

“SOFT LAW” AND INTERNATIONAL ECONOMIC REGULATION: THE CASE OF MERGERS AND ACQUISITIONS.

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With the ongoing implementation of the Uruguay Round’s multilateral trade agreements, and the associated creation of the World Trade Organization (WTO) in 1995, it has been common to think—especially in circles of international trade economists—in terms of binding rules as governing international commerce. This focus on what some call “hard rules” fits naturally with such economists’ long standing interest in the national incentives to comply with international rules in the face of pressures from domestic interests. Without implying any criticism of this worthy research programme, it is important to recognise that in recent years significant international commercial transactions are being subject to non-binding or so-called soft international rules. Moreover, in certain policy domains, national governments have explicitly rejected the negotiation of hard rules in favour of softer alternatives, often leading to the agreement of non-binding recommendations on regulatory standards and enforcement practices. A focus on hard rules, then, provides an incomplete understanding of the nature and extent of current international economic regulation.

Competition law and its enforcement is an interesting example of a state measure which has been increasingly subject to both hard and soft international rules. Many regional and preferential trading agreements include binding commitments on competition laws. The recent U.S.-Singapore free trade agreement is a case in point and contained an obligation on Singapore to enact and enforce a competition law. And, of course, the European Union’s body of competition law is of longer standing. Yet, interestingly, proposals to negotiate multilateral disciplines on hard core cartels, on core principles for competition law and enforcement (including commitments to enhance transparency and to avoid discrimination on the basis of nationality), on voluntary cooperation, and on technical

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assistance foundered at the Cancun meeting of WTO members in September 2003. The so-called July (2004) package, which it is claimed has gotten the Doha Development Round back on track, confirmed that hard rules on competition law and enforcement would not be negotiated in the WTO for the foreseeable future. This outcome reflected the determined opposition of many developing countries (in particular Sub-Saharan African and Caribbean nations), the private sector competition bar and many of the latter's official counterparts in certain leading competition enforcement agencies.

Parallel to the discussions in the WTO (which began in earnest after the Singapore meeting of WTO members) and, in the view of some, stimulated by the desire to create a non-WTO arena to further international dialogue on competition law, soft law alternatives for competition law were advocated with greater frequency in the late 1990s. The latter eventually manifested itself in the creation of the International Competition Network (ICN) in 2001.² The stated goals of the ICN are to encourage cooperation on competition law and enforcement matters and to promote greater procedural convergence of among enforcement agencies on the basis of "sound" principles. This network has no formal headquarters and is said to be "virtual" in nature. At present, 85 competition enforcement agencies are members and they are advised by a bevy of private sector competition lawyers and academics. The two U.S. antitrust agencies and the European Commission's Directorate General for Competition are the driving force behind the ICN, even though no official from these three bodies has ever been the formal head of this network.

Since its inception the ICN has undertaken a substantial programme of activities, in particular in the area of the review of proposed mergers and acquisitions. Eight Guiding Principles and 11 Recommended Practices have been agreed by the ICN's membership.³ Even though these "rules" are non-binding the ICN's members and the private sector bar (in the latter case through the so-called Merger Streamlining Group⁴) has attempted to gauge compliance with these soft rules. It should be said that for many competition agencies the notion of compliance is a very sensitive one, in part because agencies tend not to like to be seen to have fallen behind their peers. To be fair to the agencies some of the agreed Principles and Recommendations are drafted in such a way that assessing compliance in a clear-cut manner is not always possible. Even so, many officials contended at last year's Annual Conference of the ICN that more countries were in compliance with, or were converging to, the ICN's previously agreed non-binding norms.

Now why should a hard-nosed international economist be interested in any of this soft rule-making by competition enforcement officials and the private sector bar? The first important reason is that the subject of such rule-making, namely national merger reviews, influences not only national but also cross-border mergers and acquisitions (M&A). The latter, as is increasingly being recognised, is by far the largest component of foreign direct investment flows in the industrialised world. Such rule-making could, therefore, influence the pace of economic restructuring in an era of more open borders and greater

² Further information about the ICN can be found at www.internationalcompetitionnetwork.org.

³ The ICN's work programme on merger review is described at length at: <http://www.internationalcompetitionnetwork.org/mergers.html>

⁴ Information on the activities of this Group, including the surveys that it has undertaken, can be found at: <http://www.mcmillanbinch.com/MergerStreamliningGroup.html>

domestic competition. The nature of any rules adopted and the uncertainty created by them (which is said to be greatest “deal breaker” of all in M&A transactions) is, therefore, of interest.

A second reason is that, even though soft rules are not backed up a sanctioning mechanism such as the WTO’s Dispute Settlement Understanding, given the considerable time and trouble policymakers spend on soft law initiatives, interesting questions remain concerning the choice of rules, the motivation for them, and the incentive to comply with them. For example, what non-trivial factors determine the choice of soft rules over harder alternatives? What is the purpose of soft rules—to raise minimum standards, to foster convergence, or harmonisation? Do soft rules enhance the predictability of regulatory enforcement and so alter the expectation formation by the private sector? In the absence of sanctions, what incentives do competition agencies face to adopt and stick to soft rules? In this regard, are the benefits of inter-agency cooperation so large that a credible threat of non-cooperation is enough to induce broad compliance with the ICN’s merger-related recommendations? Given that most inter-agency cooperation on merger reviews is between industrialised countries, what other incentives foster compliance with the ICN’s recommendations by competition agencies in developing countries? With respect to the latter, is the promise of future technical assistance the mechanism to induce compliance by enforcement agencies in development countries? In which case one might well ask whether effective soft rules on competition law require a variety of carrots and sticks? These matters have all yet to be explored systematically.

In ongoing research, presented at a GEP-sponsored conference in October 2004, using a survey of the merger-related enforcement policies and practices of the ICN membership that was organised by a group of private competition lawyers, I attempted to estimate the factors that determine the degree of compliance with the ICN’s Recommended Practices. The considerations discussed in the paragraph above, plus some hypotheses advanced in the international relations literature, were confronted with data on 56 ICN members’ merger enforcement regimes. Although there are many caveats to be borne in mind when using qualitative survey responses provided by potentially interested parties, and given the fact that there was only one years worth of data, a number of interesting preliminary findings were established. The data rejected the hypothesis that small economies have different rates of compliance than large ones; a finding that is of interest given the arguments made by some experts in developing countries that merger review should be implemented differently in small economies where firms cannot take advantage of economies of scale. Rates of compliance were found to be independent of national legal tradition, with association with or membership of the European Union, and with membership of the ICN working group that drafted the merger Recommendations.

Richer countries tended to comply more often, as do the initial members of the ICN (who may have a greater stake in seeing this body flourish.) Recipients of technical assistance from the European Union tended to comply more whereas, somewhat surprisingly, recipients of U.S. technical assistance complied less. (In this respect it is worth noting that overall U.S. compliance with the ICN’s recommendations is reported to be less than in the European Commission’s. In the light of this information, and the findings on the effects of technical assistance reported above, it may be tempting to further hypothesise that European and American technical assistance programmes in the area of competition

law and enforcement are pulling developing countries towards different models of merger enforcement.) Finally, and not surprisingly, perceived compliance is far less when assessed (for the purpose of the survey on which this econometric analysis is based) by a private practitioner than a serving government official.

No doubt these hypotheses could be sharpened and the econometric approach strengthened. Moreover, should comparable surveys be repeated in the future, estimates of the degree, speed, and determinants of convergence will be possible. Along with data on non-ICN members, it should be possible to better identify the independent contribution of soft law to the evolution of merger review regimes. Furthermore, as more competition agencies report the number of M&A cases that they have cooperated with a peer agency on, then it should be possible to evaluate the hypothesis that ICN membership has fostered procedural cooperation.

To conclude, I have argued here that the regulation of international commerce using non-binding or soft commitments is a growing phenomenon. Using the example of merger reviews, I have described a number of economically important hypotheses that researchers may wish to examine. Moreover, as data on national participation in, and compliance with, soft law initiatives is collected, we may be able to quantify the independent contribution of non-binding international economic initiatives. More generally, this promising line of research may well shed light on the types of international economic regulation where the threat of trade sanctions is not necessary to induce compliance with international norms. Such research could have wide ranging policy implications, not least for assessing which measures should be included within the realm of the WTO.