows. Current trade disputes between Japan and the United States with regard to semiconductors, auto parts and photographic film are in part about entry barriers raised by private firms.7

2. Practices that enable geographical price discrimination

When different national markets have different price elasticities, it is a profitable strategy for companies to set different prices in each national market (i.e., price discrimination). To succeed, the company should also take measures to prevent price arbitration through parallel imports. The following agreements prevent those imports and so enable the producer to use the price-discrimination strategy:

(i) Agreements to stop parallel imports not channeled through official distributors;

(ii) All import and export limitations or prohibitions applied to their resellers;

(iii) Agreements to adjust import prices to the national price level;

(iv) Collective discounts on the total turnover in one country; and

(v) Prohibitions for dealers or local branches of a multinational enterprise to provide service or maintenance on products not brought on the market via official channels. This measure is an effective trade barrier for durable goods that need maintenance (e.g., cars, household appliances and business machines).

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7 See, Competition Policy Convergence: The Case of Export Cartels. op.cit.
Geographical price discrimination distorts trade and has negative welfare effects on consumers, because the company can cash in the benefits that would otherwise go to consumers. This practice will counter market integration and offset its benefits.

3. International cartels and export cartels

International and export cartels are agreements to assign foreign markets to firm members, with the ultimate result of raising prices. This is usually not prohibited in the home country because the effects are felt abroad. In the United States, for instance, this kind of cartel is admitted under the Webb-Pomerone Act of 1918. Affected countries often have little recourse. One of the few successful actions against this type of collusion was the European Court of Justice’s prohibition of an export cartel of North American wood pulp suppliers.8

Examples of international cartels include: oil exporters, through the Organization of Petroleum Exporting Countries (OPEC); diamonds, through De Beers, a private South African firm; liner conferences in sea trade (Stopford, 1997, pp. 348-351); and tariff agreements in the airline industry, through the International Air Transport Association (IATA).

Other attempts have been made for different commodities such as bauxite, through the International Bauxite Association; copper, through the Intergovernmental Council of Copper Exporting Countries; and Tin, through the International Tin Agreement. Less successful attempts have been made from time to time for other commodities, such as iron ore, mercury, tea, tropical timber, natural rubber, nickel, tungsten, cobalt, columbium, tantalum, pepper and quinine.9

It is sometimes argued that export cartels are beneficial. When firms combine their forces to export, they can reduce the costs of sales, financing and customs paperwork by using a common sales organization to handle the transactions. This lowers the transaction costs for exporters and allows small companies to export. In these cases both sellers and buyers may gain.

A similar kind of cartel is the import cartel. Countries might sanction import cartels for various reasons. An import cartel may be allowed to counter an export cartel. For example, after OPEC’s massive price raising in 1971, United States companies got permission to negotiate as a block against the Persian Gulf nations (U.S. Senate Foreign Relations Committee, 1975, pp. 127-133). In the United Kingdom, exemption has been granted for a joint buying pool to counter the power of foreign suppliers of sulfuric acid, and in Sweden permission has been granted for an import cartel of films (UNCTAD, 1995c, p.29). From a protectionist stand point, an import cartel can be used to limit or block imports, when these might compete with domestically produced goods.

9 See Competition Policy Convergence: The Case of Export Cartels, op. cit.
II. An overview of domestic legislation on competition policy

A. Domestic policies in the United States

The first United States antitrust laws were introduced in 1890. The United States system is embodied in laws such as the Sherman Act, the Clayton Act and the Federal Trade Commission Act. The Sherman Act consists of two sections, of which the first declares all cartels illegal and the second prohibits monopolizing markets. The Clayton Act deals with vertical restrictions, mergers and interlocking directorates among competing firms (Wood, 1996, p. 11). The Federal Trade Commission Act established an enforcing agent with quasi-judicial powers. Through several case laws, the rules have matured (Burgess, 1992, pp. 37-131). Court decisions have led to per se prohibition of all agreements to fix prices or pool output. Violating price fixing can carry fines of up to US$ 1 million and prison sentences.¹⁰ Antitrust enforcement is exercised partly by the Federal Trade Commission and partly by the Antitrust Division of the Department of Justice (Gellhorn and Kovacic, 1994, p. 449)

Their mandates are overlapping. The Department of Justice can pursue criminal charges against offenders of antitrust laws. It is argued

¹⁰ In twenty cases between 1975 and 1979, 51 people were sentenced to prison terms ranging from ten days to three years (see Scherer, 1990, p. 326).
that the combination of the two agencies has led to a more effective enforcement (Scherer, 1990, p. 13).

Persons injured by antitrust law violations are permitted to sue for the recovery of three times the amount of damages sustained by anti-competitive practices. Some suits have led to high repayments, such as US$ 500 million paid by producers of electrical equipment in the 1950s (Scherer, 1990, p. 326).

B. Integrated Competition Policies in the European Union

At the creation of the European Union, the need for a common competition policy was acknowledged. Competition rules were adopted in the Treaty of Rome. The objective was to prevent companies from raising trade barriers after these had been abolished by governments.

The European competition rules prohibit a number of cartels, horizontal agreements and the abuse of a dominant position (Whish, 1993, pp. 243-284). Guidelines on mergers have also been developed (Bishop, 1993, pp. 294-317).

The system is supranational, since European laws go above national laws. The European Commission is the central enforcing agency, and its verdicts are binding for the member states. It can start investigations on its own or after complaints by private parties. It may order a government to undo an infringement of the rules, and member states are obliged to help the European Commission enforce its decisions. All firms and public institutions have to allow Commission officials to investigate their actions. Finally, the Commission can impose fines amounting to millions of dollars. The European Court of Justice handles appeals on the decisions of the European Commission. The court has treated a large number of cases and produced case law that further specifies the competition policy of the European Union. Furthermore, individuals can start a civil procedure in any national court against a firm that acts against the European competition rules.

European competition policy encompasses a two-tier system. In addition to the European policy, individual countries have national competition policies. The European Union mainly regards competition from a trade perspective, while the member states focus on national considerations. The advantage of this system is that it saves the Commission work, since the individual countries’ authorities already know the national peculiarities.

The field of application of competition rules is quite broad. The rules apply irrespective of the location of a company: even if a company is established outside the European Union, it must comply with European rules if its actions have an effect inside the Union. Furthermore the rules are valid for both private, and government-owned firms. The only exceptions are the coal and steel sectors, agriculture and the public sector.

European competition policy is based on the concept of dominance. Anti-competitive behaviour is only prohibited if it is performed by a dominant firm. Under a dominance policy, the long-term interests of suppliers and competitors, rather than the short-term interests of consumers, are protected. Although dominance policies allow the formation of large firms, consumers may benefit from the lower prices achieved through economies of scale.

Although the structure of the United States laws resembles that of the European laws, the policies differ on many points. These differences clarify the negotiating positions in WTO or OECD discussions. Some major points are highlighted in Table 1.

C. Domestic legislation in Latin American countries
Competition policies are not new for Latin America. Argentina and Mexico adopted competition laws before the Second World War. Enforcement has been very limited, however, and other policies have often obstructed the goals of competition policies. Import-substitution policies, for example, encouraged monopolist market structures. Various price controls distorted the competitive formation of prices and tempered competition (ECLAC, 1997, pp. 21-24). Recently, Latin American countries have begun revising their competition policies and making new efforts to improve the enforcement of those laws.

1. National competition policies

The form and content of competition laws differ among Latin American countries. In the first place, some countries lack modern legislation. Not all practices are prohibited in all countries. In some countries, anti-competitive practices are prohibited per se. In other countries, the rule of reason is applied. Some practices might be excluded if they lead to gains in efficiency or if the negative effects are limited.

The current situation with regard to antitrust laws in Latin America is summarized in table 2. The first column lists the countries whereas the second column contains information on the structure of the antitrust laws. Some countries do not have a specific competition law, but a few provisions on competition policy are included in the constitution. These provisions are general and often only contain a ban on monopolistic pricing. Other countries base their policies directly on non-constitutional laws that either stand alone or as part of a commercial code. Another type of law is the administrative decree; this is a government mandate that has become part of the country’s legal structure, without parliamentary approval.

Box 2

COMPONENTS OF THE EUROPEAN UNION’S COMPETITION POLICY

(1) Prohibited cartels and agreements (Article 85 of the Treaty of Rome). All agreements, cartels and concerted practices are prohibited in so far as they lead to the establishment of barriers between national markets or the fixing of prices and output. Although agreements at the national level are not specifically mentioned in the Treaty, they are also prohibited because they can distort the competition by working as market entry barriers. Furthermore, all agreements and decisions prohibited by the Treaty are automatically void.

All agreements likely to come under the ban must be brought to the European Commission in advance for examination (Regulation 17, 1962). The Commission then decides whether to prohibit the agreement or to give a negative clearance, if fair competition is not threatened. Finally, the Commission can exempt the agreement from the overall ban, if the benefits are considered more important than the possible disadvantages of limited competition.

To save the work itself, the Commission has given block exemptions for certain types of agreements whose benefits outweigh the negative effects, including all cooperation agreements and subcontracting agreements. The Commission indicated 18 types of agreement, whose objective is to cooperate, such as information exchange, joint market research and subcontracting agreements. The Commission also allows other agreements that can produce significant benefits, such as developing technology, improving efficiency or enabling companies to enter or penetrate new markets. Necessary conditions are that consumers must obtain a fair share of the resulting benefits and, for a substantial number of these products or services that competition must not be eliminated.

Competition rules do not hold for small companies. If their agreements do not limit the competition possibilities of third parties, the sales possibilities of suppliers or the market position of the buyers, they are allowed. To qualify, the companies’ share of the relevant product market or its geographical share of the common market must be less than 5%, and the total turnover of the companies may not exceed ECU 300 million.

(2) Abuse of economic power (Article 86). Abuse of economic power is forbidden for firms that hold a dominant market position. A firm is considered dominant on a defined relevant market, if it is able to behave independently of its competitors and customers. The European Court of Justice specifies that dominance starts with a market share of 40%. For companies with a smaller market share, the same practices are allowed because their suppliers and buyers have alternatives.

Abuses are heavily fined by the Commission. In some cases, fines are as much as ECU 90 million. These sanctions can be challenged before the Court of Justice. Abuse of power includes (i) tying products with other products; (ii) charging excessively high prices; (iii) predatory pricing; (iv) boycotts; (v) exclusive purchasing agreements; and (vi) fidelity rebates.
(3) Merger and take-over control. The goal of merger control is to prevent companies from obtaining a dominant position on the Common Market. In 1989 a directive was adopted giving the European Commission the means to check on all mergers that have a "communitarian" dimension. This is the case when (i) total worldwide turnover of the participating firms together exceeds five billion ECU; (ii) total turnover in the European Union market of every firm exceeds 250 million ECU; and (iii) the participating firms do not sell more than two-thirds of their total "communitarian" turnover in one national market. These conditions are a political compromise and are not broad enough to cover all mergers with European implications.

The European Commission has a powerful position. If two firms want to merge, they should inform the Commission about their intentions. The Commission then gives a binding opinion. If the merger has not been brought to the attention of the Commission, it can demand a break-up. The Commission also has the right to request information and the ability to assess fines of up to 10% of the companies' annual turnover if the details of the merger do not coincide with the conditions outlined by the Commission (Bishop, 1993, pp. 294-317).

(4) State-owned enterprises (Article 90). State-owned enterprises are also subject to competition rules, in so far as the application of these rules does not obstruct the performance of the particular tasks assigned to them. If the member states do not respect this article, the Commission can either adopt directives or address individual decisions to specific member states. The goal is to extend the internal market to include sectors that have traditionally been closed, specifically government-controlled sectors such as electricity, telecommunications, transport, etc.

The Commission has issued a number of decisions to member states, for example about exclusive rights in air and sea transport. Furthermore, it issued a directive addressing competition in the telecommunications sector (directive 90/387). The objectives of this directive are to create an internal market for telecommunication services by obliging the member states to abolish monopolies on these services, to introduce objective, non-discriminating licenses and to abolish monopolies on the exploitation and construction of networks.

(5) Anti-dumping. Anti-dumping action is strictly forbidden in intra-Community trade.

Notes:

a This includes: market share agreements, collective exclusive trade agreements between national producers and their buyers, agreements to adjust import prices to the national price level, collective discounts of the total turnover in one member state, all import and export limitations or prohibitions and all attempts to stop parallel imports other than via official distributors.

b Prohibitions include (international) price agreements, horizontal cartels, vertical agreements or rules for retailers (such as determined prices or minimum prices), and condition cartels and agreements that limit production or sales.

c The European Commission gave a block exemption to (i) research and development agreements; (ii) joint ventures and strategic alliances; (iii) standardization and normalization agreements (so far as they are international agreements and not a new entry barrier to a national market); (iv) insurance premiums; and (v) agreements in maritime and air transport.

d Four types of agreement are allowed: (i) exclusive sale agreements, in which the buyer can only sell the products of a certain producer. The agreement must have an expiration time within 5 years (tank stations 10 years); (ii) Selective distribution systems, which specify that certain products are only sold by exclusive resellers. This is only allowed if the criteria used to select the retailers are of a qualitative nature and are applied uniformly. (iii) Franchise agreements. The franchisee gives only one concession in a certain area; in return the franchisee has to respect rules about management and marketing and he has to pay a royalty; (iv) "Open" license contracts of patents, brand names, authors rights and know-how, which give a monopoly to distribute in a certain area and in a certain time. These contracts are only allowed if they don’t interfere with the position of third parties (parallel importers and license holders for other areas).


The third column describes the functioning of the enforcement system, which largely determines the effectiveness of a competition policy. Different approaches exist, and most countries allow more than one.
Competition policy can be enforced by courts, as in judicial, civil and criminal enforcement policies. Judicial cases are brought up by the government, and private parties can file civil enforcement cases. The government alone enforces criminal law, which can lead to imprisonment of a violator. In the administrative-judicial approach, administrative enforcement is followed by judicial review. This process considerably increases the system's independence from the government. Executive-judicial policy vests the control of the competition policy in the executive branch, with a judicial review. Administrative policies dispense with the court’s ability to review the actions of the enforcement agency. Finally, federal action is a catchall category for situations in which it is not clear how the laws are enforced.

Of the countries listed, Venezuela has the most independent agency, which is only subject to judicial review. Argentina and Chile also have independent agencies, but they must obtain government concurrence with final orders. Brazil’s agency appears to be independent, but Council members defer to the Government. In Colombia, Peru and Mexico the Government controls antitrust enforcement (Coate and others, 1993, p. 34). Systems that are largely subject to government control seem to be more open to capture by interest groups, but it may be the only choice for countries without well-functioning institutions.

Table 1

<table>
<thead>
<tr>
<th>European Union competition policy</th>
<th>United States antitrust laws</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excludes small companies.</td>
<td>No special treatment for small companies.</td>
</tr>
<tr>
<td>Special section in law on state-owned companies.</td>
<td>No special treatment for state-owned companies, since there are few state-owned companies in the United States.</td>
</tr>
<tr>
<td>Integrating the markets of the member states into a union-wide market is an objective of European competition policy. Agreements that contribute to the existence of different national markets are therefore prohibited (e.g., granting exclusive selling rights in a specific country). The European Union is inclined to have a more positive judgment on mergers or joint ventures that unite companies from different countries.</td>
<td>The United States market is already highly integrated. Agreements that grant territorial exclusivity along state lines are usually seen as efficient and pro-competitive and are therefore allowed. Mergers of firms from different states are subject to the same control as mergers within a state.</td>
</tr>
<tr>
<td>Strictly prohibits most vertical agreements.</td>
<td>More tolerant view to vertical agreements, on the grounds of efficiency.</td>
</tr>
<tr>
<td>The definition of a relevant market is smaller than in the United States.</td>
<td>The definition of a relevant market is broader than in the European Union.</td>
</tr>
<tr>
<td>Companies have a dominant position if they have a 40% market share.</td>
<td>Companies have a dominant position if they have a share of 70% of the market.</td>
</tr>
</tbody>
</table>


The last three columns of table 2 examine distinct juridical approaches to anti-competitive behaviour. In all three approaches evidence must be gathered concerning the behaviour of the offending firms; in the rule of reason and dominance approaches, the market structure must also be

Department of Justice, however, remains under Presidential control. In Germany, the Cartel Office acts independently, except for merger decisions, which can be appealed by the Economics Ministry (Coate and others 1993, p. 51).
examined. A *per se* law prohibits specific behaviour, for example price fixing or mergers that lead to a monopoly. Enforcement is relatively easy; it requires fewer efforts than rule of reason or dominance cases. In the rule of reason approach, the simple finding that a certain behaviour has occurred is not enough to prohibit it. Behaviour is only illegal if it has a net anti-competitive effect. The application of this case-by-case approach is broader, because non-defined behaviour that has a negative effect on the competition can be prohibited. Finally, the dominance approach considers certain types of behaviour illegal when performed by a dominant firm and when the behaviour is harmful to consumers or business partners. The focus is narrower than under the rule of reason approach in that only large firms are examined, but it is easier to prove.

### 2. Enforcement in practice

The mere existence of laws is not sufficient to achieve the objectives of competition policy. Effective enforcement is necessary. This has been limited in Latin America, however. Laws in these countries are relatively new, and the scope has often been limited by price controls. Enforcement agencies also encounter budgetary constraints, which hamper their capacity and make it difficult to employ sufficient high-level staff. Agencies often have to rely on people who have little or no understanding of competition.

Furthermore, the position of the enforcement officers is, in general, not independent from the government. The low percentage of cases that lead to a conviction and the low penalties for violations of the law do not deter companies from pursuing anti-competitive practices. Moreover, the policies need time to mature. Case law, that sets clear precedents, has not yet been formed. Finally, enforcement activity is limited, because the public is largely unaware of the existence and scope of competition law. Data about enforcement practices in Latin American is scarce. This section therefore, focuses on those countries of which detailed information is available.

**Argentina.** The Argentine competition law of 1980 did not result in vigorous enforcement activity. The economy of Argentina continues to be characterized by widespread restrictive practices and government rules that serve as entry barriers. The enforcement authority lacks staff, resources and political independence to enforce the law sufficiently. The result is that enforcement is very slow. Cases last from one to eight years to be processed, with an average of four years per case. Furthermore, mergers are not controlled, penalties are insufficient and consumers and businesses have no practical, effective private recourse (Economists Incorporated, 1992, pp.2-3).

**Brazil.** Brazil, enjoyed an upswing in enforcement activities following the adoption of new laws in 1990 and 1991. During the period 1962-1990, only 337 cases were presented to the former enforcement agency, the Administrative Council for Economic Defense (CADE). Of these, 117 led to a procedure, but only 16 resulted in a conviction. The 1990 law created two new bodies: the National Secretariat of Economic Rights (SNDE) linked to the Justice Ministry, and the National Department of Economic Protection and Defense (DNPDE). In the first two years, these agencies started 120 new procedures against anti-competitive behaviour. This caused a change in the mentality of the public. Consumers and small- and medium-sized enterprises started a new range of complaints: from 1991 to 1994, more than 600 cases were presented, although SNDE and DNPDE are estimated to have a capacity to handle 80 processes annually (Confederação Nacional da Indústria, 1994, pp. 26-31).

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12 Of the 199 cases concluded between 1980 and 1992, 129 have been forwarded to the Secretary of Commerce (Economists Incorporated, 1992, p. 21)

13 However, consumer protection laws were very successful in this same period.
Table 2

COMPETITION POLICIES IN LATIN AMERICA UP TO 1993

<table>
<thead>
<tr>
<th>Country</th>
<th>Law</th>
<th>Enforcement</th>
<th>Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Con, L</td>
<td>Ej, C, Cr</td>
<td>Per se</td>
</tr>
<tr>
<td>Bolivia</td>
<td>Con, L</td>
<td>A, E, Cr, Le</td>
<td>Rule of Reason</td>
</tr>
<tr>
<td>Brazil</td>
<td>Con, L, D</td>
<td>Aj, E, C, Cr</td>
<td>Dominance</td>
</tr>
<tr>
<td>Chile</td>
<td>L, D</td>
<td>Aj, E, Cr</td>
<td></td>
</tr>
<tr>
<td>Colombia</td>
<td>L, D</td>
<td>A</td>
<td></td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Con</td>
<td>A, C, Le</td>
<td></td>
</tr>
<tr>
<td>Cuba *</td>
<td>Con</td>
<td>F</td>
<td></td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Con, Cc</td>
<td>F, Cr</td>
<td></td>
</tr>
<tr>
<td>Ecuador</td>
<td>Con, D</td>
<td>A, C</td>
<td></td>
</tr>
<tr>
<td>El Salvador</td>
<td>Con</td>
<td>F</td>
<td></td>
</tr>
<tr>
<td>Guatemala</td>
<td>Cc</td>
<td>A, C, Cr</td>
<td></td>
</tr>
<tr>
<td>Haiti *</td>
<td>Con</td>
<td>Le</td>
<td></td>
</tr>
<tr>
<td>Honduras</td>
<td>Con</td>
<td>F</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>Con, L, D</td>
<td>E, A, Cr</td>
<td></td>
</tr>
<tr>
<td>Nicaragua</td>
<td>Con</td>
<td>A</td>
<td></td>
</tr>
<tr>
<td>*</td>
<td>Con</td>
<td>A</td>
<td></td>
</tr>
<tr>
<td>Panama</td>
<td>Con</td>
<td>A, C</td>
<td></td>
</tr>
<tr>
<td>Paraguay</td>
<td>Con</td>
<td>F</td>
<td></td>
</tr>
<tr>
<td>Peru *</td>
<td>Con, L</td>
<td>A, Cr</td>
<td></td>
</tr>
<tr>
<td>Uruguay</td>
<td>Con</td>
<td>Le</td>
<td></td>
</tr>
<tr>
<td>Venezuela</td>
<td>Con, L</td>
<td>Aj, C</td>
<td></td>
</tr>
</tbody>
</table>


Notes: * Denotes countries whose constitutions have changed. Key to abbreviations in table:

- Con = Constitution
- Cc = Commercial code
- D = Decree
- L = Law
- A = Administrative enforcement
- Ej = Executive enforcement
- Aj = Administrative enforcement with judicial review
- C = Civil suits
- Cr = Criminal liability
- E = Executive enforcement with judicial review
- F = Federal action
- J = Judicial enforcement
- Le = Legislative enforcement
- Pf = Price fixing
- Pm = Predation and monopolization
- Pd = Price discrimination
- Rpm = Resale price maintenance
- T = Tying agreements
- Hr = Horizontal restraints
- Mm = Mergers to monopoly
- Vr = Vertical restraints

**Chile.** Active enforcement of competition rules has existed in Chile since 1973, when a new competition law was introduced. Enforcement is carried out by the Department of Justice (Fiscalía), while two commissions of specialists (Comisión Preventiva and Comisión Resolutiva) provide advise and hand down verdicts. The system has matured in its more than 25 years of existence. The enforcers have obtained more experience with competition matters, and verdicts and case law have made the system more comprehensible by giving clear signals to private companies.
In the period 1973-1993, quite a number of cases led to a verdict,\textsuperscript{14} but the fines imposed were relatively low. Chile's success is due to the consistency of competition policy with other economic policy and laws and to the relative independence of the enforcing commissions (Paredes-Molina, 1996). Chile simultaneously implemented other economic reforms, such as the prohibition of price fixing, the liberalization of imports and the revision of its tax system. The commission members are not paid, so they have no fear of losing their income should they form an opinion that differs from that of the Government. Only two members are appointed by the government; the others are academic representatives of consumer organizations and the judicial power.

\textbf{Mexico.} Mexico has actively been enforcing its competition policy since 1992, when a new law was adopted. A special commission on competition was formed with a mandate to study anti-competitive behaviour and mergers.\textsuperscript{15} In the case of the privatization of state-owned enterprises, the commission has to give positive clearance to all possible buyers after verifying whether the new private owners would obtain a dominant market position.\textsuperscript{16} The commission also plays an advocacy role on competition in the Government.

\textsuperscript{14} 367 cases were presented before the Comisión Prevenitiva between 1973 and 1993. In 166 cases, anti-competitive behaviour was proved. In the same period, the Comisión Resolutiva dealt with 227 cases, of which 67 resulted in a verdict (Paredes-Molina, 1996).

\textsuperscript{15} Between June 1994 and June 1995, this commission handled 122 cases on mergers and acquisitions and 45 on monopolistic practices. In addition, it gave 39 consultations. Most cases were reported by outside parties, and a few were started on the initiative of the commission (Comisión Federal de Competencia, 1995, pp. 95-108).

\textsuperscript{16} Personal interview with Adriaan Ten Kate.
III. The rationale for multilateral rules on competition policy

There is a clear rationale for discussing competition policy in bilateral and multilateral trade agreements. Such agreement may effectively prevent businesses from distorting competition through exports. They can prevent companies from erecting new trade and investment barriers after these have been reduced or abolished in the liberalization and integration processes. An agreement can also prevent free-riding and its possible conflicts. Moreover, while it is advantageous for a single country not to have a competition law or to be lax in enforcing it, all countries can benefit from adopting adequate legislation. Finally, an international agreement on competition could replace anti-dumping legislation, which is often abused and has many negative effects.

Game theory demonstrates that without international agreements or international mechanisms, the world (or a regional trade block) will end up in a mutually harmful situation featuring little regulation and lax enforcement of cross-border anti-competitive behaviour. This is similar to the free trade dilemma; protectionism for a single country might pay off, but free trade leads to the optimal allocation of resources worldwide. Although some types of anti-competitive behaviour with cross-border effects may produce negative effects on total global welfare, prohibiting these in all countries is not Pareto optimal. It can, in other words, be advantageous for a country to allow — either legally or de facto by lenient enforcement — or even to stimulate anti-competitive behaviour among its domestic firms.
Allowing or not enforcing a restrictive business practice may lead to extra profit for domestic industry and a transfer of welfare into the country. Governments may be tempted to protect their industries by lenient enforcement of competition rules after other protective measures have been prohibited in various trade rounds.

Game theory is the study of multi-actor decision problems. Different versions are used in different fields of economics, politics and firm strategy. In this example, the game is a static one, and complete information is assumed. Each player simultaneously chooses a strategy. The combination of the chosen strategies determines a pay-off for each player. Both players know beforehand what the pay-off will be for the different combinations (Gibbons, 1992, pp.2-14).

Table 3 shows the possible outcomes for two countries that have to make an independent choice as to whether to adopt and enforce a strict competition law. The combined choices of the two countries determine the outcomes in terms of national welfare. If neither country has a law that prohibits anti-competitive behaviour, they will end up in a mutually harmful situation in which world trade is distorted by anti-competitive practices. The best situation for world welfare is that in which both countries adopt strict legislation. However, if one country has severe domestic competition legislation while its trade partner is lax on that matter, a transfer of welfare might occur from the strict country to the lax country. In the country with lax enforcement, a firm might apply anti-competitive practices that affect its export markets in the country with severe legislation.

Table 3
INTERNATIONAL COMPETITION POLICY PAY-OFF MATRIX

<table>
<thead>
<tr>
<th></th>
<th>Strict competition law and enforcement in nation B</th>
<th>Mild competition law and enforcement in nation B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strict competition law and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>enforcement in nation A</td>
<td>2,2</td>
<td>4,1</td>
</tr>
<tr>
<td>Mild competition law and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>enforcement in nation A</td>
<td>1,4</td>
<td>3,3</td>
</tr>
</tbody>
</table>

Note: The pair of numbers account for the combined pay-off of A and B. Nation A’s pay-off is listed to the left of the coma; Nation B’s pay-off is listed to the right. The pay-offs are ranked from 1 (best) to 4 (worst).

Classic game theory holds that each country will look for the best choice given the strategy selected by the other country. Provided that country B strictly enforces competition policy, country A is better off being lax. If country B is a soft enforcer, then country A’s best strategy is also to be mild. In both cases, mildly enforcing competition law is the “best”, or dominant, solution. If country B reasons in the same way, the game will attain a non-cooperative solution in which both countries are mild enforcers, resulting in a mutually disadvantageous pay-off of (3,3). To resolve this deadlock, the two countries must reach a binding agreement on strictly enforcing competition policy. The final solution will then improve world welfare to (2,2).

Most of the practices discussed earlier fit into the characteristics of the game described, in which the non-enforcing or mildly enforcing country receives a welfare transfer advantage. All types of anti-competitive behaviour that affect other countries, such as geographical price discrimination or allotment of foreign markets, will lead to a transfer of rents from the affected

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17 In game theory terms, the game is a zero-sum or more probably a negative-sum game. In a zero-sum game, welfare is transferred from the country with strict enforcement to the country with lax enforcement. In a negative-sum game, total global welfare diminishes.
country to the country in which the practice originated. In a fair and competitive situation, these rents would be drastically reduced.

Another advantage of a multilateral agreement on competition policy is that it can include anti-dumping measures. The argument in favour of anti-dumping rules is that it prevents international predatory pricing. This occurs when a foreign producer with sufficient market power in its home markets uses domestic profits to cross-subsidizes low export prices with the intention of pricing foreign competitors out of the market. Once competitors are eliminated, prices can be raised again.\(^{18}\)

The theoretical assumptions underlying anti-dumping practices, however, are not sound. In reality, in an open economy, competition from abroad will prevent the formation of a monopoly and higher prices. Furthermore, the re-exporting of the dumped goods to the country of production will undermine high domestic profits.

Empirical evidence confirms the theoretical objections. Surveys of anti-dumping cases show that only a small percentage of all cases involved predatory dumping. Governments often use anti-dumping legislation to protect national industry. As tariffs and non-tariff barriers have been lowered in regional groupings and in WTO, the means to protect an industry have become scarcer, and anti-dumping measures remain one of the last instruments. Therefore, the pressure for anti-dumping measures by protectionist lobbies has grown. Since 1980, some 2000 cases of anti-dumping have been initiated by OECD countries (Hoekman, 1994, p).

The unilateral use or the threat of use of anti-dumping legislation should be considered a trade barrier with adverse effects on trade and competition. It causes exporting firms to alter de facto their production or production location, which may reduce global welfare.

Pressure groups can easily abuse anti-dumping rules. Margins are often miscalculated through unfair price comparisons, arbitrary selection of exchange rates and the use of a minimum profit margin. It is difficult and sometimes even impossible to draw a line between fair and unfair marginal cost pricing (Wood, 1996, p. 27). The Uruguay Rounds have led to some improvements, but it is still easy to use antidumping as a protectionist tool. A dumping investigation can be started with little evidence. For the accused company, the procedure can be costly and time consuming, so some enterprises abstain from defending themselves. If no information is available on the exporting firm, government officials are usually free to use the best available information (OECD, 1996c).

Other criticisms have been leveled at the current anti-dumping rules. First, those rules may introduce a bias against innovations. Under WTO rules, a good is considered to be dumped if it is sold for a price inferior to its cost (i.e., the average full costs). As a result, marketing new products can be perceived as dumping and therefore discouraged. During the early stages of a new product’s life cycle, producers tend to experience learning curves, with the average full costs well above marginal costs. The average costs come down after the first production series. To gain market acceptance in the first period, the product may have to be priced below current full costs. This

\(^{18}\) The theoretical basis for anti-dumping was developed by Jacob Viner (1923). He distinguished three forms of dumping: sporadic, short-run and long-run dumping. In the first case injury to the firm is transitory; in the last case, the gains to consumers outweigh the domestic producers’ losses. Only in the second case is an anti-dumping reaction justified. This reaction may then be needed to protect domestic consumers from predatory (i.e., anti-competitive) dumping.
practice may be seen as dumping. If marketing new products is discouraged through the dumping clause, some profitable uses for the innovation will be hindered, resulting in a reduced incentive to innovate.

Table 4

<table>
<thead>
<tr>
<th>Country (period studied)</th>
<th>Total cases filed</th>
<th>Anti-dumping measures not imposed</th>
<th>Anti-dumping measures imposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States (1979-1989)</td>
<td>451</td>
<td>169</td>
<td>282</td>
</tr>
<tr>
<td>Canada (1980-1991)</td>
<td>155</td>
<td>63</td>
<td>92</td>
</tr>
<tr>
<td>Australia (1988-1991)</td>
<td>40</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>European Union (1980-1989)</td>
<td>385</td>
<td>115</td>
<td>270</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1031</strong></td>
<td><strong>367</strong></td>
<td><strong>664</strong></td>
</tr>
</tbody>
</table>


Second, it is often easier to prove dumping practices during recessions, since average costs can temporarily be higher than prices. Costs per product unit are likely to rise, because of lower output. Lower demand will cause a downward pressure on prices at the same time. Third, some economists argue that anti-dumping encourages importers and domestic producers to make cooperative price agreements (World Bank, 1994; Messerlin, 1990). Fourth, a strong anti-dumping mechanism under the current WTO definition is likely to damage low-cost producers more than high-cost producers and discriminate against developing countries. Finally, the use of anti-dumping measures carries the risk of a trade war. If one country starts an anti-dumping procedure without a real basis, another country may retaliate through another anti-dumping procedure, damaging trade and their mutual political relations.

Given its harmfulness to trade, the use of anti-dumping measures should be replaced by a more effective instrument to prevent cross-border predatory pricing. An agreement that deals with other types of cross-border anti-competitive behaviour, such as a multilateral agreement on competition policy, is a good candidate.

Furthermore, because territorial jurisdiction and relevant market are no longer identical, a multilateral agreement on competition policy is necessary to prevent associated juridical problems. Relevant market is a central concept in the theory on competition policy. The relevant geographical market is the arena in which companies compete on more or less equal costs and terms. The economic literature uses the company’s share of the relevant market to determine dominant market position and to grant or deny permission for mergers and takeovers. In reality, it is hard to establish the precise boundaries of a relevant market, and competition policy enforcers often only look at the national market. However, the global relevant market differs from the national relevant market. An international agreement could solve this situation.

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19 See: Competition Policy Convergence: The Case of Export Cartels, op. cit.
20 As a rule of thumb, a relevant geographical market can be described as all the areas that would necessarily be included in a hypothetical cartel to effectively raise prices above the competitive level (Owen, 1993, sheet 34)
Globalization and integration make this problem increasingly important. For many companies, the relevant market used to coincide with the national boundaries of a country. In the last decades, however, the relevant markets shifted to regional or global markets, most notably in sectors like oil, computer software and aircraft. The reduction of transportation and telecommunication costs and of trade barriers in regional and global forums have enabled firms to offer their products on foreign markets for about the same cost as local producers (WTO, 1996, pp. 28-42).

Potential sources of conflicts abound:

1. **Difficulty of enforcing laws against foreign-based companies.** Anti-competitive practices by foreign companies can affect another country either through exports or through the establishment of a subsidiary. Enforcing legislation against these practices can be difficult. The relevant evidence may be located in a third country. Furthermore, it is difficult to force compliance from a company that has few assets in the country. Institutions in the home country of the firm generally does not enforce domestic legislation against business practices that have effects outside the country. Developing countries in particular face concrete problems. They lack resource capabilities and experience in the field of competition policy, and special expertise may be necessary to judge the sophisticated practices of multinationals. In addition, overseas-based firms often have very few assets (such as buildings, factories or land) in developing countries.

2. **Cross-border mergers and takeovers.** The last decade has seen an enormous growth of cross-border mergers, takeovers, strategic alliances and joint ventures. As a result, firms now perform under different national regimes of competition policy at the same time. Examinations by different domestic authorities may result in conflicting or incompatible conclusions. For instance, one agency may impose a divestiture of certain parts, whereas another may forbid it. Recent examples include the De Havilland case of 1991, in which Alenia of Italy and Aérospatiale of France tried to acquire De Havilland, a Canadian based aircraft manufacturer. The merger was allowed in Canada but prohibited by the European Commission. In 1992 Gillette wanted to merge with Wilkinson Sword. This merger had to be approved in 14 different jurisdictions, leading to high costs for the two companies. Another example is the Boeing/McDonnell Douglas merger, which was allowed unconditionally in the United States, but only under specific conditions in the European Union (see Pitofsky, 1997; Aribaud, 1997; OECD, 1994).

3. **Extraterritoriality.** If a company’s action or behaviour takes place in an integrated market consisting of more than one national market, and if that practice is allowed in one national market but prohibited in another, the most rigid legislation will determine the policy in the integrated market, possibly against the will of the lenient country. Investigations of anti-competitive practices in one country may, in certain cases, affect important interests in other countries. Many countries, including the United States, Brazil and Chile, apply the effect doctrine, which gives subject-matter jurisdiction over foreign conduct that has substantial effect in the home market. This can lead to jurisdictional conflicts and to an unclear situation for the actors. An example is the United States Supreme Court ruling in the case of Hartford Fire Insurance Co. versus California, in which the British insurance company Lloyds was convicted of violating antitrust law. This precedent could encourage more active prosecution of actions outside the territory of the United States.

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21 The United States and the European Union only have laws that prohibit anti-competitive behaviour with domestic effects, and not behaviour with foreign effects.

22 Some British and American insurance companies agreed to limits on reinsurance terms. This is a long-established, legal practice in Britain, but it is prohibited in the United States under the Sherman Act (Mitsuo Matsushita, 1995, p. 265).
4. **Anti-competitive behaviour of state-owned companies.** Conflicts can occur if a state-owned company behaves anti-competitively in the integrated market, or if cartelization occurs under active pressure from the government. Currently, the United States and the European Union apply the act of state doctrine. This means that a court can neither prohibit nor penalize an anti-competitive practice that results from a foreign government’s policy. The oil producer’s cartel, OPEC, is allowed on these grounds. It is uncertain, however, if this policy will be left unchanged in the future and what other countries will do.

A. **The Negotiating History of Multilateral Rules on Competition Policy**

In the last five decades, several attempts to establish multilateral rules on competition policy were undertaken in different international forums, such as UNCTAD, OECD and GATT. However, all attempts to establish strong multilateral rules on competition have failed for various reasons.

In 1948, the Havana Charter on the International Trade Organization (ITO) included a section on competition. ITO sought to prevent public or private companies from engaging in practices that could affect international trade, limit market access or foster monopolistic behaviour (Interim Commission for the International Trade Organization, 1948). Those restrictive business practices included price fixing, market division, production quota setting, discrimination against particular enterprises, collusive suppression of technology and the misuse of patent grants. ITO was to have investigative capacity and be entitled to issue recommendations on remedial measures, and it would cooperate with member states. The Charter was never ratified, however and ITO never came to existence. One of the reasons was that the United States Senate feared ITO would infringe too deeply on its sovereignty (Scherer, 1994, p.38). A number of ITO provisions on trade and investments later became part of GATT.

In 1953, during a meeting of the United Nations Economic and Social Council (ECOSOC), another international convention on competition was proposed. This agreement contained mechanisms to challenge anti-competitive practices that affect international trade (Scherer, 1994, p.39). An agency’s secretariat would receive and investigate complaints and provide recommendations to the accused companies’ home government. That nation could then undertake corrective action in accordance with its own legal system. The business community in the United States was strongly opposed to this plan: it feared that implementation would be disproportionately heavy for companies based in the United States, because of that country’s strong antitrust policies.

From 1967 onward, OECD began to consider competition policy, taking a cooperative approach. It has published various recommendations on cooperation among member states on restrictive business practices, including notification and consultation procedures.

New discussions on competition policy took place in UNCTAD starting in 1968. The aims of these talks were less ambitious than those of the Havana Conference and the ECOSOC Conference. It was decided to study restrictive business practices and the effects on trade of anti-competitive practices originating in developed countries. Special attention was paid to the consequences for developing nations.

In 1972, the UNCTAD III conference established an expert group on this topic. In the follow-up conference (UNCTAD IV) in 1976, the group was instructed to formulate a set of multilateral rules and principles to control restrictive business practices, including the actions of transnational companies, and to outline a special consultation procedure. The resolution gave special treatment to developing countries, arguing that these countries needed to develop national industries and stimulate certain economic sectors (UNCTAD/SELA, 1966, p. 5). This resolution
was adopted by the General Assembly of the United Nations in 1980 (Resolution 35/61, 5 December 1980; see UNCTAD/SELA 1996). Unlike the Havana Charter this resolution had no binding character. It was more in the form of a recommendation and was directed to states, regional groups of states and businesses. At the same time, a new intergovernmental expert group was created within UNCTAD. It drew up a set of multilaterally agreed equitable principles and rules for the control of restrictive business practices. The objective was to prevent those practices from annihilating the benefits of trade liberalization and interfering with the development of lesser developed countries.

In the UNCTAD IX conference in 1996, a resolution was adopted which confirmed UNCTAD’s extensive mandate in the area of research and cooperation on restrictive business practices (UNCTAD/SELA, 1996, p.3).

GATT has also addressed the issue of competition policy. A first attempt was made in 1955. The result was the adoption of a rule that permitted ad-hoc notification and consultation procedures on conflicts of interest between countries stemming from anti-competitive practices. These procedures have never been applied in practice, however.

In the 1960s and 1970s, GATT again held discussions on competition policy, but this did not lead to a clear result. GATT’s successor, WTO, has achieved little in the field of competition policy. Apart from the anti-dumping agreement, minimal provisions have been established in the areas of services, intellectual property rights and investments (see box 3). A consultation procedure, has also been created. The Singapore ministerial meeting of December 1996 convened a working group on the interaction between trade and competition policy. The subjects assigned to the working group include the analysis of existing instruments, the impact of state monopolies and the relation between trade-related aspects of intellectual property rights and competition policy (WTO, 1997b, p. 3).

All attempts to establish binding multilateral rules have failed, primarily because of opposition from the United States. The initial idea of a supranational enforcer was rejected, out of fear for United States’ sovereignty. A subsequent proposal to establish an international agency that would receive complaints but leave enforcement in the hands of national agencies was similarly rejected, because businesses in the United States were afraid that enforcement in other countries would be less stringent than in the United States, leading to a comparative disadvantage.

Other initiatives were less ambitious, often being reduced to recommendations for states. Their adoption was seen as a necessary first step for many developing nations that did not have existing competition law or experience in the field. Some initiatives also encompassed cooperation or notification procedures between enforcing agencies. Instead of multilateral agreements, various developed countries made bilateral agreements among themselves. Following the example of the

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23 Various bilateral agreements on competition policy have been negotiated. The focus of these agreements is on communication, coordination and the enforcement of actions potentially affecting the subjects of both parties. Examples include the agreement between the United States and West Germany in 1976; the agreement between the United States and Australia in 1992; the memorandum of understanding between the United States and Canada signed in 1984, followed by an agreement in 1995; the agreement between France and Germany in 1987; the agreement between Australia and New Zealand in 1990; a cooperation agreement between the European Community and the United States in 1991, which calls for mutual notification, when enforcement of competition policy may affect the interests of the other party and also incorporates non-binding provisions for information exchange and assistance by enforcement actions; and common policy between the European Union and EFTA countries (except Switzerland), within the framework of the European Area Agreement, although in this area anti-dumping and countervailing duties will not be applied. In practice most cooperation actions involve routine notifications or requests for publicly available information. However, there is a trend toward more coordination, as in the case of price fixing of thermal fax paper by the United States and Canada or the close coordination by the United States and the European Union in their proceedings against the software licensing practices of Microsoft Corporation. (OECD, 1996a).
European Union, other regional trade groups have implemented or are trying to implement rules on competition policy.\textsuperscript{24}

\textbf{Box 3}

\textbf{COMPETITION POLICY IN WTO AGREEMENTS}

(1) \textbf{Anti-dumping measures}

The anti-dumping agreement allows the governments of importing countries to levy compensatory duties in some cases. The agreement provides detailed specifications on when and how governments can start an investigation, what type of evidence can be used, the transparency of the procedure, and the duration of anti-dumping actions. The necessary conditions for the use of these measures are that dumping has been proved and that national industry has suffered substantial harm or faces the threat of harm. Anti-dumping duties may be imposed if the product can be considered dumped or if the export is subsidized. In the case of the former, either the foreign producer’s export price or the full cost of production must be lower than the home market price. The export and home market prices should be compared at the same level of trade, at the ex-factory level, while taking into consideration differences in conditions and terms of sale, taxation, levels of trade, quantities, physical characteristics and costs, including duties and taxes, incurred between importation and resale. Although anti-dumping is meant to counter predatory behavior, the agreement does not require an investigation of either the market access conditions in the exporter's home market, or the threat to competitive conditions on the importer's market. Anti-dumping measures can thus be abused, and have negative effects on competition in the importing country.

(2) \textbf{Services}

The General Agreement on Trade in Services (GATS) includes a number of provisions that are directly related to competition issues. Article VIII states that monopoly suppliers should not abuse their monopoly power when they supply a service outside the scope of their monopoly rights. The annex on telecommunications contains provisions on the access to and use of public telecommunications, transport networks and services. GATS also introduces two procedures: a notification procedure (art. VIII.4), which requires information whenever members grant monopoly rights for services covered by their commitment, and a consultation procedure (art. IX), which should be applied if a restrictive business practice by service suppliers restrains trade and thereby trade in services. The members addressed shall cooperate by supplying relevant, publicly available, non-confidential information, as well as other information (subject to domestic law and to the conclusion of a satisfactory agreement concerning the safeguarding of confidentiality).

(3) \textbf{Intellectual property rights}

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) includes vague provisions on competition. The treaty recognizes that some licensing practices or conditions may have adverse effects on trade and impede the transfer of technology. Appropriate measures may be needed to prevent these abuses by their holders. WTO members are completely free to define their own legislation (art. 8 and art. 40 of TRIPs). The TRIPs agreement also incorporate a consultation procedure, similar to that outlined for the service sector in article IX of GATS.

(4) \textbf{Investment measures}

The Agreement on Trade-Related Investment Measures (TRIMs) currently does not cover competition policy. It does contain a provision that, within 5 years after entry into force of the treaty, the Council for trade in goods shall consider whether the TRIMs agreement needs to be revised to incorporate provisions on competition policy (art. 9 of TRIMs)

(5) \textbf{Consultation procedure}

The WTO has established a consultation procedure for members. If a member country asks another country for a consultation, the other party must give consideration to the request and cooperate in trying to reach a mutually satisfactory solution. This procedure has been used between the United States and Japan in a recent case involving Fuji and Kodak (UNCTAD, 1996c, p.35).

\textsuperscript{24} MERCOSUR, the Andean Community and the Group of Three include provisions on competition policy. However, enforcement of these laws has been very scarce. In the negotiations of some other regional trade agreements, such as the Free Trade Area of the Americas (FTAA), the Asia-Pacific Economic Cooperation Forum (APEC) and the North American Free Trade Agreement (NAFTA), special working groups have been created to study the subject.
UNCTAD has been involved in many domestic and international competition policy projects. It has given technical assistance to various countries and regional institutions on competition laws and enforcement, and it has carried out a series of studies on restrictive business practices, the relation between trade and competition and the relation between competition policies and developing countries. The Secretariat also updates a data base on competition laws.

**B. The pioneering work at the United Nations Conference on Trade and Development (UNCTAD)**

UNCTAD compiled a model law to serve as an example for countries that are developing new competition policies. The law is basically intended for developing countries that currently do not have legislation on competition or whose legislation is limited. One of the aims of the model is to provide a basis for developing countries to establish their own competition laws.

**Box 4**

**ELEMENTS OF THE UNCTAD MODEL LAW ON COMPETITION**

1. **Scope.**
   - The law applies to persons and firms (both private and state-owned), but not to acts of the State itself.

2. **Restrictive agreements or arrangements.**
   - Prohibited measures include price-fixing, collusive tendering, market or customer allocation, restraints on production or sale, concerted refusals to deal, collective denial of access to an arrangement and association which is crucial to competition. These practices may be authorized if they produce a net public benefit.

3. **Abuse and acquisition of a dominant position of market power.**
   - Prohibited measures include limiting access to a relevant market; limiting market access of dominant firms; predatory behavior; price or conditions discrimination; fixing resale prices; vertical restraints without a legitimate business purpose; and restrictions on the importation of goods legitimately marked abroad with an identical trademark belonging to the same owner, where the purpose is to maintain artificially high prices.

4. **Administrative authority.**
   - The authority should have the following functions: making inquiries and investigations, including in response to complaints; making recommendations and sanctions; providing information to the public; maintaining a register for notifications; assisting in review of legislation; and exchanging information with other states.

5. **Notification by enterprises.**
   - When it is unclear whether certain practices are prohibited, companies should notify the authority.

6. **Sanctions.**
   - Sanctions are given when the law is violated, when the decisions of the authority are not obeyed or when a company fails to supply the required information.

7. **Appeals.**
   - It should be possible to appeal the decisions of the administrative authority.

8. **Action for damages.**
   - Anyone who is harmed by an act that is in contravention of the law is entitled to recover the amount of the loss or damage through legal action before the national court.


Internationally, UNCTAD has served as a forum for discussions on competition policy. UNCTAD was involved in negotiating a set of multilateral rules to control restrictive business practices which was adopted in 1980 by the General Assembly of the United Nations as a non-binding resolution (Resolution 35/61, 5 December 1980). This set of rules is a recommendation directed to states, regional groups and transnational corporations, with the purpose of encouraging governments to adopt laws on competition policy and to cooperate internationally. Businesses should not conduct anti-competitive practices, but rather should fully cooperate with enforcement agencies. The set of rules also contains a consultation procedure. Special treatment is given to developing countries, as these countries need to develop national industries and stimulate certain sectors (UNCTAD/SELA, 1996, p.5). Box 5 shows the details of the set.

Box 5

MULTILATERAL RULES AND PRINCIPLES TO CONTROL RESTRICTIVE BUSINESS PRACTICES

**Application**
The norms apply to all restrictive business practices, including those of transnational enterprises.
The norms apply to trade in goods and services.
The norms apply to all countries, groups of countries and companies.

**General principles**
Measures should be adopted to eliminate or reduce restrictive business practices on the national, regional and international levels.
Governments should collaborate on bilateral and multilateral levels to control restrictive business practices.
Mechanisms should be established to exchange information between governments.
Mechanisms should be established for multilateral consultation on policy questions concerning restrictive business practices.
This set of principles cannot justify a restrictive business practice that is illegal according to national law.
The needs of developing countries should be taken into account, especially their need to develop national industries and other sectors of the economy and to stimulate development through regional agreements.

**Norms for businesses and transnational enterprises**
Companies should respect the laws on restrictive business practices in the countries in which they operate.
Companies should fully cooperate in supplying all relevant information to the competition enforcement agency.
Companies should not engage in practices that limit market access or reduce competition or trade, especially that of developing countries. Such practices include price fixing, cartels, market assignment agreements, output quotas and withholding necessary inputs from competitors.
Companies should not commit the following practices when they have a dominant market position: predatory behaviour; fixing prices and conditions; fixing the price at which exported goods can be resold in importing countries; imposing restrictions on imports; and, without commercial reasons, imposing restrictions on distribution, prohibiting the sale of competitors goods, restricting resale or exportation and tying.

**National and regional norms for states**
States should adopt, improve and enforce competition laws
Laws should be enforced equally for all companies, without discrimination.
States should take measures to prevent restrictive business practices that hinder international trade or the development of developing countries.
If a state receives sensitive information from a company, it should treat this information confidentially.
States should institute procedures for obtaining necessary information to control restrictive business practices.
States should establish regional mechanisms to promote the exchange of information on restrictive business practices and the application of their laws and national policies.
States with experience in competition laws should share this with other states that want to establish or improve their systems. States should provide publicly available information if other countries request this
States should provide publicly available information if other countries request this.

**International measures**
International cooperation should be directed toward the elimination of restrictive business practices. Means to achieve this should include harmonization of national policies; annual communication to UNCTAD on the adopted measures; consultations, in which a state can request a consultation with another state, UNCTAD can assist in a consultation procedure and states should give their full attention to requests for consultation.

**International institutional mechanisms**
An intergovernmental expert group will be formed, and will work within the framework of UNCTAD.
This group will serve as a forum for discussions and the interchange of ideas and information, and will undertake studies on restrictive business practices. The group will not be a tribunal on acts of government or businesses.
**C. The work at the Organization for Economic Cooperation and Development (OECD)**

In the last decades, the OECD has paid substantial attention to domestic competition policy and international rules on competition. It has monitored country members’ practices and made various recommendations on international competition policies. Many of the OECD’s recent recommendations on competition policies are based on the notion of contestability.

The theoretical foundation of international contestability is found in contestable markets theory. According to Baumol’s definition, contestable markets are markets where firms can enter easily and exit without incurring high costs (Baumol, 1982). In these markets, the threat of new entrants will discipline private agents to be efficient, to innovate and not to demand excessive prices. A higher than normal profit would immediately attract a new entrant to the market, which would make the extra rents disappear. For this reason, dominant positions in contestable markets do not lead to anti-competitive behaviour. The fear of a new entry might even induce a monopolist to behave as though he was a smaller firm in a competitive market.

Entry and exit barriers can make markets incontestable, however, leading to oligopolistic or monopolistic behaviour. Such barriers can be erected by companies and by government policies. Scholars in this area therefore hold that governments should abstain from policies that lead to market barriers, they should try to keep the markets contestable, and they should prevent companies from erecting barriers.

A market is said to be internationally contestable if there is unrestricted market access for foreign goods, services, capital, ideas, investment and business people (Schoenbaum, 1996, p.165). International contestability can be reached if competition between companies is not distorted by government rules or by private restrictive business practices.

OECD embraces the idea of contestability and internationally contestable markets. It suggests that in a globalized economic context, the best governmental rules are those that concentrate on a policy’s impact on the operation of global markets, independent of the nationality of a product or producer (OECD, 1996b, p.3). Government policies should primarily stimulate economic efficiency and growth.

To establish an efficient worldwide allocation of resources (both static and dynamic), all firms should face equivalent access to inputs and consumers and should receive equivalent treatment under domestic regulation. Any discrimination among companies on the bases of nationality can result in an efficient company being disadvantaged vis-à-vis a less efficient competitor. Eventually, consumers pay for this inefficiency through higher prices or inferior products (OECD, 1996b, p.4).

Discrimination on the basis of a firm’s nationality not only leads to inefficiencies, but it is also increasingly difficult to carry out, given that the exact nationality of a product or company is often unclear. In the last couple of decades production processes have become highly international.
Products contain components produced in different locations. Liberalized capital movements have spread companies’ shares among international investors. The interests of a company, therefore, are not necessarily parallel to the interests of an individual country. Moreover, countries’ interests have become more mutual. This all leads to a diminished effectiveness of national governmental instruments.

Subsequent rounds of trade liberalization have improved global market access. According to OECD, governments should work toward defining new agreements on issues related to worldwide contestability. The main areas identified by OECD for future discussion and negotiation are as follows: policies that discriminate among companies on the basis of the owners’ nationality or the location of the head offices or production facilities; laws and policies that impede market access or limit the free entry and exit of firms; and policies that are essential for the efficient functioning of a global market (OECD, 1996b, p.5).

New issues to be discussed in OECD should therefore include: environmental issues; measures affecting investment; corporate governance; bribery and corruption; regulatory measures; labor standards; and competition policies and merger procedures.

Multilateral rules should be developed to stimulate market access and transparency. Other rules should prevent governments and companies from obstructing the efficient functioning of markets and impeding the process of opening up domestic markets to international competition.

OECD is a very influential organization. Many topics that have been discussed at OECD were later taken to other international fora. Some of the current ideas on contestability could therefore have serious implications for the policies applied by developing countries. Many developing nations still have industrial and development policies that favour national companies and discriminate against foreign ones. Subsidies are sometimes provided only to national companies, licenses are granted to national industries and government purchases are procured from national suppliers. Furthermore, many government rules work as entry barriers or establish monopoly rights. In the view of OECD, such policies should be abolished.

In addition, OECD wants to involve developing countries in the current discussions, because market access barriers are more present in those countries than within OECD countries. The implications of this hindered market access for the growth and employment of OECD countries are becoming increasingly important.

The agency perceives the adoption of domestic competition policies in every country as an important step toward worldwide contestable markets and increased worldwide competition. In many countries, competition laws are out of date. Laws need to be renewed, the scope of their application needs to be broadened, and the number of exemptions needs to be reduced. Many competition laws currently make exemptions for sectors and state-owned companies, perpetuating anti-competitive structures and blocking market access. For example, exemptions are often made for agriculture, energy, transport, postal services, defense and communication. Countries should strive to converge the principles of their competition laws and should come to a mutual recognition of standards in regulated sectors (OECD, 1996c, p.5).

OECD acknowledges that some forms of agreement need to be studied more extensively before agreements can be reached. For example, some forms of cooperation between firms can be efficient, because they lower transaction costs. The total effect of vertical restraints (e.g., exclusive dealing) is often unclear. Vertical restraints can act as a market barrier, but at the same time enhance competition (OECD, 1996c, pp.8-9). Enforcement measures also need to be studied more thoroughly. The debate on competition policy largely focuses on enforcement. For instance, enforcement was a central issue in the structural impediment initiative signed by the United States
and Japan in 1989. Good indicators for measuring enforcement still need to be developed, however (OECD, 1996c, p.10).

According to OECD, enlarged cooperation on international competition policies can serve as a base for the development of multilateral rules and treaties on competition policies (OECD, 1996c, p.5). In the current global economy, the anti-competitive actions of firms in one member country can seriously affect the interests of another member country. National investigations and unilateral application of national legislation can also cause conflicts between countries. Therefore, OECD adopted a recommendation on cooperation on competition policy among member countries. The recommendation includes a non-binding, but functioning notification instrument between agencies, which has been revised a number of times (European Commission, 1996, p.7). OECD recommends that the governments of member countries adopt the following procedures (OECD, 1995):

- **Notification.** When a member country’s investigation or proceedings may affect the interests of another member country, it should notify that country in advance.

- **Coordination.** Member countries should try to cooperate if they proceed against an anti-competitive practice in international trade.

- **Cooperation.** Member countries should cooperate in developing mutually satisfactory measures for dealing with anti-competitive practices. If a member country considers that a company based in its territory is engaging in anti-competitive practices in another country, it should take remedial action.

- **Consultation.** When a member country considers that another country’s investigation affects its interests, it should communicate its concerns to the other member country or request consultation.

- **Information exchange.** Member country should supply each other with necessary information on demand.

- **Conciliation.** If two countries cannot reach a satisfactory conclusion, the countries can use the OECD offices as a mediator.

OECD has established a committee on competition law and policy. This committee promotes international cooperation on competition enforcement. One of the committee’s working parties is involved in cooperation on merger control, prosecution of cartel activity and the sharing of information (OECD, 1996a, p.4). The committee also surveys the cooperation efforts of member countries.
Muliterateral rules on competition policy: an overview of the debate
IV. The Debate at the World Trade Organization (WTO)

Part of the current debate at WTO takes place in a special working group on the interaction between trade and competition policy. The group studies various issues, such as the impact of state monopolies and the relation between TRIPs and competition policy. It also analyses the scope and effectiveness of existing instruments, such as the consultation procedure and provisions on services, intellectual property rights and investments (WTO, 1997a, p.3).

Countries’ positions in the discussions differ. The European Union favours international rules, whereas the United States is more reserved toward new rules. Developing countries are divided. Some are reluctant to extend the WTO treaty to cover rules on competition policy, which is a new area for them; others are in favour of their inclusion.

A. Negotiating Objectives of the United States

1. Attitude of the United States toward International Rules

The United States recognizes that some business practices may restrict market access and trade and that competition policy should therefore be one of the new topics in trade negotiations. However, government officials and trade analysts are not much in favour of international competition rules (Wood, 1996, p.7).
A point of concern in the United States is that new WTO negotiations would require a compromise. Adhering to international competition policy rules would probably have to be exchanged for less agricultural reform, better rules of origin or a more strict dispute settlement procedure (Wood, 1996, p.32).

Furthermore, the United States does not favour harmonization of competition policy norms because inferior rules would probably become the standard. Some observers fear that the United States would have to take a step backwards and would have to permit worldwide rationalization or infant-industry cartels. Therefore, the United States prefers to seek bilateral agreements on more favourable terms (Klein, 1998).

The United States is also reluctant to replace anti-dumping rules with international competition rules. Some high government trade officials are convinced of the merits of anti-dumping. Influential pressure groups of anti-dumping lawyers are also lobbying for maintaining anti-dumping as a trade tool.25

2. Negotiating position of the United States

Although the official position of the United States is still not clear, the Advisory Committee to the President prepared a recommendation on negotiations involving international competition policy.26 This recommendation can be seen as indicative of future negotiating positions.

The report states that the link between trade and competition policy is relatively new and complex. The subject should therefore be studied in more detail and the private sector should be consulted. The outcomes of the negotiations should reflect the best interests of the United States and the world trading system. Issues that need to be examined more thoroughly include the following:

- To what extent can existing trade agreements deal with market access problems?
- What effects would international law have on competition in the United States?
- What is an appropriate relationship between international rules and the ability of national governments to investigate cases of restrictive business practices and enforce domestic policy?
- To what extent should mergers and acquisitions be addressed?
- Are foreign laws on competition policy adequately enforced?
- How do government policies reinforce or facilitate private anti-competitive actions?

The Advisory Committee considers that it is too early to engage in any competition policy initiative. A first step could be to study domestic laws. This could be conducted by a selected group of interested WTO members or through an international forum such as OECD. The study should focus on anti-competitive activity that is authorized by governments, including cartels and price fixing. Consideration of these issues and possible multilateral steps to address them would be a good first step for any eventual WTO work program.

Maintaining anti-dumping rules is a crucial aspect of the Advisory Committee’s report. Some countries may consider that anti-dumping is not needed in a globalized world economy. The Committee explicitly advises, however, that the Government should be careful not to link

25 Personal interview with J.F. Francois.
26 Based on the Advisory Committee’s report on competition policy.
competition policy with anti-dumping. As long as exporters engage in dumping, the Committee sees the need for national anti-dumping laws.

Another common view in the United States is that other countries should break the government monopoly on enforcement and allow private parties to present their cases to a judge. In the United States, private enforcement of competition policy is very important. Private parties have initiated about 90% of all competition policy cases (Wood, 1996, p.7).

The United States will be pushing to introduce more competition in foreign network industries such as telecommunications. In February 1997, a new agreement was completed, which will ensure that United States companies can compete against and invest in all existing carriers. United States Trade representatives will strive for implementation and effective enforcement.

Finally, the Committee advises against multilateral cooperation agreements. Existing bilateral cooperation agreements have been carefully negotiated. They take into account the mutual level of confidence and the nature of the competition policy system. Pluralizing the agreements might lead to poorer standards. A more beneficial approach is to aggressively pursue additional bilateral agreements, since attempting to multilateralize this type of agreement could slow down the process of establishing more and better bilateral agreements (Wood, 1996, p.34).

B. Negotiating Objectives of the European Union

The European Union is promoting the establishment of multilateral rules on competition policy in WTO. The European Commission is especially concerned with international market access. Many trade partners do not have vigorous competition law or enforcement agencies. Anti-competitive practices in these countries can impede European firms from operating in these markets. A competitive disadvantage for European firms can result if they must compete with firms that have more lenient competition policies in their home markets.

The European Union recognizes that it will be difficult to gather sufficient support to establish a supranational competition policy agency with powers of investigation and enforcement. Consequently, the European Union wants to narrow the scope of negotiations to the creation of intergovernmental procedures, similar to GATT. It favours a progressive approach. In the first stage, all members should adopt domestic competition policies. In the second stage, common rules and principles can be identified and adopted on an international level. The third stage would establish a framework for cooperation between the competition policy agencies and introduce a dispute settlement procedure (see box 6).

C. Position of the developing countries

Developing nations differ with regard to their positions on multilateral rules on competition policy. Some countries are cautious and fear a binding agreement on competition policy. Some countries are cautious and fear a binding agreement on competition policy. At the

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27 The United States enacted an international antitrust enforcement act to facilitate the exchange of confidential information with foreign antitrust authorities under certain circumstances. It only applies to countries with which the United States has a bilateral agreement on mutual assistance. United States authorities are interested in closing mutual assistance agreements under the act, but no agreements have yet been reached (OECD, 1996a, p.4).

28 This section is based on the European Commission (1996), in which the Commission outlines its vision on international competition policy.


Singapore Conference of 1996, many developing countries opposed even the creation of a competition policy working group.31

Other countries have a more favourable attitude toward incorporating competition policy in the discussions. They are especially concerned with the restrictive business practices of multinationals and the extraterritoriality of developed countries’ laws.

Source: European Commission, 1996 Towards an international framework on competition rules (Op cit)

Box 6

THE EUROPEAN COMMISSION’S PHASED APPROACH TO INTERNATIONAL COMPETITION POLICY

Stage I. Adoption of domestic competition policy structures. (i) Adopt competition policies. In this stage, all countries should adopt domestic competition policies with provisions on anti-competitive business practices, the abuse of dominant market positions and the control of mergers and acquisitions. Enforcement agencies should be established, with the power to investigate cases and impose sanctions. Private parties (both domestic and foreign) should have access to the enforcement agencies or be able to present cases on anti-competitive business practices in national courts. (ii) Reduce sectoral exemptions. The European Union strives to reduce the number of sectoral exemptions from competition policy. Currently, most countries grant exemptions to various sectors. These exemptions sometimes cover extensive parts of the economy, reducing the applicability of competition laws. To resolve this conflict, governments should first list their exemptions and try to form a commitment to a standstill. The exemptions can then gradually be reduced. (iii) Apply rules on state-owned companies. Competition rules should cover state-owned as well as private companies. Exceptions should only be made if the public task overrides the interests of competition law. (iv) Provide assistance to developing countries. The European Union acknowledges that developing countries might have problems establishing a competition structure. An agreement on the adoption of competition policies should therefore incorporate means to assist these countries with substantial resources and training.

Stage II. Adoption of common rules: (i) Identify common principles. When most member countries have implemented competition policies and have well-functioning enforcement agencies, they can start identifying common principles. These rules can be developed gradually, beginning with horizontal agreements such as price and output fixing, market-sharing cartels, collective exclusive dealing, bid rigging and export cartels. A broad consensus exists on the negative effects of this type of agreement, so it should be possible to formulate international provisions to combat them. (ii) Treat other types of anti-competitive behaviour. In a later phase, other types of anti-competitive behaviour can be treated (e.g. vertical constraints, abuse of a dominant position). Reaching agreement in these areas will take more time because different views prevail on how detrimental they are. The European Community is relatively more strict on vertical agreements than the United States. One way to proceed is to concentrate on vertical restrictions that create entry barriers to markets, most notably, hindering of access to essential facilities, tying agreements and fidelity rebates. Other practices, such as excessive pricing, predatory pricing and other vertical agreements, should be studied further. (iii) Harmonize merger and acquisition rules. In the field of mergers and takeovers, the first step is to harmonize rules and procedures. This would eliminate duplication of costs not only for firms that want to merge, but also for competition policy agencies. Further cooperation would also reduce contradictory decisions. (iv) Adopt common rules. According to the European Commission, the adoption of common rules would facilitate closer cooperation among enforcement agencies and the coordination of international enforcement activity. It would help achieve a gradual convergence of competition law and promote equal conditions for competition worldwide.

B. Stage III. Cooperation among competition authorities: (i) Establish a cooperation framework. Once an agreement has been reached on common rules, a framework for cooperation should be established. This framework must be transparent and clearly specify procedures. It should address the issues of notification, information exchange and cooperation (e.g. joint action and parallel investigations). It might also elaborate on negative and positive comity instruments. An example of a negative comity instrument is the requirement that a party take into account the important interests of another party before taking action. A positive comity instrument might allow a party to request that another party investigate activities which adversely affect the important interests of the first party. (ii) Develop channels for information exchange. The exchange of information should be developed gradually. In an initial phase, types of information that are considered confidential should be catalogued. Non-confidential information could then be exchanged within a group of core participating countries. If this proves to function well, more detailed information could be exchanged. (iii) Extend WTO’s role to include competition policy. WTO’s role as a forum for dealing with conflicts could be extended to include the area of competition policy. If a member state considers that another state is not complying with the WTO treaty (e.g., if a country does not install a competition policy or if it does not respond to a request from another government), it could bring its complaints to this forum for mediation.

Source: European Commission, 1996 Towards an international framework on competition rules ((Com (96)) 284 final, Brussel,S.

31 See Competition Policy Convergence: The Case of Export Cartels, op cit.
This final chapter discusses major issues in formulating a negotiating position for Latin American and Caribbean countries. These countries are currently under pressure from the United States and the European Union to introduce competition policies and to enforce them rigorously. This may not be in the best interest of the Latin American countries, however. It is sometimes argued that developing countries should tailor their competition polices to their particular development goals.

First, the paper addresses the question of whether it is advantageous for developing countries to introduce fierce competition laws and expose their national industry to a highly competitive environment. Do competition policies deter foreign investments? Why should small, open economies adopt competition policies, since their markets are open to foreign competition?

Second, should Latin American countries adjust their competition policies to the development process?

Finally, are international rules advantageous for Latin American countries? Is harmonization an option or is cooperation more appropriate in a first stage? Should negotiations be bilateral, as the United States wishes, or multilateral?
A. Should Latin American countries adopt Competition Laws?

1. The need for highly competitive markets in Latin American countries

Some analysts question whether Latin American countries will be better off with highly competitive markets. Opening domestic markets to foreign competition can lead to reorganizations, lay-offs and sometimes bankruptcies, especially when the domestic industry has been protected for years and domestic competition was limited or non-existent.

Several studies have shown, however, that in the long term, tough domestic competition will lead to stronger, more diversified domestic industries that perform better in international markets (see for instance Porter, 1990). For example, the United States airline industry is now a strong, innovative industry after two decades of deregulation and the introduction of competition (Wood, 1996, p.25).

2. The effect of competition policies on foreign investment

Some policy makers fear that competition laws can deter foreign investors who are averse to interference by government agencies. In addition, various companies have made it clear that before they engage in large investment projects, they want to extract semi-monopoly rents in the domestic market. They claim that these rents are necessary to make their operations profitable. However, the overall net welfare effect of such investments for the country is not likely to be positive.

Many economists consider that competition policy does not discourage foreign investors. If a country uses competition policies in a fair, non-discriminatory way, it will reassure investors that they will be treated in the same way that they are treated in their home markets. Investors will also be confident that their operations will not be hindered by restrictive business practices among local competitors or privileged public companies (UNCTAD, 1996b, p.4).

3. The need for competition policy in small, open economies

Competition from imports effectively reduces domestic market power, especially in industries with only a few competitors (World Bank, 1994, p.9). Some authors argue that liberal trade regimes can even act as substitutes for competition policy (Bhagwati and Hudec, 1996). They argue that potential and actual imports would make domestic producers act competitively. Other economists and international agencies have criticized this idea. In their view, the effects of trade liberalization on domestic competition are insufficient (World Bank, 1994, p.9). Because openness in trade does not lead to competitive market structures and efficiency, trade policy is better seen as a complementary policy.

As proponents of the latter view point out, an important proportion of economic activity is in non-tradeable (e.g., domestic services). In a free trade regime, a domestic producer of non-tradeable can be a monopolist or dominate an industry, with negative effects on efficiency, prices and technological progress. Moreover, restrictions in non-tradeable can result in severe trade barriers. Marketing, repair and maintenance, energy, communications, transport and retail are essential for successful export. Hence, in the presence of vertical restraints, foreign producers might not be able to distribute their products, and foreign competition will be limited. Incentives for domestic industry to behave in an efficient, innovative manner will be reduced.
B. Should Latin American competition laws be adapted to development needs?

This section explores how developing Latin American countries can combine their goals of industrial policy and economic restructuring with those of competition policy. In addition to promoting competition, they need to initiate new industrial activities and raise the technological intensity of national output. It might be necessary to modify their competition laws and grant exemptions to certain practices or sectors.

1. Sectional exemptions for social or industrial policy reasons

There are sound arguments why Latin American countries should grant exemptions for certain types of practices or to specific sectors. Some cartels might support the goals of industrial policy. Various countries already exclude crisis, rationalization and sunrise cartels in their competition policies.

- Crisis cartels. Some countries, including Japan, allow cartels to transform or restructure the industry in periods of severe crisis.
- Rationalization cartels. A cartel can sometimes lead to efficiency gains. In Germany and Japan, a cartel is allowed if the participants can prove its efficiency.
- Sunrise cartels. Some Asian countries, including Japan and the Republic of Korea, allow industries to form a cartel during the first phase of the product life cycle in order to stimulate new industries. This is known as the infant industry argument. In the Republic of Korea, the cartel is allowed for a period of three years.

Latin American countries might also consider granting exemptions to sectors in special circumstances. Competition does not always ensure an efficient outcome in the relevant product market (i.e., market failure). Socioeconomic or political considerations sometimes outweigh the interests of competition. Sectors to consider for these exemptions include primary sectors, strategic areas on pharmaceuticals, defense-related industries, the media and the publishing industry, financial sectors, transport industries, network industries, small-and medium-sized enterprises and public enterprises (UNCTAD, 1995c, pp.11-15) (see Box 7).
Box 7
SECTORS THAT SOMETIMES ARE EXEMPTED FROM
COMPETITION POLICY

**Primary sectors.** Many countries have special rules for primary sectors. The main reason cited is that the agricultural, forestry, fishery and mining sectors respond slowly to increased prices, and once output is expanded, it is extremely difficult to contract. Many countries treat the agricultural sector differently, to promote specific policy objectives, such as attaining self-sufficiency in food production, protecting the environment or preventing the depopulation of rural areas. In the European Union, all agreements that are deemed necessary for the achievement of the Common Agricultural Policy are allowed. The United States tolerates cooperation among agricultural producers, including price fixing. Japan admits cartels for agricultural and fishery products.

**Government monopolies in strategic areas.** A government monopoly has the result of blocking competition. Mexico designated as strategic areas petroleum and gas extraction, radioactive minerals and basic petrochemical industries. The European Union has a special competition regime for its coal, iron and steel industries.

**Defense-related industries.** For national security reasons, special regimes for defense industries are common.

**Pharmaceuticals.** The pharmaceutical sector is sometimes granted greater flexibility with regard to competition law. Some countries allow resale price maintenance (e.g., the United Kingdom and Japan) or other restrictive business practices.

**Transport industries.** Several countries grant immunity to internal transport industries (by road, rail or water). The United States, for example, grants antitrust exemptions to ocean common carriers, liner conferences and terminal operators. Germany, Japan and the United States exempt various pricing agreements between seaport providers service. The air travel industry also has a degree of immunity from competition law in many countries, although this is declining. The European Union exempts agreements relating to the operation of computer reservation systems, schedules, joint operations of services and consultations on tariffs and slot allocation.

**The media and the publishing industry.** Many countries provide special treatment to the media and the publishing industry in order to stimulate culture and preserve cultural heritage. For example, in some countries the prohibitions on resale price maintenance do not apply to transactions in literary works.

**Financial sectors.** The banking, insurance and securities sectors are subject to extensive government regulation for prudential reasons in nearly all countries. Some countries employ sector-specific competition rules, while others allow formal exemptions or alleviated enforcement activities. In the United States, for example, rules for mergers between banks are more lenient than in other sectors. Many countries grant exemptions to the insurance sectors for agreements on risk premiums.

**Network or infrastructure industries.** Network industries often contain a natural monopoly element, and they are therefore often regulated under special regimes. In many countries, these industries were state owned and operated. A number of countries have recently begun liberalizing these sectors. In countries have already liberalized these markets, the regimes are sometimes more, sometimes less stringent. The United Kingdom exempts the electricity, gas and telecommunications sectors from competition law. Chile has adopted a separate system of regulation on the granting of concessions in the telecommunications sector and the conditions to be met by concessionaires, following the application of competition law, to control vertical integration between local and long-distance telephone companies.

**Small-and medium-sized enterprises (SMEs).** Some countries have exemptions for small-and medium-sized enterprises. Japan allows some types of cartels and contracts between SMEs. The European Union allows most agreements between SMEs with a combined market share lower than 5 percent. Other countries, including Mexico, make no distinction between SMEs and large enterprises.

**Public enterprises.** Many countries exempt public enterprises from competition law. In Mexico, these enterprises are only covered by the law when they engage in non-strategic activities not expressly mentioned in the constitution as a state responsibility.

2. Building large, competitive domestic enterprises

Industrial policy may seek to build enterprises that are sufficiently large to achieve all economies of scale, not only in static functions like production and marketing, but also in dynamic areas to generate endogenous technological capability. Mergers, takeovers or production cartels may therefore be allowed or enforcement of competition law may be limited. This policy enables relatively small national firms to unite. They are then in a better position to withstand the international competition on export markets and in their home market, especially when new competitors are expected to enter following trade and investment liberalization. Latin American countries have relatively few internationally operating companies, and these are generally small in global terms. To give their companies a stronger position on the world market, Latin American countries should allow mergers. Some countries, such as France, have pursued an official policy of stimulating mergers. However, studies on the effects of the large-scale, government-brokered mergers of the 1960s and 1970s raise doubts as to whether they enhanced France’s industrial strength.

Moreover, having multinationals based in the country is not necessarily better than attracting subsidiaries of foreign-based multinationals that invest an equal amount in the country. A Company locus of control and the origin of capital are less important, as multinational enterprises increasingly internationalize their production activities. Latin American countries will probably profit more from foreign direct investments originating outside the region, because these often bring along superior technological know-how and managerial skills.

Although some countries permit practices in domestic firms that are prohibited for foreign companies, this is not very effective in strengthening national industries. Porter argues that national companies will be more competitive on the world market if they face difficult circumstances on their home market (see Porter, 1990). They will have more incentives to excel and innovate, which will help them be successful in foreign markets. Lenient rules, in contrast, will weaken the position of those firms on the home market. Furthermore, foreign-based companies will feel discriminated against, which might lead to trade conflicts or conflicts in the World Trade Organization.

3. Are conventional merger policies appropriate for developing economies?

Many developing countries recently adopted a merger control program as part of their competition laws. Some economists argue that merger control is not essential during the transition period of economic reforms, which many Latin American countries are undergoing. Some research has shown that the aim of mergers is to capture efficiencies rather than to abuse the increased market power to attain higher prices (Rodriguez, 1996). Due to the sunk costs of investments made before the transition (in a protected environment), merged parties will have an overcapacity, which lowers prices. If firms are not allowed to merge, they may put pressure on their governments to provide non-tariff protection. This reduces social welfare, and the ultimate effect might be contrary to the objective of merger control.

4. Export cartels in natural resources

Countries that produce and export primary commodities, such as mining and agricultural products, argue that international cartels of producers should be tolerated to stabilize commodity prices. Their objectives are to increase receipts from the commodity; to protect against price declines and fluctuations; to conserve depleting resources; to establish more domestic processing; and to increase local control over the industry.
The countries that produce those commodities are often developing nations. In the 1970s, they used UNCTAD as a forum to demand an international program of commodity agreements which would serve as the keystone for a “new international economic order”. The preamble included an assertion that cartelization was a necessary component of development. The program was to include 18 commodities and a common fund to finance the agreements. The agreement has never been ratified, however, (Gilbert, 1987, pp. 591-616).

5. Advocacy

The scope and effectiveness of competition is limited by inconsistent government policies and regulations. State-owned enterprises control a significant share of industry, and these enterprises often hold a monopoly position. Many regulations act as entry barriers to markets, and import-substitution strategies have not been completely abandoned.

Some authors therefore see a special role for competition policy enforcers in Latin America (see for example Coate and others, 1993; Rodríguez, 1996). In the ongoing process of economic adjustment the enforcement agency can ensure consistency and promote and advocate a free market. The United States employs advocacy programs in which the staff of enforcing agencies advise other state departments on the consequences that their proposed actions have on competition (Coate and others, 1993, pp.57-58). In the Russian Federation, the recently founded anti-monopoly committee has argued for the suspension of proposed trade safeguard measures against textile imports. The committee also helped the Ministry of Economics in determining the conditions of access for foreign investors, and it argued for the exclusion of a number of provisions which would have constituted unreasonable access barriers (UNCTAD, 1997b, p.19).

In Latin America enforcers of competition policy can give advice on new regulations and make recommendations on easy entry and free trade. They can stimulate the abolition of price controls and the privatization of state-owned enterprises. Government rules and regulations sometimes favour existing firms over firms that want to enter the market. Such rules reduce the threat of new entry and the level of competition. They enable existing firms to behave anti-competitively, especially in concentrated markets. Lawmakers do not always fully understand the implications of laws and regulations for market contestability. Sometimes the rules do not serve any social or political goal, but they are passed under pressure from companies that want to protect their position.32

6. Optimal level of enforcement

Developing countries should carefully enforce competition law. Too little enforcement does not lead to the economic objective of increased efficiency; too much enforcement can put a damper on economic processes. Therefore, countries must first acquire experience with competition policies (Wood, 1996, p.23). The repercussions of a wrong decision by competition policy enforcers are likely to be significant, especially in relatively small countries (Shyam Khemani, 1996, p.7).

Developing competition policy and establishing an enforcing agency is a complex task that requires resources and skilled people. Developing countries need assistance from experienced parties.

32 For example, Bolivia issued a regulation that specified a maximum number of pharmacies per 10,000 inhabitants. This limits market entry and competition but it does not serve either a social or a public health goal. Personal interview with Ricardo Paredes.
C. Concluding remarks

The absence of multilateral rules on competition probably affects developing countries more than developed countries. Developing countries are threatened by the extraterritorialities of the national legislation of dominant developed countries. In addition, developing countries are usually less equipped to deal with the restrictive business practices of multinationals. These are often complicated practices with effects in different countries. Evidence of infractions might only be found overseas, and experience might be necessary to determine whether sophisticated practices should be prohibited or allowed, on the basis of efficiency advantages.

Although provisions on competition may be desirable in international trade agreements, the negotiations require time, money and negotiators with experience in competition. Some negotiators argue that it is better to limit efforts to areas considered more important, such as the completion of trade, investment and services liberalization. Essentially, they believe cases of dumping and cross-border anti-competitive behaviour to be very scarce and to have limited effects.33

The need for provisions on competition policy becomes more relevant in Latin American regional and subregional integration schemes. Intra-regional trade is expanding. More trade means more transactions and more possibilities for anti-competitive behaviour and anti-dumping complaints. In regional groupings such as MERCOSUR, the Andean Community and the Group of Three, intraregional trade is currently moderate but growing fast.

Bilateral agreements tend to favour the more powerful developed countries (UNCTAD/SELA, 1996, p.15). Hence, it would be wiser for Latin American countries to join forces and try to reach a multilateral agreement.

An agreement on competition policy might take one of several institutional forms. The most far-reaching form is the supranational model with a central enforcing agency, as employed in the European Union. Many countries, including the United States, find this model unacceptable. Another form is the harmonization of legislation and competition of principles. This would also be hard to implement, because industrialized countries fear that harmonization could lead to a deterioration of their own laws. A third form is a treaty specifying which national law will be used in conflicts. Countries need to recognize the competition laws and enforcement of the other participating countries before they can have faith in this solution. Finally, a less ambitious procedure is a cooperation agreement between competition agencies. Such an agreement would help competition policy enforcers avoid unnecessary duplication of work and costs. Moreover, companies that want to merge would not need to provide information to different agencies.

33 Personal interview with Alejandro Jara in Chile.
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