

National Competition Policies in an Era of Integrating Markets

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I. Introduction

The last decade of the twentieth century saw extensive trade and investment liberalization by developing and industrialized countries. Some of that reform was unilateral, some took place in the context of regional integration initiatives, and others followed the conclusion of the Uruguay Round. These reforms have been thoroughly debated, perhaps to the detriment of other fundamental—and potentially related—changes to the international commercial landscape. These changes include the widespread acceptance of the need for national competition policies in developing economies²; the first truly global wave of mergers and acquisitions in the late 1990s that included firms from developing economies—in particular from Latin America and East Asia; and a surge in international cartel enforcement.

Each of these three changes are worthy of analysis in their own right, but their connection to trade reforms has rarely been analyzed. One might ask, for example, whether firms are responding to trade liberalization—and the increased competitive pressures that can bring—by undertaking mergers, acquisitions, or

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² For the purpose of this chapter I use the terms competition policy and antitrust policy synonymously. Therefore, I confine my discussion of competition policies to those policies that are typically views as antitrust policy—ie. Policies towards mergers, acquisitions, takeovers, cartels, vertical restraints, monopolization, and anticompetitive practices.

by accommodating new rivals in cartel agreements? The key point is that it is naïve to believe that sophisticated profit-seeking firms are only going to respond to a more liberalized trade and investment regime by competing aggressively with rival firms. Instead, strong incentives exist to circumvent additional competitive pressures—casting doubt on the view that the benefits of trade and investment reforms are being fully realized. And given the role that competition policies can play in discouraging such anti-competitive business decisions, the role of and effectiveness of national competitive policies in an era of integrating market has become a question of growing importance for developing and industrial economies alike. The objective of this short chapter is to summarize the critical economic issues raised by this question, and to offer some pointers for future reforms.

The analytical approach adopted in this paper is essentially microeconomic. As I will argue below this approach sheds light on the factors that determine the effect on resource allocation of national competition laws in an integrating world. This economic perspective raises different issues than those addressed in the growing legal literature on international anti-trust matters, and in the short space available here, I am unable to do justice in summarizing—let alone analyzing—the latter.³ Nevertheless, it is my hope that legal and economic scholars, policymakers, and negotiators find the issues raised by a purely economic analysis of interest as we prepare for the another possible round of trade reform.

³ For two excellent recent contributions to this literature see Fox (2000) and Tarullo (2000).

My focus on national policies towards merger review and cartel enforcement is another limitation on the scope of this chapter. In the next section, however, I will argue that commercial developments in the 1990s suggest that these two policies are—so to speak—where most of the action is—in both developing and industrial economies.

This chapter is organized as follows: the next section describes the recent wave of merger and acquisitions and the surge since 1993 in international cartel enforcement. This provides the context for the rest of the analysis. The third section discusses the weaknesses of two often-heard views on the relationship between trade and competitive policies—namely that a liberal trade policy can perfectly substitute for national competition policies; and that viewing trade and competitive policies through a ‘market access’ lens provides a good guide for policymaking. The fourth and fifth sections assess, respectively, the effectiveness in an integrating world of national merger and anti-cartel policies, as well as discussing the pros and cons of some well known reform proposals. Concluding remarks appear in the sixth and final section.

II. The Changing International Commercial Landscape

Amongst the various changes in corporate strategy during the 1990s, one of the most important was the wave of merger and acquisitions, which accelerated after 1995. Unlike the 1980s merger wave, firms in developing economies—notably from Latin America and East Asia—participated in this latest wave of corporate consolidation. Even before the wave accelerated in 1999-

2000, mergers and acquisitions of Latin American and Asian firms by companies outside their respective regions totaled in value just under US\$400 billion during 1994-98. Furthermore, over the same timeframe firms in these two regions acquired \$150 billion of assets from outside their respective regions. In effect, these two regions experienced two-way mergers and acquisitions. What is more, much of the inward foreign direct investment into Latin America came in the form of merger and acquisitions—not greenfield investments as is often supposed (see UNCTAD, 2001, and JETRO, 2000.)

Many factors account for this wave of global mergers and acquisitions. These include: availability of cheap financing from banks and stockmarkets in the late 1990s; deregulation and privatization of many service industries; liberalization of rules against foreign takeovers of, and acquiring stakes in, domestic firms; and in certain industries—notably in the financial sector and telecommunications—a belief that only consolidated large firms can develop the capital base required to compete against leading firms in the world market.

To be sure not all mergers or acquisitions result in higher prices and are a distortion to resource allocation. As is well known such transactions may result in efficiencies which enable firms to lower production costs that, in turn, might be passed onto consumers in the form of lower prices. This motive for mergers—whose significance has been debated vigorously—need not call for public policy intervention. However, the same cannot be said for the long standing motive for consolidation: the acquisition of market power. The latter results in prices being raised above marginal costs and sales falling short of the competitive

benchmark. And during an era of trade reforms—when puts downward pressure on prices and profit margins of incumbent firms—mergers can attenuate and in principle offset the benefits of liberalization at the border.

The second feature of the changing commercial landscape is the rise of cartel enforcement in industrial economies.⁴ These cartels have been found increasingly to have an international dimension—affecting more than one national market. A recent study found that of a sample of forty international cartels prosecuted during the 1990s by the European Commission and the United States’ Department of Justice, twenty four (40%) lasted at least four years. It would seem that—contrary to the Chicago School—these cartels do not rapidly collapse under their own weight (Evenett, Levenstein, and Suslow, 2001).

Levenstein and Suslow (2001) document the purchases of developing countries of sixteen goods whose supply was found to internationally cartelized (by the EC or US) at some point during the 1990s. They found that:

“In 1997...developing countries imported US\$81.1 billion of goods from industries which had seen a price-fixing conspiracy during the 1990s. Those imports represented 6.7% of imports and 1.2% of GDP in developing countries. They represented an even larger fraction of trade for the poorest developing countries...8.8% of their imports.” (page 2)

In interpreting such evidence it is useful to bear in mind that it refers to international cartels that were found within the EU or US. One cannot assume that these cartels operated in every developing country also. However, since

⁴ This pick up in anti-cartel enforcement started in the United States with the reforms of its corporate leniency program, which grants amnesties to qualifying firms that come forward with evidence of cartelization. The sizeable fines imposed by the US authorities have not gone unnoticed by other nations and provided a pecuniary incentive for enhanced anti-cartel enforcement outside of the United States. For a discussion of the enforcement record against international cartels in the 1990s see Evenett, Levenstein, and Suslow (2001).

cartels are more likely to operate in nations with lax anti-cartel policies—and such policies are almost certainly laxer in developing economies than in the US and the EU—then one can be confident that developing economies have been detrimentally affected by these cartels. In sum, this evidence—plus the five case studies of international cartels documented by Levenstein and Suslow (2001)—paints a potentially disturbing picture of the effects of given such cartels in the developing world.

The final development that is pertinent to our discussion is the widespread adoption of competition laws (or plans to do so) by developing economies. Although estimates vary, at least 80 countries now have anti-trust laws, or plan to have them (see ICPAC, 2000, and Palim, 1998). This trend raises a number of interesting issues, however, in this chapter I will focus on the efficacy of such national antitrust enforcement in a world of integrating markets. A related issue is whether international initiatives in the competition policy area might help reinforce the independence, integrity, and coherence of antitrust enforcement in developing economies.⁵

III. How not to think about the linkage between trade and competition policies

As competition policy moves up the international economic agenda numerous policy recommendations have emerged. In this section I discuss the

⁵ See Tavares (2001) for an account of how various Latin American initiatives on competition policies are affecting the implementation of antitrust enforcement in that region.

origins and drawbacks of two of these positions, both of which have had or continue to have support in certain quarters.

A. Liberal border regimes are a perfect substitute for national competition policies

This view asserts that, in the absence of any government-sponsored barriers to trade and to investment, national competition policy cannot improve the allocation of resources. It should be noted that there is some theoretical support for this position. Over thirty years ago Bhagwati (1968) showed that if a monopoly producer in a small open economy was exposed to unimpeded competition from abroad, then the monopolist would be unable to charge a price above the world price, and more importantly, that the monopolist would expand output until the marginal cost of product equaled the world price—eliminating the distortion to resource allocation created by prices exceeding marginal costs at the profit-maximizing level of output. This influential paper implies that competition from abroad could not only tame but actually eliminate domestic market power. If this theoretical proposition were borne out in the empirical literature then it would call into question the rationale for certain national competition policies. For example, there would be no need to worry about the merger of two domestic firms resulting in them exercising market power, since any attempt to do so would be frustrated by overseas rivals who were willing to sell at the world price of the commodity in question.

Empirical studies have certainly borne out the claim that trade reform helps reduce the exercise of market power by domestic firms (see Harrison, 1994, and Levinsohn, 1993).⁶ However, these studies have not shown that eliminating tariffs would eliminate domestic market power, a finding that would support the claim that liberal trade policies can *perfectly* substitute for competition policy. Furthermore, even if such finding did emerge it would only apply to markets in which the goods are tradable. Having said that, a broader version of the perfect substitutability thesis might assert that open foreign direct investment regimes could inject competitive pressures into non-tradable sectors. To the best of my knowledge I know of no empirical paper that substantiates this modified version of the perfect substitutability in any non-traded sector in any developing economy. In conclusion, on the basis of the available empirical evidence, it would seem that despite steps to liberalize border regimes domestic market power remains.

B. Evaluate foreign competition policies through the market access lens

Bargaining over market access concessions has been the time honored and highly effective means of lowering border barriers in multilateral trade negotiations. Perhaps unsurprisingly then, when the view emerged that inadequate competition policy enforcement could undermine the expected market access gains from trade reforms, some began to argue that international disciplines on competition policies were both necessary and should be evaluated

⁶ Feenstra (1995) and Tybout (2001) survey the research program that Harrison's and Levinsohn's papers started.

in terms of their impact on market access (see Morici, 2000, for a recent statement of this position).

This viewpoint—which for some time had considerable currency among leading US policymakers—arose out of frustration with US exporters attempts to gain access to the Japanese market. From the mid-1980s through to the resolution of the Kodak-Fuji case, many U.S. trade policy analysts argued that the Japanese authorities had tolerated their own firms engaging in anticompetitive business practices, in particular by tolerating vertical integration between producers and distributors. A vast legal and economic literature emerged on whether Japan's market were relatively more closed than other nations' markets, with little agreement emerging (see Evenett and Suslow, 2000, for an overview and analysis of much of this debate).

Here I would like to focus on the claim that international disciplines on competition policy should be devised and evaluated in terms of their effects on market access. Unlike trade reform, where reduction in border barriers typically improves both foreign access to domestic markets as well as the domestic allocation of resources, there are numerous and quite significant cases where prohibiting horizontal and vertical agreements between firms might enhance market access at the expense of economic efficiency. For example, a manufacturer may sign a long term exclusive contract with a supplier that effectively shuts out foreign suppliers from competing for the manufacturer's business. The manufacturer may forego the benefits from competition among suppliers in order to encourage one supplier to undertake relationship-specific

investments (such as the purchase of special machines, or the costs of tailoring parts to the particular needs of the manufacturers), which the supplier would be unwilling to undertake in the absence of a long-term commitment from the purchaser. The benefits of such relationship-specific investments would be lost if long-term contracting with suppliers were banned on the grounds of preserving foreign market access. The potentially different effects on market access and economic efficiency of certain competition policy decisions suggests that the former may not be as good a proxy for the latter—as it is in most negotiations over border barriers. Consequently, any initiatives on competition policy ought to be evaluated solely in terms of their effects on economic efficiency, the traditional microeconomic metric for policy evaluation.

To conclude this section, I have argued that the case for abandoning national competition policy in an integrating world is—to date—unsupported by the empirical literature. Furthermore, I have argued that national competition policies and international competition policy initiatives should not be evaluated in terms of the effects on trade flows. Instead, the effects on resource allocation, or economic efficiency, is the correct metric. Having made these two points I turn to the heart of this chapter: an assessment of the effectiveness of national merger and anti-cartel policies in an integrating world economy.

IV. National merger policies in an integrating world

The effects of a proposed merger need not be confined to those nations' markets where the firms involved in the merger are located. This possibility has led national anti-trust authorities to assert the right to review proposed mergers that may have potentially adverse effects in their jurisdiction. In turn, this has led to a proliferation of "merger notification" regimes, merger review procedures, and introduces the possibility—recently demonstrated in the General Electric and Honeywell case—that disagreement may emerge between reviewing bodies. And, in principle, each reviewing body can veto a proposed merger. Having said that, the firms who wish to merge typically offer to amend their proposed transaction so as to meet the objections of a reviewing body. Often this involves divesting certain subsidiaries or accepting restrictions on the operation of the merged firm.

Merger review is no longer the preserve of industrial countries. Many developing countries—by some counts around forty—have merger notification requirements and review procedures, and Cicerone (2001) provides a summary of these requirements for forty-six jurisdictions. Argentina, for example, demands that mergers involving worldwide sales of 2.5 billion pesos be notified to her antitrust authorities, even though not a single peso need be earned within her borders. Brazil, in contrast, exempts from merger review any proposed commercial transaction between firms with no corporate presence within her borders.

The diversity of these notification requirements, differences in the deadlines for making merger review decisions, and the presence or absence of

judicial review, considerably adds to the cost of undertaking international mergers—as well as increasing the probability that different and inconsistent decisions are made by national anti-trust authorities. In recent years, the magnitude of these transaction costs has been a source of concern for the International Bar as well as for policymakers. Several sensible proposals have emerged for reducing these costs, and the interested reader is referred to the thoughtful discussion in Chapter 4 of ICPAC (2000). In the remainder of this Section I want to dwell on the potential for resource misallocation in multi-jurisdictional merger reviews that are unrelated to transactions costs.

There are two potential types of resource misallocation that merger reviews can generate. First a proposed merger, that improves the global allocation of resources, is vetoed by at least one antitrust authority. Second, a proposed merger, that distorts the global allocation of resources, is allowed to proceed. In the first case the potential for improving resource allocation is foregone; and in the second resource allocation is actually adversely affected. The following three factors—let's them call the “international anti-trust trinity”—can generate these inefficient outcomes.

- [multiple veto] Each nation has the right to veto a proposed transaction.
- [national standards] Each nation evaluates a proposed merger in terms of its effects on firms and consumer within its border.
- [no compensation scheme] Each nation makes a decision on whether to allow a given merger without reference to any other merger or policy matter (that might be of importance to the nations reviewing the merger).

The multiple veto feature of national merger reviewed has been discussed earlier, and the other two members of the trinity are outlined below.

The standards adopted by each nation can differ and need not conform to the traditional macroeconomic standard of Pareto efficiency—or its alternative representation, the sum of consumer and producer surplus within a nation. Suppose a proposed merger, which affects only two nations, is reviewed using standards that place far more weight on producer interests than on consumer welfare. It would not be surprising if such a merger were permitted by both nations—especially if the merged firm's additional market power increased its profits by more than enough to compensate (in the eyes of the reviewing authorities) for any consumer welfare losses. In this case a proposed merger which—on the traditional microeconomic standard—distorts the global allocation of resources is permitted.

The absence of any compensation mechanism is what differentiates multi-jurisdictional merger review from many other areas of international cooperation and negotiation, including trade reforms. Antitrust officials and practitioners are reluctant to make trade-offs across cases in the same way that trade-offs across sectors occurs during trade negotiations. Consequently, any merger that has significant adverse effects in one jurisdiction is likely to be rejected—even though the benefits created by the merger in other jurisdictions could more than offset the harm done. In this manner, a merger that improves the global allocation of resources might never have come about, having been vetoed by at least one jurisdiction. Essentially, the effects of international mergers spillover

national borders and, in the absence of any compensation scheme, mergers that can in principle improve the global allocation of resources will not take place.

This trinity is useful to keep in mind when assessing international initiatives on competition policy. One class of proposals advocates procedural cooperation between national anti-trust authorities, one goal of which is to encourage the convergence of substantive standards for evaluating mergers. Another class of proposals calls for internationally-agreed minimum standards. Yet another set of proposals argues for the explicit harmonization of standards—potentially accomplished through the adoption of common regional, plurilateral, or multilateral standards. The first observation is that, even if these proposals resulted in nations adopting a common standard, it need not be the efficiency standard advocated by microeconomists. Furthermore, even if the latter were adopted as the common standard, then the resource misallocation created by the two other members of the trinity—multiple vetoes and no compensation mechanism—would remain. The sources of resource misallocation go far deeper than the adoption of conflicting merger standards by nations.

However politically infeasible it may seem at the present time, the logic of the arguments outlined above suggest that only a supra-national decision maker⁷ that aggregates the effects of a merger across national borders in a manner consistent with the microeconomic efficiency standard can avoid the resource misallocation created by national merger review. In principle such a decision maker would only consider if in aggregate a merger improved resource allocation, irrespective of the welfare gains and losses in different national

⁷ Or a national decision maker with a cosmopolitan viewpoint which other nations deferred to.

markets. (Incidentally, it is worth noting that such a supra-national arrangement might also involve the creation of structural adjustment funds which mitigates the effects of supra-national decisions that involve certain member states losing when the aggregate welfare of the group of nations improves. Such funds may be needed to reinforce political or national support for this supra-national solution—which raises the intriguing question of whether the support for the current system of Europe-wide anti-trust enforcement would be harder to sustain in the absence of European Union funds for lagging economic areas.) To summarize, let me reiterate that I do not regard such supra-national decision making as terribly likely in the near or medium term. Rather, the point is to demonstrate that such a supra-national solution might overcome the inefficiencies created by the international antitrust trinity and do so far more effectively than the proposals discussed in the previous paragraph.

IV. National anti-cartel policies in an integrating world

Private cartels attempt to raise profits through agreements to restrict the quantity supplied to a market, to fix prices, or to rig bids. Such agreements distort the allocation of resources away from the competitive norm, and for this reason many nations have passed laws that restrict or even ban agreements likely to cartelize markets within their jurisdiction. (In contrast, many nations have often exempted from anti-cartel laws firms which attempt to cartelize overseas markets, presumably on the grounds that the harm is done to

consumers abroad.) These preliminaries aside, I now turn to an analysis of whether the effectiveness of national anti-cartel laws is compromised in a multi-country world.

National anti-cartel laws have a dual purpose: to punish cartels' that are found to exist and to deter cartels from forming in the first place. The magnitude of the deterrent depends critically on the severity of the punishments and on the probability of assembling sufficient credible evidence of cartelization. The following three factors undermine the deterrent provided by a nation's anti-cartel law in a world of many jurisdictions (see Evenett, Levenstein, and Suslow, 2001 for a more detailed exposition of the following points).

- Difficulties in collecting evidence abroad, interviewing witnesses overseas, and extraditing persons from other jurisdictions.
- Reductions in the attractiveness of national corporate leniency or amnesty programs to firms that fear applications for leniency in one jurisdiction will leave them exposed to investigations and potential punishments in other jurisdictions. This is particularly worrisome as such programs have been instrumental in encouraging firms to “defect” from a cartel agreement and to supply evidence of wrongdoing by other firms to state authorities—and rarely are cartel members successfully prosecuted without one former member turning states evidence.
- Fines for cartelization are a function of the cartel's effects within a jurisdiction—without considering the possibility that cartelizing a given nation's market enhances the profits from cartelizing other nations'

markets too. (These so-called 'multi-market effects' on the incentive to collude have been extensively analyzed in theory).

Although practitioners have recognized the difficulties created by the first two factors mentioned above, the third factor has received little attention outside of economic circles. Furthermore, only a few jurisdictions have taken steps to overcome the first set of difficulties—principally through signing bilateral cooperation agreements on antitrust matters (as Australia and the United States did in 2000) or by invoking—where possible—Mutual Legal Assistance Treaties (as in the case of the United States and Canada).⁸ What more could be done to enhance the deterrent posed by national cartel laws in a multi-jurisdictional world?

The first option would be to extend the set of existing cooperation agreements on antitrust matters to include more nations. A slightly different alternative might be to sign regional, plurilateral, or even multilateral agreements that permit signatories to request other signatories to collect evidence, interview persons, and to consider extraditing those charged with cartelization. Yet another possibility would be to establish agreed minimum agreed standards for cooperation between jurisdictions, and then allow nations to tailor cooperative agreements to their specific needs.

⁸ Waller (2000) describes the extensive and fruitful cooperation between the United States and Canada in these matters, and contrasts this with the absence of any sustained cooperation on cartel enforcement between the European Commission and the United States' Department of Justice.

The second option, which could easily build on the first, would be to allow for the simultaneous application of corporate leniency in multiple jurisdictions. In addition, nations could agree on a minimum extent of leniency awarded to successful petitioners and the minimal conditions required to receive such leniency. Under this proposal each nation would retain its own leniency program, and there would be no pooling of sovereignty. Of course, a more ambitious alternative would be for a group of nations to agree to establish a common leniency program, whereby firms would apply to a single body for leniency in all of the jurisdictions that are parties to the agreement. This would avoid the difficulties created by inconsistent leniency decisions made by more than one antitrust authority.

The third option would be to establish a panel that would estimate the pecuniary gains that a cartel has made from all the markets in which it has been found to operate. Such a panel could be entirely advisory, suggesting fines that each jurisdiction could impose and doing so in a way that the total fines equals or exceeds the total gains from cartelizing many markets. These panels could be formed on a case-by-case basis and their membership would draw from the professional economic and antitrust communities.

In sum, much can be done to enhance the effectiveness of national anti-cartel laws against international cartel without creating new supra-national agency or without pooling national sovereignty. Furthermore, much could be accomplished regionally, plurilaterally, or through organizations such as the

OECD. And indeed nations with more aggressive anti-cartel regimes could move ahead more quickly, taking the steps outlined above with like minded nations.

IV Concluding remarks

In devising a negotiating strategy for international competition policy matters policymakers are best advised to give efficiency primary consideration, not market access. (Indeed, the latter played no role in the last section's discussions on cartels). From the efficiency perspective I have given several reasons why national antitrust laws may perform sub-optimally in an integrating world economy. These reasons differ for cartel and merger policies—which highlights another point, namely that the all-too-often generic debate over trade and competition policy needs to be replaced by specific analyses of the problems faced by national enforcement of different types of antitrust laws. These analyses point to markedly different reforms options for the two types of antitrust laws considered here. While there is in principle a case for supra-national approaches to merger review, nations need not pool sovereignty to better fight international cartels.

Although the analysis here is economic in nature one will not forget that the principal practitioners of antitrust law are lawyers who are typically attuned to operating in a single jurisdiction. Given differences across nations in legal traditions and procedures, when dealing with other jurisdictions legal practitioners place much emphasis on procedural cooperation. Such cooperation may over

time enhance trust in an overseas jurisdictional procedures and practitioners, and is arguably the first step in forging new approaches to international competition policy. This form of procedural cooperation is to be encouraged and is not to be confused with my earlier skepticism about the efficiency-enhancing effects of procedural cooperation that leads to convergence in national standards for merger review.

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