

1. The role of competition law and enforcement supporting development in Central American sub-region.

The goal of this section is to describe the many ways in which competition law and its enforcement can affect prices, poverty, competitiveness, and economic development. The importance of these variables cannot be under-estimated: poverty is explicitly mentioned in the Millennium Development Goals, and competitiveness and economic development are the focus of UNCTAD XI. As there is much confusion concerning what competition law is and what it is not, this section begins with a few preliminary remarks to define terms.

1.1 Competition law: definition, instruments, and objectives

Before proceeding further it will be useful to distinguish between the terms competition law and competition policy. As one group of scholars recently put it:

“[c]ompetition (or antitrust) law lays down the rules for competitive rivalry. It comprises a set of directives that constrain the strategies available to firms” (Audretsch et al. 2001, page 614.)

In contrast, competition policy is a far broader term. The term competition policy refers to all of those government measures that can influence the intensity of competition in national markets or that bear on an economic entity’s freedom to trade (World Bank-OECD 1997, page 2).¹ Consequently, a nation’s competition laws are part of its competition policy, but so are many other laws and policies including trade policies, measures towards foreign investors, domestic business regulation, privatisation initiatives and the like.

Given the focus here is on competition law, it may be useful to report that UNCTAD (2002) has identified the following five state measures that tend to be enacted through competition legalisation:

1. Measures relating to agreements between firms in the same market to restrain competition. These measures can include provisions banning cartels as well as provisions allowing cartels under certain circumstances.
2. Measures relating to attempts by a large incumbent firm to exercise independently market power (sometimes referred to as an abuse of a dominant position).
3. Measures relating to firms that, acting collectively but in the absence of an explicit agreement between them, attempt to exercise market power. These measures are sometimes referred to as measures against collective dominance.
4. Measures relating to attempts by a firm or firms to drive one or more of their rivals out of a market. Laws prohibiting predatory pricing are an example of such measures.
5. Measures relating to collaboration between firms for the purposes of research, development, testing, marketing, and the distribution of products.

¹ It should be stressed that the weight given to these two components has tended to vary across jurisdictions and over time.

In addition, some national competition laws give the agency entrusted with enforcing these laws the right to comment on, or otherwise intervene in, the formation of competition policies more generally. When a competition agency comments on the policy proposals of another state body, or when it makes the case for greater inter-firm rivalry, it is said to be engaging in *competition advocacy*. It should be noted that not every nation with a competition law in Latin America (or elsewhere) has or enforces all of the six measures above.

There is a considerable debate over the goals of competition law. Many observers from industrialised countries contend that the goal should be to enhance the static and dynamic efficiency of an economy by altering the allocation of resources (Posner 1978, 2001; Baumol 2001). However, for better or for worse, many jurisdictions have given their competition laws a number of non-efficiency-based objectives such as Mexico's Federal Economic Competition law which seeks "to protect the competition process, and the free market access."² [IS THERE A BETTER EXAMPLE IN LATIN AMERICA. I CANNOT FIND ONE.]

1.2 The effects of enforcing competition law on prices, poverty reduction, competitiveness, and dynamic economic performance

By and large, the enforcement of competition law can have a large number of pro-developmental effects. Some effects are felt in the near term, and some in the longer term. And some of the benefits of credible and effective competition law enforcement do not require actions by the state at all. In this section, the principal effects are summarised.

Whether or not one is interested in short term or longer term effects, it is important to appreciate that effective competition law works through three channels. First, the investigation of competition agencies can result in anti-competitive practices being broken up—just as in the case of the poultry cartel in Lima, Peru. Here enforcement is *corrective* and can put a stop to an anti-competitive act. Second, competition laws can require that some acts that firms want to undertake—such as mergers, acquisitions, or agreements between distributors and manufacturers—be reviewed before they actually occur. Here competition law is *pre-emptive* in its effects. Third, once credible, the threat of competition law enforcement can dissuade firms from undertaking anti-competitive acts in the first place. Here competition law has a *deterrent effect*.

The fact that competition law works through three channels is no guarantee that the outcomes are beneficial to society. Competition laws must not reinforce entrenched economic interests. The staff necessary to enforce them must be well trained and able to interpret often complex pieces of economic evidence. Moreover, the power granted by law to competition enforcement officials must not be abused through corruption or bureaucratic harassment of the private sector. In short, having a competition law on the statute books is no guarantee of pro-development outcomes—and one of the goals of this subregional report is to identify the very steps that Central American nations might take to ensure that any competition laws and enforcement practices are better aligned with national development strategies.

² <http://www.cfc.gob.mx/EnContenido.asp?P=DirResults.asp?txtDir=http://xeon2/cfc01/Documentos/ing/Legislation/Federal%20Law>

In the near term, an immediate effect of competition law enforcement against price-fixing and collusion is to encourage inter-firm rivalry, which typically results in lower prices for purchasers. It is a mistake to think that only consumers are purchasers. (This mistake is compounded when it is realised that many of these consumers are the poor that development policy hopes to lift out of poverty!) Firms and governments buy many goods and services too. When enforcement lowers the prices of inputs to production, competitiveness of the purchasing firm improves. And when competition enforcement attacks bid-rigging, governments pay less for essential items (such as medicines) and for building projects (like schools and hospitals).

While the above short run effects of competition law and its enforcement are quite widely accepted, what is far more controversial is the relationship between enforcement and dynamic—or long-term—economic performance. It would take too much space to describe each and every viewpoint, so instead the major arguments are summarised below. Interested readers are referred to a longer account in WTO (2003). Put simply, the following five arguments contend that promoting rivalry between firms enhances dynamic economic performance:

1. Greater competition between firms sharpens incentives to cut costs and to improve productivity.
2. The benefits from trade reform, deregulation, and privatisation will not be realised without the potential for active and effective enforcement of competition law.
3. The appropriate enforcement of competition law adds transparency to a nation's commercial landscape which, in turn, attracts foreign direct investment.
4. Greater competition in product markets stimulates both product and process innovations.
5. Rivalry in the market for future innovations can be protected by the active and appropriate enforcement of merger and acquisition laws which prevents, for example, one firm taking over another firm which has a potentially strong, but not as yet fully developed, range of rival products.

Without claiming that each of these arguments applies with equal force in every developing country, in my view the conceptual arguments and the available empirical evidence by and large supports the view that promoting inter-firm rivalry³ enhances the dynamic economic performance of developing economies.⁴ Furthermore, it is worth noting that in the second, third, and fifth arguments above the appropriate enforcement of competition law plays a direct role in promoting long-term economic performance; in the other two arguments such enforcement plays an indirect role by first fostering inter-firm rivalry.

On the other hand, the following four arguments question whether unfettered rivalry between firms promotes development:

³ Or preventing reductions in such rivalry now or in the future.

⁴ Of course, this is not to say that other government measures cannot promote such rivalry.

1. Missing markets, especially financial markets, imply that investments can only be financed out of retained profits, which are eroded by unfettered competition between firms.
2. Firms, it is argued, need to achieve a certain size to compete effectively on world markets or to withstand competition from imports. This view has clear implications for the conduct of reviews of proposed mergers and acquisitions, especially in those sectors where so-called national champions currently, or might in the future, operate.
3. Governments need not intervene to promote rivalry in markets where innovation is the principal source of competition. In such markets current monopoly profits act as a spur to innovation and the creation of new products and processes.
4. Maximising rivalry leads to inefficient outcomes in national monopolies and in some network industries.

The first three of these arguments are flawed and certainly do not provide a general critique to implementing competition law and enforcing it properly. The first argument is unpersuasive as it suggests that competition law should somehow compensate for inadequate capital markets and banks; the solution, of course, being to develop the latter directly so that firms can borrow to invest. The second argument applies at most to the few export industries with substantial economies of scale. It turns out that few manufacturing industries in developing economies have falling costs of production when output rises. Moreover, even if one is convinced that the firms actually fit the definition of national champions, the most they call for is an exemption from competition law—and therefore, this not a valid argument for implementing a competition law in the first place. The third argument cannot apply to those many markets in developing countries where prices—rather than innovation—are the central focus of competition. Moreover, empirical studies have shown that competitive pressure strengthens the incentive to innovate, not weaken it (see WTO 2003 and references contained therein.)

The fourth argument above (which referred to natural monopolies) can be taken into account in the design of a national competition law. Exemptions can be offered for natural monopolies and an appropriate regulatory framework created to encourage the large incumbent firms not to exploit their monopoly power. It should be noted that nothing prevents a competition enforcement agency acting as a sectoral regulator too.

To summarise, the appropriate and well-resourced enforcement of competition law can promote development by lowering prices, encouraging competitiveness, reducing monopoly power, and advancing long-term development. The arguments advanced against adopting a competition law are at best arguments for an exception to those laws—at worst, these arguments are flawed. The consequences described here are the ones that Central American economies can expect to reap as they enforce their competition laws. Typically, the initial case load of competition agencies is cautious and conservative. But as experience develops, and as an enforcement agency's credibility is enhanced with the private sector, then the deterrent effects of competition law will reinforce the corrective and pre-emptive consequences of these laws.

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