

Would Enforcing Competition Law Compromise Industry Policy Objectives?

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I. Introduction.

One recurring concern in the debate over the efficacy of enacting competition laws in developing countries is that its enforcement may compromise important industrial policy goals. This concern has been raised in regional fora and in multilateral organizations such as the World Trade Organization, where officials have considered the pros and cons of including competition provisions in international trade agreements. However, the concern is broader and often national debates over the merits of adopting a competition law touch on the implications for the operation of national industrial policies. In fact, as the chapters in this book on China, Malaysia, and Vietnam attest the apparent primacy given to industrial policy has substantially colored recent debates over whether to adopt a competition law. Given the recent upturn in interest in industrial policy in Europe and in Latin America (see Melo 2001, Rodriguez-Clare 2004, and Rodrik 2004), and the considerable dissatisfaction with the Washington Consensus elsewhere in the developing world, the discussion in this chapter will also be of interest to scholars and policymakers outside of East Asia. In Europe, none other than the European Commissioner for Industry was reported in January 2005 as calling for the re-evaluation of the way in which

prospective mergers and acquisitions are reviewed (a form of competition law enforcement) so as to bolster international competitiveness, which is a traditional industrial policy goal.

This chapter is devoted to examining the extent to which active industrial policymaking in East Asia necessitated government measures to curb inter-firm rivalry. So as to fix ideas the leading notions (definitions is too strong a word) of industrial policy are described and their relationship to competition law and its enforcement discussed. Then postwar evidence on the extent to which the intensity of inter-firm rivalry has been modulated as part of national industrial and development strategy is discussed, drawing on the leading analyses of four fast-growing East Asian economies. This account also sheds light on the prevalence and effectiveness of attempts to modulate competition in these economies and, therefore, on the extent to which industrial policy objectives would have been compromised by the effective enforcement of competition law. In addition, five ways in which competition law can be drafted or implemented so as to carve out space for industrial policy concerns are identified on the basis of actual national experience. This last section is important, for if readers are not persuaded by the postwar evidence presented here, they can be assured that countries can—and have—found ways to reconcile the implementation of competition law with the goals of industrial policy.

II. Characterizing industrial policy.

The characterization of industrial policy in the extant literature is considerably less precise than in the case of competition law¹, and this alone is no doubt a source of considerable confusion in discussions on development policy. Given no single accepted

¹ Competition law was defined in chapter X of this volume.

definition of industrial policy exists, a number of different perspectives are described in detail below.

A recurring theme is that an objective of industrial policy in developing economies is to facilitate a “structural transformation” of their economies. Singh (2002) puts it this way:

“...the crucial importance of industrial policy is to achieve structural changes required for development” (page 22).

Likewise, in their survey of developing countries’ industrial policies, Dervis and Page (1984) argue:

“In the period following the Second World War, structural change in favour of industry was viewed as a necessary pre-requisite for modernisation and growth in most, if not all, developing economies. The primary objective of their industrial policy was to speed up the process of industrialization in order to achieve levels of industrial development that were comparable with those in Europe and North America” (page 436).

Pugel (1984) in his analysis of post-war Japanese industrial policy strikes a similar note:

“Japan’s industrial policy in general aims at achieving real economic growth by encouraging shifts in resources to more productive uses, both shifts within firms and industries and shifts in the relative sizes of different industries” (page 421).

Therefore, the final objectives of industrial policy appear to be faster national economic growth and economic development; the intermediate objectives are to expand the output of those sectors with high value added or the potential for considerable growth of value added. It is worth emphasizing that not every industry need—on the definitions above—be identified as high value added or having prospects for fast growth. Furthermore,

nothing in principle prevents a non-industrial sector—such as a service or an agricultural sector—from being so identified.

Some scholars are unsatisfied with the available definitions of industrial policy and have detected other objectives for industrial policy. For example, Bora *et al.* (1999) argue as follows:

“It should be pointed out at the outset that the term ‘industrial policy’ is not a well-defined one. It is ill-defined in relation to its objectives, the industries that are covered and the instruments that are used. The World Bank (1993)² has provided a working definition of industrial policy as ‘government efforts to alter industrial structure to promote productivity based growth.’ This definition is useful since it focuses on the objective of economy-wide factor productivity growth rather than on merely changing the structure of outputs.”

“With regard to objectives, many developing countries have in mind the potential for long run productivity growth improvements. However, in most cases industrial policy is pursued with multiple objectives, increasing short-term employment, increased output, better income distribution and enhancing technological capacity. They are often also, rightly or wrongly, non-economic objectives of national pride and prestige, as well as the perceived need to promote ‘strategic’ domestic industries.”

“These objectives are further confused to the extent that many developing economies have taken the view that ownership of assets matter. There is a concern that foreign ownership may not always fit in well with broader development objectives, including enhancing domestic capabilities. In some

² Here Bora *et al.* are referring to the World Bank’s well known study titled *The East Asian Miracle*.

cases, foreign ownership could crowd out domestic firms. Thus, even if the World Bank definition is adopted...the fact remains that developing countries have raised concerns about the source of growth” (Bora *et al.* 1999, pages 1-2).

In sum, then, there appears to be a multiplicity of objectives of industrial policies employed by developing economies.

Like competition policy, there appears to be no accepted set of instruments that are considered as part of industrial policy. Several characterizations of this set can be found in the literature. In his path-breaking and heterodox analysis of East Asian industrialization, Wade (1990) differentiates between functional and sectoral policy instruments. The latter he defines as follows:

“A sectoral industrial policy aims to direct resources into selected industries so as to give producers in those industries a competitive advantage” (page 13).³

In contrast, functional policy instruments affect either economy-wide factors (such as the supply of engineers or the price of energy) or, in principle, alter in the same manner firms’ or investors’ incentives irrespective of the industry or sector in which they operate. An example of a functional instrument of industrial policy would be an economy-wide investment subsidy or tax credit.

Tilton (1996) identified two types of industrial policy instrument in his analysis of postwar Japanese economic performance. The first instrument is described below:

³ Noland and Pack (2003) define selective industrial policies in a similar manner to Wade’s definition of sectoral policies. On page 10 of their monograph Noland and Park argue:

“We define selective intervention or industrial policy briefly as an effort by a government to alter the sectoral structure of production towards sectors it believes offer greater prospects for accelerated growth than would be generated by a typical process of industrial evolution according to static comparative advantage.”

This observation is of interest as Noland and Pack present an orthodox or neoclassical perspective on East Asian development that reaches very different conclusions than those found by Wade.

“The principal way industrial policy functions here is by allocating resources to favoured sectors. It can do so through policies that directly provide resources to industries, such as tax breaks, loans, subsidies, and import protection. More important, however, have been policies to reduce competition between firms...Industrial policy may also support industry by providing or helping to circulate information about market or technological opportunities” (pages 2-3).

He goes on to add:

“A second form of industrial policy, strategic trade policy, seeks to appropriate the benefits of strategic industrial sectors by promoting them at home and helping them gain a larger share of world markets” (page 3).⁴

For the purposes of this chapter, Tilton’s characterization of industrial policy is important because it highlights that some competition policy and trade policy instruments are also seen by some as industrial policy instruments.

Pangestu (2002) presents perhaps the most exhaustive categorization of the instruments of industrial policy:

“In practice, countries have used a wide range of instruments in the name of industrial policy. These can be categorized as external, product, and factor market interventions.”

“*External market interventions* involve protecting domestic industries from imports, using instruments such as import tariffs, quotas, licensing, and local

⁴ Strategic trade policy involves the setting of national trade policies—such as tariffs—so as to enable a domestic sector to reap greater economies of scale from the protected home market or to enable the sector to expand output and lower costs through so-called learning-by-doing effects. Both of these result in lower production costs enabling a nation’s exports to, in principle, expand export sales. In addition to expanding the output of the domestic industry, proponents of strategic trade policy note that it can result in profits being effectively “shifted” from foreign firms to domestic firms.

content programs, as well as export promotion measures to assist industries to catch up and break into new markets. Common export promotion instruments are export subsidies, export promotion zones, and subsidized credit (sometimes tied to export targets).”

“*Product market interventions* to promote competition in domestic markets include competition policy (to ensure fair competition between domestic players as well as for foreign players) and domestic market entry regulations.”

“*Factor market interventions* include policies such as performance requirements and restrictions on foreign direct investment (FDI) designed to influence the operations of foreign affiliates so that the host country realizes a net benefit from FDI. Factor market interventions in the capital market and the financial sector are aimed at correcting financial market imperfections, promoting infant industries, and protecting or phasing out declining industries. These measures include setting up development finance institutions, providing direct capital subsidies to selected industrial enterprises, furnishing capital subsidies and capital assistance to declining or mature industries and providing priority access to credit (often at subsidized rates) by requiring financial institutions to lend to particular sectors or types of companies. Intervention in the labor market may have efficiency and equity objectives. The former have to do with human resource development through education and training; the latter include minimum wage requirements and social safety net schemes” (pages 150-1).

Pangestu's characterization of the instruments of industrial policy is of interest for a number of reasons. First, her characterization highlights how the enforcement of competition law is *one* of the large number of policy instruments associated with industrial policy.⁵ This is important because it implies that the preponderance of industrial policy instruments fall outside of the domain of competition law. Second, Pangestu presumes the goal of competition law here is to promote rivalry and not to restrain it as Tilton suggested. This the first hint of divergent views as to the contribution of rivalry between firms to economic development. Third, the very fact that Pangestu feels the need to list so many policy instruments so as to accurately characterize the term "industrial policy" suggests that the latter term is so wide-ranging as to be of little more than descriptive value.

III. The postwar experience in four East Asian economies with modulating competition to meet industrial policy and developmental goals.

The goal of this section is not to describe or summarize *current* policies in East Asia, nor is it to dwell on the broader and voluminous literature on the factors responsible for this region's economic fortunes. Rather, it is to assess the *postwar* relationships between competition and industrial policies in the national development strategies of selected East Asian economies which have been the subject of scholarly contributions relevant to the relationship of competition and industrial policy. The discussion focuses particularly on

⁵ Noland and Pack (2003) offer a similarly extensive list of policy interventions as constituting part of industrial policy. They argue:

"Credit directed at specific sectors at below-market interest rates for long term and working capital, sectorally differentiated profit taxes, subsidized electricity rates, research and development subsidies, control of the entry and exit of firms, export targets, and highly differentiated tariffs and non-tariff barriers are all forms of industrial policy" (Noland and Pack 2003, page 10).

the extent of and contributions to firm, industrial, and national economic performance of governmental competition policy-related measures to stimulate or to retard inter-firm rivalry. Only the literature that directly speaks to this matter is described at any length below; consequently, the reader may not see reference to some leading studies of East Asian development that do not place particular emphasis on the role of competition policies in that region's economic performance.⁶ This section looks, in particular, at the experience of four economies: Japan, Korea, Taiwan, and China.

III.1. Japan.

Amsden and Singh (1994) analyzed Japan's use of competition policy instruments during the high economic growth period of 1953 to 1970, an epoch which some have argued is particularly relevant to developing economies today.⁷ Amsden and Singh (1994) observe that the legacy of the antitrust laws imposed by the US occupation authorities in the post-WWII period was short-lived. Increasingly, the Japanese government prioritized the achievement of national development goals over competition and is said to have pragmatically managed competition in domestic key industries. Institutionally, it is argued, this was reflected at the time by the dominance of Japan's Ministry of International Trade and Industry (MITI) over the Japanese Fair Trade Commission. In fact, in order to promote investment and to stimulate increases in productivity, MITI encouraged the formation of cartels and mergers in a variety of industries, particularly

⁶ Much of the recent literature on East Asian development is summarised in World Bank (2003).

⁷ Singh (1999) later remarked that:

"The evolution of Japanese competition policy in the 1970s and 1980s is interesting but not as relevant to developing countries as the competition policy practised by Japan between 1950 and 1973. This is because, at the beginning of the period, Japan was very much like a developing country with low levels of industrialisation and economic development" (page 10).

during the 1950s and 1960s. Most of MITI policies during the high-growth years of Japan are characterized by a bias against competition, implemented through the agency's use of "administrative guidance" to firms and industry associations. Furthermore, as noted earlier, government guidance to a domestic industry was carefully tailored to the stage of the life-cycle that the industry was in.

On this view, competition policy in Japan was implemented with dynamic considerations in mind, with MITI orchestrating collusion and competition so as to best serve the goals of external competitiveness, factor accumulation, and technological progress. Amsden and Singh (1994) quote approvingly the following characterization of MITI's methods by Yamamura (1988):

"What MITI did was to 'guide' the firms to invest in such a way that each large firm in a market expanded its productive capacity roughly in proportion to its current market share – no firm was to make an investment so large that it would destabilize the market. The policy was effective in encouraging competition for the market share (thus preserving the essential competitiveness of the industrial markets), while reducing the risk of losses due to excessive investment. Thus it promoted the aggressive expansion of capacity necessary to increase productive efficiency in output" (Yamamura 1988, page 176).

More generally the Japanese model, as the country's state-led industrialization effort is usually referred to, comprised a much larger set of policies as those directly relating to competition. Porter *et al.* (2000, page 22) lists the main building blocks of this model:

1. Activist central government with a stable bureaucracy
2. Targeting of priority industries to enhance economic growth

3. Aggressive promotion of exports
4. Extensive “guidance,” approval requirements, and regulations
5. Selective protection of the home market
6. Restrictions of foreign direct investment
7. Lax antitrust enforcement
8. Government-led industry restructuring
9. Official sanctioning of cartels
10. Highly regulated financial markets and limited corporate governance
11. Government-sponsored cooperative research and development projects
12. Sound macroeconomic policies

Those who view such government intervention as having played a crucial role in Japanese post-war development tend to argue that:

“the Japanese were the first to recognise that international competitive advantage could be deliberately created by government not just to nurture a few infant industries to supply the domestic market but to push broad sets of industries toward areas of growth and technological change in the world economy” Wade (1990, page 25).

The combination of protection with restrictions on domestic competition assured high levels of domestic profits which, it is said, translated into high rates of investment and strengthened incentives to upgrade technology; so enabling Japanese firms to successfully compete in foreign markets. Moreover, Amsden and Singh (1994) identify:

“the emphasis on exports and on maintaining oligopolistic rivalry – instead of concentrating resources and subsidies on a single ‘national champion’ as the key

factor distinguishing Japanese policies from those of other dirigiste countries” (page 946).

Furthermore, concentration ratios in Japan’s major industries fell over time, a finding which Amsden and Singh (1994) contend is:

“...in contrast to the conventional paradigm in economic development...which proposes that competition leads to economic growth, the Japanese experience suggests reverse causality; that it was growth which stimulated competition, at least in the sense of reducing industrial concentration, rather than the other way round” (page 947).

The view that restricting rivalry promoted Japanese economic development is not universally shared. It is not a matter of challenging the argument that the Japanese authorities attempted to limit rivalry; rather a matter of questioning the effectiveness of such state initiatives. As noted earlier, Porter *et al.* (2000) saw lax antitrust enforcement, government-led restructuring (often through state-inspired mergers between private firms), and official sanctioning of cartels as elements of Japan’s industrial policy. Given this record of state intervention, Porter *et al.* (2000) asked the following question:

“Does the Japanese government model explain the nation’s success? To answer this question, we sought to understand whether the application of the model and some of its key practices actually discriminated between Japan’s competitively successful and unsuccessful industries” (page 29).

Porter and his co-authors formed a sample of 20 internationally competitive sectors and another sample of seven uncompetitive sectors, and then examined in detail the nature, timing, and extent of different Japanese government interventions in those sectors. Thus,

the focus is not just on successful sectors. Furthermore, this approach enables the contribution of competition policy to be assessed along side other government initiatives in the same industry. (Porter *et al.*'s summary tables of the nature of government intervention in these 27 sectors are available from the author upon request.)

Porter and his co-authors summarized their findings as follows:

“In this broad sample of competitive industries, we found that the government model was almost entirely absent....There were no major subsidies and little or no intervention in competition. We found only one partial exception, sewing machines, an older industry that was targeted in the early years after World War II to meet domestic demand for clothing and [to] provide employment. Yet even here, Japan today is competitive not in household but in industrial sewing machines, where targeting and the other practices were largely absent. The Japanese government model, then, does not explain Japan's competitive successes” (Porter *et al.* 2000, page 29).

This is not to say that *all* forms of Japanese government intervention were ineffective in promoting the internationally competitive industries. Porter *et al.* (2000) goes on to argue:

“Looking deeper at the internationally competitive industries, we found that the government was indeed involved, but in various unexpected roles. Through a slew of initiatives, government stimulated early demand for new products, helping to foster the competitiveness of some industries⁸” (page 29).

And,

⁸ Porter *et al.* (2000) go on to describe such initiatives in the fax machine and robotics sectors.

“In other cases, government regulation triggered innovation through setting standards” (page 30).

Moreover,

“To these government policies that encouraged competitive success, three other cross-cutting Japanese government practices can be added: policies to encourage patient capital, a universal and rigorous basic education system, and a supply of engineering graduates from universities. Although not figuring prominently in the traditional model, those practices are important in the success cases” (page 31).

They conclude,

“Overall, then,...government did play a variety of roles in the successful Japanese industries. However, these roles were very different from what is closely associated with Japan, and they were not the Japanese policies that have been the most widely emulated. Not only was there little of the intervention in competition associated with the received government model; in some successful industries, such as automobiles, the industry actually spurned government’s efforts to suppress competition” (Porter *et al.* 2000, page 31).

Turning to their analysis of those unsuccessful Japanese industries, these authors argued:

“...the policies widely believed to explain Japan’s success were far more prevalent in the nation’s failures...” (Porter *et al.* 2000, page 33).

One such policy was the state-sponsored formation of cartels whose purported goals included preventing “destructive competition” and fostering cooperation and collective action. Porter *et al.* (2000, pages 36-39) document the formation of such cartels, showing

that around 1965 just under 250 of these cartels were active. These scholars went on to examine whether “...these industries became competitive because of cartels or in spite of them?” (page 39).

Several case studies were conducted on industries where cartels operated, and Porter *et al.* (2000) found that:

“...cartels are rarely found in competitive industries. In the relatively few competitive industries in which cartels were formed, they were not strong enough to significantly limit rivalry because of the industry’s structure. Conversely, cartels were common in uncompetitive industries. Legalized cartels, then, were not a source of competitiveness, they actually contributed to uncompetitiveness” (page 39).

Noland and Pack (2003) also discuss the effectiveness of tolerating anti-competitive practices in Japan and its potential contribution to Japan’s post war economic growth. They argue:

“Another possible channel of industrial policy was the tolerance of anti-competitive behavior by private firms, explicitly by the sanctioning of ‘recession’ or ‘rationalization’ cartels, or implicitly through the lax or absent enforcement of competition policies. While there is considerable evidence that anti-competitive behavior, typically facilitated by government regulation, has impeded the access of foreign goods and investment to the Japanese market, the scope for using such practices as industrial promotion policy is less clear: the most obvious examples are related to declining natural resource sectors such as soda ash or the construction industry and appear to be driven by narrow

parochial political concerns and not forward-looking strategic policies” (page 32).

Moreover, Noland and Pack (2003) observe in a discussion of the potential contribution of informal administrative guidance to Japanese economic performance:

“The one study that attempted to model the impact of administrative guidance (Weinstein 1995) found that administrative encouragement of cartels had only a minor impact on prices, margins, and sectoral resource allocation during the period 1957-88. Sakakibara and Porter (2001), who examine the impact of the tolerance of cartels on domestic competition and international trade performance, interpret their results (cartels are negatively associated with domestic competition which, in turn, is positively associated with international competitiveness) as undercutting what they perceive as the conventional wisdom that sectorally targeted policy has promoted Japanese competitiveness” (page 36).

In the light of these findings, it would be misleading to argue that there is an intellectual consensus behind the proposition that limiting rivalry promoted Japanese economic development. Moreover, in a contribution to the WTO’s Working Group on the Interaction between Trade and Competition Policy in 2001, the Government of Japan has argued that intra-firm rivalry has previously played and continues to play an essential role in Japan’s development:

“While it has been commented that Japan’s post-war economic development was achieved by subordinating competition policy to industrial policy...much of Japan’s economic dynamism has in fact been rooted in the robust market

mechanisms created through competition among firms. Industrial policy and competition policy coordinated mutually and developed an environment that allowed companies to engage in free and fair competition. The introduction of competition policy early in Japan's economic reconstruction, as well as the subsequent evolution of this in response to economic development, was a great factor in Japan's rapid economic growth in the past. Even today, it is those sectors where competition has been intensive - the automobile industry, for example - which tend to have the greatest international competitiveness" (Japan 2001, page 2).

III.2. Korea.

To the extent that accounts of Korean economic development focus on government measures to alter inter-firm rivalry, the case has been made that steps were taken to promote the development of large firms that could compete on international markets while at the same time encouraging fierce competition between these firms. That is, these measures are thought to have secured the benefits of large firm size without the costs associated with diminished competition. The paragraphs below describe this argument and discuss how—in the eyes of some—this argument has fallen out of favor in recent years.

Rodrik (1995) succinctly summarizes the thesis of one of the leading authorities on Korean economic development since World War II, Alice Amsden:

“Amsden (1989) describes in detail the Korean government's use of trade protection, selective credit subsidies, export targets (for individual firms), public

ownership of banking sector, export subsidies, and price controls – all deployed single-mindedly in the service of acquisition of technological capabilities and of building industries that will eventually compete in world markets. She argues that government policy was successful not because it got prices right, but indeed because it got them purposefully wrong. However, a key element of the strategy, Amsden argues, was that in exchange for government subsidies and trade protection the government also set stringent performance standards. Firms were penalized when they performed poorly, as when they became subject to “rationalization” (government-mandated mergers and capacity reduction) in the wake of over-extension. They were rewarded when they fulfilled government objectives, as when they were awarded subsidized credit for fulfilling export targets. Such discipline kept the system free of rent-seeking that has contaminated incentive regimes in other settings...” (Rodrik 1995, pages 2946-7).

The implications of this apparent mix of policies is described further by Amsden and Singh (1994). They contend that:

“The Korean government both contributed to the rise of big business, through its licensing and subsidised credit policies (it owned or controlled virtually all financial institutions), and went out of its way to ensure that big business did not collude, by allocating subsidies only in exchange for strict performance standards” (Amsden and Singh 1994, page 948).

High and growing concentration ratios were thought to be the result of these policies. Smith (2000) reports a trend of growing market power by the so-called chaebols over the

period 1970 to the mid-1980s. From 1977 to 1994, the 30 largest chaebols controlled between 32 and 40 percent of total national output. Total sales by the top five business groups as a percentage of national income in 1994 was 49 percent (Smith 2000, page 114). Amsden (1989) shows that in 1982, out of 2,260 commodities only about 18%, or 30% of all shipments, were produced under competitive conditions. With such facts in mind, Smith argued that:

“The end result has been an industrial structure different from that which the market would have produced. The actions of the Korean state have also been complemented by large, diversified business groups which occupied a dominant position in the economy. Their size and level of diversification meant they were less subject to the discipline of the market than to the discipline of managerial hierarchies” (Smith 2000, page 12).

In his recent overview of Korean industrial policy, Lall (2004) makes the following telling points:

“One of the pillars of Korean strategy, and one that marks it off from the other Tigers (but mirrors Japan), was the deliberate creation of large private conglomerates, the *chaebol*. The *chaebol* were handpicked from successful exporters and were given various subsidies and privileges, including the restriction of [trans-national corporation] entry, in return for furthering a strategy of setting up capital and technology-intensive activities geared to export markets...This was a costly and high-risk strategy. The risks were contained by the strict discipline imposed by the government: export performance, vigorous

domestic competition and deliberate interventions to rationalise the industrial structure” (page 19).

Others have argued, however, that the costs of creating such a cadre of large firms could not be so readily contained. It is said that these large firms used their market power at home to frustrate entry by rivals, to raise prices and slow the pace of technological change⁹, and to resist the enactment and enforcement of competition laws that could have put a stop to these adverse outcomes. These points have been made with some force in a submission by the Government of Korea to the WTO’s Working Group on the Interaction between Trade and Competition Policy in 2001. Korea notes that:

“The Korean government first tried to introduce competition law in 1963, but its efforts were not successful. The government’s concern was mainly focused on stabilizing prices of monopolies and oligopolies and preventing cornering and hoarding practices. There were some efforts of course to introduce competition law, but it never passed the National Assembly due to lack of perception of its importance and heavy lobbying from the corporate sector.”

Moreover,

“Korea’s experience demonstrates that it is better to introduce a competition regime at the initial stage of economic growth, when monopolies have not yet gained political and economic power. Despite their merits of achieving economy of scale, large monopolies, if left unchecked, are very likely to engage in excessive facility investments, cause price hikes resulting from their inefficient operations, and hinder opportunities for new entrants. This

⁹ Noland and Pack (2003) report the following:

“Park and Kwon (1995) conclude that during the heavy and chemical industry drive, the establishment of oligopolistic positions by the chaebol restricted technological change.”

eventually necessitates the introduction and enforcement of competition policy to remove anti-competitive elements in the market under the political and social pressure stemming from the rising public discontent against the unbalanced distribution of wealth” (Korea 2001, page 3).

In addition,

“Korea had to pay dearly for its failure to reconcile industrial policy with competition in the domestic economy from the initial stage of economic development. In many ways, the 1997 financial debacle and the ongoing malaise experienced by *chaebol* are linked to the absence of a competitive domestic economic environment during the past decades. Building on lessons learned the hard way, the Korean government is currently making strenuous efforts to establish a pro-competitive market structure, although it is encountering various problems in the process as vested interests in the status quo are showing more resilience than expected. The nurturing of monopolies or oligopolies through industrial policy has created these vested interests and, after decades of expansion and dominance over the economy, their necessary conversions exact a heavy toll on the economy. The Korean experience points to the importance of having faith in the benefits of competition from the early stage of economic growth and of incorporating competition policy based on the market function of autonomous adjustment into the basic framework of economic policy.”

“With the progressive liberalization of world trade, developing countries can no longer resort to the export-oriented economic growth policy through the protection of domestic industries. Therefore, competition policy should be put

into operation from the early stage of economic development to respond proactively and promptly to the rapidly changing economic conditions at home and abroad. Greater competition will ensure that unrestrained interaction of competitive forces will yield the best allocation of economic resources, thereby helping promising small and medium enterprises to grow on market-driven foundations and form a healthy industrial platform” (Korea 2001, pages 3 and 4).

For policymakers convinced of the need for industrial policies to groom internationally competitive firms or “national champions”, one implication of the Korean experience is that mitigating the adverse domestic side effects of such a policy will require measures, such as the enforcement of competition law, that stimulate or ensure rivalry between these firms.

III.3. Taiwan.

The role of government intervention in the economy of Taiwan is generally regarded as having been on a smaller scale than in Korea, with a greater role ascribed to market forces. Rodrik (1995) summarizes the findings of one leading analyst of development in Taiwan:

“Wade (1990) does not deny that there were elements of the free-market (i.e. Hong Kong) recipe in the Taiwanese strategy, but he qualifies the picture significantly. He calls Taiwan a [regulated] market economy, characterized by: (i) high levels of investment, (ii) more investment in certain key industries that would have resulted in the absence of ... intervention; and (iii) exposure of

many industries to international competition. He documents the pervasiveness of incentives and controls on private firms through import restrictions, entry requirements, domestic content requirements, fiscal investment incentives, and concessional credit. He argues that Taiwan has consistently acted in anticipation of comparative advantage in such sectors as cotton textiles, plastics, basic metals, shipbuilding, automobiles, and industrial electronics..." Rodrik (1995, pages 2946-7).

With reference to official measures that are related to competition law, there is some evidence of selective measures aimed at industrial reorganization. Wade (1990) argues:

"Industrial reorganization programs—to promote mergers, encourage greater specialization between firms in the same industry, and promote modernization of equipment—have been attempted only selectively. Most of the time the government has encouraged and supported an industry's own efforts at greater specialization and modernization, but has not tried to compel them; and it has been distinctly ambivalent about promoting mergers" (Wade 1990, page 186).

Having said that, Wade goes on to argue:

"Occasionally, however, the government has taken the initiative in promoting mergers when vital sectors are in trouble. In one such case the government virtually ordered the four polyvinyl chloride (PVC) producers to merge...Another example is the merger of five of Taiwan's major synthetic fiber producers in 1977" (Wade 1990, pages 186-7).

It would seem that only rarely were policies towards mergers implemented with certain industrial policy goals in mind, and then only in declining industries. Wade (1990, pages

187) also notes that mergers were very infrequently forced on unwilling partners. Government intervention was more prevalent in encouraging long-term relationships between buyers and sellers which, in principle, could have had implications for the enforcement of laws on vertical restraints. However, after describing some initiatives to this effect, Wade argues that:

“...with long-term subcontracting relations being unfamiliar in Taiwan, the results have so far been meagre” (Wade 1990, page 187).

Interestingly, Wade’s account does not point to official toleration or encouragement of cartels in the manufacturing sector of Taiwan. (The authorities did, however, fix the price of certain agricultural products; see Wade 1990, page 302). None of this is to suggest that the Taiwanese authorities did not try to influence the degree of competition between firms. (Indeed, Wade does document how entry into markets and access to investment funds were actively regulated by official bodies.) Rather, Wade’s account demonstrates that the measures typically associated with relaxed enforcement of competition laws (tolerating cartels, enforced mergers, sympathetic assessments of proposed mergers and vertical restraints) were used rarely, if at all, and when used there is little evidence of their effectiveness.¹⁰

IV.4. China.

Over the last two decades, the role that inter-firm rivalry has played in advancing development in China differed from that in Japan, Korea, and Taiwan. Unlike the latter

¹⁰ In their account of Taiwan’s industrial policy Noland and Pack (2003) do not mention state measures to reduce rivalry between domestic firms. Reducing competition from abroad, principally through the trade regime, was one of the three pillars of Taiwan’s industrial policy according to these authors. The other two pillars being directed credit and the creation of state enterprises to undertake economic activity when private sector entrepreneurship was not forthcoming (Noland and Pack 2003, pages 52 and 53.)

economies, China started from a centrally planned socialist economic system and has subsequently managed its transition towards a socialist market economy (Wang 2002). Throughout this transition, the rate of economic growth in China has regularly exceeded seven or eight percent per annum and tens of millions of people have been lifted out of poverty, especially in the coastal regions. Although much has been written on the development of the Chinese economy (see, for example, Lardy 1998, Naughton 1995, Nolan 2001, Perkins 2001, Steinfeld 1998, and World Bank 2003), very few researchers have focused *specifically* on the role that inter-firm rivalry has played in promoting or detracting from China's development.

Although this transition has been accomplished without the full range of competition laws, it would be a mistake to suppose that national measures did not deliberately attempt to influence the degree of inter-firm rivalry. In fact, according to Jiang (2002), it is possible to identify three phases when industrial policies had different effects on the degree of competition between firms. Jiang (2002) argues that:

“From the perspective of market competition, China's industrial policies have undergone three stages of development: (1) from the late 1970s to the mid-1980s, the industrial policies promoted competition; (2) from the mid-1980s, the industrial policies limited competition; and (3) since the mid-1990s, industrial policies have promoted and limited competition in concert” (page 49).

During the first phase it is said that the government saw value in injecting some competition into the prevailing economic system; a point that Jiang (2002) makes in the following paragraph:

“During the economic restructuring in China in the late 1970s, the Chinese government became keenly aware of the drawbacks of central planning and thus began to encourage enterprises to compete with each other to increase output, improve efficiency, develop new products, and increase employee salaries. To effectuate this new emphasis of Chinese industrial policies on competition, the government employed three new policy measures: (1) the encouragement of new enterprises; (2) the encouragement of competition among existing enterprises; and (3) the relaxation of price controls” (page 49).

In the refrigerator manufacturing industry, the effect of these policies was to reduce the four firm concentration ratio from 74.5 percent in 1982 to 29.0 percent in 1988. During the same period, total output rose 75 times to 7.576 million units per annum (Jiang 2002, page 57).

The growing competition faced by state-owned enterprises caused them increasing difficulties. In China this takes on an additional dimension as these state-owned enterprises are not only large employers but also providers of social and other welfare services. Concerns that increased rivalry was undermining the viability of these enterprises lead, it is argued, the Chinese government from the mid-1980s to the mid-1990s to adopt measures that restricted competition between firms (Jiang 2002, page 58). These measures included those to restrain the establishment of new small and medium-sized enterprises (principally through regulations on construction), measures to restrain competition between rural and state-owned enterprises, and requirements that only designated enterprises would produce certain products.

For example, Jiang (2002, page 60) reports that during this epoch the Ministry of Light Industry decided that only five firms were allowed to produce refrigerators. The medium- to long-term effectiveness of these measures has, however, been called into question. Jiang (2002) remarks that:

“This restrictive policy ultimately worked for only one or two years. With domestic demand snowballing and the refrigerator industry remained lucrative, local governments and enterprises scrambled to build new refrigerator manufacturing firms by bypassing the restrictions of the central government’s industrial policy various pretexts. Throughout 1987 and 1988 [two and three years after the initial measures were announced], refrigerator production in China reached an all-time high with the addition of an additional 180 refrigerator factories” (page 62).

Industrial policies since the mid-1990s are said to have a mixed effect on the degree of inter-firm rivalry. On the one hand, domestic consumers and investors were dissatisfied with the prevailing mix of quality and prices in concentrated industries. Jiang (2002) offers the following account of the decision to promote competition:

“During the mid-1990s, pressure from three groups prompted the central government to deal with the issue of competition in these monopolistic industries. First, domestic consumers resented the poor quality and unreasonable fees of these industries and demanded improvements in the industries’ efficiency and services. Second, new investors wanting to enter these industries began to pressure the central government to address these industries’ long-standing monopolies and high profit levels. Third, with China’s recent accession to the

WTO, China will have to give in to long-standing external pressure to open its service markets. This pressure originally convinced both the central government and the monopolistic industries that they would be unable to compete with transnational companies from foreign countries once China entered into the WTO if they did not break up the monopolies and improve efficiency through competition. As a result, in the past five years, Chinese industries that several large state-owned enterprises formally dominated have reoriented themselves to prepare for foreign competition” (page 64).

On the other hand, the continuing erosion in the viability of state-owned enterprises in the mid- to late-1990s—with its attendant consequences for unemployment, labour unrest, and social welfare—is said to have persuaded some Chinese policymakers of the need to moderate competition in certain sectors (Jiang 2002). Typically, it did so by reducing production capacity in an affected sector. In particular,

“The government focused on closing down five types of small non-state enterprises: coal mines, steel rolling plants, cement factories, refineries, and glass-producing firms. The shutdowns in 1999 accounted for 10%-15% of the production capacity in each of these respective industries. The government believed that the closure of these small enterprises would solve the problem of overproduction and alleviate the pressure of competition on the state-owned enterprises” (Jiang 2002, page 65).

It should be recognized, however, that these policy measures may have been motivated by other concerns; not least the inability of smaller non-state enterprises to meet the social and financial obligations borne by other firms.

Yet the extent of rivalry that the Chinese government appears to have decided is best for its own development is increasing, according to Jiang (2002). He contends that since the mid-1990s, the:

“...Chinese industrial policies widely carried out to support industries in short supply and restrict industries in overproduction have seen their domains dwindling steadily over the last few years. In contrast, antimonopolistic industrial policies are becoming inextricably intertwined with government policies” (page 65).

In sum, then, as far as competition in its domestic markets is concerned, Chinese industrial policies have shifted towards encouraging inter-firm rivalry. This has been accomplished without compromising another stated government goal; that of building a cadre of large firms able to withstand competition on world markets (see Box 4.1). Moreover, to the extent that enhancing competition in the domestic markets is a pre-requisite to performing well on global markets, Chinese industrial policies towards rivalry in domestic markets could well have underpinned the exporting prowess of this select group of firms.

Box 1 The creation of a “national team” in China

Nolan (2001) is probably the leading recent analysis of the Chinese policies towards development of internationally-competitive industries or so-called national champions. Nolan starts his discussion by noting that there has been some debate over the relative contribution of large and small firms to economic growth since the program of Chinese economic reforms began in the late 1970s:

“It is widely argued that China’s rapid economic development was primarily a result of the explosive growth of small enterprises, often under de facto private ownership. ...This was referred to as a ‘quiet revolution from below’ ...In fact large enterprises played a key role in China’s economic growth in this period. The Chinese state consciously nurtured a group of large enterprises that it hoped would be able to challenge the world’s leading enterprises on the ‘global level playing field’” (Nolan 2001, page 16).

During the 1990s, Nolan contends, the perceived need to develop a number of large enterprises as China’s means of competing in international markets grew even stronger. Nolan (2001) describes the creation of these enterprises as follows:

“In the 1990s a ‘national team’ of 120 large enterprise groups was selected by the State Council in two batches, in 1991 and 1997 respectively. These enterprises were predominantly in those sectors considered to be of ‘strategic importance’, including electricity generation (8), coal mining (3), automobiles (6), electronics (10), iron and steel (8), machinery (14), chemicals (7), construction materials (5), transport (5), aerospace (6) and pharmaceuticals (5)” (page 18).

A number of policies were used to support the growth of the national team. Most importantly, these firms sheltered behind high trade barriers. Foreign firms, it is said, were routinely excluded from access to domestic distribution channels. Chinese officials often chose the domestic partner with whom a foreign investor could establish a joint venture. As far as investment and innovation of these selected firms are concerned, Nolan (2001) notes:

“Members of the national team typically were given enhanced rights at a relatively early stage in the economic reforms to manage the key aspects of their business, including such

fundamental issues as profit retention, investment decisions and rights to engage in international trade. They were permitted to establish their own internal finance companies. They were given the right to manage other state-owned firms within the enterprise group. Many state-run R&D centres were simply transferred to members of the national team, in order to enhance their ability to sustain technical progress” (page 19).

As well as a variety of special rights, the national team received large-scale financial support from the four large state banks, supporting the progress of industrial concentration. Encouraged by the State Council, the state banks provided favoured access to large-scale loans.

As a result, by the late 1990s, Nolan (2001) contends that:

“the 120 enterprise groups chosen by the State Council were invariably leaders in their industries. The six trial groups in electricity generation and supply, for example, produced over half of China’s electricity. The eight metallurgy groups produced 40 per cent of the nation’s iron and steel and the six approved vehicle makers manufactured 57 per cent of China’s vehicle output. The three civilian airlines controlled over 55 per cent of the domestic market. The groups were based upon large-scale enterprises which were the ‘core members of the group’ with the ‘capability to act as investment centres’... In 1997 the 120 groups accounted for one third of total output value of the whole state-owned sector, they accounted for over 50 per cent of total profits, paid 25 per cent of taxes and made over 25 per cent of all sales. Of the 120 groups less than ten were loss-makers at the end of 1995” (page 20).

IV. Established means for resolving the perceived conflict between competition law and industrial policy.

Even if one is persuaded that there has been no general postwar tendency to subordinate inter-firm rivalry to the goals of industrial policy, specific situations may arise that give policymakers pause for concern. Moreover, there may be a variety of economic, political, and social reasons why governments will sometimes wish to shield particular activities or sectors from the application of competition law or to pursue goals or initiatives that may be in conflict with the objectives of such a law. Consequently, this section is devoted to describing five means by which potential tensions between competition law and industrial or other policy objectives have traditionally been managed in economies having active competition regimes, including industrialized and developing economies. The fact that these five means exist further reinforces the argument that competition laws can be introduced in developing countries with active industrial policies.

First and foremost, it should be emphasized that measures taken by governments in their capacities as sovereign states, even where they tend to restrict competition in markets, are not actionable under the competition laws of most countries having such legislation on the statute books. For this reason, most of the traditional instruments of industrial policy such as tariffs, subsidies, training programs, public ownership, and concessionary financing for exports are most unlikely to be challengeable under competition law. Even regulations or policy directives that deliberately restrict entry to markets or otherwise limit competition (e.g., state-mandated mergers) are unlikely to raise concerns under competition law, so long as they are implemented pursuant to valid governmental

authority and otherwise meet tests or requirements that may apply under national laws (WTO 1997).

A second way in which potential tensions between competition law and the attainment of developmental objectives is managed in many countries is through the explicit incorporation of these objectives in national competition laws. For example, as has already been pointed out in chapter X, the Competition Act of 1998 in South Africa includes a multiplicity of objectives. Opinion is divided as to the merits of introducing wider social goals into competition law, and there appears to be a general trend toward focusing on economic efficiency or on consumer welfare as the principal goals of competition policy. The following quotation from a recent submission to the Third OECD Global Forum on Competition by the Republic of Ireland is representative of this point of view:

“Policy makers may seek to use competition policy to further other (broader) policy objectives such as industrial policy, regional development or the ‘the public interest,’ as for example in a public interest test for mergers. There are two reasons why it is best not to use competition policy as a wider policy instrument. First, broadly specified policy objectives can be ambiguous and as such are subject to ‘capture’ or ‘hijack’ by the politically strongest private interests, usually those of producers or workers. Thus de jure public interest objectives may de facto serve private interests. Secondly, non-competition policy mechanisms are generally superior for achieving non-competition policy objectives. To elaborate, restricting competition in an attempt to achieve a

broader policy objective will have inevitable anti-competition side effects...”

(Ireland 2003, page 3).

Nonetheless, it is beyond dispute that, traditionally, other goals have frequently been referred to and served to guide the application of national competition laws in industrialized as well as developing countries.

A third point to be made is that, even where developmental or similar goals are not explicitly written into competition laws, responsible officials can and increasingly do take into account dynamic as well as static efficiency considerations in the application of relevant laws. Indeed, given the goal of improving long term economic performance is one of the often-stated objectives of industrial policy, it is worthwhile pointing out that in a growing number of jurisdictions the actual application of competition law in particular cases has been deliberately adapted to assess dynamic factors. This shift towards greater openness to dynamic efficiency considerations has, in most cases, not required overhauls of competition legislation; rather, it has been achieved through the progressive adaptation of guidelines and the techniques used in case analysis. This trend has been evident since at least the mid-1990s and, in some cases, before then (WTO 1997; see Anderson and Khosla 1995 for a survey of developments in various industrialized countries).

As one illustration of efforts to adapt the application of national competition laws to facilitate and promote the achievement of efficiency gains, in the United States, successive versions of the antitrust agencies’ “merger guidelines” over the past two decades have placed progressively greater emphasis on these matters (see US Department of Justice and Federal Trade Commission 1997). The concept of “innovation markets” was developed for the specific purpose of ensuring that competition law enforcement in

the US is well-adapted to promote rather than impede the realization of dynamic efficiency gains. This concept recognizes that: (i) competition is a key underpinning of innovation; and (ii) anti-competitive mergers or other inter-firm arrangements can undermine the incentives for innovation in particular cases (Gilbert and Sunshine 1995). Such concerns have been the basis for a number of decisions by the US competition agencies to block mergers in a number of cases (Gilbert and Tom 2001).

The growing propensity to enforce competition law with considerations of innovation and dynamic efficiency in mind is highlighted in a recent analysis of the evolution of US antitrust policy in the 1990s by Litan and Shapiro (2001). These authors point out that:

“...the 1990s covered a period during which new technologies had a marked impact on a range of markets, with the Internet and information technology leading the way. Increasingly, the fruits of competition are seen in the form of new technologies which lead to new and improved products. At the same time, intellectual property rights, in the form of patents, copyrights, and trade secrets, increasingly have become a key source of competition advantage for firms controlling such rights. How natural, then, that antitrust authorities have paid more attention to ‘innovation competition’ and intellectual property rights” (page 3).

Similarly, after carefully reviewing the enforcement records of US agencies since 1990, Gilbert and Tom (2001) conclude that:

“innovation is not quite ‘King’ in antitrust authorities, although its role has become increasingly important and has been decisive in several merger and non-

merger enforcement actions that have potentially very significant impacts for consumer welfare” (page 3).

It is noteworthy that this shift was achieved through the progressive adaptation of guidelines and techniques employed in case analysis.

A fourth way in which potential tensions between competition law and the attainment of industrial policy objectives can be managed is to allow for exemptions, exceptions, and exclusions from competition law. Almost all jurisdictions with competition statutes have some exemptions and exclusions. The rationale for exemptions from national competition laws has been clearly articulated by the Chairman of the Australian Competition and Consumer Commission:

“A competition regime needs to operate in conjunction with other government policies. Inevitably, conflict between policies will arise and it will therefore be necessary to determine priorities based on an assessment of national interests. For this reason, a mechanism is needed to provide for exceptions from the general application of a competition regime” (Fels 2001, pages 3 and 4).

The fifth option would be to allow a governmental body to overrule a decision made by the competition enforcement agency on the grounds that national development priorities would be compromised. The former governmental body could be the national cabinet, the head of government, or a minister. Although some nations’ competition laws, for example Germany’s, provide for such overrides in certain well-defined circumstances, the clear trend is toward eliminating such overrides and strengthening the independence of the agencies that enforce competition law (WTO 1997).

In concluding this section it is worth noting that each of these five means of reconciling industrial policy measures or its objectives with the implementation of competition law has pros and cons. The fact that an institutional arrangement is feasible does not make it desirable. For example, the last option could substantially undermine the effective independence of the competition agency and essentially politicize competition law enforcement. When policymakers conceive of a tension between industrial policy and competition law, care will have to be taken to identify which of the five options outlined above (and potentially others) best attains the industrial policy cost while compromising the goals of competition law the least.

V. Concluding remarks.

The purpose of this chapter was to assess measures to promote or to retard such inter-firm rivalry have played in the development of four East Asian economies. The goal was not to present a more general account of the effects of industrial policies in East Asia, an objective that would have gone well beyond the remit of this chapter. Nor was the goal to summarize the current development policies or priorities of the economies concerned. Even with this chapter's narrower focus, a number of findings have emerged from this foregoing discussion of the extant literature.

First, in China and Japan the state occasionally took measures to constrain competition; and in both cases, scholars have in recent years presented evidence that questions the effectiveness of such measures. Second, the Korean experience was instructive in highlighting that the effective enforcement of competition law is needed to counter the adverse domestic consequences of policies to create national champions. This point is

accepted by authors from very different schools of thought. Third, the special problems faced by transition economies was highlighted in the account of China's reforms since the late 1970s. Concerns about employment loss and social dislocation have, it is argued, led to some measures to constrain competition. Yet, the frequency with which such measures are employed seems to have been declining.

Overall, any claim that measures constraining rivalry were a central component of development policies, and certainly the view that such measures were effective, is increasingly at odds with the conclusions of more recent empirical research into East Asian development. Recent research on the effectiveness of cartelization in Japan seriously calls into question whether the success of Japan's internationally competitive industries depended on state-sponsored or state-tolerated price-fixing and similar practices. Korean and Chinese experience seems to suggest that policies to create large national firms ought to be complemented by measures to ensure continued rivalry in domestic markets. In sum, this recent literature adds further credibility to the view that the active and appropriate enforcement of competition law in these four East Asian economies would have reinforced rather than compromised their national industrial policies and overall development strategies.

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