

Competition Policy, Globalization and Economic Development

by

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Mr. Chairman,

It is a great privilege to be asked to address your Commission. My subject is competition policy and economic development. In accordance with the Study Commission's remit to me I would examine these issues from the perspective of developing countries.

1. Summary of the Argument

In my presentation this afternoon I shall in summary make the following main points.

First, I shall suggest that developing countries today need a competition policy even if many of them have not had one in the past. This is for two reasons.

- a) international merger movement
- b) structural changes within these economies themselves emanating from privatisation and deregulation.

Second, I shall argue that the competition policy that is appropriate for developing countries and that takes into account the "development dimension" cannot and should not be the same as the policy that is implemented in advanced countries such as the US and those belonging to the European Union.

* This document draws heavily on my previous papers, specifically, Ajit Singh and Rahual Dhumale, "Competition policy, development and developing countries", working paper 7, South Centre, Geneva, 1999; Ajit Singh, Alaka Singh and Bruce Weisse, "Corporate governance, competition, the new international financial architecture and large corporations in emerging markets", paper presented at the UNCTAD Workshop on management of capital flows, held in Cairo, March 2001 and an informal paper, A. Singh, "Competition policy and development", presented to Commonwealth Secretariat Expert Group on Multilateral Level Competition Policy, March 2001.

Third, the kind of competition policy needed in developing countries requires rather different economic concepts than the ones used in advanced countries. Indeed in the context of the international studies on this issue currently being carried out at the WTO and elsewhere, I shall strongly argue that the development dimension cannot adequately be taken into account without fresh concepts and definitions. The conduct of this discourse in terms of the language and the normal framework of the WTO - market access, national treatment, reciprocity and the most favoured nation clause – does not do justice to the specific economic conditions prevailing in developing countries; indeed, such concepts are arguably prejudicial to developmental needs in this particular context.

Fourth, the new concepts I shall be outlining this afternoon for addressing the developmental dimension are thoroughly grounded in modern economic theory and there is considerable empirical evidence to support them. However, I hasten to add these are new only in relation to the current international discourse on the subject, but in fact some are implicit in the WTO agreements themselves. They have been used there to further the interests of advanced rather than developing countries.

I shall elaborate on these points in the rest of my presentation.

2. Do Developing Countries Need A Competition Policy?

Mr. Chairman, despite strong encouragement and assistance from the World Bank and other international organisations to institute competition policies, there are still many developing countries which do not have such policies. The fact of the matter is that until recently developing countries have not normally needed these policies mainly because the state in these countries actively controlled economic activity and regulated many markets. Competition policy was not required because governments often had the powers to use direct price controls to restrain monopoly power if necessary. But now, with extensive privatisation, a much diminished state sector and deregulation, it is clearly necessary for developing countries to have some policies to regulate anti-competitive behaviour.

Moreover, the international economy under globalisation and liberalisation has been subject to a gigantic international merger wave during the last decade. There have been large merger waves before in advanced countries which have occurred simultaneously in several countries (e.g. the merger wave of the late 1960s) but these have generally not involved any significant amount of cross-border takeovers. However, the current merger wave in the UK and US (these two countries have good historical statistics on this subject dating back to the end of the 19th century) is not only likely to be the largest ever recorded in terms of the total value of the corporations acquired (suitably adjusted for inflation and the size of GDP), it also has, for the first time, a large cross-border component.

The cross-border mergers and acquisitions (M&A) activity has mainly involved corporations in advanced countries. Nevertheless, there has been considerable M&A activity in emerging markets as well. The latter have mostly been undertaken by foreign multinationals (the domestic market for corporate control in emerging markets is typically very small, if non-existent). These takeovers by foreign multinationals in emerging markets have direct implications for competitive behaviour of firms and hence for competition policy. In addition, even if the mergers take place only among advanced countries' firms, these mergers could also have important potential consequences for competition and contestability in emerging markets.

Thus, the new circumstances, in which developing countries find themselves, makes it necessary for them to have a competition policy. This raises two questions. First, what kind of competition policy is appropriate for these countries? Second, should such a policy be implemented at a multi-lateral level, e.g. as a constituent part of WTO disciplines.

3. Developing Countries And Multilateral Level Competition Policy

The second question is more easily answered from developing countries's perspective. At the WTO a number of advanced countries have been pressing developing countries to negotiate to make competition policy subject to that organisations multilateral disciplines, so as to ensure 'fair play' and 'level playing fields' between countries.

Developing countries have been opposed to such proposals. Their formal stance has been to suggest that as many of them have no experience of competition policy, they are not in a position to be able to enter into negotiations on these matters. The real reason for developing countries opposition is that they do not wish any new disciplines to be included in the WTO agreements because of the provision of cross-sanctions: a violation in one area may be penalised in another by the complaining country (if the complaint is held to be justified). Developing countries take the view that the Uruguay Round Agreements, that established the WTO, need to be properly reviewed for their impact on economic development before undertaking a new round of tariff cutting or starting negotiations on new subjects such as competition policy and the multi-lateral agreement on investment. There is an addition in any case a formidable "built-in" agenda in the WTO Agreements themselves.

I now turn to the first question.

4. What Kind Of Competition Policy Is Appropriate For Developing Countries?

Here I distinguish between two types of developing countries.

a) those with weak and ineffective states, usually at low levels of industrialisation.

b) semi-industrialised countries with competent states (such as Korea, India, Mexico, China and Brazil).

Recent advances in economic theory, particularly the agency theory, the transactions costs theory, the game theory and the information theory, have greatly enriched our understanding of how competition and competition policy may work in various spheres of the economy and in different economies. Thus, one of the world's leading authorities on the theory of industrial organisation, the French economist J. Laffont, has recently observed:

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

Professor Laffont provides a number of examples to support his contention. All of these involve what economists call the theory of the "second best." The latter asserts that if any one of the assumptions required for the validity of the fundamental theorems of welfare economics cannot be met, restricted rather than unrestricted competition may be a superior strategy.

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

For developing countries with competent governments there are other considerations which also derive from economic theory as well as experience, are relevant.

A central issue here is that for a developing country the purpose of competition policy cannot simply be the promotion of competition as a good thing per se, but to foster economic development. This would in some instances involve restriction of competition and in others its vigorous promotion. In order to raise the living standards of their people over time, developing countries need high rates of investment to achieve fast growth of

* J. J. Laffont, "Competition, Information and Development", Annual World Bank conference on development economics, 1998, Washington, D. C.

productivity. High rates of investments in turn normally require reasonable, if not high, rates of profits in order to maintain the private sector's propensity to invest. This consideration leads to the view that there may at times be too much competition rather than too little. Competition would be too much if it leads to price wars, sharp falls in profits, all of which are likely to diminish the corporate propensity to invest. In the real world of incomplete and missing markets which is particularly the case in developing countries, the latter may also require government co-ordination of investment decisions to prevent over-capacity. A developing country cannot therefore afford to have maximum competition, rather it must operate with an optimal degree of competition or with an appropriate blend of competition and co-operation to achieve its long term goals of faster and sustained economic growth.

This is in contrast to competition policy practiced in advanced economies such as the U.S and the U.K. In these countries consumer welfare and static efficiency appear to be the main objectives of competition policy. The essential focus of competition law appears to be reduced prices for consumers and competition per se. As the WTO Report for 1997 notes, "A guiding principle that is often referred to by competition agencies and tribunals or courts is that 'competition law protects competition, not competitors'" (WTO, 1997, p.44).

5. National Treatment And The Development Dimension

The above analysis suggests that competition policy for developing countries should have different objectives to those for advanced economies; further, it also needs to be specific to the stage of a country's development. Importantly, in addition, there is a need for special and differential treatment of developing countries in relation to competition policy. This is required in order to truly 'level the playing fields' in an operational sense. Even large developing country firms tend to be both relatively small and also handicapped by the many deficits that arise from economic underdevelopment as compared to the large multi-national firms from advanced countries. In these circumstances, instead of 'national treatment' of foreign multi-national firms, a developing country competition authority may, for example, prohibit takeovers by such companies operating in the country and yet allow domestic firms to amalgamate in order to compete better against the larger multinationals. In this instance, non-national treatment may serve both competition and economic development.

6. New Concepts In Relation To Competition Policy For Economic Development.

The above analysis and my other work on the subject suggest new economic concepts to address the developmental dimension of competition policy. Specifically, the following points are significant:

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

The development dimension is thus far from being fully taken into account by suggestions that all that developing countries need is a longer time frame to be able to implement the US or UK type of competition policy. The special and different circumstances of developing countries and their developmental needs require a creative application of the new concepts above to competition policy questions.

However, as noted earlier, these concepts are only new in relation to the current WTO discussions on the subject. They are paradoxically, implicitly recognised in the WTO agreements themselves, but usually to benefit rich rather than poor countries . For example the TRIPS Agreement allows temporary restraint on free competition in order to promote technical progress. However, the extra patent protection provided under the WTO Agreements benefits mainly rich countries who hold or produce most of the world’s patents.

Similarly, the notion of industrial policy is implicit in the Agreement on Subsidies and Countervailing Measures, which does not prohibit government grants to private firms to promote R&D, to aid disadvantaged regions and to help implement new environmental laws. This again favours advanced countries. Prohibited subsidies on the other hand, include those contingent on export performance or those given to the use of domestic in preference to imported products – the kind of subsidies successfully used by developing countries in the pre-WTO regime.

Conclusion

To sum up, the main message of this paper is that developing countries require special treatment in the sense of being allowed to pursue competition policies which are appropriate to their stage of development. There should certainly be no multilateral discipline of the WTO type that obliges developing countries to have universal

competition policies or indeed any policy at all if they do not think the cost-benefit analysis of such a policy is worth their while.

However, even the development friendly competition policy sketched out above may not be adequate to cope with the potential anti-competitive effects of the current international merger wave. For this, ideally, an international competition authority is required to be able to prevent abuse of dominant position by large multinational firms and other anti-competition behavior. The need for such an authority arises from the fact that even an advanced country like the US, with all its paraphernalia of competition laws and its extra-territoriality, is unable to prevent price fixing by international cartels. Not too long ago, a European cartel of vitamin producers was fined three quarters of a billion dollars for illegally fixing (high) prices. If this can happen to the US, there would be little to prevent cartelisation by subsidiaries of multi-national companies in developing countries and for them to engage in similar activities. In the absence of an international competition authority, which the advanced countries are not as yet prepared to accept, developing countries would be better off in dealing with anti-competitive behavior of large multinationals collectively, through regional organizations, rather than on an individual basis.