UNCTAD/DITC/CLP/2004/1

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

COMPETITION, COMPETITIVENESS AND DEVELOPMENT: LESSONS FROM DEVELOPING COUNTRIES

CHAPTER I

UNITED NATIONS
New York and Geneva, 2004

I

Prerequisites for development-oriented competition policy implementation

I.1. THE ECOLOGY OF ANTITRUST: PRECONDITIONS FOR COMPETITION LAW ENFORCEMENT IN DEVELOPING COUNTRIES [**]

Michal Gal [*]

1. Introduction

The number of developing countries that have adopted a competition law has grown exponentially over the past two decades.[1] Often the passing of a competition law has been treated as one of the cornerstones of the liberalization and pro-market reforms that have swept through many developing countries. Yet the mere adoption of a competition law is a necessary but not sufficient condition for it to be part of market reform. Just as ecological conditions determine the ability of a flower to bloom, so do some preconditions affect the ability to apply a competition law effectively.

This study seeks to identify the ecology of antitrust in developing countries: the soil, sun, water and pesticides of competition law adoption and enforcement. In particular, it analyses the socio-economic ideology (soil), the institutional and organizational conditions (sun and water), and the political economy conditions (pesticides) that are necessary for competition law to bloom. It does so based on a theoretical framework as well as by analysing the experiences of developing countries in applying competition laws. Of course, other conditions may also affect the efficiency of competition law enforcement. These may include, for example, the size of the market (Gal, 2003), its openness to trade, or the extent of its privatization process. These conditions are, however, country specific and will only be dealt with in this paper inasmuch as they shed light on the above preconditions.

The first section sets the stage by elaborating on the special characteristics of developing countries. The second section analyses the inevitable connection between a country's socio-economic ideology and the enforcement of its competition laws. It delineates the experiences of several jurisdictions in adopting a competition law at different stages of development and with differing socio-economic ideologies. As will be shown, the ideology of policy makers must strongly support a pro-market reform for competition law to have a significant impact on markets. The section also highlights the two-way interaction between competition law enforcement and competition policy in developing countries. As will be argued, the competition authority has an important role to play in creating a competition culture. It can do so, *inter alia*, by advocating the creation of pro-competitive conditions to regulators and the general public and by enforcing the law to limit private barriers to trade, thereby exemplifying the benefits of antitrust.

The third section focuses on the political economy of antitrust. It delineates possible challenges to the adoption of a competition law in developing countries. As will be argued, competition law is susceptible to political influences given its non-sector-specific and long-term nature. It is thus necessary to adopt pesticides, either internal or external, to overcome such obstacles. Such pesticides will also be analysed.

The fourth section focuses on the organizational and institutional preconditions for antitrust enforcement. As Richardson observed, firms will commit their investments and productive resources into production activities, as long as they have a reasonable expectation of obtaining a return for their investments (Richardson, 1960). Such assurance depends not only on one's competitive advantage but also on the existing institutional setting, which determines the actual enforcement of laws, including those limiting the creation of private barriers to trade (De Leon, 2000: 14). To ensure credible and impartial enforcement, the institutional landscape should provide the enforcing bodies with efficient and effective tools for enforcing the law and for educating market players in its provisions and its benefits. It should also reduce the motivations of the enforcing bodies to make decisions that favour specific interest groups. The section will analyse the necessary institutional preconditions to achieving such goals, with a special focus on developing countries.

Clearly, the themes of this paper are interrelated. The political economy of antitrust affects the existing socio-economic ideology, and the institutional features of the enforcing agencies will affect their ability to educate the public in the benefits of competition law in order to create a competitive culture. Yet, the somewhat sterile differentiation between the preconditions for antitrust enforcement serves an important function by enabling us to place a spotlight on each of the components of the ecology of antitrust.

It should be emphasized from the outset that this paper does not seek to answer the question of whether competition policy is an optimal tool for promoting the economic and social objectives of developing countries. It is based on the assumption that the answer to this question is positive, at least to a considerable degree. Yet, it does seek to answer the question of what preconditions must be present for a competition law to apply in practice.

2. Why focus on developing countries? Identifying the challenge

Developing countries pose unique and interesting issues for competitiveness and competition law enforcement. Their low level of economic development, which is often accompanied by institutional design problems and complex government regulation and bureaucracy, creates real-world challenges that have to be recognized before the successful implementation of an antitrust regime. The experience of many emerging competition authorities underlines the importance of identifying the specific challenges developing countries face in adopting and enforcing competition law as part of an overall public policy mix in pursuit of economic development.

The role of competition law has arisen in response to the privatization and liberalization movements that have swept many developing economies in the past two decades, which have been spawned by technological, economic, political and ideological forces. To enjoy the benefits of liberalization, however, an appropriate regulatory framework must be put in place. Otherwise, private barriers may simply replace governmental barriers to trade, an outcome which might prevent improvements in social welfare. Trade liberalization alone does not necessarily lead to more competitive markets. An important share of economic activity in developing countries relates to non-tradable goods and services (e.g. electricity, financial and legal services), which are only marginally exposed to international competition (Correa, 1999: 368–369). Moreover, trade liberalization may sometimes exacerbate the need for competition law, as the liberalization process in many developing economies has entailed the displacement and closing down of many small and medium local enterprises, and has led to market dominance of a few firms through unilateral or coordinated conduct (Khemani, 1996: 107). If such markets are not subject to constraints on private limitations to competition, companies might not be able to take advantage of competitive opportunities and social welfare might even be harmed (UNCTAD, 2000: 12).

Moreover, the need for competition laws has increased due to globalization and the changes it has brought about at the international level, including the gigantic cross-border merger movement of the 1990s (Singh, 2002: 9; UNCTAD, 2002a: 17). Developing countries might be significantly affected by the monopoly power of large international firms, exercised either unilaterally or collusively, if such power is not properly regulated (UNCTAD, 2002a: 11). Competition law is thus an important part of market reform, to ensure that social welfare is increased and that developing countries can enjoy at least some of the benefits of world markets.

A study on the effective implementation of competition laws estimated that competition authorities in advanced countries are 40 per cent more effective than their counterparts in developing countries (World Bank, 2002). What, then, are the obstacles to the effective implementation of a competition law in developing countries and what can be done to overcome such obstacles and create a strategy that supports reduction of private barriers to trade? This will be the focus of the remainder of the paper.

3. Soil: socio-economic ideology and competition law

Competition law is a regulatory tool that limits the conduct of economic actors to ensure that the benefits of competition are not frustrated by the erection of private barriers to trade. It does so, *inter alia*, by limiting abuses of monopoly power by dominant firms, by prohibiting cartelistic activity and by preventing mergers and other types of cooperative conduct that would harm social welfare. Yet competition law is not a stand-alone regulatory tool. Rather, it is generally part-and-parcel of a wider set of public policies in pursuit of social welfare. As such, it is shaped and transformed by the existing socio-economic ideology and by the other policy tools that are implemented.

As the experience of many jurisdictions clearly indicates, socio-economic ideology, sometimes termed the competition culture, determines to a large extent the success or failure of a competition law. Several developing countries have had antitrust laws for many decades, but until recently none appears to have been regularly enforced to further the aims generally associated with competition law. This was because competition law clashed with the existing socio-economic ideology, which shaped public policy and, thus, it did not enjoy full and consistent support by the enforcing government. This section analyses the experiences of developing jurisdictions in adopting a competition law in different public policy settings. It points to non-market ideology underlying public policy as a major obstacle for applying competition law, and proposes some methods to limit this obstacle.

The Israeli experience serves as a good example of the effects of socio-economic ideology on competition law enforcement (Gal, 2004). Israel adopted a competition law in an early stage of its economic development, as a response to a public outcry against private cartels. The Israeli Competition Act dates back to 1959, only 11 years after the country was established, at a time when it was trying to create an economic infrastructure to serve a small, developing, immigrant country, while combating formidable monetary problems. To do so, the government adopted a highly interventionist and paternalistic industrial policy that regulated almost all aspects of economic activity. The market was likened to an infant, who cannot walk on his own and who has to be directed so that he would eventually learn to walk. Since the belief in the market's invisible hand was very limited, the government held the reigns of the market, *inter alia*, by controlling import certificates, by providing monetary funding to economic activity that it deemed beneficial, by granting exclusivity rights to some producers and suppliers, and by directly controlling prices and trade conditions of many goods and services. As a result, competitive conditions in the Israeli market were very limited. Free competition, it was believed, would have prevented the establishment of efficient domestic firms and would have destabilized the market.

This raises the question of what role a competition law has to play in such an environment: How does a competition law apply when prices are controlled by direct price control rather than by market forces, where investment decisions are indirectly subject to approval by government officials, or where joint ventures between potential competitions are supported by the government in order to achieve economies of scale and prevent market destabilization? The answer is that the application of the competition law reflected this socio-economic ideology. The Antitrust Tribunal, which was charged with determining the legality of business conduct, gave little weight to competitive considerations in its decisions. Rather, its decisions mirrored the controlling ideology by broadly interpreting the public interest exception that was included in the law.

The Tribunal's decisions in the 1960s and 1970s are characterized by an emphasis on nationwide goals, such as the encouragement of export, the realization of economies of scale, and the improvement of the country's balance of payments while placing little emphasis on the establishment of competitive conditions. Accordingly, the Tribunal ordinarily approved agreements among competitors, which had the potential to increase productive efficiency by designating the production of different types of products to different firms. It also approved many agreements which were geared towards an increase in exports, even if the effect was increased dominance in the Israeli market. This is exemplified by the Plywood decision,[2] in which the Tribunal approved an agreement among plywood producers that fixed prices and designated quotas, although the agreement clearly increased prices in the Israeli market. It reasoned that the agreement was necessary to increase exports of plywood and to increase productive efficiency. This application of the law fit well with the prevailing ideology. The first Director of the Antitrust Authority, who adopted a more pro-competitive approach, was not well accepted by the government and most of his recommendations were not applied in practice.

It was only in the mid-1980s, when the socio-economic ideology of the Israeli government changed significantly towards a pro-market orientation, that the Competition Act began to have a significant effect on the Israeli economy. The government's pro-competitive approach resulted in the lowering of governmental barriers to the free operation of markets, the implementation of privatization plans and the liberalization of trade to ensure that competition was the main driving force of most of the Israeli markets. Similarly, the Tribunal and the Antitrust Authority began to give more weight to competitive considerations and applied long-term, dynamic economic analysis. In the span of only a few years, a large corpus of decisions based on economic analysis was created and enforcement rates rose significantly. The Israeli Supreme Court likened the Competition Act to the Magna Carta of consumer rights and free competition.[3]

This change can be exemplified by the decision in the case of Poligar.[4] There, the Antitrust Authority was requested to approve a joint marketing venture between the only two Israeli producers of polyethylene covers. In analysing the effects of the proposed venture, the Director stressed the disciplining effects of potential and existing imports on the market power of the domestic firms. He approved the venture since it would enable the domestic firms to reduce their costs and thus compete more effectively with foreign importers, without harming the Israeli consumer. This reasoning differs significantly from that on which past decisions to approve joint ventures were based. Whereas in the past, emphasis was placed on the ability of the parties to the venture to reduce their costs without a real analysis of total welfare effects, the decision in Poligar approves the venture based on the need of the parties to act more efficiently in order to meet foreign competition. The analysis promises that the Israeli consumer, as well as the Israeli firms, will enjoy the benefits of the venture. This sort of analysis, which gives much weight to competitive considerations based on market conditions and evaluates the effects of the conduct on all market players, characterizes most of the decisions from the 1990s on.

What are the lessons to be learned from the Israeli experience? Most importantly, that competition law does not stand alone. The prevailing socio-economic ideology and public policy are determinant factors in the application of a competition policy. Without the elimination of governmental barriers to competition and a real change in public policy it is not possible to create a level playing field in which firms will invest and compete effectively. It is thus imperative that the government truly and consistently accepts the principles of competition in all of its spheres – the judiciary, the government and the legislature – for competition law to be effectively implemented. Competition law, of the kind known and accepted in most developed economies, could only bloom in a society which is based on a belief in the benefits of the market's invisible hand over direct regulation, at least in most of its markets.

A similar conclusion can also be discerned from the experience of other jurisdictions, which have adopted a competition law without a real conviction and belief in a competitive system. Several Latin American countries have had competition laws for long periods. Yet, competition policy enforcement clashed with the industrial development policies prevailing in the region. Even when economic liberalization was under way, governmental barriers still existed in the form of capacity licensing, investment and procurement policies and price controls (Frischtak, Hadjimichael and Zachau, 1989: 2). This conflict delayed the successful implementation of competition laws, as the setting within which Latin American competition law grew was not receptive towards the ideas and values ingrained in competition policy. Unsurprisingly, in this context competition could not emerge as a worthy social value. It was only when the paradigms of public policy in some Latin American countries changed profoundly to endorse market functioning, rather than government action, as the cornerstone of economic development that competition law could begin to blossom (De Leon, 2000).

Owen has also observed that comparative success in market reforms and the application of a competition law appears to be due in significant part to a policy consensus within the government. Competition law enforcement has been successful in some Latin American countries, such as Chile and Mexico, in which there is a substantial national commitment to market reforms. In countries where the political and social commitment to market reforms is more ambivalent, or where other priorities prevail, such as in Argentina, competition agencies appear to have been less successful (Owen, 2003: ii).[5] The following statement of the Brazilian Agency is indicative:

"Although Brazil has had an antitrust system for more than 30 years, it was only after all the necessary structural reforms had been implemented that it did in fact become operational. The reforms included trade liberalization, privatization and the creation of sectoral regulatory agencies, which made it possible to enforce competition rules. These reflected the change in understanding over who should be responsible for the promotion of economic growth: before, there was the government leading the investment and indicating the relevant sectors for the private businesses, and then free market allocation of resources."[6]

The importance of a strong and unambiguous pro-market policy as a key factor underpinning the enforcement of a competition law is also emphasized by the experiences of Korea, Jamaica, Zambia, Poland (ICN, 2003: 28), Pakistan and India (CUTS, 2003a).

One can legitimately ask why would a country adopt a competition law without a sound competition policy and a market-oriented ideology to support it? Several reasons may explain this puzzle. It may well be that the law was adopted in response to pressures from certain groups or institutions. These can be internal, such as in the case of Israel, or external, as in many Latin American and Eastern European countries which have adopted competition laws for the purpose of ensuring the successful negotiation of trade agreements, or in response to demands of international lending agencies who viewed the introduction of a competition law as a fundamental component of institutional reform. In other countries the adoption of the law was sometimes guided by rather superficial concerns, such as a potential antidote to spiralling price inflations, without the parallel creation of a competitive environment.

To sum, the experiences of many jurisdictions indicate that the socio-economic ideology of a country has an important role to play in shaping the antitrust landscape. Without a supporting belief in pro-market reforms, competition law alone has a very limited effect on changing market conditions. Such support should be not only theoretical, but must also be manifested in other policy tools that serve to create a competitive environment, to induce and increase private players' efforts to attain and maintain competitiveness. Thus, if competition law is to be an effective deterrent to private anti-competitive behaviour, a real change in the socio-economic ideology underlying public policy is required.

To be sure, this does not mandate the adoption of competitiveness or economic efficiency as a stand-alone goal. It does, however, require the government to limit competition only where such limitations are necessary in order to accomplish more important social objectives, after weighing the costs of reduced competitiveness against the benefits of such policies. This point is worth elaborating upon, given the resistance of many developing countries to the adoption and the implementation of a competition law, which is often based on the argument that it may harm the furtherance of goals, which are crucial to the country's economic development or to its social values. In particular, it is argued that application of a competition law can harm the creation of a technological infrastructure that would enable firms in developing countries to achieve dynamic efficiency and compete in the future in global markets, and that it would strengthen distributive justice concerns.

These concerns about the goals of antitrust are not necessarily valid. If correctly applied, a competition law should take account of dynamic efficiency considerations rather than be based on a static appraisal of business conduct. It may, thus, sometimes promote competition and in other cases allow for its limitation. Moreover, although the main goal of competition law is the enhancement of economic efficiency (OECD, 2003), there is no inherent limitation in the law to the furtherance of broad industrial policy and socio-economic goals. In fact, developing countries may, and often do,[7] give weight to other public policy concerns, such as distributive justice or employment concerns. South Africa is an often-cited example. There, the competition law is applied in a manner that balances between competitive considerations and broader policy initiatives, such as the protection of low-income inhabitants from price rises. A mixed approach to antitrust, while creating costs in loss of efficiency, especially for small economies (Gal, 2003), may be justified in those developing economies in which a purist approach might prevent societal acceptance and disintegrate the social fabric. This is particularly important where economic efficiency considerations alone would strengthen or maintain existing wealth disparities, especially where it parallels a racial divide. As Chua has argued, the overlapping of class and ethnicity characteristics, which characterize many developing economies, mandate that the distributional effects of a market economy be taken into account. Otherwise, this may create instability in democracy, which could convert into an engine of potentially catastrophic ethno-nationalism (Chua, 1998, 2000). Thus, the goals of competition law may, in some cases, need to be broadened to include distributional effects, which may be an important factor in the social-welfare function. Such social policies may be especially important in the first years of transition to a more competitive economy (APEC, 1999: 37) and may then be changed to be more efficiency-oriented. Thus, in some settings, competition law enforcement should not be blind to societal failures which might be even more important than market failures.

As argued above, a pro-competitive socio-economic ideology, whether or not intertwined with other social goals, is the soil of competition law. But the picture is more complicated than that, as the interaction between the competition law and socio-economic ideology is a two-way stream. While a competition law might be flexible enough to accommodate industrial policy or distributive objectives through the valve of a public benefit test, competition authorities, where they exist, have an important role to play in influencing public acceptance and awareness of competition law and policy. Competition advocacy, i.e. those activities conducted by the competition authority that are related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms (ICN, 2002), is, perhaps, the most significant task of competition authorities in developing countries.

Two advocacy roles can be identified: the first is the advocacy of the benefits of competition to governmental institutions (governmental advocacy). The second is the advocacy of competition to the general public, and especially to consumers and other market players (public advocacy). There exists a complex interaction between these two roles. Public advocacy can serve as an indirect form of government advocacy in two ways. First, it serves to increase the acceptance of pro-market policies, and thus the willingness of the government to adopt such policies in the first place. Second, public advocacy of the benefits from competition law enforcement can create public pressure on the government to change its policies. Therefore, strategies aimed at gaining public support for competition law enforcement are highly important. Public advocacy should be approached, however, carefully, as the competition agency is an integral part of the government and should not operate too strongly against the government's stated policy objectives.

Let us first focus on governmental advocacy. For it to exist, some degree of support for pro-competitive market reforms within the government must be present, as the authority is part of the government whose views and ideology it wishes to change. Yet the competition authority has a central role in assisting governmental and other regulatory agencies to realize and analyse the competitive effects of their decisions. The Venezuelan competition authority's proactive efforts to air the arguments on market dynamics and the impact of different economic measures on market conditions, for example, assisted the process of opening up and liberalizing its economy. The awareness of public authorities of the long-term benefits of competition to the society, even when the adoption of competitive conditions may create difficulties and may clash with other social policies, is an important ingredient in building a competitive environment. By changing decision-makers' perceptions and understanding, it may change the range of options perceived by them to be rational and acceptable. Such awareness can be raised by a theoretical analysis of the social effects of market conditions. It might be best to build a convincing case for competition by focusing on examples and success stories derived from the experiences of developing countries. Taking examples from environments that are seen to resemble the local context more closely may help to make policy makers in developing countries aware both of the seriousness of the competition problems in their countries and of the benefits they could derive from adopting a competition law (ICN, 2003: 25). The enforcement of a competition law can also serve as a governmental advocacy tool, if such implementation changes the decision parameters of decision makers, either by convincing them of the benefits of increased competition or by creating societal pressure to adopt competitive measures. While it may be difficult to engage in governmental advocacy where the government is hostile to competition law issues, the Zambian and Zimbabwean experiences show that if the government is merely indifferent to competition a strong-willed competition authority can be effective (Holmes, 2003: 7). The institutional conditions for governmental advocacy are elaborated in the fourth section.

Public advocacy is no less important. Without popular support, the regime will not afford the benefits that competition law may bring about. This is especially important in democratic regimes, in which a change in policy must have visible short-term or understandable long-term positive effects that consumers and other market players can appreciate. Accordingly, it is vital to create a competition culture among consumer organizations, the private sector, the media and other stakeholders that might otherwise be ignorant of the law and its virtues. Such awareness-raising activities also enhance the credibility and the convincing power of competition authorities. The institutional and organizational tools for public advocacy are elaborated in the fourth section.

To conclude, a pro-market socio-economic ideology dictates to a large extent the effectiveness of a competition law in reducing private barriers to trade. Simply adopting a competition law is not sufficient when such adoption is not part of a broader pro-competitive microeconomic policy to which the government is strongly committed. The competition authority has an important role in advocating competition, should it exist at such stages.

4. Pesticides: political economy obstacles to antitrust

Assume that the adoption and enforcement of a competition law is socially desirable for a developing country and that such policy fits well with the country's socio-economic ideology. Will it inevitably be adopted and implemented? The answer is not necessarily positive. As the field of political science has taught us, those who make the choices underlying public policies do not always have the motivations to adopt socially desirable policies. Accordingly, this section seeks to identify the forces that may lead decision makers to deviate from optimal social policy in the context of competition law. As will be argued, there may exist strong political forces that affect the incentives of decision makers to adopt a competition law. It is thus vital to recognize such forces and to devise ways to effectively limit their effects. The latter are the pesticides of the ecology of antitrust.

Let us first identify the problem. The adoption of a competition law may encounter resistance from many groups in society. Generally, such adoption involves a significant change in the "rules of the game". As noted above, it limits the ability of an incumbent monopolist to create artificial barriers to the entry or expansion of its rivals; it limits the ability of firms to raise their prices or profits collectively; and it limits the ability of firms to achieve market power by changing the market structure by way of merger or joint venture. As a result, it may change the legal status of deep-rooted types of business conduct. For example, in many developing countries, trade associations have served an important function under the previous economic order by setting prices and quotas for all market participants (Stewart, 2004). This form of conduct may well be prohibited under a competition law. Altering the legal status of entrenched conduct might encounter resistance from those who fear change, especially when they do not fully understand the benefits it brings about.

But more importantly, altering the rules of the game may change the existing economic equilibrium by impairing the economic status of some market participants that were sheltered from competition by governmental-made or private barriers to entry. This change often involves high personal stakes of the existing dominant firms, entrepreneurial associations and employees of state-controlled enterprises who are likely to be adversely affected by the reduction in the intervention role of the government in the market. The prospect of reform may thus motivate such firms to engage in rent-seeking behaviour, aimed at limiting change in the existing regime. The higher the stakes of private groups in the policy at hand, the stronger their motivations to influence the policy makers. According to some scholars, such groups would invest in securing or maintaining a policy that favours them up to the total expected profits they stand to gain from it (Posner, 1976: 8–18). They may do so directly, by appealing to decision makers to take into account their interests, or indirectly, by creating social resistance to the adoption of a policy, by building upon fears about change and misconceptions about the effects of competition law enforcement. Such conduct, even if it harms social welfare, is generally perfectly legal, and therefore cannot be limited by legal means.

Why should such interests affect decision makers, if they believe that the adoption of a competition law is socially desirable? The problem is simply that, in the absence of constraints, both legislatures and government officials may have motivations to abuse their decision-making power by singling out particular individuals or groups and bestowing government largesse upon them in return for political support (Kaplow, 2003). This problem is known as regulatory capture. Such capture arises when small groups with large *per-capita* stakes in a policy organize and cause the government to regulate in ways that are against the public interest and usually against consumers, who are poorly organized and have small *per-capita* stakes in the specific regulation. Regulatory capture is exacerbated in democratic societies, especially where the ultimate policy decision lies in the hands of one politician or a small group of politicians (e.g. the relevant minister or a legislative committee) rather than the government as a whole, as specific, well-organized sectors can ensure the politicians' re-election (Wiley, 1986). Social logic may thus not always coincide with the logic of politics.

As noted elsewhere (Gal, 2002), the problem of political influence might be aggravated with regard to competition law. This is because the benefits of competition law enforcement are inherently non-sector-specific and look at the long-term horizon. The law applies similar rules to all industries, which are based on total welfare considerations, rather than on the welfare of specific market players. It also usually spells out a long-term vision for society, beyond the immediate pain of the adjustment or change in specific industries and beyond the profitability considerations of specific firms. For example, a merger that would create significant market power would generally be prevented even if it results in financial loss for the firms wishing to merge. Yet, these two traits of competition law – non-sector-specific principles and its long-term horizon – create inherent political pressures to limit its adoption and its applicability.

The law's non-sector-specific nature increases the influence of politically influential groups, as its beneficiaries – consumers and small businesses – are generally dispersed. Moreover, its focus on long-term goals usually requires political fortitude that is typically in short supply among political figures. Most professional politicians who rely on regular and frequent popular elections are mainly concerned with their personal survival and advancement. This implies that they have an inherent tendency to discount heavily all events occurring beyond their personal time line. Instead, they tilt towards the achievement of short-term goals (Shepsle, 1999).

In addition, the adoption of a competition law is usually an integral part of a change from a centrally controlled market to a decentralized market regime. It involves significant decentralization of decision making, a shrinking of the size of the public sector, and a significant reduction in the interventionist role of the state in the economy. This often means the loss for politicians of some of the power that they used to survive politically, and some of their political allies.[8] The outcome often is that decision makers, even those convinced of the need for economic policy changes, could not escape considering the political wisdom of adopting and pursuing them.

The effects of political pressures on decision makers can take many forms. In the most extreme case, such pressures may be sufficiently strong to virtually inhibit the willingness of decision makers to adopt a competition law at all. But the effects may be subtler, by limiting the width or strength of the legal provisions adopted. Such effect might be articulated, *inter alia*, in limits placed upon the discretion granted to independent enforcement bodies, in the height of the sanctions for non-compliance with the legal prohibitions, in the weight given to the furtherance of economic welfare and freedom in the constitutional hierarchy, in the inclusion of wide social goals in the law, or in the adoption of sector-specific exemptions from the application of the law. In Israel, for example, the agricultural lobby has succeeded in including a specific exemption in the law for agreements for the marketing of agricultural produce (Gal, 2004). Alternatively, the effects of political pressures may be less visible by affecting the institutional and organizational conditions for antitrust enforcement which are, as elaborated below, the sun and soil of the ecology of competition law. To give but a few examples, decision makers may not properly fund and structure the competition agency in order to reduce its ability to enforce the law in practice, or they may not provide it with the political support necessary for a strong agency to strive. This, for example, was the case in Argentina (Owen, 2003: ii). Of course, members of the competition law enforcement bodies are also susceptible to regulatory capture, an issue that will be dealt with separately in the next section.

These concerns are especially significant for developing countries. The reason is that economic power in developing economies tends to be more concentrated in the hands of a few rather than dispersed amongst many small competitors. Moreover, often the economic and governmental elites are intertwined. This reality increases the probability of lobbying, rent-seeking behaviour, and political influences aimed at the pursuit of private objectives. The problem is also exacerbated by the fact that in developing economies many consumers – who are the main beneficiaries of competition law enforcement – cannot be easily educated in the benefits of competition law enforcement, and will rarely join forces to vie for it.

Given these political motivations, we should wisely recognize that the effect of politics on the adoption and the implementation of competition law cannot be simply ignored. Instead, it requires a modicum of responsiveness, away from Adam Smith's absolute economic liberalism, by devising ways to reduce political pressures that might reduce government officials' willingness to adopt and implement a socially desirable competition law. While such mechanisms may sometimes need to be tailored to the particular circumstances of each country, some general pesticides may well be applicable to most cases.

One possible method to reduce opposition to desirable reforms, which is sometimes suggested, is the adoption of a limited reform that does not fully apply the whole arsenal of competition law to incumbent firms but instead allows them to continue to engage in some types of business conduct that benefit them and would have otherwise been prohibited by the law. Such limited reform could definitely reduce political obstacles to the adoption of the rest of the legal provisions, especially if the law is a result of negotiation with pressure groups. At the same time, such limited reforms come with a large price tag attached. Obviously, limited applicability means limited competition and limited ability to achieve the benefits of a competitive system. In addition, as Kaplow rightly observes, such concessions may create higher costs for the implementation of socially desirable policies in the future. Special interest groups already have strong incentives to lobby for favourable treatment. If the norm is that if and when a change in the legal regime is implemented the special interests will be compensated or otherwise protected, then their initial incentive to lobby for such policies will be increased. It is thus not obvious that the net effect of buying-off opposition, when one includes the effects of future undesirable policies and wasteful rent-seeking expenditures, would be positive (Kaplow, 2003).

Another method to reduce the pressures of power groups on politicians is to balance these pressures out by creating opposite, pro-law pressures. This requires a political anchor or godfather for competition law, which can be a politically strong body, such as the Prime Minister's office (CUTS, 2003b: 18), or decision makers that are less affected by pressure groups and narrow considerations, whether because they do not need the support of interest groups for their political survival, or because their motivation to adopt a competition law is stronger than their will to give in to pressure groups. Decision makers are often best placed to think strategically about managing opposition, taking advantage of opportune moments and putting together supportive coalitions for reform. Politicians often have a detailed knowledge of power relationships that could help hinder efforts to reform, and can carefully craft the content, timing, and sequence of reform in order to mobilize support and manage opposition. For example, a crisis situation can be utilized to reduce political obstacles, as decision makers are likely to give more weight to societal concerns in such situations, and change is likely to be more dramatic and comprehensive (Grindle and Thomas, 1991: 5).

An extremely powerful and important method for combating political influences on decision makers is the creation of a strong and educated public opinion in favour of antitrust. Such public opinion may refocus the political interests of politicians on long-term and general goals and lead to the channelling of their private aspirations in more constructive and overall efficient ways. Even if politicians may not look beyond the next election, the interests of those who chose them may be long-term and non-sector specific. Education thus has the effects of lengthening the time horizon of politicians.

For public pressure to exist, however, two conditions must be met. First, the beneficiaries of the competition law, consumers and market participants who have so far been excluded from the market, as well as opinion formers, should be educated in the benefits of competition law enforcement. Second, the collective action faced by many individuals with a mutual interest should be overcome. A competition authority, where it already exists and is non-political, may play an important role in this process by educating consumer groups, businessmen and academia alike on the merits of antitrust enforcement to ensure that the public is well aware of the consequences of the decision made and by solving the collective action problem.

There exists, however, a chicken-and-egg problem, as the same law that pressure groups would like to limit its adoption in the first place often leads to the creation of a competition agency, which is the natural vehicle to solve the collective action problem by advocating consumer benefits in competition. Consumer groups, academics and concerned public figures can instead play an important role in taking the reigns of public support by forming consumer interest groups that would encourage lobbying aimed at establishing more efficient forms of regulation.

As internal forces to constrain problematic political motivations are likely to be limited, external sources, such as global institutions (e.g. the World Bank, UNCTAD or the WTO) or trading parties, may sometimes serve to overcome internal political economy issues. In this light, one can view the pressure of international bodies that developing countries adopt a competition law as a positive phenomenon, as it limits the discretion of policy makers and adds another factor to their political logic equation. In fact, many developing countries have adopted a competition law in response to external pressures, and external advisors that are generally devoid of internal political pressures have drafted their laws. One positive outcome of such laws is that they create a competition authority that, as elaborated above, if structured and funded properly (sun and water), may serve an important function in reducing internal political pressures to limit the law’s applicability. Such external pressure is only positive, however, when it echoes the desired socio-economic policy of the country to which it is applied.

5. Sun and water: institutional and organizational preconditions

The actual enforcement of a competition law is no less important than its adoption. Enforcement is determined, to a large extent, by the organizational and institutional conditions in which the enforcing bodies operate. Such conditions determine whether antitrust is workable and its enforcement is credible and reputable: whether there exist efficient and effective tools for antitrust enforcement, and whether appropriate measures are implemented to ensure that the motivations of the enforcers to apply the law in specific cases are not limited by political pressures. The institutional and organizational conditions in which the enforcing bodies operate are, thus, the sun and water of competition law, as they allow it to develop and take root.

The competence and credibility of competition law enforcement are necessary in order to limit anti-competitive conduct. The more effective the enforcement bodies are in detecting and sanctioning legal violations, the more instances of anti-competitive conduct will be prohibited *ex post*. But, more importantly, the institutional conditions of the enforcing bodies affect the expectations of economic actors and their incentives to engage in such conduct in the first place. The higher the possibility of detection and sanctioning, the stronger the deterrence effects on market participants. In the face of uncertain enforcement, firms will reduce the possibility that they will be caught and charged with anti-competitive conduct and will have stronger motivations to engage in such conduct. If, on the other hand, enforcement levels are high, firms' motivations to commit their resources into anti-competitive activities will be lower. Regulation by deterrence should be the main course of antitrust enforcement, as it is much more efficient than direct regulation of conduct in limiting anti-competitive conduct.

The competence and credibility of the enforcing bodies are, in turn, highly dependent on the institutional and organizational conditions in which the enforcing bodies operate. The level of deterrence depends on market players' awareness of the objectives and scope of antitrust law. Thus, it is important to design and implement efficient mechanisms for disseminating information about competition law and its enforcement. Deterrence also depends on the existence of adequate human and financial resources for monitoring, detection, proof of violation and sanctioning, and on the enforcing body's ability to make impartial decisions. It also depends on the stature of the authority within the public at large, as enforcement is influenced by the general perception that the decision-making process is predictable, impartial, and equitable.

Accordingly, this section seeks to shed light on the organizational and institutional conditions that are necessary to ensure the successful enforcement of competition laws in developing countries. It builds upon the vast literature of the past decade on the institutional economics of antitrust enforcement. William Kovacic (Kovacic, 1995, 1997, 2001), among others, has emphasized the great importance of institutional competence, credibility and independence to the effectiveness of competition policy. Several international institutions have also generated detailed and interesting reports on the institutional conditions for antitrust enforcement (e.g. APEC, 1999; UNCTAD, 2002; CUTS, 2003a, 2003b; ICN, 2003).

It is regularly recognized that developing countries often face institutional difficulties in enforcing competition laws. These involve, *inter alia*, inadequate judicial systems, excessive bureaucracy, corruption and a lack of transparency, a lack of resources and professional expertise within the competition authority, extensive capture by regulatory groups and weak professional and consumer groups. These problems can and should be addressed by developing the ability and institutional strength of the competition enforcement bodies. No unique model exists for all developing economies. The mix of institutions and organizational features has to be tailored to the particular economy in which it is applied. Yet several general principles can be discerned for competition law to be workable.

Of course, competition law enforcement is only part of a broader legal enforcement environment. Thus, it is vital that reforms be undertaken on several fronts to increase institutional competence and credibility (e.g. by creating a competent judiciary) and to build an environment that will support the efficient decisions of market participants (e.g. enforcement of contract law). Where there is no law and order, where corruption is rampant and where the informal sector is large, competition law enforcement might be extremely difficult. Yet some institutional measures that focus on the antitrust enforcement bodies can still improve the conditions for antitrust enforcement. This section focuses on such conditions.

The organizational and institutional conditions for competition law enforcement are for the most part cumulative: efficient enforcement depends on their parallel existence. For example, empowering the competition agency with investigative powers is not effective without sufficient human and financial resources to carry out investigations. Some conditions are mutually reinforcing. For example, educating consumers in the law and its benefits may significantly reduce enforcement costs and thus budgetary needs of a competition authority, by creating motivations for consumers to inform the authority of possible anti-competitive conduct. Interestingly, in some cases the organizational and institutional conditions necessary to perform certain functions conflict. This is the case, for example, with the double function of a competition authority: enforcement of competition law and creating support for competition policy, *inter alia*, by advocating the reduction of non-governmental barriers to competition. The institutional conditions for achieving both goals are, however, different. If enforcement is the goal pursued, then the institutional structure should favour independence, predictability and fairness of decision making. On the other hand, if competition-oriented reforms are the most important policy objectives, then the institutional structure must allow for the greatest possible influence with the policy makers. Leaving antitrust decision making to a judge, for example, favours independence while downplaying advocacy, especially when antitrust is completely left to private initiative (ICN, 2003: 30). Each jurisdiction should thus find a balance between the achievements of these two goals that would fit its special setting.

It is useful to differentiate between two different types of institutional obstacles that must be tackled for enforcement to be effective: the practical ability to enforce the law and the motivations of the enforcing bodies to enforce it in practice. The two following sub-sections fit this divide.

5.1. Tools for effective enforcement of competition laws

Simply having a competition law on the books is not sufficient for its enforcement. The enforcing agencies must have a tool-kit that would enable them to apply the law effectively and efficiently. This requires financial and human resources, but it also requires legal mechanisms that would support such enforcement. This sub-section analyses such tools, based on a theoretical framework as well as on the experience of antitrust authorities, especially in developing countries.

1. *Human resources:* the best of laws cannot be applied without adequate human resources, i.e. a staff of sufficient size with adequate technical competence. The last condition is especially important in the area of competition law, which often involves a high-level economic analysis that complements a legal one in order to detect and to analyse the effects of business conduct. Lack of such human resources may lead to under-enforcement of the laws. It may also undermine the standing and reputation of the competition authority, especially where it results in incompetent enforcement efforts such as the loss of many cases brought by the authority.

Competition authorities thus need to employ lawyers, economists and investigators familiar with competition law and policy. In addition, several attorneys with litigation experience and a sound knowledge of administrative law and civil procedure should be hired. Particularly in its early years, the competition agency might be required to convince the courts that its cases are procedurally sound and substantively meritorious. It is vital that the agency be ready to prevail on such issues, as this will determine the breadth and scope of the legal basis for its future actions (Kovacic, 1997: 431).

Yet the attraction of professional staff that can deal effectively with antitrust issues is a major obstacle to competition law enforcement in developing countries (Stewart, 2004: 184). Developing countries must therefore devise ways to overcome such obstacles. In the long run, low levels of professionalism can be countered by building links with universities and ensuring that they teach the appropriate relevant courses (APEC, 1999: 9.3.14). In the short run, staff training programmes in procedural, methodological and substantive matters are key mechanisms for overcoming human resource constraints. Such training can be provided internally, but often there is an important role for external training. Internships, or seconded staff from more mature authorities, should be arranged to guide staff while gaining practical experience. Technical cooperation agreements and exchanges with other competition agencies are crucial in this respect, as long as they match the learning curve and annual operational targets of the authority (UNCTAD, 2000: 38). It might also be advisable to retain outside counsel in important cases. To combat the problem of high staff turnover rates that is plaguing competition authorities in developing countries, it was recommended that training of staff should be offered on the condition of being bonded for several years (Stewart, 2004).

The inevitable disparities between private- and public-sector salaries also create problems of professional staff retention. The ability of the authority to overcome this problem will be determined, *inter alia*, by its standing and reputation within society. The independence, transparency and regard for due process all serve to create an attractive working environment for the high-quality economists and lawyers. Poland's successful antitrust authority, for example, took early action and created a good reputation that set off a virtuous circle. Its advocacy role reinforced its success and it has continued to attract good staff and political support. Yet there is here a kind of a chicken-and-egg problem, because in order to achieve a positive reputation, the authority will need skilled staff. Just as a competent, reputable agency generates a virtuous circle which attracts appropriately skilled and competent staff, so too does a poorly performing agency create a vicious circle that might repel those who may be able to turn it around (ICN, 2003). It is thus most important to invest in institutional conditions for antitrust enforcement from its start. Barbados has overcome this problem by setting up the agency and training its staff before its competition law was adopted. In that period, staff were recruited and trained in competition law and investigation procedures. By the time the law was passed, the Commission was ready to start operating (Stewart, 2004). Yet the Barbados experience has its costs, as it requires hindsight regarding the passage of a law or the postponement of the adoption of a competition law. An alternative method to tackle the problem of financial compensation disparities is by emphasizing to possible skilled employees the impact of their work on increasing social welfare. The personality of the authority's director will play an important part in such motivation-building efforts.

To reduce human resource problems it is also important that professional knowledge be accumulated in the agency, and is not totally dependent on specific people. Guidance manuals may provide new staff with access to the approach to be adopted. These should be supported by case histories so that the collective memory of the authority is easily and continually available (APEC, 1999: 2.9.17).

2. *Financial resources:* financial resources are a necessary complement to human resources. These expenses encompass the salaries of professional and administrative staff and the creation of an infrastructure to support the work of such staff. The Chilean agency was considered, for many years, a "second-tier" agency, due to insufficient resources, despite the fact that most of the Prosecutors were highly respected and influential individuals (OECD, 2004). Similarly, the Israeli authority did not have, for many years, a budget that could support engagement in investigations of the conduct of market players (Gal, 2004). This condition, among others, pre-

vented it from effectively enforcing the law. Conversely, the Zambian authority was well resourced, a fact that contributed to its ability to apply its laws (Holmes, 2003: 5). Since competition law cases often consume large sums in investigation and trial costs, it is also vital that enforcement decisions be taken on a rational basis and cases should only be tried where enforcement costs are lower than the harm prevented in the specific case or by the possible deterrence effects that would prevent similar cases. This is especially true for small economies, which naturally have lower enforcement budgets.

3. *Legal enforcement tools:* while this paper does not deal directly with the content of competition laws, there are several legal provisions and conditions that affect the institutional competence of the competition authorities. Three such conditions are elaborated below. The first condition is ensuring that the law is compatible with general legal principles and constitutional values. Jamaica has had the very unfortunate experience of having a fundamental error in its competition law, in that the investigative and adjudicative arms of the Fair Trading Commission were not separated. The competition authority was taken to court for breach of natural justice, lost the case and the appeal, and is now in the process of revising the law. This has had significant negative effects on the reputation of the competition agency and on its ability to operate, since it cannot pursue any cases until the law constituting the institution is amended. The lesson to be learnt here is that it is essential to have the draft law vetted by several experts of general legal principles (Stewart, 2004).

The second condition is that the authority be granted broad investigative powers. Competition agencies need to be able to monitor markets and obtain information on the conduct of market participants if they are to be effective. To perform such tasks, the competition authority must be equipped with investigative tools that enable it to obtain the relevant information (CUTS, 2003a: 67). For example, the authority should be empowered to enter into business premises to collect information, to investigate managers and employees of firms and to demand information from business entities, where there is suspicion of a violation. There should also be a high penalty for failing to comply with investigative efforts. The importance of such tools can be illustrated by the Zambian experience. The Zambian Competition Authority had much trouble getting information from Coca Cola on possible anti-competitive violations. It was only when the government passed a law making it punishable by incarceration if a firm fails to cooperate with the authority, that the authority got immediate cooperation. While this is an extreme example, there are less draconian means by which firms could be persuaded to cooperate (Stewart, 2004).

The third legal institutional condition is that the enforcing bodies be able to impose high penalties for anti-competitive conduct. Economics has long taught us that the level of deterrence of a law is largely determined by the probability of detection of a violation and the level of sanction imposed upon the violator. If sanctions were not sufficiently high, then it would still be rational for market players to engage in anti-competitive conduct. Accordingly, the law should provide the enforcing bodies with sanctions that are high enough to act as a disincentive to engage in anti-competitive conduct, when taking into account enforcement levels. The Peruvian experience is a case in point. At first, the fine for engaging in anti-competitive conduct was set at US$ 40,000, but this was found to be too low to create disincentives for large multinational companies, and the fine was raised (Stewart, 2004). However, it might be better to base fines on the potential and actual profits from the anti-competitive conduct or on the yearly turnover rates of the firms instead of on predetermined sums. Sanctions should also depend on the law's level of clarity. Where the legal principle is clear, the sanction can be higher than when there is some uncertainty in the legal provisions. This is because imposing high sanctions in instances in which laws do not clearly define legal conduct can prevent pro-competitive conduct. It is also suggested that where courts lack institutional competence, it might be better to leave sanctions in the hands of an independent competition agency and to avoid private remedies and treble damages.

4. *Institutional tools for building credibility and stature of enforcing bodies:* to increase social acceptance and compliance with competition law, the enforcing bodies should be regarded by consumers and producers as credible and should be respected. The authority's stature, in turn, increases its ability to enforce its laws on both domestic and international firms. Accordingly, technical compatibility for enforcing the law must be accompanied by reputation-building procedures and tools. Here we shall focus on several tools. Others will be elaborated in the next sub-section, which analyses the tools for limiting political influences on the enforcement of antitrust laws.

An important tool for building credibility involves taking-on large incumbent players at the early stages of enforcement. Beyond educational and immediate social-welfare purposes, this will signal to market participants that the enforcing authority is determined to follow a resilient agenda of enforcement. It is also important to choose the first cases very carefully in order to build credibility. Jamaica's experience exemplifies how important it is to exercise prosecutorial discretion. The Jamaican antitrust authority chose as one of its first cases to challenge the Bar Association, claiming that its Canons of Professional Ethics, including restrictions on advertising and fixing of fees, were inconsistent with its competition law. The Commission lost the case and its credibility, as the court decided that the Bar is exempted from the application of the competition law. It is thus important to choose cases that are easy to investigate and to win, in which the issues are easily understood by the public (Stewart, 2004). Follow-up on compliance with the authority's orders is also a valuable method for establishing credibility as a strong enforcement institution. Moreover, to enhance credibility, the law should apply to all sectors of the economy and exemptions should be limited. Otherwise, consumers might perceive enforcement to be discriminatory or marginal. The personality of the director of the competition authority is also important to build credibility and respect. The impact of the competition agency in South

Africa, Peru, and other developing economies was clearly derived from the respect for senior figures (Holmes, 2003: 8).

Transparency is also an important mechanism for enhancing credibility. This includes transparency in administrative procedures and regulations, the right to appear before the enforcing bodies unless strong reasons mandate otherwise, the publication of fully reasoned decisions and, where feasible, the maintenance of a web site on which the authority publishes its decision as well as guidelines and speeches and other public statements. In Chile, for example, the Prosecutor's Office has prepared a database containing summaries of many of the enforcing bodies' rulings that is reachable through its web site (http://www.fne.cl/).

A strong emphasis on consistency and due process are also central in developing the credibility of the authority. This could be achieved, in part, by adopting guidelines and notices setting out the manner in which the authority will apply substantive and procedural elements of the law, and by following such guidelines to the extent possible. It is also useful to set pre-determined time periods for the treatment of cases. Choosing and pursuing articulated priorities with a reasonable and well-explained rationale may also enhance credibility as a non-discriminatory agency (De Leon, 2000). All these methods serve to demonstrate that the authority is acting impartially and efficiently within its legal mandate.

5. *Judicial competence:* the judiciary plays an important role in the institutional apparatus of antitrust enforcement. In most countries, decisions by the competition agency are subject to judicial review and in some cases the judiciary has also the initial decision-making power. It is thus crucial that the judiciary support sound and credible antitrust enforcement for limiting anti-competitive conduct and for creating deterrence effects.

A serious problem with the judiciary, encountered by many countries, is the low level of expertise of judges in antitrust issues (e.g. Rodriguez and Williams, 1994; Cook, 2002). This stems from the judiciary's possible lack of experience in competition cases and from their difficulty in dealing with cases that require economic analysis, as is often necessary in defining and proving anti-competitive conduct. The judiciary may, then, issue decisions that are incompatible with the principles of competition law or resort to purely technical reviews instead of determining the merits of the case. The problem of judicial competence is so significant that Jamaica identified the main constraint it encountered in the implementation of competition law as the fact that the judiciary is not conversant with competition principles. Similarly, the Russians experienced competition law enforcement problems due to the lack of experience and understanding of the judges of the necessary economic concepts (APEC, 1999).

This is why the training of judges in competition matters is crucial to competition law enforcement. Another solution is to set up a specialized tribunal, as has been done in South Africa and in Israel, that is exclusively empowered to hear competition cases. This allows for a small body of judges to develop experience in the application of the competition law. Judges will, over time, learn the guiding principles of competition law and will be less inclined to uphold purely technical reviews in preference to determining the merits of the case. It may also be wise to structure the court of first instance as an administrative tribunal, which is headed by a judge, but composed also of competition experts, both lawyers and economists, to assist the courts in reaching their decisions. To ensure that the benefits of specialization are not lost, however, the appeals court should be limited in its review of the decisions of the tribunal to significant errors of law or fact.

It might also be useful to allow the competition agency to submit written comments to the courts in order to draw the court's attention to issues that are important for the consistent and effective application of the law. Belgium and Finland, for example, empower the competition authority to submit its comments to the court. The issuance of the opinion of the authority to the courts, in the name of the public interest (as "*amicus curiae*"), is an important tool for creating consistent and credible antitrust enforcement (ICN, 2003).

Where problems of corruption or lack of expertise in the court system cannot be easily overcome, it might be wiser to place decision making in the hands of an administrative body rather than a court. This circumvents the problem of generalist or corrupt judges taking decisions on competition matters. It also provides for swifter access to the decision maker and it frees the adjudicative bodies from the extreme formalism that frequently characterizes judicial processes. Yet, administrative enforcement lacks the diffused onus of responsibility, and increases the possibility of political considerations, as elaborated below. The institutional structure should thus be determined by the special characteristics of each country.

6. *Role of competition authority in regulatory reform:* competition may not only be hindered by private anti-competitive conduct, but also by public regulatory intervention and rule making. Some examples include licensing, standards, import and export quotas, privatization decisions, and policies for access of competitors to bottleneck segments (Tirole, 1999: 3). Such government-made obstacles may be warranted where they are necessary to correct market failures or for the achievement of more important social goals. However, regulatory intervention may go beyond the strictly necessary. This might be due to the influence of interest groups, or to the insufficient weight given to competitive considerations (ICN, 2002: ii–iii). The competition authority may provide important tools for minimizing both problems. While the next sub-section will deal with the institutional tools to reduce political economy issues of antitrust enforcement, below we elaborate on the institutional mechanisms available to tackle the lack of competition culture problem.

Increasingly, it is recognized that competition authorities play an important role in the promotion of a competitive environment by pro-actively influencing regulatory activities to ensure the rejection of unnecessarily anti-competitive regulatory measures. This government advocacy role may, in some cases, be more important in promoting competition than the repression of anti-competitive behaviour through antitrust enforcement. A study undertaken by the OECD showed that the competitive process can be appropriately stimulated by the intervention of competition authorities when firms in a regulated sector abuse their privileges to the detriment of consumer interests. In fact, some of the greatest successes of competition authorities identified by developing countries are in the prevention or reduction of anti-competitive legislation and other interventions by government in the competitive process (ICN, 2003). For such a scenario, a proper institutional framework must be put in place. Creating an institutional framework for competition advocacy is especially important for developing countries. In such countries, many functions are still subject to direct regulation. This gives rise to an intensive rule-making process in which competition advocacy has an important role to play (ICN, 2003: iii). The competition authority can assist in the adoption of socially desired policies.

The interaction between the competition authority and other regulatory frameworks takes place at two stages. First, the competition authority may seek to influence the rules that govern the sector, by ensuring that the concerns of competition are taken into account at the time the regulatory system is set up or reformed. Second, advocacy may take place at the implementation stage, by convincing other public authorities to abstain from adopting unnecessarily anti-competitive measures, and helping regulatory agencies to clearly delineate the boundaries of economic regulation (ICN, 2003: iii). Both require some institutional preconditions for their existence.

An important prerequisite for effective government advocacy is that competition authorities be informed about regulatory initiatives in a timely manner, to ensure that the competition agency is consulted at a time when there is still opportunity for considerable feedback. This task is best placed upon the legislative or regulatory body, by mandating it to inform the competition authorities of any act that may reduce competition. In the US, for example, some provisions ensure that the Department of Justice gets timely notice of proceedings.

A second institutional issue is whether the consultation of the competition authority is mandated by law or discretionary. The OECD's Regulatory Reform Report recommended providing competition authorities with the authority and the capacity to advocate reform throughout the government (OECD, 1997). Some authorities can only conduct studies or make recommendations when requested by the Ministry they belong to and they cannot decide on their own to make the contents of their reports public or to pressure for their recommendations to be taken into account (ICN, 2002). In other jurisdictions, the authority may participate in meetings of the Government on an occasional basis, e.g. upon invitation to pronounce its view on a specific project. It is much preferable that competition authorities be granted the power to act on their own initiative. Some procedural safeguard or formalization of the consultation process is also desirable.

A third institutional issue involves the formal power of the competition agencies to influence governmental regulations: does the competition authority issue opinions that are binding on the policy maker? There is a wide range of answers to this question. At one extreme, the competition authority has a decisive role in regulatory and reform processes. This can be achieved by a participatory role, as in Chile, where the competition institutions are included in the process of regulating infrastructure monopolies. Alternatively, the authority may have an influential supervisory role. In Uzbekistan, for example, the Anti-monopoly Committee may require state administrative bodies to terminate or modify legislative acts and orders which are found to contradict antimonopoly legislation. Similarly, in Hungary, if the Hungarian competition authority finds that any public administrative decision violates the freedom of economic competition, it may request the public administrative institution to amend or revoke the decision in question. If the public administrative institution fails to do so, the authority may seek a court review of the decision.

Yet in most jurisdictions, the law places upon the agencies the smaller but important role of commenting from a competition policy perspective on issues that that will be decided by other sectors of the government. The UNCTAD Model Law on Competition requires that regulatory barriers to competition incorporated in economic and administrative regulation should be assessed by competition authorities from an economic perspective (UNCTAD, 2002b). This recognizes the authority's expertise in determining market power and the conditions that must exist for effective competition, yet leaves the ultimate decision to the specific regulator, who may have expertise in the industry at hand.

In politics as in politics: another means of practising to create government advocacy is to join forces with other governmental bodies with similar goals. This can be illustrated by the battle against the Israeli monopoly in public transportation. For years, one firm dominated the Israeli public transportation market. The Ministry of Transportation was reluctant to open up the market to competition. The Antitrust Agency joined forces with the Ministry of Treasury to create public opinion for the introduction of competition into the market, which eventually led to the creation of more competitive conditions.

7. *Public advocacy as an enforcement tool:* the importance of educating market participants in the rules of competition law as a tool for reducing political economy obstacles and for creating a socio-economic ideology has already been emphasized. Here, we focus on its importance as an enforcement tool, to increase compliance and deterrence effects, and on the institutional tools necessary for it to be effective.

It is possible to identify several ways in which public advocacy assists competition law enforcement. Competition advocacy serves to change the mindset and *raise the awareness* of market participants to the legal framework. It can thus act as a preventive measure, as it adds to the economic calculation of market participants the perceived costs of anti-competitive conduct. In many developing countries, a significant problem with antitrust enforcement results from the fact that firms are simply not aware of the antitrust implications of their conduct and there is no sense of wrongdoing, especially where conduct has been legal for many years. To give but one example, the five largest poultry producers in Trinidad indulged in collusive increases of price, without being aware of the anti-competitive nature of their acts (Stewart, 2004: 184). Accordingly, there should be an intensive educative programme that will focus on trade associations and dominant incumbents prior to and during the implementation stage of a competition law. A successful case against a particular form of behaviour can also have significant educative effects. A highly publicized UK test case in early 1959 resulted in the voluntary abandonment of over 2000 cartels (APEC, 1999: 9.3.10).

Also, education of the general public may increase enforcement levels. Competition authorities are always straddled for funding. They are also in constant search of proof of anti-competitive market conduct. Market participants can play an important role in increasing enforcement levels and reducing resources needed to detect anti-competitive effects by informing *the agency* of anti-competitive conduct. To create incentives for private players to collect the relevant information and to file complaints with the authority, however, three conditions must exist. First, there must be an open channel to the antitrust authority. Second, the potential enforcers – most importantly consumers and small and medium-sized competitors who are the authority's natural allies – must be educated with the legal provisions and the benefits they bring about. Third, they should have motivations to supply the information, which are influenced by their belief that the agency will indeed investigate their claims and, if justified, take action against the violator. Public advocacy is thus a crucial ingredient in disseminating enforcement efforts.

Finally, and of no less importance, the strength and compliance with the law result, *inter alia*, from *the recognition and acceptance* of competition mechanisms within society. Where there is no acceptance, there is a stronger reluctance to comply. Such acceptance is especially important in those developing economies in which the levels of compliance with the legal system are relatively low. Thus, educative efforts, where society can fully grasp the benefits and content of competition law, may be decisive in ensuring the successful implementation of the law in the long term. Education also serves to reduce the danger that expectations of consumers for competition law enforcement be too high. Understanding the limitations of competition law enforcement, or the kind of evidence necessary for it to apply, is sometimes no less important than understanding its benefits. To increase social acceptance, advocacy should not only focus on informing society about the benefits of competition law, but also on the authority applying the law correctly and impartially (APEC, 1999: 2.9.9).

How is such public advocacy to be brought about? In the past few years, there have been several extensive studies on competition advocacy that analyse the tools at a competition authority's disposal to strengthen the competitive culture (see, e.g., ICN, 2002, 2003). I would like to focus on some that are especially relevant to developing economies. In the specific context of developing countries, consideration must be given to potentially low income levels and high illiteracy rates, both of which may impact on the ability of consumers to understand the benefits of the law. Accordingly, the objectives, principles and tools of competition law should be explained in simple, “lay” rather than legal terms. The costs of monopoly, cartels and competition distorting regulations should be explained, while also reassuring the business community of legitimate forms of competition. Also, where other social goals may receive primacy over consumer welfare, the advocacy programme should include emphasis on the goals of competition law and how it interrelates with other policy tools. Such information should be disseminated through multiple channels, including giving public lectures to professional and trade associations, academic institutions, organizing conferences, writing articles for publication in specialized or general reading publications, holding press conferences and otherwise publicly explaining the importance and implications of competition and market principles. Another way of public advocacy is to select cases that resonate loudly with consumer concerns and relevant to the family budget. Some competition authorities have consciously selected cases that make a difference to the ordinary lives of low-income consumers. Peru, for example, took early action against cartels in the bakery and chicken industries, which resulted in a reduction in the price of such products. Even an uneducated consumer can easily grasp the effects of competition in this everyday context (ICN, 2003). Indeed, the recipe for success might well be said to choose the initial cases with a view to strong impact on the general public and the publicity benefit that might be obtained. Thus, the application of the law should initially be focused upon cases with little chance of loss and with a high and direct consumer benefit (APEC, 1999: 2.9.8).

Another interesting idea to make the introduction of a competition law more acceptable in developing countries could be the adoption of a consumer protection law at the same time as a competition law, and to have both sets of laws administered by the same agency. Thereby, competition policy would become more visibly associated with consumer protection. It should, however, be ensured that the two policies work in a complementary way by focusing jointly on consumer welfare (ICN, 2003) and that consumer protection does not take up too much resources.

5.2. Institutional solutions to political obstacles to competition law enforcement

The previous section focused on strategies available to developing economies to counter political pressures on legislatures to refrain from adopting a competition law or to limit its breadth or scope. This sub-section deals with the institutional tools available to reduce political pressures *on the enforcing bodies* to limit competition law *enforcement* in favour of specific interest groups. As noted above, the enforcement of a competition law involves high personal stakes, both to incumbent market players and to politicians. Such high stakes are often translated into lobbying, rent-seeking behaviour, aimed at limiting enforcement efforts in specific sectors or cases.

As the competition authority is an integral part of the government, no such authority is completely independent from political pressures (Pittman, 1992).

Yet careful institutional design and social planning can significantly improve upon the influence of political motivations on competition law. The key is the creation of an autonomous and non-partial agency. This sub-section will analyse the tools available for limiting political pressure, based on a theoretical framework as well as on the experience of antitrust authorities, especially in developing countries. It is based, in large part, on the author's previous work (Gal, 2002). The tools suggested are often intertwined. To give but one example, in a cyclical manner, the less political the authority's decisions are perceived to be, the stronger the public support, and the more powerful the public opinion to reduce political pressures in the first place (Gal, 2002).

1. *Autonomous agency:* probably the most important condition for combating political pressures on enforcement is ensuring that the antitrust authority is independent, to the extent possible, from political figures. This requires that the authority be a separate body and not an integral part of a ministry and that its decisions could not be overturned by a political figure. The possible consequences from lack of independence are exemplified by a Pakistani case, in which the decision of the competition authority was overturned due to the intervention of a minister who was on the board of the company in question (Holmes, 2003: 4) .

In some circumstances, however, the politicization of the antitrust authority need not be rejected. Russia provides a fascinating example (Yuzhanov, 2002). Russia has adopted an Antimonopoly Law as an integral part of wide-scale economic reforms to move from a centralized, communist government to a market-oriented economy. A minister, who is an active member of government, heads the Russian Antimonopoly Ministry. This proved to be beneficial: the antitrust principles were so different from the embedded ones, that to be effective, the head of the antitrust authority had to be a strong political figure that took part in the ministerial discussions on the adoption of economic policy. Although some decisions were based on political considerations, others could not have been reached or implemented without strong political power. Once the new economic order matures, however, it might be wise to change the institutional organization and create a more autonomous agency.

2. *Non-political nomination of the Director:* in reality, the head of the agency largely determines the authority's priorities and the outcomes of its decisions. Even if he is not legally empowered to authorize certain types of conduct, he may nonetheless decide whether or not to conduct an inquiry of certain markets. It is thus crucial that he not be politically oriented towards any specific group of interests. Although political pressures on the nomination process cannot be totally eliminated, it is important to minimize such pressures. In Chile, independence is sought by nomination by the President of Chile. In Hungary, the leading officials of the competition authority are appointed by the President of the Republic on nomination of the Prime Minister, and their appointment is for 6 years, 2 years longer than the mandate of the govern-

ment. In Israel, the Director of the Antitrust Authority is chosen by a special committee headed by a judge, which selects amongst the contenders to a public tender in accordance with their personal qualifications. The Minister appoints only one of the three committee members. The chosen director must meet the criteria necessary for a justice of the peace. Another often-used method involves prohibiting the Director from working in the private sector on antitrust-related issues for a predetermined period after his/her term is over, as is done in Israel. This reduces, at least to some extent, his/her inclination to weigh the considerations of possible future employees or clients. Such institutional tools may reduce political pressures on an important decision.

3. *Independent budget:* yet even the most impartial person will have limited ability to disregard political considerations if he does not have the fiscal resources to carry out his actions. It is thus extremely important that determining the agency's budget be free of political considerations. Although this cannot be accomplished in full, the agency being part of the government, there are several methods to reduce political pressures through budget setting. One method is to base at least part of the budget upon some income that is generated by the agency, such as on fees charged by them for merger decisions and on fines imposed for anti-competitive conduct.[9] Another important method is to separate the agency's budget from that of other governmental functions and make it transparent to the public. The stronger the public scrutiny, the more difficult it will be for the political system to cut back the agency's budget. Here the competition agency has an advocative role, which it can carry out by publishing its expected enforcement costs relative to the proposed budget, the relative budgets of successful competition agencies in relatively similar countries, the estimations of international bodies of the expected costs of competition law enforcement, and the expected savings to society that will result from such enforcement. A third method is to establish a minimum budget as part of the law, to ensure that the agency has funding to carry out at least some of its tasks.

4. *Juridical scrutiny:* juridical scrutiny of the antitrust authority's decisions, where there exists a strong, independent and objective judiciary, may also be used to reduce political pressures. For such scrutiny to be meaningful, the scrutinizing court should be an expert one that is empowered to hear cases *de novo*, rather than determine whether the decision was reasonable. In South Africa, the court was even granted special inquisitorial powers. Yet, for several reasons, juridical scrutiny is a limited tool. First, it is very difficult to question cases in which the authority has decided not to take any operational step. Second, there may exist informational asymmetry problems between the agency and the court. Third, for such scrutiny to be operational, there needs be a plaintiff who is willing to invest resources in questioning the authority's decision. Fourth, juridical scrutiny is often not timely. Yet juridical scrutiny may still reduce political pressures if politicians know that the agency's decision might be subject to investigation and might be overruled by an objective body.

5. *Transparency of decisions:* an important method for minimizing political influences is by ensuring the transparency of antitrust decisions to public scrutiny. This requires the adoption of several complementary methods. Most importantly, the decision maker, whether the Director of the authority, the court or any other body, should be mandated to issue reasoned decisions. Technical tools to disseminate decisions in a timely manner, such as via an Internet site or via a newsletter should complement this. In addition, hearings before a competition court should be public, except to the extent necessary to protect confidential information.

6. *Empowerment of consumer groups:* another method to reduce political pressures is to grant consumer groups standing in the decision process. In South Africa, for example, some third parties with a material interest (such as the parties entitled to notice about mergers) may participate in hearings before the Competition Tribunal, with the right to put questions and examine evidence presented.

7. *Criminalization of antitrust proceedings:* the criminalization of antitrust proceeding may serve to limit political pressures on the antitrust authority. Where interference with an ongoing criminal investigation is an offence, politicians might be more cautious before intervening in an antitrust investigation, unless they enjoy legal immunity for the consequences of such interference.

Therefore, institutions play an important role in providing the tools necessary for a workable competition law. The law is similar to a fort, which must be correctly built and protected in order to protect its inhabitants (Popper and Kegan, 1957: 66). Accordingly, the success of competition law enforcement depends on the adoption of institutional and organizational tools to ensure social acceptance of the law, to enable the enforcing bodies to enforce the law in practice and to limit political pressures.

6. Conclusion

A competition law is an important tool for creating competitive conditions, yet the creation of a workable competition law is not an easy endeavour. As this article has shown, the adoption of a competition law is only one precondition for the enforcement of the law. For the law to take root and bloom, other conditions must also exist, which are the soil, sun, water and pesticides of competition law.

As has been argued, the socio-economic ideology of the government is an important determinant of the adoption and the enforcement of a competition law. A competition law is generally broad enough to incorporate divergent ideologies – from total rejection of power and large size, to the acceptance of monopolistic positions as necessary for creating incentives for firms to compete in markets. Its enforcement, thus, depends to a large degree on the view of the enforcer regarding the role of market forces and the role of the government in its regulation. Accordingly, its efficiency as a pro-market tool depends on the government's competition culture and its public policies based on it. Changing the socio-economic ideology of a country is one of the most important and difficult challenges for a developing country, in which a market ideology is not deeply ingrained and protective policies are often used to solve economic problems.

In addition, it is vital to recognize the obstacles created by political pressures to limit the adoption and implementation of a competition law. Such influences should be combated by both internal and external counter-tools that are crafted to meet the specific concerns of each jurisdiction. Otherwise, political logic might triumph over social logic.

The legal tools must also be accompanied by institutional and organizational conditions that are conducive to the enforcement of competition rules. As such, they should provide the regulatory bodies with the necessary resources – human, financial, and legal – that are needed in order to apply the law effectively.

The implementation of a pro-market regulatory framework thus requires more than simply liberalizing trade or supporting privatization processes or adopting a competition law. It also requires strategic thinking about the ecological conditions for effective competition law enforcement, of the kind suggested in this chapter.

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Notes

** I wish to thank Tal Sheratzky and Boris Sherman for their most helpful research assistance.

* Senior Lecturer and Director of Law and MBA Program, Haifa University. Academic Fellow, NYU Centre for Law and Business.

1 Until 1990 only 16 developing countries had a formal competition policy. With encouragement and technical assistance from international institutions, 50 countries have completed legislation for competition laws in the 1990s, and another 27 are in the process of doing so (Singh, 2002: 6).

2 Antitrust file 202/240/5 Plywood producers *vs*. Director of Israeli Competition Authority, 48 District Court Decisions, 158.

3 Civil Appeal 2247/95 Director of Competition Authority *vs*. Tnuva Inc., 52 Supreme Court Decisions, 213.

4 Request for Exemption from Court Approval for Agreement to Establish Poligar, in Antitrust (Bar Association, Tel Aviv, 1994), vol. A, 108.

5 For a similar conclusion in the case of Venezuela see UNCTAD (2000: 24).

6 Brazilian response to ICN capacity working group (ICN, 2003: 28).

7 Virtually all developing countries that have adopted a competition law include public interest objectives in their laws. These countries include, *inter alia*, Cameroon, Gabon, Jamaica, Kenya, Macedonia, Morocco, Pakistan, Sri Lanka, Chinese Taipei, Tunisia and Zambia.

8 Unless, of course, the politicians' political allies are the beneficiaries of such policies.

9 This method might, however, have some negative effects, as it might create incentives for the competition authority to use broader merger notification standards, to bring more cases and to impose higher penalties than is socially optimal.

I.2. PREREQUISITE FOR DEVELOPMENT-ORIENTED COMPETITION POLICY IMPLEMENTATION: A CASE STUDY OF NEPAL

Ratnakar Adhikari

1. Introduction

Competition policy was not a priority for most least-developed countries (LDCs) in the era of widespread state intervention in economic activity, which was underpinned by the concept of import substitution industrialization (ISI). However, subsequent developments, both internal and external to these economies, demonstrated the need for specific pro-competitive initiatives. Internally, the adoption of liberalization policies, the rise in privatizations, and the fact that most privatized entities in the utilities sector are natural monopolies underscore the importance of a solid competition regime to elicit the most favourable efficiency and welfare effects of liberalization and privatization. Externally, the massive international merger wave and the existence of international cartels (WTO, 2001) and their potentially negative impact on market contestability posit a case for competition policy to equip developing countries with the tools to deal with the increased market power of multinational companies and their anti-competitive practices (Adhikari and Knight-John, 2003).

Most LDCs have, explicitly or implicitly, adopted some kind of competition policy measures during the past decade. The majority of them have virtually done away with a licensing regime, accelerated the process of privatization, deregulated or delisted many industries from the earlier "reservation" system, and opened themselves up to international trade and foreign investment (Adhikari and Regmi, 2001; Musonda, Mbowe and Sampson, 2001).

Theoretically speaking, these measures have the potential to significantly contribute towards increasing market contestability in the domestic markets of the LDCs. However, implementation of these policies has not been as effective as was originally thought. The prevalence of a host of anti-competitive practices has hindered the process of creating a competitive environment in the marketplace. A lack of political will, coupled with apathy within the concerned agencies to implement these policies, is considered one of the reasons for policy failure in the LDCs.

In order to ensure that pro-competition policies meet their desired objectives, they should be anchored on the development dimension. Since economic development is the major priority for most LDCs, it is essential for them to prepare development-oriented competition policy and legislation in tune with their development requirements.

Although LDCs are designing competition policy and enacting competition law due to a growing realization of their merits, most LDCs are worried about the possibility of their competition regime encroaching upon the pursuit of their development objectives. They are looking for mechanisms to ensure that they could design their competition regime in a development-friendly manner. For instance, Nepal, an LDC, which has made a commitment at the time of its accession to the World Trade Organization (WTO) to prepare a competition law (WTO, 2003) needs to design a development-oriented competition policy and law. However, policy makers, who have limited exposure to these issues, are unable to reach a consensus on how to design and implement a development-oriented competition policy framework. This calls for a thorough analysis of the development implications of the competition policy and law to be prepared in Nepal.

The overall objective of this chapter is to prepare a policy document to identify the *prerequisites for the successful implementation of competition policy in developing countries and the mechanisms through which this may operate*, taking Nepal as a case study. In the process, the chapter also looks at various facets of competition policy and law including their application in various jurisdictions. Section 2 discusses development objectives of the LDCs, particularly Nepal, in the post-liberalization era. Section 3 investigates the constraints faced by developing countries and LDCs to implement competition policy and law. Section 4 briefly sketches the nature of anti-competitive practices in Nepal and their impact on various sectors of the economy and segments of the society. Section 5 discusses the issues of the development dimension of competition policy as adopted in other countries – their merits and demerits as well as their successes and failures. Section 6 discusses the *prerequisites for the successful implementation of competition policy* in Nepal. The final Section concludes and provides some policy prescriptions to His Majesty's Government of Nepal (HMGN), so as to help them design and enact their competition law.

2. Development objectives of LDCs in the post-liberalization era

LDCs have, for decades, been striving to find the right development strategy to enable them to promote sustainable development by reducing poverty and malnutrition, engendering development-oriented institutions, and promoting social justice. Over the past two decades, an increasing number of LDCs have placed their hopes on a development strategy based on increased participation in the world economy, through exports and inward foreign investment (UNCTAD and Commonwealth Secretariat, 2001: 1) to achieve the goal of sustainable development.

To this end, they have vigorously promoted an outward-looking economic development strategy. Indeed, as per the UNCTAD LDC Report (2000), trade liberalization in the LDCs has actually proceeded further than in other developing countries. In 1999, 60 per cent of the 43 LDCs for which data are available had average tariff barriers below 20 per cent and non-tariff barriers that covered less than 25 per cent of production and trade. Similarly, UNCTAD data on foreign investment regimes in the late 1990s show that out of a sample of 45 LDCs, only nine maintained strict controls on the remittance of dividends and profits and capital repatriation (Cuddy, 2001: 3). However, it is worrisome to note that the LDCs, despite serious efforts to achieve their development objectives are not able to realize their potentials (Adhikari, 2004).

The efforts to integrate these economies with the outside world have also been supplemented by a wave of economic reform measures at home. Most LDCs have started their domestic economic reform measures – including privatization, deregulation and financial sector liberalization – due to the conditionalities of the Bretton Woods Institutions. These measures were not necessarily a product of thoughtful consideration aimed at instilling competition in the economy, but rather were a part of a donor-driven exercise. Nonetheless, these measures, in theory, are important from the perspective of enhancing competition in the marketplace. However, it is an irony that they have not been able to achieve even the purpose they were intended to serve, let alone promote competition. We now turn to look at the problems faced by the LDCs and the efforts made by them to achieve their development objectives.

2.1. Employment generation

Lack of productive employment opportunities and consequent exacerbation of poverty is the single major problem for most LDCs. Since the majority of the populations in these countries depend on agriculture for their livelihood, they are not only hit by international price fluctuation of the primary commodities, but are also affected by the lack of market access opportunities in the North. Their process of diversification into secondary and tertiary sectors has been glacially slow.

Therefore, creation of a viable industrial and service base for absorbing the ever-growing youth population that enters the employment market every year is one of the major objectives of most LDC governments. In the case of Nepal, this objective is reflected, for example, in the Tenth Five-Year Plan (2002–2007) of HMGN, which is also the Poverty Reduction Strategy Paper (PRSP) adopted by the government through a wider consultation with relevant stakeholders at various levels (National Planning Commission, 2002).

2.2. Promoting investment

In order to accelerate the pace of economic growth and provide employment opportunities to their growing populations, most LDCs are rigorously promoting investment. Against the backdrop of the reduction in official development assistance (ODA) and change in donors' priorities as well as focus, the LDCs are providing extra incentives to foreign investors to invest in their respective countries.

For example, in Nepal, under the "one-window" policy, foreign investors are provided with a one-stop clearance procedure for their proposal. Except for the limited number of sectors, excluded mainly on cultural and national security grounds, all economic activities are open to foreign investment. Approval is almost automatic, provided the relevant environmental criteria are fulfilled. However, most LDCs are lagging behind in terms of attracting foreign direct investment (FDI).

A study conducted by CUTS (2003a: 3–4) on the investment regimes of three LDCs – Bangladesh, Tanzania and Zambia – revealed that only Tanzania has improved its foreign investment performance, while Bangladesh and Zambia are lagging far behind. Similarly, as per the World Investment Report, 16 under-performers (with low FDI potential and low FDI performance) during 1999–2001 are LDCs (UNCTAD, 2003: 10).

2.3. Enhancing competitive ability

In the era of global competition, it is not sufficient for LDC companies to be locally competitive. They need to be globally competitive, for which they should possess some competitive advantage such as economies of scale, cutting-edge technology, marketing strengths, efficient production and distribution systems, and/or cheap labour (Adhikari and Ghimire, 2001: 7). The LDCs do not generally have a comparative advantage in any one of these areas except for the availability of cheap labour.

However, because of the low productivity of such labour, resulting mainly from lack of education and skills and poor health, even this comparative advantage of the LDCs has not been fully exploited. Therefore, one of the major development objectives of LDCs in the post-reform era is to identify and harness the potential areas of their comparative advantage, and at the same time enhance their competitiveness in the global market.

2.4. Removing supply-side constraints

In the LDCs, lack of linkage between production facilities, service and infrastructure facilities limits their potential to specialize in crucial productive sectors and reap the benefits of productivity gain. While poorly developed human resources have led to a paucity of managerial, entrepreneurial and technical skills, the ability to conduct adaptive research is severely constrained by a lack of incentive and entrepreneurial zeal.

Similarly, poorly developed infrastructure (e.g. transport, power and storage facilities), support services (e.g. telecommunications, financial services and other technical support service institutions), and a general lack of trade facilitation measures limit their ability to supply even otherwise competitively produced goods to the international market. Therefore, removing the supply-side constraints to be able to export by taking advantage of market access opportunities is another objective being pursued by most LDCs (Adhikari, 2004).

2.5. Diversification of export profile

The LDCs have not been able to diversify their domestic production structures, not only with regard to manufactured goods, but even with respect to their primary commodities. This renders them especially vulnerable to international market volatility. Of the 4,162 products exported by LDCs to 30 major trading partners in 2000, 127 accounted for 90 per cent of their total export trade. On average, the top three commodities exported by each LDC usually account for over 70 per cent of its total exports (WTO, 2001). The export concentration ratios (defined as the share of the principal export product in the total export value) have remained high and largely unchanged since 1980 for all LDCs. Several countries greatly depend on particular primary commodity exports, especially in sub-Saharan Africa.[1]

What makes the situation even worse for many LDCs is that, while exports of a single product may constitute a large share of their export basket, they count for relatively little in terms of the international supply, so that they are unable to influence world prices in a way that is beneficial to them (Chandrasekhar and Ghosh, 2000: 4). Therefore, diversification of the export profile with a view to reducing their vulnerability to global demand shock is another objective being pursued by most LDCs.

3. Impediments to effective implementation of competition policy in LDCs

It is generally accepted that competition policy and law is required for all the countries irrespective of the level of their economic development, partly because perfect competition is merely an economist's dream, and unattainable in a real life situation. The theoretical underpinning of their needs stems from the inherent nature of market failure, which is caused mainly by information asymmetries, natural monopolies, natural growth of firms and mergers and acquisitions (CUTS, 2002: ix). The problem is further compounded by the desire of firms to attain a certain degree of market power. These problems have led the prevailing wisdom to advocate the design and establishment of institutions that ensure that clandestine market power is not achieved and that those with market power do not abuse it (CUTS, 2002). However, it is not always easy for the governments of the developing countries and LDCs to effectively implement competition policy and law due to several inherent problems. While some of them are unique to LDCs, some others are found in a variety of shades in other countries too.

3.1. Conflict with other policy objectives

LDC governments tend to be inimical to the idea of implementation of competition policy and law because they, rightly or wrongly, believe that these actions unnecessarily constrain the ability of the governments to exercise their sovereign rights to achieve other genuine policy objectives. For example, given the fact that one of the major development objectives of the LDCs is to generate employment opportunities, they would be hesitant to expose their small and medium enterprises (SMEs) to foreign competition because of the latter's potential to provide employment opportunities.

Even in a developed country such as Japan, competition policy discipline was subordinate to the industrial policy. Its powerful Ministry of International Trade and Industry (MITI) never flinched from ignoring the basic tenets of antitrust regulations if they interfered with the export-oriented industrial policy for which it became famous (Moisés, 1998).

While one of the objectives of competition policy and law is to reduce economic concentration by regulating mergers and the creation of market power, firms in LDCs cannot attain a minimum efficient scale and be able to compete with the foreign firms if this objective is vigorously pursued by the State. Lachmann (1999: 12) is of the view that all the successful market economies began industrialization shielded by trade protection – the only exception being Hong Kong. Therefore, LDC governments should also be allowed to use interventionist policy in order to help their enterprises attain economies of scale so as to be able to compete with foreign enterprises. He argues that the "the initial costs of protection [not competition] will be outweighed by the long-run benefits of increasing competitiveness and participation in international trade" (Lachmann, 1999).

Realization that the government needs to pursue active industrial policy in the initial stage of industrialization led HMGN to bind tariffs at levels higher than those being applied, at the time of Nepal's accession to the WTO (WTO, 2003).[2] This may be, in part, a reflection of the failure of the strategy adopted by the government in the recent past to spur economic growth through unilateral liberalization of trade, investment and finance.

At times, rather than refraining from enacting the competition law with the fear that it might restrict the policy options of the government, some countries have attempted to strike a balance between conflicting objectives of the government at the time of drawing up the competition law itself. The South African Competition Act of 1998 provides a classic example of an attempt by a government to accommodate its conflicting objectives.[3]

3.2. Resistance from vested interests

"Competition is always in danger. Since it is uncomfortable or even threatening, business tries to avoid it. To use a metaphor: competition is not a weed that grows even if left alone; rather it is a cultural plant that needs constant government attention" (Lachmann, 1999: 19). Implementation of competition policy and law in countries where competition culture is lacking (which is the case with most LDCs) entails, among others, convincing the business enterprises to move beyond myopia. It is about asking them to weigh the long-term costs and benefits of competition policy and law implementation.

There is an inherent tendency among business people to see their (anti-competitive) actions as virtuous and viewing others actions as evil. Take the example of a domestic firm, which commands a dominant position in the market in the present context. It does not abuse its market power but is opposed to bringing its sector within the ambit of competition law. It does not know that since there is no entry barrier, a multinational corporation (MNC), with financial muscle as well as better knowledge, skills and expertise to run a similar enterprise, could enter the market and introduce predatory pricing. In such a situation, the firm would be the first one to realize that bringing its sector within the ambit of competition law would have saved it from unfair competition.

For example, in the case of Nepal, it was found that manufacturers, who demand protection and oppose competition in their sector, complain about a cartel in the financial (mainly banking) sector, which by limiting their access to credit impedes their ability to become competitive. They do not realize that in the absence of the strict application of competition rules they could also be faced with the situation where the suppliers of raw materials form a cartel and raise the price of their inputs making it impossible for the former to source their raw materials at a market-determined price. Should such a situation occur, they could become staunch supporters of competition policy and law.

Interestingly, some businesspersons engaged in anti-competitive practices publicly defend their behaviour. Transport entrepreneurs, who are engaged in syndication (as discussed in detail below), defend their action as being welfare enhancing overall. According to them, a syndicate system is an orderly mechanism that assures the consumers of uniform price, and quality of service (as per their benchmark), and saves the consumers from the hassle of being annoyed by the call boys at the bus stations. In the absence of a syndicate system, as the argument goes, there could be unhealthy competition because the government does not have a system in place to determine the optimum number of buses that could ply a given route, which then results in misallocation of resources.

3.3. Lack of good governance

One of the reasons for the failure of the most LDC governments to implement policy measures aimed at spurring economic growth is the lack of good governance. In most LDCs, a public choice theory seems to apply perfectly with the government willing to provide concentrated benefits to a small group of the favoured and well-organized population (e.g. a business lobby), to the detriment of widely dispersed and unorganized groups (e.g. consumers).

A politics–business nexus, fuelled by the attitude of the people in power to make decisions based on their personal preference and connection, rather than on merits, has further exacerbated this problem. In the smaller LDC economies, where people tend to know each other fairly well and there is a strong cultural tradition to favour the relatives, friends and cadres, it is almost impossible to root out corruption and mal-governance. In Nepal, for example, mal-governance is one of the reasons for the failure of the government to contain anti-competitive practices, even if some of them are outlawed by the Consumer Protection Act 1997.

Adhikari (2002a: 17) documents yet another example of corruption contributing to anti-competitive conduct.[4] The manufacturers of polythene pipes, who are engaged in bid rigging, mentioned that the part of the rent they earned through bid rigging is, more often that not, shared with the officials of the public sector, who invite the bid. They even say that the compulsion for rent sharing has led them to adopt bid-rigging practices. This has led to the creation of vested interests even on the consumers' side, who want to zealously maintain the *status quo.* These officials would always defend the riggers and would not be inclined to support the competition investigation, even when it is initiated by the competition authority.

3.4. Tension with sector-specific regulators

Despite massive changes in technology, several segments of the infrastructure in the LDCs are natural monopolies, because of the limited size of markets and the lack of entrepreneurial zeal to make risky investments in sectors with high gestation periods. Moreover, competition authorities do not have the required competence to deal with such complex issues as redistributive policy (through cross-subsidization) and universal service obligations (Tirole, 1999). Therefore, sector-specific regulators will continue to play a major role in ensuring that natural monopolies do not abuse their position in the market, and make optimal arrangements for the supply of public goods, for which they were created.

One of the responsibilities of the sector-specific regulators is to maintain price-cap regulation in the sectors under their jurisdiction – an activity that impinges on competition. While simultaneous jurisdiction is not uncommon even in developed countries, this is a source of tension in most LDCs because of a lack of clear-cut demarcation of authorities and responsibilities. Some of the tensions in LDCs as documented by Basant (2001) are presented below.

In Zambia, a clear overlap exists between the tasks of the Zambian Competition Commission (ZCC) and the Securities Exchange Commission (SEC). In a case where the ZCC required the shares of the acquired entity to be floated on the stock exchange in order to prevent the concentration of stock in the hands of the acquirer, the SEC allowed the acquirer to offer the share to the minority shareholders. Although this resulted in the acquirer having total control over the company with negative implications for competition, the ZCC could not prevent this as the SEC's decision prevailed.

The case of Tanzania is interesting as the sector-specific regulation was initially under the purview of the competition authority. Subsequently, some other sector-specific regulatory authorities were created. The conflicts between the competition authority and the Tanzania Communication Commission (TCC) became obvious when the former filed a complaint against the latter for permitting the dominance of two cell phone companies (Mobile and Tritel) in the country. The TCC had to provide detailed explanations for its conduct and subsequently registered other cell phone providers, e.g. Vodafone.

3.5. Resource and capacity constraints

The issues of resource and capacity constraints are perhaps some of the most significant problems facing competition authorities in the LDCs. Whilst the dismal resource base is linked to the fiscal crunch that confronts most LDCs and the need to balance and prioritize competing demands on the government budget, it is also a reflection of an absence of political backing for competition policy and law. Exclusive dependence on state funds has a disastrous impact on the capacity of the competition authority in terms of quality and quantity of staff, opportunities for training and human resource development, and support facilities and infrastructure, while also undermining its independence to a large extent (Adhikari and Knight-John, 2003).

The resources available to remunerate staff are a crucial determinant of the skills and expertise that the authority can attract. The salaries paid to employees of the competition authorities are lower than the levels in the private sector in most LDCs (CUTS, 2002).[5] As documented by De Zoysa and Wickramaratne (2001) even in a developing country such as Sri Lanka, staff of the Fair Trading Commission (FTC) were paid salaries that were lower than those in the rest of the public sector.

Competition agencies require a considerable degree of skill and competence to address complex issues ranging from how to determine dominance or at what level to set threshold limits or to how to evaluate competition cases using a "rule of reason" approach. However, in the developing countries and LDCs, competition agencies struggle with these issues and are unable to handle their caseload because of a lack of qualified staff. In Sri Lanka, for instance, the erstwhile FTC (now Consumer Affairs Authority) only investigated two mergers and 23 restrictive trade practices in the 1996–2000 period, while India's Monopolies and Restrictive Trade Practices Commission (MRTPC) had to struggle with an enormous backlog of cases with only seven professional staff members (CUTS, 2003b: 43).

3.6. Lack of political will and independence

A common feature in most developing economies is the absence of political ownership and support for competition policy. This also translates to political interference in the activities of a competition agency, undermining its independence as a professional "watchdog" of competition. CUTS (2003b) lists some of the criteria that define independence: legal independence, where the competition agency is not a part of any government department and where members cannot be removed without proper justification, financial independence, and, *de facto* independence where it would have the cooperation of other government agencies in enforcing its decisions.

Legal or on-paper independence does not necessarily provide for *de facto* autonomy, as is evidenced in the case of Pakistan where the government interfered in several cases, most notably that of the cement cartel. The Indian tale of the soda ash and cement cases that set a strong lobby group comprising a few big industrial houses against an association of small builders and ordinary consumers also indicates the threat to independence from strong business lobbies (Adhikari and Knight-John, 2003). The reasons for the lack of political support relate mainly to the mal-governance issue highlighted in Section 3.3 above.

3.7. Absence of competition culture

A significant problem confronting most LDCs is the absence of a national constituency to support competition policy work. While a bottom-up approach – pressures from groups such as consumer and other civil society organizations (CSOs) that operate outside the government – is particularly relevant in countries that lack the political commitment to competition policy, this appears to be lacking in most of the LDCs.

Business enterprises, devoid of the sense of competition, are least prepared to listen to the idea of competition advocacy. Worse still, in the case of Nepal, they were found not even willing to provide their suggestions to the government and CSOs in helping them improve the content of the draft competition legislation, in which they will have a significant stake, once passed.[6]

Inculcating competition culture among the government officials is yet another challenge. A former Secretary at the Finance Ministry of Nepal, after having attended a Competition Policy Conference organized by the World Bank and the International Bar Association, among others, in New Delhi in March 1997, commented that he felt that the introduction of competition law would inhibit the foreign direct investors from investing in Nepal, as they would perceive it as yet another regulation!

As these examples point out, a conscious effort to promote competition through the implementation of competition policy and law may not be sufficient to infuse competition in the marketplace. Even if a state-of-the-art as well as home-grown competition law is enacted, it could encounter serious implementation problems if constituencies it is meant to serve are not convinced of its benefits.

4. Anti-competitive practices in Nepal and their impact on economic development

It is evident from the foregoing analysis that market failure is common in LDCs for various reasons. Nepal is no exception. There are various historical, cultural and social reasons, besides economic ones, contributing to the prevalence of anti-competitive practices in Nepal. While some anti-competitive practices were prevalent even prior to the initiation of economic reform measures in Nepal, others have recently surfaced.

4.1. Transformation of public monopoly into private monopoly

Most of the LDCs have initiated a privatization process as a part of the structural adjustment programme (SAP). Analysis of the privatization policy, for example in Nepal, reveals that despite serious efforts, they have not been able to make the privatization process as broad based as possible. If the privatization process is not conducted properly, that is without transparency, accountability, due process before the law and without contestability, it is quite possible that the process would simply remove state monopolies and create private-sector monopolies (Musonda, Mbowe and Sampson, 2001).

In the case of Nepal, most of the public-sector enterprises, which were monopolies in the hands of the government, have either been transformed into private monopolies or are in the process of becoming so. Very few public enterprises have enhanced their competitive ability after privatization. Due to the absence of clear-cut guidelines, the lack of regulation, competition culture and a legal framework, and the virtual absence of post-privatization monitoring and an evaluation mechanism, the privatized enterprises have failed to infuse competition in the economy. Rather, they are weakening the competitive base of the economy (Adhikari and Adhikari, 2001).

4.2. Cartel

In LDCs, market-sharing and price-fixing cartels are prevalent in various degrees. For example, in Nepal, it is very normal for the business associations, which were established with the objective of protecting their professional interests, to have converted themselves purely into cartelizing bodies. Examples include the Nepal Bankers Association (NBA),[7] the Foreign Exchange Dealers Association of Nepal (FEDAN), the Colour Photographers Association of Nepal, the Nepal Association of Travel Agents (NATA), the Airlines Operators Association of Nepal (AOAN),[8] the Brick Manufacturers Association of Nepal, etc. So much so that even barbers in Nepal have formed their association, the Nepal Barbers Association, and its members are instructed to charge a given price for their services (Paudel, 2001: 14). The norm among these associations is such that those who undercut the price face strict sanctions from their associations, and at times even exclusion.

In the context of Nepal, there cannot be a more classic example than that of the sugar industry when one has to see how far cartel can go. In August–September 1999, leading sugar industrialists approached the government to increase the tariff on the import of sugar to 40 per cent so as to prevent Brazilian sugar from entering Nepal. Their justification was that since Nepal already had sufficient domestic capacity to produce sugar, importation was redundant and that a higher tariff was necessary to protect the "infant" sugar industry. When the government raised the tariff, domestic industries, a cartel as they were, stopped supplying sugar to the market and pressurized the government to increase the retail price of the sugar. The government, instead of clamping down on the cartel by utilizing the provision of the Consumer Protection Act 1997, yielded to the pressure. Interestingly, the cartel timed the move to the beginning of the festive seasons (when demand for sugar shoots up exceptionally), and succeeded in forcing the government to bow down (Adhikari, 2002b). Consumers are forced to pay a higher price for the local sugar because of the cartel. Even now, the sugar tariff remains at 40 per cent and its retail price is 29 rupees per kg, whereas the landed price of imported sugar would be 20 rupees per kg, if the tariff barrier were to be removed. This policy of the government has deprived the consumers of the opportunity to consume sugar at a much lower price.

4.3. Syndicate system

The major portion of the surface transportation system of Nepal is based on a syndicate system. This syndicate system is a collusive agreement among the transport entrepreneurs, who form an association, which determines the route and the frequency of plying buses or trucks for each member of the association. This system disallows any outsider to enter the road-transport network and if they do so they are not only faced with sanctions but also physical assault (Sharma, 2000). This system ensures that the consumers are made to pay what the syndicate wants, thus robbing them of their right to choose. Further, due to a lack of competition among the transport entrepreneurs, they have no incentive to upgrade or enhance the quality of the services provided to the passengers as they are fully convinced that this will not bring any extra benefit to them since the consumers have no choice but to use their services.

In January 2003, the Nepal Contractors Association Kaski (NCAK) filed a complaint at the District Administration Office (DAO) against the Gandaki Truck Operators Committee (GTOC) which was resorting to syndication in the name of cooperatives. The committee had been practising syndication after it announced its entry into the cooperatives system. This had compelled the consumers to pay an additional 1,000 rupees per trip for transporting, *inter alia*, sand and concrete. The truck operators increased the charge from 1,600 rupees per trip to between 2,200 and 2,700 rupees per trip after the formation of the “committee”. However, the DAO failed to take any action against the syndicate members (Bhadgaunle, 2003).

Despite a clear-cut provision outlawing syndication in the Consumer Protection Act 1997, the government could not muster enough courage to implement that provision because of the sheer strength and clout of the transport entrepreneurs. Whatever little effort made by the government to bring the culprits to heel has failed. The syndicate system, which is not only rampant but has gone unchecked, has ripped off the consumers. Moreover, this has caused considerable damage to the industries because of the higher input costs resulting from the higher freight charges.

4.4. Bid rigging

This practice is widely prevalent especially in the construction and/or supply sector, where contractors or suppliers sit down together and decide the price at which <u>one</u> contractor or supplier will receive the contract. It is decided beforehand who would be winning the contract and the norm is that the winner has to be from within their group. Then, the person/firm who receives the contract compensates the other contractors/suppliers. If such contracts are to be awarded on a perennial and regular basis, then the contractors/suppliers decide the timing and the amount of contract each one of them is going to receive on a rotation basis. The manufacturers/suppliers of polythene pipes to the Nepal Drinking Water Corporation (NDWC) operate under this system in Nepal (Adhikari and Regmi, 2001). This practice is not only hurting the consumers, but also the taxpayers because the NDWC is a natural monopoly funded by the government. And when it incurs unsustainable losses, the government comes to its rescue, by making use of taxpayers' money.

Another example reported in a newspaper is the bid-rigging practice followed by the suppliers of rations to the Royal Nepalese Army and Nepal Police (Kantipur, 2003). This practice is directly hurting the taxpayers. Similarly, some municipalities in Nepal have refused to follow the guideline of the prevailing financial regulations of the country, which requires the awarding of a contract to the lowest bidder, at the time of execution of the development project because of the prevalence of bid rigging among the contractors (Gyawali, 1997).

4.5. Tied selling

Tied selling can be of two types: (a) a subtle form of tied selling by combining the sale of a slow-moving item with fast-moving items; and (b) a blunt tied selling carried out by bundling related goods and services. Both types of tied selling are widely prevalent in Nepal.

Having to buy a slow-moving item in return for the seller selling a fast-moving item is a routine affair in the case of Nepal. Since the market is imperfect, the creation of an artificial scarcity through hoarding or limiting supply is quite common. Even when the product is abundant in supply in the intermediary markets, it reaches the consumers in a quantity and at a price desired by the producers and/or middlemen. Since it has become more of a routine, consumers are not surprised if they are asked to purchase 25 sacks of Indian cement while purchasing 50 sacks of Nepalese cement.

A more direct type of tied selling takes place in educational institutions (schools) and hospitals. In most of the privately run schools, it is mandatory for the students to purchase books, stationary and uniform from the school itself – ostensibly to maintain uniformity among the students and maintain quality. However, the hidden motive behind such business is to extract as much money as possible from the parents in the name of imparting "quality" education (Khadka, 1998). Similarly, in some of the private hospitals and nursing homes, it is mandatory for all patients to undergo the pathological tests in the same hospital or nursing home once they have consulted the physicians, even if the tests have been done very recently in another hospital of similar status or reputation (Paudel, 1998).

4.6. Predatory behaviour

As mentioned earlier, monopolist or dominant firms in LDCs are so powerful that they do not want to see any new firm entering the market and trying to steal away their market share. This may not be the case in bigger economies where size of the economy is such that it can accommodate a large number of firms. In small economies, firms operate either under a monopolistic or an oligopolistic market structure. Therefore, in order to preserve their monopoly position (and continue to earn rent), they may attempt to drive out the competitors by reducing their prices to an unreasonably low level.

Another type of predatory intent, which is typically found in the case of LDCs, due to the small size of the market, is the predatory behaviour by a foreigner supplier. When predatory behaviour crosses a border, it becomes a case of dumping. One classic example of dumping, which was prevalent in the Nepalese market during the 1980s was the dumping of the *Maggi* brand of instant noodles by Food Specialities Ltd. (FSL), India (which later became Nestle India Ltd.). FSL was the only supplier of instant noodles in the Nepalese market (i.e. it had enjoyed a monopoly position), until Gandaki Noodles Pvt. Ltd. (GNPL) of Nepal started producing the *Rara* brand of noodles in direct competition with *Maggi*. In response to this, FSL slashed the price of its noodles to such a level that its sales price in Nepal was 25 per cent lower than that in India. Even though predatory intent was suspected, the Nepalese authorities could not do anything because Nepal did not have an anti-dumping law or institution.[9]

The price undercutting strategy was ostensibly adopted by FSL with the intention of driving *Rara* out of the market. However, FSL did not succeed in its endeavour and finally decided to maintain a low profile in the Nepalese market (Adhikari, 1997). Now there is stiff competition in the noodle market with the entry of new firms. While GNPL is losing ground too, *Maggi* noodles' share in the market has shrunk considerably.

A recent case of alleged predatory pricing behaviour that is visible in the market relates to the pricing of English language broadsheet dailies. There were two such newspapers in the country until 2002 – one private and one government owned. After the entry of the private newspaper *The Kathmandu Post* (TKP) in 1993, the share of the government-owned newspaper *The Rising Nepal* has shrunk considerably. In 2002, a new daily *The Himalayan Times* (THT) entered the market with an aggressive pricing strategy charging 2 rupees per copy, as opposed to the 4 rupees charged by the incumbent newspapers. THT was able to considerably increase its market share surpassing the circulation of TKP, which, in turn, fought back later by reducing the price to 1 rupee 50 paise. In response to this, THT has reduced its price to 1 rupee.

There is a suspicion among the competition experts that THT could have been indulging in predatory pricing. However, given the fact that consumers are gaining as of now and that there is no law to prevent such practices, it is unclear which course this price war will take in the future. One view could be that as long as there is a credible threat from the competitor, which could match the price howsoever low it might be, there is no reason for alarm. However, another view could be that TKP will be eventually wiped out of the market, clearing the way for THT to enjoy a near-monopoly position in the market and abuse its market power. The jury is still out to say the least.

4.7. Price discrimination

As per a study conducted by Adhikari and Regmi (2001) to document anti-competitive practices in Nepal, it was found that price discrimination was the most frequently occurring restrictive business practice. Seventy-eight per cent of the respondents interviewed during the survey mentioned that price discrimination was prevalent in the Nepalese market. Blatant price discrimination is observable in the financial sector – with banks providing lower interest credit for big borrowers and charging higher interest to small borrowers for the same category of loan.

The banking regulator (the Central Bank) used to impose a requirement on them, until recently, not to deviate by more than 0.5 of a percentage point from their published rates while discriminating between two types of customers, for each category of loan. Commercial banks, finding it difficult to discriminate between their customers by more than 1 percentage point, came up with an ingenious idea. They sub-categorized each loan category and preserved their right to discriminate between their customers by up to 3 percentage points.[10]

Banks justify their action by saying that they are basing their lending rates decisions on their risk perception, i.e. charging higher interest rates to customers with weak credit standing to compensate for a possible loss. However, this turns out to be a facile argument because the major portion of the banks' non-performing assets (bad debts) is concentrated in big business houses (belonging to the so-called corporate category).[11]

The major implication of such a discriminatory practice is the reduced access to credit for small business enterprises and start-up ventures, which not only imperils the competitiveness of existing small businesses, but also creates an entry barrier for new entrepreneurs. Since an alternative route for mobilizing capital (i.e. a capital market) is also not well developed in Nepal, market contestability is seriously lacking – at least in those sectors where capital requirement is high.

The Central Bank has also done away with the requirement not to deviate by more than 0.5 of a percentage point for each lending category arguably because it did not serve the intended purpose. Banks are now free to decide their lending rates, thus providing them with an opportunity to discriminate against the smaller borrowers to the extent that they feasibly could.

5. Development dimension of competition regimes and their relevance to LDCs

Though the overarching goal of competition policy is to promote economic efficiency and enhance consumers' choice, it can have several objectives. While some of them are complementary to each other, some others run at cross purposes. At the same time, competition policy does not function in a vacuum and it has to interact with various government policies. As mentioned earlier, there could be a considerable degree of conflict between competition policy and other policy objectives of the government. Promoting SMEs by shielding them from competition, promoting balanced regional development by offering incentives to those firms that invest in a particular location, and promoting "national champions" through trade protection and government supports – which are considered part of the boarder issue called developed dimension – can contradict the stated goal of competition policy.

The question of the development dimension is largely a Southern phenomenon, although this issue has received considerable attention in the policy-making processes of the developed countries as well. All the sectors of economies in the developing countries may not be equally capable of facing competition especially from foreign companies.

Further, the infant industry argument calls for sheltering nascent sectors of the economy from outside competition. Even the developed countries of today made use of such mechanisms in the past. For example, in Japan between 1961 and 1973, close to 1,000 cartels per year on average were exempted from antitrust law (Lachmann, 1999). However, in order for the infant industries to gain significant economies of scale and become globally competitive in the true sense of the term, such protection should be applied selectively, made conditional upon meeting performance standards, should be transparent, time limited, involve minimum discrimination, and be constantly reviewed. It has to be also recognized that providing protection to the domestic sector, particularly to infant industries, is the second-best option (Lachmann, 1999).

At the same time, there are arguments against merger control in LDCs, which could be detrimental to the developmental interest of the country. This arrangement clips the wings of those enterprises that wish to grow, so that they are never able to attain a critical mass and economies of scale (SAWTEE, 2003).

Against this backdrop, this section attempts to discuss the development dimension of competition policy in the following areas, mindful of the fact that there is a clear overlap between some areas.

5.1. National champion

Active industrial policy calls for governments' support for specific industries, possibly through approving economic consolidation and intervening in the industry structure, i.e. "picking winners" and channelling market forces into working for the particular interests of those winners (Pham, 2003: 1). A strong argument in favour of such "national champions" picked by the government, is that competition policy should not be too concerned with the emergence of dominant firms, or with mergers that will create firms with large shares of the domestic market, if large-scale operation is essential to succeed in the world market.

Generally, a strategy to promote a national champion is adopted by the countries in the initial stage of their industrialization. Once these champions become globally competitive, they are exposed to international competition. Some advanced countries have reflected this commitment in their legislation. For example, the competition laws of the UK and the Netherlands, which no longer require promotion of national champions, propose to limit ministerial intervention to national security grounds at the most; other national interest deliberations will be left to the competition authorities (Mehta, 2002).

However, some other industrialized countries continue to develop "national champions" in some critical areas even if they conflict with the objective of competition policy. For example, the German Economics Ministry overruled, for the second time, a decision of the Federal Cartel Office (FCO) rejecting E.ON AG's proposed US$ 10.2 billion takeover of Ruhrgas AG, Europe's largest gas importer. The Ministry argued that the takeover would create a powerful national champion to negotiate in international markets, despite the allegations from German scholars that the Ministerial prerogative was tantamount to "keeping the back door open for industrial policy" (Pham, 2003: 3).

Equally illuminating is the example of the merger of two dominant dairy companies in New Zealand with an international marketing group, which was approved by the introduction of legislation to exempt them from the business acquisition provisions of the country's Commercial Act, with a view to enhancing their international competitiveness. The new merged entity, named Fonterra Co-operatives Group Ltd., now controls 95 per cent of New Zealand's milk supplies, contributing 7 per cent of its annual Gross Domestic Product (GDP) and ranks as the world's 14th largest dairy company (Pham, 2003: 4).

In Japan, which achieved spectacular GDP growth and growth in its share of world exports by 10 percentage points between 1950 and 1973, competition policy was subordinate to industrial policy, an essential concern of which was to maintain the private sector's high propensity to invest. The then-powerful Ministry of International Trade and Industry (MITI) not only encouraged a variety of cartels, but also encouraged mergers between leading firms in key industries believing that large-scale enterprises were required for the promotion of technical change and for Japanese firms to compete effectively with their western counterparts (Singh and Dhumale, 1999: 12).

The Korean government broadly followed the Japanese strategy of economic development. It also had a strong industrial policy which, as in the case of Japan, dominated competition policy. The government helped create mammoth conglomerates, the *chaebols*, which went on to capture global markets (Singh and Dhumale, 1999). Though Korea has one of the highest levels of industrial concentration in the world, the giant *chaebols* compete with each other fiercely for government support proving their mettle by meeting specified performance targets for exports, new product development, and technological change. As in Japan between 1950 and 1973, the Korean government until recently has purposefully coordinated industrial investments by competing *chaebols*, so as to prevent overcapacity and excess competition (Singh and Dhumale, 1999).

Virtually all the countries in the world, whether developed, developing or least-developed, have made use of the national champion argument to foster the competitiveness of their industries in one way or the other. It must be remembered that comparative advantages of today are mostly the result of successful government interventions of yesterday. For example, it used to be argued that economic development in Britain was possible only by following the free-trade policy. However, as recent research points out, Britain propagated free trade only in those areas in which it was already competitive; in all other sectors of the economy, its average tariffs were higher than in France – a country blamed for pursuing a blatantly protectionist trade policy (Lachmann, 1999: 11).

While some countries have made explicit provision in their legislation to give precedence to industrial policy, some economies have made use of industrial policy in a more subtle manner. For example, Taiwanese Fair Trade Law (competition law) contains a clause that gives explicit precedence to other laws where they conflict with competition law. Similarly, the Australian Trade Practices Act allows for the possibility of the Australian Competition and Consumer Commission (ACCC) to grant immunity on public-interest grounds for Merger and Acquisition (M&A) cases, which would or might otherwise breach the provision on "substantial lessening of competition". This mechanism is called "authorization" and cannot be overturned once granted (Pham, 2003: 3).

However, in the USA, where it is proclaimed that competition policy itself is industrial policy, competition authorities have gone ahead and provided approval for some large mergers that have an impact not only on their own market but also on the international scene, precisely because of their potential to become "national champions". The mergers between G.E. and Honeywell, Boeing and McDonnell Douglas, and Exxon and Mobil are examples of such large-scale mergers, which were approved, despite the fact that these mergers would have led to a high market concentration *ex post*.

Even when one looks at the control of merger and takeover from a broader perspective – not merely from the narrow perspective of the "national champion" argument, the debate centres on one issue – whether these activities are desirable or not from a development perspective. The philosophy underpinning merger control is that big is unavoidably ugly. Textbooks on Microeconomics and Industrial Organization suggest that bigness or market power could create massive rents for the business enterprise thus taxing its efficiency to the detriment of the consumers. However, as per another school of thought, big is not necessarily bad because it provides the enterprises with the opportunity to attain economies of scale, avoid duplication of assets, enjoy synergistic benefits, and invest in research and development (R&D).

All these features lead to cost reduction, which could ultimately be passed on to the consumers.

Those who subscribe to the second school of thought also argue that competition law may hinder the ability of domestic firms to become competitive because it makes it difficult for them to coordinate their business policies and consolidate operations through such strategies as M&As. They also feel that the risks, uncertainty and low profits associated with competition limit their ability to conduct R&D and innovate or improve product quality.

As mentioned above, in an increasingly globalized world, big firms are becoming bigger so as to compete globally, and competition authorities around the world are taking lenient stands on such practices. Therefore, there is no need for the competition authorities of the LDCs to frown upon firms having less than a 40 per cent market share (Adhikari, 2003a). This realization has led some small economies to adopt competition law without any merger control regulation. For example, Protocol VIII of the Treaty of Chaguaramas, which deals with anti-competitive business practices of the Caribbean Community (CARICOM) region, does not provide for merger control regulation (Stewart, 2000).

Due to a high degree of openness, merger regulation can become irrelevant to the small economies in particular LDCs. Openness means that local firms have to compete at the international standards in the domestic market. The majority of firms are micro-firms so there is a need to achieve a critical mass for developing economies of scale and scope.

5.2. Protection of vulnerable sectors/segments

As mentioned earlier, although the role of SMEs may not be that important in terms of generating export revenue, their contribution in terms of providing employment opportunities is enormous.[12] If we expose such enterprises to foreign competition, the vital nerve of the national economy may collapse. Therefore, it is necessary to shield these enterprises for a temporary period so that they could be brought up to speed and face competition from large domestic as well as foreign enterprises at a later stage.

The South African Competition Act explicitly states that ensuring SMEs have an equitable opportunity to participate in the economy is one of the objectives of the legislation. Similarly, Chapter VIII of the Revised Treaty of Chaguaramas provides for a *de minimis* rule (Article 181), by which the Commission may exempt from the provisions of this section (Chapter VIII) any business conduct referred to it if it considers that the impact of such conduct on competition and trade in the CSME (CARICOM Single Market and Economy) is minimal. It has been interpreted that such a *de minimis* rule provides a carve-out for the SMEs to be subjected to competition discipline of the CSME (SALISES, 2004). At a sub-national level, the United

States Virgin Island Anti-Monopoly Law provides for the exemption of import cartel agreements between small entrepreneurs engaged in retail sale.[13]

It is generally accepted that competition is good for all economic participants in the long run, but that it is bound to create displacement in the short term. Therefore, it is necessary to protect the interest of the poor, marginalized and vulnerable segment of society from the onslaught of competition in the short term. As has been made amply clear by the foregoing analysis, due to market failure, displacement is bound to occur in the LDCs. For example, trade and investment liberalization and the application of competition law provide benefits to the relatively better-off firms and people from the upper echelons of society, leaving behind the vast majority of enterprises and people to suffer the burden of adjustment.

While some governments have made conscious efforts not to subject vulnerable sectors and sections of society to the strict application of competition rules, some others leave it to the mercy of market forces. For example, at the time of accession to the WTO, Nepal was able to bind its tariff on agricultural products at 42 per cent on average, and for some of the sensitive agricultural products, the production of which was linked to the livelihood of the poor, marginalized and vulnerable farmers, the bound tariff is up to 60 per cent (WTO, 2003). These rates, coupled with the trade remedy measures available under the WTO Agreements (which can be used now), are likely to provide a cushion to the farmers against the possible unfair competition such as dumping or surging of imported agricultural products.

At the time of drawing up its Foreign Investment and Technology Transfer Act (FITTA) 1992, HMGN has also made a deliberate effort to protect some sectors of the economy from foreign competition. Listed in Annex 1B of the Act, most of them were included in the reservation list in order to protect the vocation of the indigenous and ethnic communities. The exclusion of travel agencies, trekking, rafting and pony-riding enterprises, and the operation of small lodges and hotels from foreign investment was designed to protect the employment opportunities of the *Sherpa* communities, who live in high mountains and have been excluded from the national mainstream for a long time. This community owns the majority of the business enterprises listed above.

Similarly, as explicitly mentioned in the South African Competition Act, one of the objectives of the legislation is to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons (i.e. the black community). Accordingly, such exemptions have also been inscribed into the law.

Finally, since the working class (i.e. labourers) is considered vulnerable in developing countries and LDCs, competition law in many jurisdictions protects the collective bargaining rights of the labourers. Since their service also represents an input into the production process, there could be a tendency among firms, pressured by competition, to take away such rights of the workers. However, as mentioned above, countries which not only promote competition as the only goal and take other socio–

economic interests into consideration, tend to preserve this right of the workers. Moreover, countries which have signed the Core Labour Standard of the International Labour Organization (ILO) are obliged to guarantee these rights. Some of the countries that have explicitly inscribed an exemption for collective bargaining rights of labourers include South Africa and Zambia.

5.3. Efficiency defences

As mentioned earlier, the fundamental purpose of competition law is to ensure the efficient use of resources through vigorous competition. For relatively small open economies characterized by a high concentration in many markets, firms may not be operating at a minimum scale of efficiency, which causes efficiency issues to be particularly important. Since most LDCs bear the above-mentioned characteristics, it is important for them to learn from the associated practices elsewhere.

There may be instances in which apparent restrictions of competition can mean more efficient resource use (World Bank and OECD, 1999: 124). Such restrictions can be broadly classified into two categories – pro-competitive and anti-competitive. The first category of restrictions includes a merger between two small competitors to make themselves into a more effective rival to a larger competitor, and a joint venture between two potential competitors to develop a new product.

The second category of restrictions includes two competitors merging to take advantage of economies of scale thus making better use of resources, but charging a higher price to the consumer because of the market power that they are able to enjoy post-merger. Some other real-life examples of restrictions falling into this category are: two potential competitors entering into a joint venture to develop a new product to eliminate duplicate research and development (R&D) and avoid the cost of racing to be the first in the market, resulting in a delay in the introduction of the new product/process to the market; and two multi-product competitors agreeing to specialize production with each supplying the needs of the other, providing each other with the opportunity to know each other's costs thereby leading to less price competition.

Some countries (Australia, Canada, New Zealand, the UK and the USA) have either a statutory or an administrative provision for an efficiency exception or defence. The European Union (EU) allows for the exemption of anti-competitive agreements that also bring about economic benefits. According to Article 85 (now Article 81) paragraph 3 of the Treaty of Rome, some collusive behaviour restricting competition in a non-minor way may be exempted because of sufficient beneficial effects. Four conditions are required:

- the agreement must contribute to the improvement of the production or distribution of goods or promote technical or economic progress;
- it must allow the ultimate buyers a fair share of the resulting benefits;
- the restriction must be necessary for the attainment of the objective; and

- the firms concerned must be unable to eliminate competition with respect to a substantial part of the product in question.

The trade-off of expected efficiencies against expected anti-competitive effects is universally recognized as difficult. Scholars have suggested elegant and objective methods of doing so, but there are significant difficulties in applying them. A widely recognized model developed by Oliver Williamson (1977) would permit a merger that on balance increases "total surplus", notwithstanding an increase in prices above the competitive level. That is, the cost savings resulting from efficiency gains generated by the merger must exceed the "dead-weight loss" caused by the expected anti-competitive price increase (OECD, 1996: 7). This approach is also known as the aggregate economic welfare approach or trade-off analysis (World Bank and OECD, 1999: 128). The major fallacy of this approach is that it ignores the redistributive consequences of the exercise of market power.

An alternative to the total surplus standard is the "consumer surplus" standard, which requires that the efficiency gains be so substantial as to ensure that the merger will not result in a wealth transfer from consumers to producers. This standard ordinarily would require the showing of a much greater magnitude of efficiencies than the total surplus standard (OECD, 1996: 7). This approach requires that the net effect increases or at least does not reduce consumer surplus. It is called the consumer surplus or pure consumer surplus standard because it prevents any redistribution of surplus from consumer to merging entities. It is also called a price standard because it does not allow a merger or agreement to increase a price materially (World Bank and OECD, 1999: 128).

Nevertheless, the consumer surplus standard is employed in some countries. The language of the European Commission (EC) merger regulation indicates that consumer surplus is the EU operative standard, as it was in the US, at least prior to the 1992 US Horizontal Merger Guidelines. In Canada, total surplus is apparently the relevant standard (OECD, 1996: 7).

Similarly, R&D cooperation is another area that is increasingly being accepted by competition regimes around the world as a means to enhance efficiency, outweighing its possible anti-competitive effect. For example, the Canadian Competition Act provides a defence for joint R&D ventures involving a specific programme of research that would not otherwise take place. Agreements among competitors with respect to cooperation in R&D are exempt from the criminal conspiracy provisions of the Act unless they lessen competition unduly with respect to prices, output, markets, customers, or channels of distribution (World Bank and OECD, 1999: 135). Similarly, the US courts are required under the National Cooperative Research and Production Act to judge joint research and production arrangement on a "rule of reason" basis.

There is considerable support for joint R&D at the conceptual as well as empirical levels. According to Jacquemin (2000: 25): "Cooperative R&D can be viewed as a means of simultaneously internalizing the externalities created by significant R&D spillovers – hence improving the incentive problem and providing a more efficient sharing of information among firms." D'Aspremont and Jacquemin (1988) have used a model to study the impact of R&D spillovers on a firm's optimal R&D investment. In comparing the symmetric cooperative and non-cooperative solutions, they find that large spillovers lead to higher R&D expenditures and production levels under the cooperative scenario; this behaviour is superior from a social welfare point of view.

However, contrasting with these potential advantages of cooperative R&D, effects leading to a harmful reduction in competition must also be considered. One danger is that cooperative R&D could be a way for a dominant firm to avoid competition through innovation, by co-opting potentially innovative rivals and by controlling and slowing down the innovation race. A second situation involves an extended collusion between partners, resulting from their action in R&D and creating common policies at the product stage (competitive level).

Discussions about R&D can for example spill over into illegal discussions on pricing policy (Jacquemin, 2000: 26).

5.4. Export cartels

Export cartels are associations of firms that cooperate in the marketing and distribution of their product to foreign markets. The competition laws of virtually all countries exempt such export cartels from prosecution by domestic authorities (Evenett, Levenstein and Suslow, 2001). Previously, only developed countries exempted their export cartels from their competition disciplines, but now developing countries as well as economies in transition are joining the bandwagon. While some scholars and several WTO members have recently condemned such cartels, others have argued that they allow efficiency gains that actually promote competition and trade (Bhattacharjea, 2004).

The study of Evenett, Levenstein and Suslow (2001: 45) lists 12 countries (OECD countries and economies in transition) where national exemption is provided to the exporters by their respective competition laws. Out of these, four countries (Germany,[14] Japan, the UK and the US) had some sort of notification/authorization requirement, while eight others (Canada, Estonia, Hungary, Latvia, Lithuania, Mexico, Portugal and Sweden) do not even require the same. In these countries, there is very limited information regarding the number or activities of export associations, and most of the provisions relating to the exemption of export cartels were explicit. However, implicit exclusion is now the norm in the EU. Any export cartel formed for the purpose of exporting goods to non-EU countries is outside the scope of Article 81 of the Treaty of Rome.

In the US, export cartels are shielded from antitrust action by three statutes, two of which involve a registration procedure. Consequently, they are more visible to foreign competition agencies (and private researchers). The 1918 Webb-Pomerene

Act (WPA) gives registered export associations qualified immunity from Section 7 of the Clayton Act (which regulates mergers) and the Sherman Act, which otherwise prohibits "Every contract, combination … or conspiracy in restraint of trade or commerce among the several States, *or with foreign nations*" (emphasis added).

Likewise, Article 6 of Mexico's 1992 Federal Law of Economic Competition contains explicit provision relating to export cartel: "Associations or cooperatives that sell their products directly abroad do not constitute monopolies". This provision exempts export cartels formed by associations or cooperatives, which do not sell or distribute such goods within Mexican territory, subject to the fulfilment of certain requirements. It appears that Pakistan is one of the developing countries to have introduced exemption from export cartels in its competition legislation, namely the Monopolies and Restrictive Trade Practices Ordinance of 1971.

Other developing countries or countries in transition, which have either amended or replaced their earlier legislation, or prepared a completely new legislation, have introduced such exemptions in their laws. Probably they have started understanding the virtues of the same!

For example, Section 3(b)(i) of the 1998 South African Competition Act, which replaces the old Maintenance and Promotion of Competition Act of 1979, lists "maintenance or promotion of exports" as one of the possible grounds for granting an exemption for a restrictive agreement or practice.

Likewise, Section 5(ii) of India's 2002 Competition Act, which replaces the earlier Monopolies and Restrictive Trade Practices Act of 1969, is a more far-reaching "carve-out": "Nothing in this section [on anti-competitive agreements] shall restrict … the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export." (Bhattacharjea, 2004).

As per Article 2(2) of Bulgaria's Law on the Protection of Competition, introduced in 1998: "…activities, the consequences of which restrict or might restrict the competition in another State, unless otherwise provided in an international treaty which has entered into force and to which the Republic of Bulgaria is a party". This provision could be interpreted to make an export cartel legal since the export cartel has a consequence of restricting competition in another State.

As mentioned above, currently the trend is towards making explicit mention of the exemptions provided to export cartels, given that it is pursued by almost every country. However, the debate on the efficiency implications *vs*. the "export of anti-competitive effect" (or beggar-thy-neighbour effect) of such a cartel is far from settled.

Based on the analysis of the export cartel practice of the American Natural Soda Ash Corporation (ANSAC) – a WPA association – and their efficiency claims, Bhattacharjea (2004), provides the following taxonomy of economic efficiency:

1. *Saving on variable costs:* of transportation, warehousing and handling, by being able to negotiate better rates for larger volumes.
2. *Saving on the fixed costs:* of market research and setting up and maintaining networks and facilities for shipping, customs clearance, storage, marketing and distribution, and liaison with government officials where necessary. These are likely to be specific to each destination, and individual producers might find that their volumes are too small to justify incurring such costs. Or they could avoid unnecessary duplication by centralizing these functions in a common agency.
3. *Pooling of risks:* Although not spelt out in any of the case reports, this appears to involve two separate considerations. First, access to the production facilities of many producers yields a more reliable source of supply, resulting in the cartel being better placed to meet orders. Second, common marketing gives each producer a share in a diversified portfolio of buyers, spreading the risks of non-payment by buyers, demand slumps, or disruption in deliveries caused by political or natural events in particular markets.

Similarly, as reported by Bhattacharjea (2004), an examination of Japanese export cartels in their heyday led to a finding that most of them did not appear to affect export prices or volumes; if anything, they contributed to cost reduction and quality assurance in some cases. In other cases, exporting firms cooperate by engaging in price fixing: either agreeing to sell their exports at the same price or to sell them through a single, joint sales agency that will accomplish the same thing. Firms may also use cooperative export organizations to jointly market products (Evenett, Levenstein and Suslow, 2001). These activities are clearly anti-competitive, with implications for the importing country's economy and consumers. They could have the same effect as hardcore international cartels (such as the infamous bromine, citric acid, graphite electrodes, steel tubes and vitamins cartels).

Despite criticisms, the international community does not seem to be too concerned about the export cartels, not least because of the limited volume of export made under such arrangements. No recent studies have been done to ascertain their impact. However, Dick (1992) reports that WPA associations covered 2.3 per cent of US exports in 1962 and a mere 1.5 per cent in 1976. The limited information available from other countries shows a declining pattern. The OECD reported in 1984 that between 1972 and 1982, the number of export cartels in the UK held constant, the number in Germany declined slightly, and the number in Japan declined markedly (Evenett, Levenstein and Suslow, 2001).

There is a general trend towards viewing export cartels as being beneficial for the developing economies. SALISES (2004) strongly supports both import and export cartels in the absence of which it would be difficult for small entrepreneurs to engage in international trade. Similarly, Scherer (2000: 395–403) acknowledges that most countries would be reluctant to prohibit cartels in commodities, which are major sources of export earnings, and recommends that any agreement should allow each country to exempt export cartels (or participation in international cartels) in up to three industries, defined at the four-digit level of the Standard International Trade Classification (SITC). He also makes a qualified case for permitting developing countries to maintain cartels in industries producing manufactured exports, to allow for economies of scale, coordinated marketing, financing of technology development, and even coordinated export pricing so as to avoid charges of dumping in foreign markets (Bhattacharjea, 2004).

In their submission to the WTO Committee, Thailand, India, China, Indonesia and Egypt invoked the principle of "Special and Differential Treatment" to argue that developing countries should be allowed to continue to exempt their export cartels, on the grounds that they were comprised mainly of smaller firms, while requiring developed countries to abolish their exemptions (Bhattacharjea, 2004).

6. Prerequisites for the implementation of competition policy and law in Nepal

Having highlighted the imperatives of putting in place an appropriate mechanism to ensure competition in the marketplace in the LDCs, despite the small size of the market, we now list out the essential ingredients or contours of the competition policy and law. Care should be taken, however, to ensure that the objectives of competition policy and law are achieved without having to compromise the development objectives of the country concerned. Moreover, these measures should have at their core the objective of enhancing the competitiveness of the domestic enterprises.

6.1. Competition policy

Trade liberalization: Competition from foreign firms provides a vital spur to the efficiency of domestic firms. It does not, however, follow that a liberalized trade regime obviates the need for a national competition policy because a large part of LDCs' economies (such as retail, distribution) are not in traded sectors, and domestic consumers need to be protected from the abuse of dominance and restrictive trade practices by foreign firms (Jenson, 2001: 2). In order to have continued competition from foreign firms, it is also necessary to provide predictability in the domestic trade regime. Nepal's recent accession to the WTO is likely to be instrumental in locking-in the trade policy reform that the government had initiated since the early 1990s (Adhikari, 2003b). Though some of the sensitive sectors of the economy are still going to be shielded from foreign competition due to relatively higher tariff bindings, the majority of the sectors in the economy are going to face stiff foreign competition. This, in turn, is expected enhance the competitiveness of the domestic enterprises exposed to foreign competition.

Deregulation and privatization: Government controls, the imposition of a permit system, impromptu regulations and work processes, besides a dilatory bureaucracy, have contributed to dampening the private sector's entrepreneurial zeal and enthusiasm. Government organizations have only added to the nation's economic burdens. Various negative tendencies such as "rent-seeking" surfaced in the economic system. As a result, Nepal suffered from low growth syndrome (Ligal, 1997: 14–15). In order to overcome these obstacles to private-sector participation and economic growth, the government initiated a series of economic reform measures including deregulation and privatization. However, in the context of Nepal, neither is the regulatory system up to speed[15] nor has the privatization process helped to infuse competition in the marketplace. Therefore, the government needs to initiate regulatory reform, make the privatization process more transparent and broad-based and institute a system of post-privatization monitoring to ensure that they contribute to the desired competitive outcomes. For example, as mentioned above, even if only regulatory reform in the banking sector contributed to eliminating discriminatory lending rates charged by the banks, the market contestability and competitiveness of the small incumbent, as well as the start-up domestic enterprises, would be enhanced.

Investment policy: A low level of domestic saving and a decrease in ODA are not the only reasons to encourage FDI. One of the major motives of encouraging FDI is to infuse competition in the domestic market. Another aspect of FDI which helps enhance the competitiveness of the domestic enterprises is the possible transfer of managerial skills and technology. This has already been seen from the experience of the commercial banks, which have not only been able to considerably upgrade their technology, but also are introducing new products to the market. Technology and skill transfers from foreign banks have helped local banks constantly upscale their services even after the former have left.[16] However, despite serious and genuine efforts on the part of the government, including the enunciation of a one-window policy, the success in terms of attracting FDI has been minimal. This is in part due to the current political crisis in the country and the deteriorating industrial security fuelled by insurgency.

Consumer protection policy: Although only briefly discussed in the earlier sections, consumer policy can complement competition policy by creating a strong constituency in support of building a competition culture in the economy. Given the propensity of the private sector to try and avoid competition as long as they can, the government should design an active consumer policy aimed at creating awareness among the consumers and building their capacity to advocate for the cause of promoting healthy competition with a view to complementing the former's effort to instil competition in the market.

6.2. Competition law

There is no hard and fast rule on what should be considered a benchmark for the enactment and enforcement of competition law, as this is largely a subjective issue and depends on a number of factors. It has been made abundantly clear that there is no "universal" law that fits every country. While the UNCTAD Model Law on Competition (2002) and the World Bank/OECD (1999) Model Law on Competition provide useful guidelines for enacting competition law, they should be tailored to specific requirements of the LDCs in general and in Nepal in particular. However, based on the foregoing discussion, it is not impossible to lay down the essential contours of the competition law for a country like Nepal.

Preventive as opposed to curative measures: Rather than focusing on curative measures (i.e. penalizing the wrongdoers after the offence has been committed), competition law should be such that it would facilitate the prevention of the offence itself. The requirement to register all potential anti-competitive practices with the competition authority, as done under the former Indian Monopolies and Restrictive Trade Practices Act (MRTPA) is something worth emulating in Nepal. While competition authorities around the world have been moving towards "conduct" as the criterion to trigger action, focus on "structure" could help them adopt preventative measures. Mere existence of "market power" (or monopolistic tendency) is not anti-competitive, but if the same is not properly watched, market power is a potent tool for "market exploitation". For an LDC such as Nepal, given its institutional endowment and capacity, a focus on "structure" is a better tool to prevent anti-competitive practices from taking place.

In order to deter business enterprises from engaging in anti-competitive practices, fines and penalties should be considerably larger than the extra profits that they anticipate earning through their illegal behaviour (Khemani, 1995). Some countries have even found that the deterrent effect of penalties is enhanced considerably if the anti-competitive acts are characterized as a criminal offence and if individuals as well as enterprises are made liable – as found in the antitrust legislation of the USA. Moreover, it is advisable to base fines on the percentage of turnover rather than fixing an absolute amount. This will ensure on the one hand that small enterprises do not go bankrupt after having been fined by the competition authority, and on the other create a sufficient deterrent effect for companies with a high turnover to engage in anti-competitive conduct. Moreover, a minimum level of fine/penalty should also be specified such that the competition tribunal or courts cannot use their discretionary power to impose a negligible penalty on anti-competitive conduct of a significant magnitude.

Separation of investigative and adjudicatory powers: In order to promote specialization and to make an impartial judgment on the existence of anti-competitive practices, it is necessary to separate investigative and adjudicatory powers. Otherwise, the competition authority may become the investigator, prosecutor, judge and jury, all rolled into one (Khemani, 1995). Moreover, if both the powers are given to one agency, there could be a tendency in the competition authority to be biased in favour of the investigation report and the judgment could invariably go against the business enterprises, which have been seen as conducting anti-competition practices as per the report of the investigative agency. Should this happen, business groups will automatically be against the very existence of the competition authority (Adhikari and Knight-John, 2003).

Even in the case of adjudication, litigation should be used as the last resort and other mechanisms of alternative dispute resolution should be used as extensively as possible. Litigation tends not only to be costly but also to be adversarial in nature (Adhikari, 2003b).

Triggering an investigation: There must be clear criteria to trigger cases or investigations, in the absence of which, the law will create business uncertainty and undermine the competitive market process. While too strict an application of competition rules may impede the ability of companies to attain a critical size and tax their efficiency, too lax an approach may lead to the entrenchment of monopolistic enterprises in the market (Khemani, 1995).

The problem is further compounded by the fact that there are a number of grey areas in the administration of competition law. For example, a merger need not be harmful as long as it does not result in providing "market power" to a business enterprise. It is therefore advisable to specify the threshold level of "market power" for triggering an investigation at the time of drawing up the law. Likewise, while some business practices (such as cartels) are regarded as illegal in virtually all jurisdictions and hence prohibited, some other practices (such as exclusive dealings or vertical mergers) should be examined on a case-by-case basis applying a "rule of reason" approach (Adhikari and Knight-John, 2003).

Appeal mechanism: In order to enhance the credibility of the competition authority and to provide a fair opportunity for all parties to get access to justice, there should be an effective appeal procedure, whereby any party not satisfied with the decision of the competition authority on points of fact and/or law may appeal to a higher authority. The competition authority could also commit some errors of law and/or interpretation. However, the existence of an appeal mechanism poses a credible threat for the competition authority to exercise the utmost caution while delivering judgment against any business groups or enterprises (Adhikari and Knight-John, 2003).

Private as well as public enforcement: A sound competition law should include mechanisms that address the concerns of consumers and companies affected by anti-competitive practices. In some countries, private action for the redress of injury resulting from violations of the competition law may be instituted before an appropriate court or tribunal by those people (both private companies and consumers) who have been harmed (Knight-John, 2003). Such private action has at least two benefits: it supplements and reinforces public enforcement of the competition law, and it frees the competition authority from having to obtain such redress on behalf of private parties.

Prohibition and remedial orders: The appropriate remedy for many types of anti-competitive practices is to simply demand that the offending party stop engaging in the conduct or take other actions to eliminate the effects of the unlawful practices. Punishment is also appropriate if the conduct is egregious. However, some of the illeffects of anti-competitive behaviour are not readily apparent to business people, who may have engaged in the conduct initially in good faith. The competition law should empower the competition agency to prohibit the conduct or redress the harm caused by it (Adhikari, 2003c).

Protection of confidential information and avoidance of conflict of interest: If the competition authority were to receive cooperation from business sectors while conducting an investigation into a potential competition abuse case, they should institute a system for protecting the confidentiality of private information, which was acquired during the process of investigation or proceedings (Khemani, 1995). Such information, if handed over to competitors, could cause enormous businesses losses. Moreover, there lies a strong possibility that competitors would try to acquire and use such information for furthering their own profit motive, by using the officials of the competition authorities. Such activities should therefore be legislated as being illegal.

Competition advocacy: Since policy formulation is a dynamic and evolving process, the government is constantly involved in revising, reviewing and updating its policy space. At times, private restrictive business practices (RBPs) are often facilitated by various government interventions in the marketplace. Thus, the mandate of competition authorities should extend beyond mere enforcement of competition law. It must also participate more broadly in the formulation of its country's economic policies, which may adversely affect the competitive market structure, business conduct and economic performance. It must assume the role of competition advocate, acting proactively to bring about government policies that lower entry barriers, promote deregulation and trade liberalization, and otherwise minimize unnecessary government intervention in the marketplace (World Bank and OCED, 1999: 93). This makes the government and competition authority more accountable, increases awareness of the costs and benefits of alternative policies, and helps to ensure that government policy objectives do not work at cross purposes (Adhikari, 2003b).

Of late, concerns have also been expressed by civil society entities with regard to the narrow tailoring of the existing definition of competition advocacy, as it focuses solely on the role of competition authority. As such, there is a strong demand – and a very valid one – from consumer organizations to expand the definition of competition advocacy to include the roles of other interested parties (such as consumer groups), which have a significant stake in fostering competition.

Budgetary provisions: Implementing competition law is a resource-demanding task. The competition authority requires a considerable degree of skill and competence to address complex issues ranging from how to determine dominance or at what level to set threshold limits to how to evaluate competition cases using a "rule of reason" approach. However, in several countries, competition agencies struggle with these issues and are unable to handle their caseload because of a lack of qualified staff.

The apparent problems, especially an exclusive dependence on the government budget for funding the activities of the competition authority, bring us to the related issue of whether and how the authority can become financially independent. Adhikari (2002a: 30–31) provides a list of alternative means to raise resources. First, resources could be raised by way of fines. While this option has been challenged on the grounds that it could create an incentive for the competition agency to charge unduly high fines to function as a financially sustainable unit, the establishment of an appellate mechanism would allow a party to contest not only the decision of the authority but also the amount of the fine.

A second alternative could be for the competition authority to charge fees for the services that they provide to the government and business associations, while a third choice could be to introduce a system similar to a court fee whenever firms file complaints against their competitors. The advantage of this approach is that it would deter frivolous complaints. A final option could be to obtain support from the bilateral and multilateral donor agencies for funding and technical assistance. In summary, the most practical solution would perhaps be a mix between state and other sources of finance, with the former option progressively forming less of the resource base than the latter.

Independence of competition authority: A common feature in most developing economies is the absence of political ownership and support for competition law. This also translates into undermining its independence as a professional "watchdog" of competition. Some of the prerequisites to create independence within the competition authority include legal independence, where the competition agency is not a part of any government department and where members cannot be removed without proper justification, financial independence, and, *de facto* independence, where it would have the cooperation of other government agencies in enforcing its decisions.

As suggested by Adhikari and Knight-John (2003), some practical options for enhancing the independence of a competition agency would be to stipulate that the agency should be accountable to the legislature or to a Parliamentary Committee, for instance to fix the term of Commissioners so as to enable them to receive adequate exposure and experience, but not too long so as to run the risk of political or regulatory capture, and to provide for start-up funds from the government budget whilst leaving the responsibility for generating more funds to the agency through fines, fees or donor support, etc.

Exemptions and exceptions: Based on the review of exemptions and exceptions provided for in the competition legislation of countries around the world and given the peculiarities of the Nepalese economy, it can be argued that the following areas should be excluded from the application of competition law: (a) SMEs, (b) small farmers and farmers' cooperatives, (c) R&D cooperation between competitors for the introduction of new product or process, (d) joint purchasing or import of raw materials by small enterprises to reduce their costs, (e) trade associations formed to gather and exchange statistics, determine product standards, exchange credit information, and institute environmental protection measures, (f) agreements entered into between the producers or suppliers to promote export, and (g) the collective bargaining rights of the workers. However, it is necessary for the government to review most of these measures periodically and to introduce a sunset clause to ensure that such exceptions are not provided permanently.

Based on the above analysis, it is necessary for Nepalese agencies drafting the competition law to be cautious about the process as well as the content of the legislation. Moreover, it is necessary for the government to take stakeholders into confidence before enacting the competition law. Once the law is enacted, a programme on competition education and advocacy should also be launched in order to create a competition culture among all the concerned stakeholders. Some useful initiatives are already under way on the side of CSOs.[17] It is necessary for the government to engage the private sector as well as other stakeholders in the process.

7. Conclusion

Despite serious efforts made by the LDCs to achieve their development objectives, they have not been able to do so due to a variety of reasons. While they have either consciously or spontaneously adopted various types of competition policy measures, including trade and investment liberalization, privatization, deregulation and trimming down of the government's role with a view to creating a space for the participation of the private sector in the economic development endeavours, they have not been able to infuse competition in their economies. Nepal is no exception.

Nepal has made a commitment to enact competition law at the time of its accession to the WTO. However, due to limited knowledge among the policy makers about the functioning of the competition policy and the design and implementation of competition law, they seem to be worried that competition law might remove the sovereign rights of the government to achieve legitimate policy objectives. Moreover, it is clear from the analysis of the functioning of the competition regimes in various developing countries that implementation of competition law is a stupendous task, not least because it is resource demanding and it requires a very high level of sophistication. Further, there is a fear that lack of political will, competition culture and the prevalence of mal-governance may imperil the prospects for their effective implementation.

Fortunately, however, a cursory glance at the competition regimes in developed and developing countries around the world suggests that they do not take "economic efficiency" as the sole criterion for judging the legality of various anti-competitive practices. Most of the competition laws do provide some policy space for the governments to achieve their development objectives.

It has been well established that competition law must be based on the socio-economic and political reality of each country concerned and that one size of competition law does not fit all countries. One also needs to understand that the implementation of a comprehensive competition policy and law requires a strong government, which many developing countries at a low level of industrialization do not have. Therefore, at the very least, for such countries there will need to be far fewer and simpler competition rules which are capable of being enforced. Clearly, it would be unfair, if not absurd, to subject a Sierra Leone-type country (or Nepal for that matter) to the same competition policy discipline as the US (Singh and Dhumale, 1999). Therefore, it is advisable for the LDCs to make full use of development dimension provisions while drawing up their competition policy and law.

Even if a state-of-the-art competition policy is designed and competition law enacted, taking development dimension fully into consideration and after a series of consultations with the stakeholders, their implementation could still be hampered by a number of factors. Unless and until a competition authority is provided with much needed independence – both in terms of decision making and budget – the chances are that it would not serve the intended purpose. If a minister is allowed to appoint the commissioners and authorized to remove them without any reasons given whatsoever, it would lead to disastrous consequences.

Another issue that merits attention is that the introduction of a development dimension to the competition policy does not mean that the government should use these measures on a permanent basis for all the sectors/areas. Therefore, the introduction of a sunset clause to the legislation itself could help remedy the likely problem of the creation of vested interests seeking eternal protection. Moreover, clear criteria should be laid down for providing exemptions and exceptions and the scope for discretionary decision making circumscribed. Discretionary power only means providing an incentive for the competition authority to engage in corruption.

One of the major objectives of competition policy and law implementation is to foster the competitiveness of domestic enterprises so as to enable them to compete in the international market. As has been made amply clear by the examples of Japan and Korea, rivalry among domestic enterprises at national level forces the enterprises to become competitive both at national and international levels.

It is worth sounding a word of caution, however. Competition policy is only one of the elements to help ensure competitiveness by forcing companies to be more efficient, engage in R&D and foster innovation in order to improve the quality of products and cut costs. There are a host of other measures that need to be taken in order to enhance the competitiveness of domestic enterprises – such as improving access to affordable credit, improving supply-side constraints, trade facilitation and above all good governance.

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Notes

1 For example, coffee comprises 82.7 per cent, 69.4 per cent and 63.6 per cent of the share of total export value of Uganda, Rwanda and Ethiopia, respectively. See Chandrasekhar and Ghosh (2000: 3).

2 On average, Nepal's applied tariffs on agricultural products are less than 10 per cent and on industrial products 12.5 per cent. However, the government was successful in maintaining its bound tariff on agricultural products at 42 per cent and on manufactured

products at 24 per cent on average. See WTO (2003).

3 As per Section 2, the purpose of the Act is to promote and maintain competition in the Republic in order –
a) to promote the efficiency, adaptability and development of the economy;
b) to provide consumers with competitive prices and product choices;
c) to promote employment and advance the social and economic welfare of South Africans;
d) to expand opportunities for South African participation in world markets and to recognize the role of foreign competition in the Republic;
e) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
f) to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

4 It is, however, like a chicken and egg situation, making it extremely difficult to find out which was the cause and which was the effect – whether corruption led to anti-competitive practices or *vice versa*.

5 For example, in Tanzania, salaries of the personnel at the competition authorities were on par with government (which is very low), and much lower than that of the private sector. See CUTS (2002).

6 Convinced of the need to develop competition culture in Nepal, South Asia Watch on Trade, Economics & Environment (SAWTEE), a Kathmandu-based NGO has been implementing a 3-year programme entitled *Competition Advocacy and Education Project (CAEP)*. The first workshop under the Project was organized in Birat Nagar, an industrial town in Eastern Nepal. One of the objectives of the workshop was to provide an opportunity for the stakeholders to comment on the proposed competition legislation of the country. People from various walks of life made a significant contribution to improving the draft legislation, but business people were found to be least interested in making any major contributions.

7 A comparison of the lending rates offered by the then 11 commercial banks in two periods (January 1998 and May 2000) for three categories of loan (priority sector loan, importers loan and loan against fixed deposits) conducted by Adhikari and Regmi (2001), revealed that there was a clear pattern of interest rate cartel, facilitated by NBA.

8 A comparison of the airfare charged by the then six private airlines as of June 1999, as documented in Adhikari and Regmi (2001), revealed that there was a clear pattern of fare cartel, facilitated by AOAN.

9 Nepal still does not have an anti-dumping law or institution.

10 Earlier they used to have working capital loan (WCL) as a category. Later they provide separate interest rates for their "red-carpet" clients (corporate and multinational), then the normal category, within which they have two sub-categories – prime and others. The interest rate difference between, say, a multinational company and a customer falling within the "others" sub-category could be up to 3 per cent (10 per cent for MNCs and 13 per cent for the "others" sub-category of clients. See http://www.nibl.com.np/interest_rate.htm (accessed on 28 March 2004) for a sample interest rate structure of a Nepalese bank, namely Nepal Investment Bank Ltd.

11 For example, in the case of Nepal Bank Ltd., the oldest commercial bank of Nepal (as of December 1999), of the total loans of 8.5 billion rupees, 33 per cent is concentrated in the top five big business groups. The Golchha organization, the largest business house in the country, alone accounts for 39 per cent of the total loans of these five groups. It is to be noted that 6.6 billion rupees is the bad debt out of the total outstanding loan of 8.5 billion

rupees. See Upadhyaya (2001). As per the latest information, which is not readily available due to reasons of confidentiality, the situation is reported to be even more alarming. See also Spotlight (2001).

[12] For example in the case of Nepal, SMEs account for 90 per cent of all enterprises, employ 95 per cent of the non-agricultural workforce and contribute 50 per cent of the industrial GDP. See Khatiwada (2001).

[13] Article 1505 (Exceptions), Provision 11 of the Act states "the establishment of formal agreements between small entrepreneurs engaged in the retail sale of the same or similar commodities for the purpose of bulk purchase of those commodities in order to meet in good faith, competition of businesses with substantially larges sales volumes. For the purpose of this paragraph, the term "small entrepreneur" means a merchant whose gross receipts from all sources in any year cannot reasonably be expected to exceed US$ 250,000 and who will not employ more than 12 persons."

[14] This requirement has recently been abolished.

[15] Refer to the example of price discrimination prevalent in the banking sector discussed in Section 4.7 above, which is mainly due to the inability of the Central Bank to control such malpractices.

[16] For example, Nepal Indosuez Bank Ltd. used to be a 50:50 joint venture bank between local shareholders (institutions and individuals) and the Credit Agricole Indosuez (CAI) Group of France. In 2002, the CAI group sold its 50 per cent stake to local shareholders, who then converted the name of the bank to Nepal Investment Bank (NIB) Ltd. No formal customer satisfaction survey has been conducted to assess the service level of the new entity, but, from casual observations, it can be concluded that the level of service has improved. The Bank having been judged "Bank of the Year" by the London-based Financial Times Group's – the Banker – for the year 2003 is a testimony to this. "As the only major bank in Nepal that does not have foreign banks as shareholders, NIB made significant improvements in its technology and services last year. These include the roll-out of debit cards for constant access to banking services, and telephone banking. It plans to launch internet banking and Visa credit cards soon" stated the release issued by The Banker on 03 September 2003, after handing over the award. Visit http://www.thebanker.com/news/fullstory.php/aid/593/Nepal.html for further details.

[17] For example, since February 2004, South Asia Watch on Trade, Economics & Environment (SAWTEE) has started a 3-year programme entitled *Competition Advocacy and Education Project* mainly with the objective of building a healthy competition culture in the country. This project is being implemented in close coordination with the Ministry of Industry, Commerce and Supplies (MoICS).

I.3. EXEMPTIONS AND EXCEPTIONS: IMPLICATIONS FOR ECONOMIC PERFORMANCE. THE CASE OF THAILAND

Deunden Nkikomborirak

1. Introduction

Every competition law provides for exemptions and exceptions. The question is whether, and to what extent, these exemptions and exceptions actually contribute to greater economic efficiency or the attainment of other societal goals. According to Khemani (2002), *exemptions* are broader in scope in that they often apply to sectors or industries, whereas *exceptions* tend to be narrower in scope in that they are determined on a case-by-case basis through the application of the "rule of reason" approach. For example, certain mergers and acquisition cases that are likely to result in a highly concentrated market may be granted an "*exception*" and allowed to proceed on the basis of a strong efficiency defence.

Exemptions from the application of a competition law are normally provided for in the competition law itself or by court, executive or administrative decisions, depending on the administrative and legal structure of the particular country. For example, *exemptions* for agricultural cooperatives, labour unions, liner shipping and export cartels are often specified in the competition law. Sectors with a *suis generis* law are generally exempted from the general competition law because a competition law does not have precedence over sector-specific laws such as the Telecommunications Act or the Electricity Act. Certain competition law does not apply to restrictive practices that have an effect outside the national boundary such that export cartels are granted an automatic exemption. Certain countries, like the United States, do not list exemptions in any legislation. Rather, they are defined by the court and congressional actions.

The above exemptions are *de jure* exemptions in that they are exemptions according to the law or regulations. There are, however, exemptions at the implementation level, or *de facto* exemptions. For example, the absence of necessary implementing rules and regulations may render certain sectors of the law inert, which is tantamount to a broad exemption until the particular provision becomes effective. In the same vein, an inability to enforce the law extraterritorially can also be taken as an exemption for businesses that are not incorporated locally.

Unlike *exemptions, exceptions* are not legislated, but are often determined at the administrative level. Usually, exemptions take the form of clearance of an *ex ante* notification of a potentially restrictive trade practice such as the pre-merger or pre-agreements notifications. Any administrative decision not to prosecute restrictive practices on whatever ground can also be taken as an exception on the basis of a rule of reason approach.

In general, the broader the objective of the competition law, the greater the discretionary power the administration has in granting exception to competition cases. For example, the primary objective of the competition legislation in Canada is to maintain and encourage competition, with emphasis on promoting economic efficiency. In the case of South Africa, Indonesia and many Asia-Pacific countries including Japan, South Korea and Taiwan, the competition law is expected to address not only economic efficiency, but also fairness and the promotion of small and medium enterprises. This would imply that exemptions could be granted on the basis of any one of these objectives.

This paper seeks to examine the scope and the nature of *de facto* exemptions and exceptions in the application of the Thai competition law since its enactment in 1999. The first section provides an overview of the Thai competition regime, including its structure, procedure and past performance. The second section addresses the nature of the exemptions and exceptions from both the law and its implementation. The third section assesses the impact of such exemptions and exceptions on economic performance of the sector(s) concerned. The final section summarizes the lessons learned and offers recommendations with regard to how to ensure exemptions and exceptions that are in the interests of the public.

2. The Thai competition regime

2.1. The law

Thailand has had a competition law since 1979 known as the Price Control and Anti-Monopoly Act B.E. 2522 (AD 1979). At that time, the objective of the law was to protect consumers from inflationary pressures and from widespread collusive practices among businesses that had led to excessive pricing. The provisions concerning anti-competitive practices were incomplete as they did not cover many vertical restraints, and sections on mergers and acquisitions were missing. While the price control mechanism was easily implemented, the anti-monopoly provisions were hardly enforced. This was because the law required that a business accused of anti-competitive practices had to be officially declared a "controlled business" by the competition authority – i.e. the Department of Internal Trade, Ministry of Commerce – before the law could be enforced. Since there were no clear rules by which a monopolistic business could be defined, only one business, ice manufacturing, was declared a controlled business in the two decades during which the law was in effect.

In 1999, the Price Control and Anti-Monopoly Act B.E. 2522 (AD 1979) was replaced by two laws, namely the Trade Competition Act B.E. 2542 (AD 1999) and the Goods and Services Price Control Act B.E. 2542 (AD 1999). The price control provisions were in effect separated from the anti-monopoly provisions. Two different commissions were formed. These are the Goods and Services Price Control Commission, which is responsible for price controls, and the Trade Competition Commission (TCC), which is responsible for safeguarding fair competition in the markets. The secretariat of both commissions remains within the Department of Internal Trade, the Ministry of Commerce.

Compared with its predecessor, the new competition law is much more comprehensive in terms of its substantive provisions. The Act automatically applies to all enterprises and business activities with the exception of (1) state enterprises (2) cooperatives and agricultural cooperatives (3) central and regional government agencies and other businesses prescribed by Ministerial Regulations. The requirement that the competition authority declare an accused business to be a "controlled business" was dropped. The main substantive provisions of the law include abuse of dominance in section 25, merger control in section 26 and collusive practices in section 27. Types of abuse of dominance and collusive practices that may constitute a violation of the law were also specified. Certain practices, such as price fixing and bid rigging are governed by a *per se* rule, while other types of collusive practices and mergers are governed by a *rule of reason*[1].

In addition to the mentioned provisions, section 29 deals with unfair trade practices. It prohibits any act contrary to free and fair competition, which results in the obstruction, damage, and restriction of other business operations. The scope of the application of this particular provision remains unclear, as the letter of the law is rather broad and vague. This leaves much discretion to the administrator of the law. Businesses have questioned this "catch-all" provision and are pressuring the competition authority to pass implementing regulations that specify the types of behaviour prohibited by this particular section.

2.2. The administrative body

The Office of Trade Competition (OTC) resides within the Department of Internal Trade, the Ministry of Commerce. The Thai Trade Competition Commission (TCC) consists of the Minister of Commerce as Chairman, Permanent-Secretary for Commerce as Vice-Chairman, Permanent-Secretary for Finance and not less than eight, but not more than 12, experts in various disciplines. These experts are nominated by the Minister of Commerce and appointed by the Cabinet. The law strangely stipulates that at least one-half of the experts must be representatives from the private sector. Consequently, the current practice is to have three commissioners from the Federation of Thai Industries and another three from the Thai Chamber of Commerce. The Director General of the Department of Internal Trade is both a member and secretary of the Commission. Each appointed commission has a 2-year term. There is no staggering term so that a change in the government can change the entire composition of commissioners when their terms expire. Therefore, the Commission is very vulnerable to political influence.

2.3. Past performance

Since its inauguration in 1999, the Commission has deliberated on only four competition cases. These are cases concerning (1) a cable television monopoly, (2) a tied-sale case, whereby a near-monopoly whisky producer was alleged to have tied the sale of beer with that of whisky, (3) unfair trade practices in the retail trade, and (4) exclusive dealing in the motorcycle market. No charges were made in the first two cases. In the case of the cable monopoly, the Commission decided that since cable charges are subject to approval by the Mass Communication Organization of Thailand (MCOT), the state-owned enterprise responsible for granting cable television licenses, the organization should be responsible for reviewing the charges (see more details in Box 1). As for the tied-sale case, the Commission found that there was

Box 1: The Cable Television Monopoly.

The nationwide cable television service in Thailand became a monopoly in February 1998 as the two incumbent operators, namely the International Broadcasting Corporation (IBC) and the United Television Network (UTV), merged. At that time, the Trade Competition Act was not yet legislated so that mergers were beyond state regulation. Against the wishes of the public, the merger was approved by the Mass Communication Organization of Thailand (MCOT), the government organization which was authorized to issue broadcasting licenses. The main justification for the merger was the need for the operators to consolidate, given the cost hike following a sharp depreciation of the baht in June 1997, following the financial crisis. The "efficiency defence" was that with a single operator, movie licenses could be procured at a lower cost since competition between the two operators was eliminated.

A little over a year after the merger, UBC raised its monthly subscription fee for its "gold package" - i.e. the subscription package offering the largest number of channels - by a whopping 22.47 per cent from 890 baht (US$ 22.25) to 1090 (US$ 27.25) in May 1999. Price hikes were justified by the fact that the company was still recording losses each year and that new channels were added to increase consumers' choice. A consumer group filed a complaint to the competition authority. It alleged that the cable operator abused its monopoly by charging excessive prices.

An expert subcommittee was assigned to investigate the case. According to the subcommittee's report, the merger halted the fierce price and non-price competition between the two incumbents. However, the subcommittee was not able to establish whether the price was excessive or not since that would have involved a much more complex exercise of cost assessment, which should be reserved for the sector-specific regulator. Nevertheless, the subcommittee found that UBC had abused its dominance by limiting the choice of consumers as it failed to offer a lower-priced package known as the "silver package" that had fewer channels. Consequently, customers were forced to subscribe to the "gold package" that included many expensive sports and movie channels. This was also a clear violation of the licensing condition.

The Trade Competition Committee agreed that the cable operator was a monopoly but decided to refer the case to the MCOT since the government agency was responsible for monitoring compliance with the licensing agreement as well as for approving tariffs. Although the tariff was not revised, public pressure has constrained further price hikes that were pending at the time. However, a few months later, a further price increase was approved by the MCOT. Subscribers are presently given the choice of subscribing to a less expensive package. However, the content of the package has been altered in that licensed channels (such as the CNN, Discovery) have been withdrawn. The remaining channels consist exclusively of in-house productions. Thus, the silver package no longer represents a "real choice" for consumers. It is hoped that once the independent sector-specific regulatory agency has been established, consumers will be better protected against abuse of market power.

evidence of abuse of dominance. However, since the definition of "dominance" has not yet been established, it was not possible to enforce section 25 of the law, which deals with abuse of dominance.[2] The case is therefore temporarily suspended until a formal definition of dominance is officially declared.

The third case concerns unfair trade practices in the retail trade. Since the economic crisis in 1997, most discount stores in Thailand are now owned by foreign multinationals such as Tesco of the UK, Carrefour and Casino of France and Royal Ahold of the Netherlands.[3] While these foreign retail companies compete rigorously among themselves and with Thai department stores, their extremely aggressive business culture has caused tremendous friction with suppliers, both large and small. Some of their business practices, such as mandatory enrolment in price-promotion schemes, preferential treatment for own brand products, and collection of various service fees were alleged to be unfair trade practices. The Thai Trade Competition Commission passed a "Retail Industry Code of Ethics" in response to suppliers' complaints.

The fourth and last case is a landmark case. It is the very first case that the TCC found an infraction of the law and decided to take legal actions against the defendant. In this case, a motorcycle manufacturer was alleged to have practised exclusive dealing in the sales of its product. This particular brand is very popular and holds approximately 80 per cent share of the motorcycle market. It is interesting to note that the particular company was found to have violated section 29 of the law, which concerns unfair trade practices, rather than section 25 on abuse of dominance, despite the fact that the practice obviously constitutes an abuse of dominance rather than an unfair trade practice. Although the Commission's decision can be explained by the fact that section 25 is still unenforceable, its failure to do the same in the case of the tied-sale discussed before raises suspicions that the enforcement is selective and discriminatory.

To sum up, the competition regime in Thailand is barely functioning as is evident in its performance. This can be attributed to many factors including political intervention, interest groups lobbying, legal loopholes and the lack of transparency in the administration. With so few cases having been dealt with since its inception 5 years ago, there is no doubt that the majority of anti-competitive practices go unchallenged. The question is why are these practices able to remain elusive to the reach of the law. That is the focus of the next section.

3. Exemptions and exceptions under the Thai competition law

3.1. Exemptions

This section examines the nature of both *de jure* and *de facto* exemptions under the Thai competition law. One can categorize various exemptions under the current competition regime into four types. The first type includes exemptions as stipulated in the competition law. The second type refers to exemptions that result from the inability to enforce certain sections of the law due to the absence of the required implementing rules and regulations. The third type consists of regulated sectors where business practices may be governed by a sector-specific law. The last type of exemption applies to companies incorporated overseas whose restrictive practices are beyond the reach of the national competition law.

Exemptions de jure

Since the Thai competition law is only 5 years old and is rarely enforced, it is no surprise that there are very few exemptions. The provision for exemptions as appeared in the Trade Competition Act is as follows:

Section 4: *This Act shall not apply to the act of:*
1. *Central administration, provincial administration or local administration;*
2. *State enterprises under the law on budgetary procedure[4];*
3. *Farmers' groups, cooperatives or cooperative societies recognized by law and having as their object the operation of businesses for the benefit of the occupation of farmers;*
4. *Businesses prescribed by the Ministerial Regulation, which may provide for exemption from the application of this Act in whole or only in respect of any provisions thereof.*

Unlike most countries that do not exempt government agencies or state enterprises that are involved in commercial activities, Thailand chose to provide a blanket exemption for the entire government sector. The rationale for exempting the entire state sector is because it is believed that state enterprises do not operate on a purely commercial basis. Rather, they carry social obligations that may require them to carry out practices that are unintentionally anti-competitive. For example, low prices that can be seen as predatory pricing may help promote the universal service goal by ensuring affordability. High prices may be necessary for cross-subsidy when funding for a universal service is not available. Hence, to treat a state enterprise that carries social goals as a purely commercial entity would be inappropriate. The practical reason for exempting state enterprises from the general competition law is that – as one would expect – the state often operates in a monopolistic environment and can be an easy target for allegations concerning restrictive practices. Consequently, the new competition authority may be overwhelmed by complaints in relation to regulated businesses.

This fear of being overloaded with complicated regulatory issues is understandable when sectoral regulatory regimes are not yet in place. In the absence of a well-developed sectoral regulation that lays down clear rules with regard to competition structure and behaviour, throwing the entire state sector under the general competition law would indeed be equivalent to opening a Pandora's box. For example, private power producers may complain about the terms and conditions of the electricity purchase of the state electricity authority that is the designated sole buyer of electricity in a single buyer model. Similarly, in the absence of rate re-balancing, the private local telecommunication operators may accuse the state-owned enterprise of unfairly conducting cross-subsidization between local telephone services and long-distance and international telephone services. In that case, the nascent competition authority would be inevitably drawn into highly technical and complex sectoral regulations that it is unlikely to be able to handle.

Clearly, the option of exempting state enterprises is not the first-best solution, but given the obvious capacity limitations of the competition authority, it may be the most reasonable second-best solution, depending on where the priorities of the competition regime lie. If the aim is to tackle restrictive practices carried out by state enterprises, then the exclusion will not be necessary. However, if the objective were to address private restrictive practices, then one would consider exempting the practices of government enterprises from the law in order to protect the competition authority from being forced to perform regulatory functions. At this point, it would be a practical rather than a theoretical question that needs to be addressed.

Of course, the option of exempting the regulated sector altogether is there. However, a sweeping exemption would imply that private operators that operate on a purely commercial basis would also enjoy the exemptions. While, in principle, all entities engaged in similar activities should be subject to the same set of rules and regulations to ensure fairness and non-discrimination, as long as state-owned enterprises can claim public service obligations, there will always be a case for exempting them from the competition law.

Besides state enterprises, the law also exempts farmers associations. This is understandable given that approximately 40 per cent of employment is still in the agricultural sector. Most farmers are indeed very small scale and, thus, placed at a disadvantage when bargaining with large food manufacturers or middlemen. Exemptions allow farmers to form cooperatives in order to enhance their relative bargaining power so as to ensure fair and stable prices for agricultural products.

Finally, the law allows discretion on the part of the Minister of Commerce to issue Ministerial regulations that designate additional exempt businesses. All Ministerial Regulations must be published in the Royal Gazette. To date, no businesses have been granted an exemption by means of the Ministerial Regulation.

Exemptions de facto resulting from the absence of necessary implementing rules and regulations

Although the Trade Competition Law automatically applies to all business entities with the exception of state agencies and enterprises and agricultural cooperatives, its enforcement is still pending on the passing of key rules. The law stipulates that the Trade Competition Commission has the duty and power to establish the threshold level of market share, and sales figures have to be established for section 25 (abuse of dominance) and section 26 (merger). The proposed threshold will have to be approved by the Cabinet and published in the Royal Gazette. Without these figures, a company cannot be declared “dominant” and so its trade practices will not be subject to the particular disciplines provided under the law. Similarly, without a threshold level of post-merger market share or sales or assets figures, no companies are required to submit a request for permission to merge. In effect, provisions on abuse of dominance and mergers and acquisitions are currently inert.

The former Trade Competition Commission proposed a “dominance threshold” to be a one-third market share and a sales revenue of one billion baht (US$ 25 million at 40 baht per US dollar). As expected, these figures were opposed by large businesses whose market shares and sales exceeded the suggested limits. The OTC submitted the proposed definition of market dominance to the Cabinet for approval towards the end of 2000. Due to heavy lobbying by large businesses, however, the approval was effectively blocked. The change in the government in the beginning of 2001 placed everything on hold.

The issue emerged once again after a very long silence as the Commission failed to meet for over a year. But once the newly appointed TCC met in May 2002, the message was clear that the Commission did not believe in determining a market dominance threshold based on a threshold market share as required by the competition law. It opines that such a threshold would render the regime too rigid. References were made to a more advanced test of dominance such as the “hypothetical monopoly” test used in many countries. But no suggestions were made concerning how to make the provisions enforceable. The Minister of Commerce, as the Chairperson of the TCC, merely suggested that the OTC should take more time to study competition laws in foreign countries.

In 2003, at the height of the controversy over the exclusive dealing in the motorcycle market and unfair trade practices in the retail industry, the Trade Competition Commission suggested a sector-by-sector dominance threshold in order to make section 25 enforceable for these particular cases. It proposed two thresholds, a 20 per cent market share and US$ 700 million minimum annual sales for retail and a 33.33 per cent market share and US$ 130 million for motorcycles. This approach was heavily criticized by both sceptics and academics. Sceptics view the threshold for retail trade as being too high since none of the large discount stores that are the targets of complaints had such a large market share. Interestingly, the question of how the market was defined was not raised. Academics, on the other hand, view the proposed threshold market shares and minimum sales as arbitrary. They are, however, more concerned about the fact that the sector-by-sector dominance threshold will lend itself to a highly selective and discriminatory competition regime and will undermine the broad application of the law. In the end, the proposal was not submitted to the Cabinet. It is not clear whether the outrageous proposal served simply to diffuse public demand for a dominance threshold. From this event until the present, the Commission made no further efforts to make sections 25 and 26 enforceable.

Consequently, abuse of dominance practices and mergers and acquisitions continue to remain unchallenged.

Exemptions for regulated industries

Although the Trade Competition Act does not provide exemptions for regulated industries, in practice, the Trade Competition Commission refers cases that involve regulated industries to the government authority or the state-owned enterprise that is responsible for the regulation. This is evident in the case of the cable television monopoly as mentioned earlier, where the government leaves the question regarding cable tariffs to the state-owned enterprise responsible for handing out cable licenses and approving programs and monthly fees.

Except for telecommunications, Thailand does not yet have sector-specific laws that govern restrictive business practices in a regulated industry. The Telecommunications Act 2003 stipulates that the telecommunications industry is subject to the general competition law despite the fact that the law itself does contain certain provisions concerning anti-competitive practices, albeit not as comprehensive as those stipulated in the Trade Competition Act. The case of telecommunications is not to be taken as a precedent with regard to the relationship between the competition authority and the sector-regulatory authority. There is no clear policy in this regard.

Exemptions for companies not incorporated locally

Besides business activities that are granted exemptions by domestic laws, multinational companies operating outside the national jurisdiction are also beyond the reach of the domestic competition law. In theory, the Thai competition law applies extraterritorially, which means that all restrictive practices that have an effect on the domestic market are subject to the national competition law regardless of where the action may have taken place. In practice, however, it is almost impossible to investigate restrictive practices that take place outside the national boundary – i.e. export and international cartels – without due cooperation from the competition authorities of the countries where the multinational companies are registered. The fact that most competition regimes provide an exemption for cartels that do not have an effect on their own domestic market allows these collusive practices to remain in no-man's land.

3.2. Exceptions

Except for certain types of agreement, all provisions on restrictive practices in the Thai Trade Competition Act are subject to a rule of reason approach. Section 25, which deals with abuse of dominance, is as follows:

Section 25. *A business operator having market domination shall not act in any of the following manners:*

1 <u>unreasonably</u> fixing or maintain purchasing or selling prices of goods or services;

2 *unreasonably fixing compulsory conditions, directly or indirectly, requiring other business operators who are his customers to restrict services, production, purchase or distribution of goods, or restrict opportunities in purchasing or selling goods, receiving or providing services or securing credits from other business operators;*
3 *suspending, reducing or restricting services, production, purchase, distribution, deliveries or importation without justifiable reasons, destroying or causing damage to goods in order to reduce the quality to that lower than the market demand;*
4. *intervening in the operation of business of other persons without justifiable reasons.*

Indeed, words like "unreasonably" and "without justifiable reasons" provide a basis for the rule of reason approach in assessing abuse of dominance practices. In the absence of implementing guidelines that expand on these vague terms, there is much room for subjective discretion on the part of the administrative body.

Section 26 deals with mergers and acquisitions. As is the case in most competition laws, a pre-merger notification is required for mergers that are expected to result in a certain level of concentration in the market. But, as mentioned earlier, the threshold post-merger market share and minimum sales figure have not yet been established, rendering this particular section unenforceable. It is also unclear on what basis the Commission's permission may be granted as there is no mention of the types of defence that may be admissible, be it an "efficiency defence" or a "failing firm defence".

Section 26. *A business operator shall not merge businesses, which may result in monopoly or unfair competition as prescribed and published in the Government Gazette by the Commission unless the Commission's permission is obtained.*

The publication by the Commission under paragraph one shall specify the minimum amount or number of market share, sale volume, capital, shares or assets in respect of which the merge of business is governed thereby.

Section 27 concern agreements. Here, the law describes 10 different types of agreements. The law prohibits the first four types of agreements. These are price or quantity fixing and bid rigging. The third type of prohibited agreement – i.e. *entering into an agreement to have market domination or control;* is somewhat vague. It seems to refer to the "intention", rather than the actual trade practice, which can be very subjective.

As for the other types of agreement, businesses must apply for permission by filing an application with the Commission. Again, the law does not mention efficiency. Rather, it states that permissions may be granted if it is "commercially necessary" to undertake such agreements. There are no implementing regulations that would elaborate on what such a term means.

Section 27. *Any business operator shall not enter into an agreement with another business operator to do any act amounting to monopoly, reduction of competition or restriction of competition in the market of any particular goods or any particular service in any of the following manners:*

1 *fixing selling prices of goods or services as single price or as agreed or restrict the sale volume of goods or services;*
2 *fixing buying prices of goods or services as single price or as agreed or restrict the purchase volume of goods or services;*
3 *entering into an agreement to have market domination or control;*
4 *fixing an agreement or condition in a collusive manner in order to enable one party to win a bid or tender for the goods or services or in order to prevent one party from participating in a bid or tender for the goods or services;*
5 *fixing geographical areas in which each business operator may distribute or restrict the distribution of goods or services therein of fixing customers to whom each business operator may sell goods or provide services to the exclusion of other business operators from competition in the distribution of such goods or services;*
6 *fixing geographical areas in which each business operator may purchase goods or services or fixing persons from whom business operators may purchase goods or services;*
7 *fixing the quantity of goods or services which or to which each business operator may manufacture, purchase, distribute, or provide services with a view to restricting the quantity to be that lower than the market demand;*
8 *reducing the quality of goods or services to a level below that of previous production, distribution or provision, whether the distribution is made at the same or at a higher price;*
9 *appointing or entrusting any person as a sole distributor or provider of the same goods or services or those of the same kind;*
10 *fixing conditions or procedures in connection with the purchase or distribution of goods or services in or order to ensure the uniform or agreed practice.*
11 *in the case where it is commercially necessary that the acts under (5),(6),(7),(8),(9) or (10) be undertaken within a particular period of time, the business operator shall submit to the Commission under section 35 an application for permission.*

Finally, section 29 is a catch-all section that focuses on unfair trade practices. This is because Thailand models its competition law after that of South Korea, which – with its *chaebols* – is particularly concerned with the difference in the size of competing companies. Unfair trade practices do not necessarily concern competition in the market. Rather, they concern unfair practices resulting from unbalanced bargaining power between two business partners that may lead to one party taking advantage of the other by prescribing unfair conditions on trade.

The key feature that distinguishes section 29 from previous sections is that in this case an impact assessment is required. Again, there are no implementing regulations or guidelines on what constitutes unfair trade practices, which leaves the business community uneasy about its extremely broad scope.

Section 29. *A business operator shall not carry out any act which is not free and fair competition and has the effect of destroying, impairing, obstructing, impeding or restricting business operation of other business operators or preventing other persons from carrying out business or causing their cessation of business.*

To conclude, while the Thai competition regime has very few *de jure* exemptions, it has plenty of *de facto* exemptions as a result of the administrative body's failure to pass the requisite implementing rules and regulations. The regime also provides the competition authority with broad discretionary power to grant exemptions given that the law does not specify the underlying objectives or identify priorities in its implementation. Vague and unclear terms, combined with the absence of implementing regulations and guidelines, render the competition regime obscure and unpredictable in terms of the scope of its application, exemptions and exceptions.

4. Economic impact of exemptions and exceptions

4.1. Impact of exemptions

Exemptions for state-owned enterprises

While the blanket exemption extended to state-owned enterprises[5] is understandable from a practical viewpoint as explained earlier, the absence of competition oversight in the state-owned commercial entities does have relatively grave consequences.

The number of state-owned enterprises (SOEs) in Thailand is currently numbered at approximately 60 (excluding those in the financial sector that was nationalized as a result of the economic crisis in 1997). A number of these enterprises hold a dominant position in the market, in particular those that operate in the utilities sector such as telecommunications, energy, electricity, transport and water. The exemption has allowed certain SOEs to pursue anti-competitive practices to stifle private competition or overcharge consumers where private competition is absent. The absence of sector-specific regulatory agencies – i.e. in telecommunications, water, electricity and transportation – allows these practices to continue unrestrained. The problem of anti-competitive practices is likely to be much more severe when the SOE performs the regulatory role itself.

For example, the Telephone Organization of Thailand (ToT), the state-owned domestic telephone service provider, hands out several domestic telecom concessions to private companies.[6] Through the conditions set out in these concessions, the private company has to obtain prior approval from the ToT concerning (1) tariff schedules; (2) tariff adjustments; (3) technical specification of telecom equipment; (4) introduction of new services and (5) location of new fixed-line installations. Indeed, the ToT does not hesitate to exploit its regulatory power to restrain private competition. For example, TT&T, a private concessionaire responsible for the provision of a telephone service in the provincial area, complained that the state enterprise refused to approve its request to reduce domestic long-distance charges in response to the ToT's own price adjustment. As a result, the company lost a significant portion of the market share. This is a blatant anti-competitive and unfair practice. Similarly, ToT's ability to dictate where the private concessionaire could install landlines also served to protect its own market.

Private concessionaires are not the only party affected by SOEs abuse of market power; consumers also bear the price of having state monopolies. According to a research report conducted by the Thailand Development Research Institute (Thailand Development Research Institute, 2002), the cost of a 128 kbps leased line in Thailand is highest among ASEAN countries. It is approximately 20 per cent higher than that in Malaysia and the Philippines, and 70 per cent higher than its counterpart in the Philippines. Since then, prices have come down considerably as a result of competition from the private concessionaire. Similarly, consumers and businesses are paying relatively high overseas telephone service tariffs where the Communication Authority of Thailand (CAT), the state monopoly in the toll market, has been the sole provider of the service by law. Although the high overseas telephone tariffs can be partly attributed to the high interconnection charge that the CAT pays to the ToT, which is supposed to be inclusive of contributions to the universal service fund, tariffs remain excessive. In the absence of a regulatory body and an exemption from competition law, these excessive prices have never been challenged.

Exemptions for agricultural cooperatives

Unlike many countries where agriculture still contributes to a significant share of the GDP, Thailand does not have a marketing board. The government's involvement in commodity trade has been limited to occasional price-support programs when there is a glut in the supply, or when the world prices of the particular agricultural product fall too low. Although the exemptions for agricultural cooperatives allow farmers the opportunity to join together in order to coordinate their actions to protect their interests, it cannot help solve farmers' problems. Thai farmers have not been able to form a coalition at national level to build their bargaining power against large food-processing manufacturers or middlemen simply because the number of farmers is very large and they are scattered across the country. Success stories of agricultural cooperatives have been limited to district-level only, which is hardly sufficient to support the price of agricultural products.

Exemptions due to the absence of necessary implementing regulations

The lack of enforcement of sections 25 and 26 of the competition law has left businesses and consumers at the mercy of large incumbents with market power. Obvious anti-competitive practices such as the tied-sale case have expanded to include the tying of soda and bottled drinking water at the expense of both large and small competitors in these markets. During 1995–2003, through various anti-competitive practices including tied-sale, exclusive dealing, cross-subsidization and predatory

Box 2: A Merger in the Cement Industry

The cement industry is notorious for its collusive practices worldwide. This may be the case because the industry tends to be concentrated as it displays a significant economy of scale. Moreover, high transportation costs limit competition from imports, while homogeneity of the product is favourable to price-fixing arrangements.

The cement industry in Thailand is also concentrated with the largest producer, Siam Cement PCL (SCC), taking a 40 per cent market share. The second and third largest producers are the Siam City Cement PCL (SCCC) with a 25 per cent market share and TPI Polene PCL with an 18.5 per cent market share. Both SCC and TPI Polene are local firms, while the SCCC is controlled by the Swiss multinational cement producer, Holcim AG. The three firms together control approximately 83.5 per cent of the market share.

Before the entry of TPI Polene, the industry was a duopoly. Prices were high and producers were content with relatively high ROA figures. The situation changed with the emergence of TPI Polene. As the lowest cost producer, it helped contain cement prices in the market during the bubble period. During the post-crisis economic slump, the company slashed prices in order to boost sales in a shrinking construction market. Prices of cement basically halved during the late-1999 to April 2002 period to the benefit of the construction industry.

The entire picture changed, however, with the news that SCCC is about to take a majority equity share in TPI Polene, which is in the process of restructuring. Another foreign suitor, Cemex from Mexico, appeared to be the front-runner in the beginning, but seemed to have fallen behind Holcim as it could not compete with the latter's offer. Should the choice of investor in the ailing TPI Polene simply be a business decision? The answer is no if the merger is likely to limit competition in the market, potentially resulting in high prices. This is where the role of the competition authority as a protector of public interest comes in.

According to the analysis of almost every security house in Thailand, the merger between the second and third largest producers will result in a duopoly in the market. With TPI Polene, the most aggressive competitor, taken over by a less aggressive producer, price competition would certainly be terminated. In fact, the price of cement in the market already doubled in anticipation of the merger as its due date drew near. That is, the fact that SCCC (or Holcim AG) was able to bid a higher price for TPI's equity share was not because of its superior efficiency, but rather because of its ability to generate a post-merger price hike.

In countries with an effective competition law, the competition authority would have certainly rejected such an anti-competitive merger. Unfortunately, section 26 of the Trade Competition Act 1999, which deals with mergers, remains ineffective in the absence of a threshold post-merger market share and revenue that would require a pre-merger notification. There is no doubt that the delay in establishing these badly needed implementing regulations has proved extremely costly for the Thai economy and its people.

pricing, the market share of the defendant in the beer market increased from almost zero to almost 70 per cent. In the absence of a requirement for pre-merger notification, a planned merger between two large competing cement companies is likely to lead to post-merger price collusion (see Box 2). More mergers in the steel industry in the pipeline will likely lead to a highly concentrated market.

Thai consumers are being forced to pay high prices for whisky as a result of unfair cross-subsidization between the whisky and beer markets. The price of cement has also increased with the pending merger, despite the fact that Thailand has the most efficient plant in this region according to a productivity report undertaken by McKinsey & Company (McKinsey & Company, 2002). In future, they may be paying higher prices for steel as well if the ongoing consolidation in the industry lessens competition in the market. The fate of small local bottled water manufacturers is left entirely to the whims of the large incumbents. It is therefore of the utmost urgency to make these sections in the law effective in order to stem the tide of these anti-competitive behaviours that threaten the survival of SMEs and thus, the livelihood of many families, as well as the welfare of all Thai consumers.

It is clear that the image of the OTC and the TCC has been reduced to nothing more than a "paper tiger". The fact that the Commission's reputation has been tarnished even before it had a chance to establish one is detrimental to the entire process of building a competition culture in Thailand.

It is not only the public that has lost faith in this agency, but also the OTC's own staff, which seem to be losing morale. These officers have been working very hard in developing the technical and analytical skills required to deal with competition cases and have put the acquired skills into use in preparing competition cases for consideration by the Trade Competition Committee. But all their efforts appear to be in vain when decisions are often made at the whims of the politician rather than based on the well-researched facts presented.

With continued political intervention and lobbying of interested business groups, the enforcement of the competition law is likely to remain stalled for the foreseeable future. However, there are solutions, albeit challenging and time-consuming ones.

Exemptions for companies incorporated overseas

As a small open economy, Thailand relies extensively on imports, which renders it vulnerable to price fixing and market-sharing agreements undertaken by international cartels. According to various studies, Thailand has been affected by many international cartels, including the vitamin cartel, the heavy electrical equipment cartel, the steel cartel and the cigarette cartel (The Economist, 2001). In the case of the vitamin cartel, the size of the loss in terms of overcharges paid was US$ 78.45 million from a total import value of US$ 271.61 million (Evenett, 2003) for the period 1990–1999 during which the cartel operated. Unfortunately, similar estimates of the cost of other cartels are not available.

Thailand is also affected by shipping cartels that are beyond the reach of the domestic competition law. Like export cartels, liner shipping is often exempted from anti-trust provisions in industrialized countries with national shipping lines. The exemption allows liner conferences to allocate markets and set freight tariffs. Thai exporters have complained about various ancillary charges that are often applied, such as terminal handling charges and adjustment factors for fuel and currency fluctuations. These are designed to transfer risks from shipping companies to shippers without a clear formula. As a result, small Thai shippers that lack bargaining power to negotiate more favourable rates have had to shoulder high costs that further disadvantages them in terms of cost competitiveness.

To the author's knowledge, the Thai Frozen Food Association has been the only trade association in Thailand that is able to unite in order to counter the market power of liners. The association was able to obtain preferential freight rates and bargained with the liners to waive the terminal handling charges. Unfortunately, other attempts to follow the success of the frozen food group failed, mainly because large players in the industry were unwilling to sacrifice their competitive edge over smaller players that had less bargaining strength and thus, faced higher freight rates. The liners divide shippers by offering different rebates for shippers of various sizes. Larger shippers are content with the deal they have secured, and are unwilling to help smaller shippers that compete with them in the market. Without the large shippers, smaller shippers can never hope to build up enough bargaining power to counter the liners.

To better balance the negotiating power between domestic shippers and international shipping companies, the government is considering passing domestic regulations that require international liners to consult the national shippers' council or association before any price increase is enacted. A Maritime Bill was drafted that stipulates that adequate notice of a rate increase must be given to the local regulatory agency and that shipping liners must negotiate with shippers before any increase. The Bill proposed that liners intending to increase freight rates must give 90 days' notice to the Office of the Maritime Promotion Commission and outline the reasons supporting the increase. If the state does not object within 15 days, the new rates can be enforced. If the two parties fail to reach an agreement, an arbitration committee made up of impartial outsiders would be formed and its decision would be final. In 2001, a new government came into power and did not push the bill further. Malaysia is considering a similar law.

4.2. Impact of exception

Since the promulgation of the Trade Competition Act, the Trade Competition Commission granted exceptions to two cases. The first case is the cable monopoly, where the exception is based on the fact that the service is regulated by the state enterprise, the Mass Communications Organization of Thailand (MCOT). The second case concerns unfair trade practices in the retail trade where the TCC decided to pass an Industry's Code of Ethics rather than examine in detail whether any of the practices that were the basis of complaints violate section 29 of the law.

In the first case, the decision to refer the case to the responsible regulatory body seems reasonable. In many countries, the competition authority does not have jurisdiction over regulated industries. However, in the case of Thailand, reference to the sector-specific regulator may not be suitable, given that these regulators sometime hold commercial interests in the private businesses that they regulate.

For example, in the case of the cable monopoly, the state enterprise that is responsible for regulation is entitled to a 6.5 per cent revenue share from the private concessionaire that it regulates. As a result, it has an interest in ensuring a healthy profit margin for the licensee. The blatant conflict-of-interest no doubt renders the regulatory regime ineffective. Similarly, high fixed monthly fees for mobile services were sustained for a considerable period of time despite public outcry because the government enterprises responsible for handing out these concessions enjoy a large revenue share from the private concessionaires.

In the second case of a large discount store, the issue is relatively complex as it involves unfair trade practices resulting from unbalanced bargaining between large multinational discount store chains and smaller local suppliers. There were complaints about predatory pricing, slotting allowances, own brands, mandatory participation in in-store promotions, forced rebates, etc. Most of these practices may have reasonable commercial justifications and may contribute positively to the welfare of consumers that include also small moms and pops stores that buy products from these discount stores for resale; however, some may in fact constitute unfair and discriminatory practices, in particular against smaller suppliers. In the absence of a transparent procedure, the decision not to prosecute was viewed with much suspicion by the public.

5. Lessons learned and policy recommendations

The Thai experience shows that while *de jure* exemptions may be justified on economic, social or even practical grounds, *de facto* exemptions resulting from the administration of the law can be problematic. Exemptions for state-owned enterprises and exceptions provided for regulated private companies have certain justification, but proved to be costly to the Thai economy when effective regulatory regimes are not yet in place. But, given that both the general competition regime and the sector-specific regulatory regime are not functioning, perhaps the exemptions make little difference in terms of economic performance.

The maladministration of the competition law leads to wide-ranging exemptions and exceptions from its application that are not as visible as the case above. The failure to pass the necessary implementing rules rendered key provisions on abuse of dominance and mergers and acquisitions unenforceable. The lack of transparency in the administration also leads to discriminatory treatment of exemptions and exceptions. For example, the whisky-beer tied-sale case was provisionally exempted on the basis that the section on abuse of dominance was not yet enforceable without a dominance threshold. The motorcycle exclusive dealing case, on the other hand, was charged under a different section that does not require a proof of dominance, despite the fact that both cases constitute an abuse of dominance. Similarly, the failure to thoroughly investigate, assess and report possible infractions of the law in the case of the alleged unfair trade practices in the retail industry seems to confirm the selective enforcement of the law.

The impact of these exemptions and exceptions vary, depending on the scope and scale of the alleged restrictive practices and the nature of players in the market. In the case of exemptions provided for state-owned enterprises that operate mainly in the utilities sector, consumers have had to pay higher prices for many of the monopoly services in the absence of a sector-specific regulatory regime that can perform an overseeing role in lieu of the general competition authority. The impact on the competing private companies is not as grave as in the case of restrictive practices in the manufacturing sector where many small and medium enterprises prevail. Indeed, these enterprises are more vulnerable to anti-competitive practices by larger competitors than are, say, large telecommunications companies. That is why the inapplicability of sections 25 of the law on abuse of dominance has had grave consequences on the competition environment.

The inability to apply national competition laws to foreign suppliers without registered assets in the domestic jurisdiction also imposes significant costs in particularly small countries that are often on the receiving end of cross-border restrictive practices undertaken by large multinationals. It is hoped that one day there will be a binding multilateral rule that will be able to effectively deal with these restrictive practices.

What does the Thai experience suggest? First, it shows that independence of the competition authority from both business and politics is extremely crucial in an environment where there are not sufficient checks and balances within the political, administrative and social environment. The composition of the Thai Trade Competition Commission is the converse of independence. Second, it illustrates that it is necessary that a competition law is fully enforceable upon its enactment. It would be a mistake to leave requisite implementation laws or rules to the administrative body, in particular when the body is vulnerable to political interventions and business lobbying. On the third and related point, where the administration is not transparent, it is perhaps better to minimize the discretionary power on the part of the administrative authority by legislating simple and straightforward rules rather than leave them to the authority. The legislative process is much more transparent than the administrative process. Indeed, a more flexible but complex regime can be desirable, but it also lends itself easily to discriminatory application of the law that can be devastating to the competition environment. Broad administrative power should be reserved for competition regimes that are more transparent and subject to effective checks and balance mechanisms. Finally, it is of the utmost importance to ensure transparency and due process in the administration of the competition law. One can ensure that exemptions and exceptions are justified if stakeholders have the opportunity to present their views, submit evidence and appeal in cases where they are not content with the decision. The availability of detailed implementing rules and regulations, disclosure of commission's decisions and minority views and the reasons for supporting them, notifications in the rule making, etc., can do much to enhance the transparency and ensure overall impartiality and effectiveness of any competition regime.

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Notes

1 In a civil law tradition, rule of reason implies that such practices must obtain approval from the administrative authority concerned.

2 This issue concerning exemptions will be discussed in detail in section 3.

3 The Thai partner has recently bought back all equity shares of the “Tops” supermarket chain in which Royal Ahold once held a majority share.

4 This includes all enterprises whose majority of the equity share is held by government agencies or state enterprises.

5 The definition of a state-owned enterprise is an enterprise with state ownership exceeding 50 per cent of equity share.

6 This is because, prior to the legislation of the Telecom Act 2001, only state enterprises were allowed to own and operate telecommunications network and services. Thus, private telecom companies could only operate through a build-transfer-operate (BTO) arrangement, whereby the private company installs the network, and then transfers ownership of the network to the state enterprise before it starts operation. In exchange for its investment, the private company obtains long-term exclusive access to the network.