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Competition Policy  
and Development

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ERD POLICY BRIEF NO. 39

# **Competition Policy and Development**

**Douglas H. Brooks**

October 2005

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As globalization proceeds, developing Asia is progressively becoming more market-oriented and open. But opening markets is not enough by itself for countries to reap the full benefits of competition. Firms will still find incentives to engage in anticompetitive practices, so policies to promote and protect competition are now prominent on the domestic and trade policy agenda in Asia. These competition policies are important both in public sector management where, for example, public utilities may have characteristics of natural monopolies, and in private sector development. They ensure that the benefits of competition help promote the international competitiveness of a country's firms as they encounter the discipline of connecting to the global economy.

Competition serves to diffuse socioeconomic power and broaden economic, social, and political participation while providing opportunities for new entrepreneurs. Competition in product and factor markets widens choice, lowers prices, and increases production efficiency, ultimately contributing to a country's growth and development. For the greatest efficiency gains, new and efficient firms must be able to enter the market with relative ease, while old and less efficient firms must upgrade or exit, with their resources reallocated to new or more efficient firms.

During economic transition or reforms, the benefits of trade reform and developing a market economy are magnified when most restrictions on competition are removed. This important lesson has motivated initiatives aimed at promoting competition in a number of developing Asian economies, including People's Republic of China or PRC (which has firm plans to develop and implement a new competition policy), India (where competition policy has been revised and expanded), and Viet Nam (where a new competition policy was adopted in late 2004). In the PRC and Viet Nam, stringent competition legislation is considered a constructive step toward the development of a market economy and a defensive measure to level the playing field between domestic firms and foreign-invested firms.

This policy brief describes the role of competition policy, and uses Asian experiences to highlight some aspects of its design, implementation, and place in the broader policy lattice. Priorities for countries at different stages of development are suggested.<sup>1</sup>

## **The Role of Competition Policy**

Competition policy, taken here to include competition law and competition advocacy, is concerned with both private anticompetitive practices and government measures or instruments that influence competition in markets (see box). Note that properly enforced competition law does not target firm size but threats to, and actual distortions of, the competitive process and resource allocation.

### **Elements of Competition Law**

UNCTAD (2002) provides a list of firms' actions that may be addressed by competition law. The following five figure prominently in most such laws:

- (i) agreements between firms in the same market to restrain competition
- (ii) attempts by a large incumbent firm to independently exercise market power (abuse of a dominant position)
- (iii) attempts to exercise market power by firms acting collectively but without an explicit agreement between them
- (iv) attempts by a firm or firms to drive one or more of their rivals out of a market (for example, through predatory pricing)
- (v) collaboration between firms for the purposes of research, development, testing, marketing, and distribution of products

In India, Korea, Malaysia, and Thailand, among others, restricting anticompetitive practices became a policy priority after measures to promote private sector development yielded adverse side effects. The interest in the late 1990s in Korea and Thailand in promoting more vigorous competition followed from the perception that incumbent firms had too often in the past taken too much advantage of their substantial market positions, with little or no offsetting benefits. In Korea in

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<sup>1</sup> This policy brief draws heavily on Brooks and Evenett (2005), which includes country studies of People's Republic of China, India, Korea, Malaysia, Thailand, and Viet Nam.

particular, curbing the power of the *chaebol* became a policy priority after the 1997–1998 financial crisis, which was believed by many to have been aggravated by actions of the large conglomerates.

Competition policy aims at enhancing consumers' freedom of choice and firms' freedom to trade and to access markets. For example, trade barriers, barriers to foreign direct investment, and licensing requirements can influence the extent of competitive pressures in markets and so can be appropriate concerns of competition policy. In India, the preamble of the new competition law refers to the objectives of preventing practices having adverse effects on competition, promoting and sustaining competition in markets, protecting the interests of consumers, and ensuring freedom of trade carried on by other participants in markets in the country (*The Competition Act 2002*).

### **Design and Implementation Issues**

Innovation, productivity improvements, and resulting long-term economic performance are likely to be promoted rather than impeded by interfirm rivalry and, therefore, by the enforcement of competition laws that promote such rivalry. However, some temporary market power may be necessary after a new invention or innovation is introduced to provide firms with the incentive to undertake further such inventions or innovations. Thus, finding a balance between promoting short-term competition and preserving long-term incentives for innovation and invention becomes an increasingly critical challenge for sustaining growth and development.

In addition, competition policy must take into account the technological characteristics of markets. There can be instances in which consumers prefer concentrated market outcomes with a small number of firms because of the network externalities that large output levels can create.<sup>2</sup> Many communication and infrastructure services exhibit network externalities. Such services include telephones, railways, etc., that are important for economic development.

In most developing countries, the interests of consumers are poorly represented and are much weaker than those of producers. In this regard, it can be crucial that the authority charged with promoting and enforcing competition adequately represents consumer interests

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<sup>2</sup> For example, the internet with its millions of sites and users attracts many more users and uses than does a network with only a few sites.

and has independence from ministries or other agencies representing producers or producer groups. Organizing and promoting consumers' rights creates a potent force for ensuring the promotion of competition. At the same time, competition policy's implementation serves to reinforce consumer rights and the competition culture that helps to ensure the benefits of competition will be realized.

The good intentions of policymakers in enacting competition law can be undermined by factors such as: interference by government ministers, officials, and other politicians; lobbying by interest groups; legal loopholes; lack of transparency in decision making; lack of human capacity; and lack of funding. The judicious choice of cases to bring to court is one factor often credited with raising the credibility of a competition agency. Knowing which cases to fight, and when, can be particularly important for new competition agencies in demonstrating their effective enforcement capabilities and the economic importance of competition.

Thus, design and enactment of laws is not enough; what matters is judicious and efficient enforcement, since the deterrent effect of a competition law depends on firms' perception of the effectiveness of its implementation. For example, while Thailand has had a competition law for years, its enforcement has been weak and generally ineffective due to lack of adequate resources, political will, and independence of the competition authority. The challenge in the coming years will be to design implementing practices and institutions that are robust, fair, and transparent, especially in societies with a history of close business-government relations.

A positive example can be seen in Korea. To reinforce the prestige and credibility of the competition enforcement agencies, the government endowed the Korea Fair Trade Commission (KFTC) with significant powers to tackle anticompetitive practices and to force the economic restructuring of large business groups. The chairman of the KFTC answers directly to the prime minister and sits in the cabinet of the national government. These institutional arrangements provide the chairman of the KFTC with the mandate as well as the means to help ensure that any new legislation will be consistent with the principles of competition.

Appropriately enforced, competition policy is affordable. In most countries it will more than pay for itself. Outlays needed to enforce national cartel laws can usually be generated from the savings on government purchases resulting from a reduction in bid rigging alone. Even greater may be the increase in tax revenues resulting from additional competition-induced growth. Moreover, including

commitments to properly enforce competition laws in bilateral and regional trade agreements can help the relevant enforcement agencies secure more funding from national legislatures.

If the enforcement of competition law prevents or discourages incumbent firms from taking steps to foreclose entry by potential rivals, then such enforcement strengthens the incentives of the latter firms to invest in innovation. Rivalry, both real and potential, in the market for future innovations can also be protected by the active and appropriate enforcement of merger and acquisition laws that prevent, for example, one firm taking over another which has a potentially strong, but not as yet fully developed, range of rival products. This requires consistency and coherence between competition, intellectual property rights, industrial, trade, and investment policy regimes.

### **Competition Policy and Other Policies**

The benefits of competition flow more freely with strengthened property rights, a credible legal and judicial system, trade and foreign direct investment liberalization, and infrastructure expansion. Korea's experience showed that trade liberalization does not automatically lead to a more competitive domestic market, and that better outcomes are achieved when trade and investment liberalization is accompanied by measures to increase competition. This highlights the importance of competition from an early stage of economic growth and of incorporating competition policy into the broader economic policy framework.

For foreign investors the existence of a competition policy indicates some commitment by the government to ensure a level playing field among domestic and foreign investors, and adds transparency to the commercial environment. Relaxing foreign participation requirements can generally be expected to contribute to increased competition in the host economy. Competition policy is therefore complementary to other policies, and liberalization and privatization policies cannot be expected to automatically contribute to economic growth if competition policy and its related institutional infrastructure are lacking.

Competition policy can be designed to accommodate a wide range of national interests. The desire to preserve national industrial policies was a prominent concern in drafting India's and Viet Nam's

recent competition laws.<sup>3</sup> In the PRC and Malaysia, proposed competition legislation contains similar provisions. There are also parallels between India's and Malaysia's concerns about the impact of a competition law on the well-being of certain social groups.

The complementarity of competition and competition policy with industrial, trade, foreign direct investment, and other policies highlights the need for active competition advocacy to ensure that other legislation and regulations are compatible with the goals of competition policy. Too often, the advocacy functions of competition authorities are neglected at the expense of competition law enforcement, only to create the need for even greater enforcement when other legislation is enacted without consideration of its implications for competition. Country analyses demonstrate the importance of administrative, judicial, and political factors as well as economic considerations in the design and use of competition law.

## **Conclusion**

Effective competition policy depends on active and fair enforcement. Therefore clear property rights and a sound legal system are prerequisites. For countries in transition or at early stages of market development, first-generation reforms that lay the basis for macroeconomic stability and development of institutional infrastructure must be top priority. But even late reformers such as Viet Nam, which still face challenges from the first round of reforms, are already acting to ensure that restraints to competition will not hinder future development. Considering competition policy issues at an early stage helps to ensure that they mesh well with other policies.

For countries with more developed market systems and macroeconomic policy framework, the challenge in second-generation reforms is to promote a competition culture in the general population, and to ensure the relative independence of a competition agency with adequate resources and a clear mandate. Cooperation between competition agencies in different countries is becoming increasingly important in the globalization process, and can be an important source of knowledge exchange and skills development.

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<sup>3</sup> When designed to be compatible with industrial policy, competition policy is usually not as effective, since industrial policies are often ill-conceived or intended to serve the interests of privileged groups and there is an inherent conflict between competition policy and directed investment. The point here is that regardless of existing priorities in an economy, competition policy can be designed with flexibility.

In implementing competition policy, developing countries in the Asian and Pacific region should draw on lessons from the experience of Japan and Korea, should start early, and take a long-term view. Most have completed macroeconomic reforms, which play a key role in laying the basis for greater competition. Yet challenges remain. While many countries are moving to implement or strengthen their competition policies, it is notable that none appear to be moving toward repealing them.

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