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The effects of anti-competitive business practices on developing countries and their development prospects

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FOREWORD

During the last decade, many developing countries have adopted or are in the process of enacting competition laws. There is growing awareness among developing countries of the adverse effects of anti-competitive practices on their economies as well as their populations. The effects of such practices are not easily quantifiable and may therefore not be obvious. Nevertheless, developing countries have come to recognize the potential benefits that can be derived from competition law enforcement. The drive to establish legal and institutional frameworks in order to fight anti-competitive practices has intensified in recent decades.

In over three decades working with many developing countries across the globe, UNCTAD has accumulated a wealth of knowledge and expertise in making competition law and policy work for development. The Accra Accord (paragraph 104) recognizes that "*UNCTAD is the focal point for the work on competition policy and related consumer welfare within the United Nations system. It provides to its Member States a forum for intergovernmental policy dialogue and consensus building in the area of competition laws and policies. … a forum to discuss competition issues on the multilateral level, … . UNCTAD's work in this area should promote competition law regimes that take into account the prevailing conditions in the developing countries*." Within this framework, the current publication brings together studies by practitioners and academics focussed on identifying the effects of anti-competitive practices on developing countries and their development prospects.

The various sections of this publication cover a wide range of cross-cutting competition issues. The publication highlights the synergies between competition and consumer laws and policies. It emphasizes the role of competition law and policy as a complementary policy tool in poverty alleviation. It also draws attention to competition concerns in commodity markets, which are of crucial importance to developing and least developed countries. Moreover, it provides lessons from a broad range of experiences from developed as well as developing countries, including economies in transition. The contribution

of competition enforcement can often be indistinguishable from that of other economic policies in increasing efficiency and competition. Nonetheless, this publication upholds the view that competition law and policy are supportive of the overall process of economic development by curbing anti-competitive practices that negatively impact consumers and increase costs to business.

It is my hope that this publication, which is being launched at the ninth session of the Intergovernmental Group of Experts on Competition Law and Policy in Geneva, in July 2008, will contribute to the enhanced understanding among government officials, private-sector stakeholders, consumer organizations and civil society of the necessity of competition law and policy and raise awareness on the damage caused by anti-competitive practices on the economies of developing countries.

I would like to reiterate that UNCTAD will continue to support developing countries in their efforts in adopting competition and consumer laws and establishing and strengthening the capacities of their competition authorities through technical assistance and capacity-building programmes.

Supachai Panitchpakdi
Secretary-General of UNCTAD

EXECUTIVE SUMMARY

During the 1990s, many studies were undertaken to demonstrate the effects of anti-competitive practices on consumers and producers both in developing and developed countries. Damages caused by such practices to developing countries have implications for the purchasing power of consumers through increased prices. Producers in the developing world are also affected by anti-competitive practices through increased barriers to entry by restriction of information on technology. A World Bank study[1] shows that, in 1997, developing countries imported US$81.1 billion worth of goods from industries where companies were involved in price-fixing arrangements in the 1990s. These goods represented 6.7 per cent of imports and 1.2 per cent of GDP in developing countries. These figures reveal the significance of the economic impact of the damages of anti-competitive practices on developing economies. It is worth mentioning that the quantitative effects of anti-competitive business practices are not easy to demonstrate. The most obvious effect of such practices is seen in the form of price increases in markets involving output-restricting or price-fixing cartels and dominant firms abusing their market power. In such cases, consumers are the ones who suffer directly from restricted competition.

One of the policy options available to governments to prevent or eliminate anti-competitive practices is the introduction and enforcement of competition law. The interrelationships between competition law and other government policies, such as consumer protection, macroeconomic policies and poverty alleviation, are an important catalyst to economic development and better livelihoods. Among these policies the synergies accruing between competition and consumer protection law enforcement to protect consumer interest and welfare are worth noting.

This publication is a compilation of studies done by competition practitioners and academics. It brings together studies quantifying the

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[1] Margaret Levenstein and Valerie Suslow (2001), *Private International Cartels and their Effect on Developing Countries*, Background Paper for World Bank's World Development Report 2001, available at http://www.worldbank.org/wdr/2001/bkgroundpapers/levenstein.pdf.

effects of anti-competitive practices, on the one hand, and, on the other, studies demonstrating/emphasizing the benefits of competition law and policy, through establishing links between competition and other cross-cutting issues. Part A deals with the interaction between competition and consumer policies. Part B focuses on competition law and policy and on poverty eradication. Part C discusses competition issues in commodity markets. Part D is devoted to lessons learnt from competition policy and law enforcement; experiences of developing as well as developed countries from both national and regional implementation perspectives. Lastly, Part E deals with specific anti-competitive practices, such as cartels, abuse of dominance and patent policy, which have a bearing on competition in the market.

The Interface between Competition and Consumer Policies

Competition and consumer protection law and policy areas form part of the development perspective of UNCTAD's work. Considering the needs of consumers, especially in developing countries, and the imbalances they face in economic terms, educational levels and bargaining power, UNCTAD published the *Guidelines for Consumer Protection*.[2] The objectives stated in the Guidelines include, among others, assisting countries in controlling abusive business practices by all enterprises, which practices adversely affect consumers, and encouraging the development of market conditions, which provide consumers with greater choice at lower prices. These objectives point to the close relationship between consumer protection and competition policies.

Competition law and consumer protection policies are complementary and mutually reinforcing. Competition in the market increases efficiencies and encourages innovation. Competition also creates incentives for product differentiation and improves the quality of goods and services provided. In that sense, competition enhances consumer welfare by providing consumers with a wider choice at competitive prices. Consumer protection strengthens competition in the markets. Consumers make informed decisions in their preference for goods and services in respective markets when they are well informed.

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[2] *UN Guidelines for Consumer Protection*, United Nations, New York and Geneva, 2001, available at: http://www.unctad.org/en/docs/poditcclpm21.en.pdf.

This increases competition between firms and results in efficiency and/or quality improvement, which in turn benefits consumers. In this publication there are studies that quantify benefits to consumers from competition in different sectors of the economy as well as those that quantify the adverse effects of anti-competitive practices on consumers (Sections 1, 2 and 3). These studies illustrate the strong link between competition and consumer protection. Other studies use econometric models to demonstrate the contribution of competition law to alleviate the costs of cartels incurred by consumers. Some competition authorities have even estimated the rate of return in terms of consumer welfare on each dollar spent on competition law enforcement (Section 2).

In some cases, total damages caused by the violation of competition law are found to be significant while the damage per consumer is relatively low, especially with respect to the price of the product and the household budget. These are some of the factors hindering or discouraging consumers from initiating private damage actions. There are particular cases in which the market where violation takes place is different from the market where the damage occurs. Therefore damages are not visible to individual consumers. In such cases, consumers may not be aware of the costs they incur. Market assessment can be a useful tool to give visibility to damages caused by anti-competitive practices. Such studies would strengthen the competition advocacy work of competition authorities, by analysing the level of competition in the market as well as the causes and possible consequences of all factors restricting competition. The outcomes of these studies may be used by policy makers in decision and policy making (Section 13). It is interesting to note that one of the tasks of the US Federal Trade Commission's Bureau of Competition is to provide information for consumers, businesses and policy makers on competition issues and market analysis (Section 1).

With respect to the interface between competition and consumer interest, there are trade-offs between the two. Competition law works to achieve efficiencies in the market. These can be categorized as productive, allocative and dynamic efficiencies. It is unlikely to achieve all these efficiencies at the same time. Therefore, the competition authorities have to make an assessment as to which efficiency shall be given more weight in each competition case. This creates a trade-off between different types of efficiencies. One trade-off

is between static and dynamic efficiency while another occurs between productive and allocative efficiencies. For instance, although consumers would not gain from dynamic efficiencies resulting from innovation in the short term, they may benefit significantly in the long term (Section 1).

Tensions between competition and consumer interest arise in situations where competition results in outcomes not favourable to consumers, such as high switching costs, trade-offs between price and quality. Additionally, consumers may have difficulties in price calculations due to complex pricing schedules offered by companies. This problem is prevalent in recently liberalized sectors, such as utilities and professional services, where there could be need for regulations to protect consumers and ensure that an adequate quality of services is provided. However, such regulations may reduce competition in these markets and in the extreme cases may even result in anti-competitive practices (Section 1). Furthermore, competition in the market may lead to negative effects on the environment and may not fully address the social benefits of public good. In these areas, there is need to impose regulatory rules to balance the long-term costs and benefits in terms of social welfare. Health and safety issues also require attention by consumer protection authorities since information asymmetries impede the functioning of competitive markets, such as in the restaurant food and used car markets (Section 2).

In jurisdictions such as India, the EU and the US, competition law includes promotion and protection of consumer interest and welfare among its goals. In these cases, there is a direct reference to consumer welfare and interest. In the case law of many jurisdictions, relevant courts or competition authorities consider consumer interest in their decisions. Although consumer interest is one important element of competition law, not all aspects of consumer interest, such as safety, health, environment and privacy, can be addressed by competition law enforcement. These additional aspects of consumer interest require specialized laws, which also protect consumers against unfair business practices (Section 1).

However, Section 3 provides examples of how effective enforcement of competition law in developing countries can inherently enhance consumer welfare. Case examples exemplify how merger evaluation accords the competition authority with an opportunity to approve mergers with conditions geared towards enhancing consumer

welfare. Such conditions may include continued availability of goods and services in the domestic market and a better quality and wider range of products.

The synergies between competition laws and consumer protection laws should be exploited to promote competition and consumer welfare. These two policies use different tools but reinforce one another to correct market failures. Competition law facilitates the work needed by consumer policy by ensuring effective competition in markets, while consumer policy contributes to strengthening of fair competition, that is, competition on merits rather than through fraud and deception, between firms by enhancing the ability of consumers to make informed decisions and exercise choice (Section 1).

Government support is crucial in providing the necessary infrastructure to develop and implement consumer protection policies and in ensuring consumer participation in developing countries. Competition laws that are not complemented by consumer protection provisions or separate consumer laws risk failure to protect consumers against anti-competitive practices (Section 2).

Competition and Poverty Eradication

We live in an era of market-driven globalization, in a world increasingly interdependent and with unprecedented openness in the global economy, a world in which the volume of trade and economic growth has no precedent in history. This is an era, which, though largely beneficial, has also brought about poverty and inequalities in wealth and opportunities for the people and small and medium economic actors in the markets. It is also an age that needs to translate these positive aspects into gains for developing countries and particularly their people.

Poverty is one of the greatest challenges facing developing countries today. The phrase "*living on less than a dollar a day*" has crept into modern literature, news items, journals and other media to describe the dire hopelessness of the poor within world populations. In this context, the Millennium Development Goals, and in particular poverty alleviation/reduction and/or eradication, comprise a subject that has been elevated in profile. It features among the top priorities of all international organizations and governments for policy implementation.

Poverty has become a subject of study by research institutions and individuals. It has also been identified as one of the most important areas for ensuring coherence and aligning global and domestic policies.

Poverty is a reality in almost all countries at various dimensions and magnitudes and the denial of it in any context negatively affects the efforts made in dealing with it. The existence of poverty is associated with many causes including government policies, poor planning and non-motivation. Nonetheless, the cause of poverty not withstanding, its alleviation is perceived to emanate from some policy interventions (Section 5 and 6). Therefore, it is necessary for governments to identify the poor, what they need and where they are located.

Certain factors have been identified as causes of poverty in developing countries. They include lack of progressive economic growth due to other factors, for instance prevalence of diseases such as HIV/AIDS, high population growth rates, lack of infrastructure support, etc. Debt burden perpetuates poverty in many developing countries where a large percentage of GDP goes to debt servicing, leaving limited resources to tackle poverty-related issues (Section 5). Other possible factors could be associated with high inequality in income between the rich and the poor, or between those who are able to exploit the available opportunities and those who are not. Disparities could be based on rural-urban, inter-racial and/or inter-social factors, climatic conditions, access to markets and historical factors.

In connection with this, many authors have studied the pro-growth and pro-poor benefits of competition in the markets, finding indications that economies with competitive domestic markets generally tend to have higher growth rates and *per capita* income.

International competition has seen a period of intensification, now that interdependence of national economies has increased to a point where all economies are exposed to the influence of events and policies originating in other parts of the globe. The widely accepted economic notion that barriers to competition impede innovation, growth and prosperity is supported to some extent by the proliferation of policy and law initiatives dealing with competition at both national and regional levels. Bearing this in mind, in a spirit of continuous coherence, the United Nations took the step of adopting in 1980 the *UN Set of Multilaterally Agreed Equitable Principles and Rules for the Control of*

Restrictive Business Practices. The adoption of the UN Set has been widely received as a key effort in articulation at a global level, since it is the only multilateral instrument on competition policy providing a set of rules for the control of anti-competitive practices. Crucially, these rules also recognize the development dimension of competition law and policy and provide a framework for international cooperation and exchange of best practice. It is important to recall that UNCTAD is the focal point on all capacity building and technical assistance work related to competition policy and consumer protection within the United Nations system.

In this regard, assessing the actual contributions and potential implications of competition in poverty alleviation is a complex exercise, particularly because the implications of competition on poverty alleviation, on welfare and on the overall development prospects of developing countries remain an open debate. Within this context, the authors have endeavoured to take on these multifaceted issues and challenges giving us their useful insights, from the perspective of legal economic theory and policy (Section 4), and also from the point of view of the practice of competition on the ground (Section 5 and 6).

Section 4 describes the two classical visions on a desirable competition law: (1) that of developed countries, which often insists that antitrust is only for aggregate efficiency and consumer welfare, believing that any broader focus will lead to the protection of small competitors undermining the overall efficiency of the economy; and (2) the reply given by developing countries, which argue that their antitrust laws and policies must also address issues of distribution and power.

Elaborating on the broad question of how to obtain gains from competition, Section 4 advances the notion that antitrust should not be used to protect inefficient small economic actors against big actors. It should be used to *empower* small economic actors against big actors by facilitating mobility and market access, which in turn produce efficiencies in the society.

Competition law and policy intervention have been advocated as policy tools to deal with poverty in developing countries. These instruments should take deliberate measures aimed at expanding the entrepreneurial base, through the prohibition of anti-competitive arrangements and the control of mergers/acquisitions, and at promoting

effective competition in infrastructure industries. Energy, telecommunications, and financial markets are important pillars of economic growth and also contribute to the creation of direct and indirect employment, which is an essential tool for alleviating poverty (Section 6).

Experiences from developing countries have shown that prudent competition policy and law enforcement can assist specific key sectors to accommodate/include more players. Many rural communities in developing countries, who totally depend on the agricultural sector, are classified as poor. Therefore, a competition authority would pay attention to these sectors in order to tackle anti-competitive practices affecting them. Such intervention can directly and/or indirectly contribute to wealth maintenance and creation, which is key to poverty alleviation. Section 5 gives examples of some agricultural sub-sectors that can be identified for intervention by competition policy and law. The analysis illustrates the contribution of competition law enforcement efforts in alleviating poverty, in the cotton, horticulture, floriculture, poultry and beef sectors and points to the fact that intervention has yielded positive results.

Competition Issues in Commodity Markets

Given the importance of commodities as a source of income and livelihoods in many developing countries, it is inevitable that they form part of any poverty reduction strategy. According to the Common Fund for Commodities, there are more than 55 developing countries for which 50 per cent or more of all merchandise exports are comprised of non-oil commodities, the majority of which are located in Africa, where approximately half of the countries are commodity dependent. In many cases only one or two commodities are the main exports of many countries. Further, commodities account for 70 per cent of the merchandise exports of the least developed countries and more than 70 per cent of the world's poor live in rural areas and directly or indirectly depend on commodities for their livelihood[3]. These statistics emphasize

[3] Common Fund for Commodities: *Basic Facts 2007*. 2007 available at: http://www.common-fund.org/download/content/CFC_BF_English.pdf.

that developments in commodity sectors have implications for poverty reduction.

There are certain competition problems in commodity markets, which are usually characterized by a high degree of concentration as well as vertical integration between various stages of the value chain. Section 7 provides the developments and problems encountered in the cocoa market in the Ivory Coast, which supplies 40 per cent of the world demand for cocoa. The analysis of the value chain from Ivorian farm gate to a bar of dark chocolate on the shelves of French supermarkets reveals that chocolate makers and/or distributors have been gaining more and more from a bar of dark chocolate between 1992 and 2001 (Section 7).

The trend following the liberalization of cocoa markets has been the elimination of small local traders through tough competition with large multinational firms. Over time, the remaining local exporting and processing companies became subsidiaries of large multinational firms. On the other hand, cocoa markets have been experiencing increased horizontal concentration through mergers of large multinational companies, such as those between large chocolate companies and cocoa processing firms, or through takeovers by large international companies of smaller companies operating at the national market. As a result of these developments, small local cocoa producers have to contend with a strong purchasing power held by several large multinational companies.

The existence of an oligopolistic market structure with high concentration and market power points to competition law enforcement as a potential instrument to curb anti-competitive practices. Nonetheless, it is difficult to gather evidence on anti-competitive behaviour, such as collusive agreements and other concerted practices, in oligopolistic markets. Another policy option is merger control, which ensures that mergers and acquisitions likely to increase market concentration and reduce potential competition are either prevented or approved with conditions. As for abuse of market power in commodity markets local farmers do not have enough bargaining power and are in a disadvantaged position to negotiate fair prices for their products *vis-à-vis* large international cocoa traders. The approach to competition law implementation in commodity markets should be on how to protect producers from the purchasing power of international traders and

processors rather than how to protect consumers from market power. There are also other policies to exploit, such as price stabilization, which were dismantled during the liberalization process (Section 7).

Another important issue that concerns consumers as well as producers in developing countries is voluntary product standards imposed by industry associations, which are sometimes composed of dominant firms. While product standards may seem to aim at improving consumer welfare *via* increased quality and safety, or encourage environment-friendly production processes, they can also be used by dominant firms as entry barriers against competing firms (Section 8). This is where competition authorities may step in to curb the anti-competitive effects of such practices. Examples show mposition of voluntary product standards has implications especially for small and medium-sized enterprises in developing countries. Product standards increase the cost of production and export for these small producers/exporters thereby restricting their access to the markets of developed countries.

Lessons from Competition Policy and Law Enforcement

Developing countries and economies in transition tend to be more vulnerable to anti-competitive practices. This scenario may be attributed to high entry barriers, less diversified and smaller markets, rather asymmetric firms, and in general conditions that allow dominant firms to abuse their position. Some developing countries do not have competition laws in place and, in those that have laws, their competition authorities have limited experience and resources for effective enforcement. For these countries, it is especially beneficial to learn from other countries' experiences.

As national economies integrate into the world economy through liberalization and with each other through regional trade agreements, barriers to trade are normally eliminated. In such an open international economy, no country can escape the effects of anti-competitive practices originating outside their national borders, such as international cartels or mergers and acquisitions, which may restrict competition. Also, there are difficulties faced by small and medium-sized firms in developing economies, such as business networks providing support for the 'insiders' and making it more difficult for 'outsiders' to

enter particular activities or markets. Such practices restrict the development of entrepreneurial capabilities due to lack of competition. For these reasons, it is becoming particularly important to tackle these problems both at regional and national levels. This can be achieved by including competition provisions in regional trade agreements, especially between developing countries.

In this regard, Section 9 discusses competition law and policy at regional level in the context of the Economic Community of West African States (ECOWAS) and explores the usefulness of an effective competition law and policy in this region. The authors identify two major considerations in the design of an effective competition policy in this regional grouping. One concern is whether or not there should be a regional competition law, together with the mechanisms by which this law would be made effective within members' national legal frameworks. The other concern is whether the region should establish a separate competition authority that will treat individual cases either alone or in cooperation with national competition authorities and courts. This Section recommends the promotion of a regional competition policy, which will improve gains at all levels and tackle cross-border anti-competitive practices, which are negatively affecting the development prospects of countries in this region. It makes a general call for coherence at all levels, including both at policy and law making. It is essential for competition authorities around the globe to learn and borrow from each other's experiences, especially from the history of good practice and reform.

Competition law and policy have become crucial in transition economies due to privatization policies, where there is always the risk of replacing state monopolies with private ones. Section 10 presents the experience of Romania and provides an assessment of the effectiveness of its competition policy implementation. Competition policy plays an important role in the liberalization of certain sensitive sectors of the economy. Privatization and development of a competition policy represented a real challenge for Romania in its process of transition to a market economy. This challenge also entailed reforms to economic regulations and the adoption of other necessary legislations besides competition law. Romania's experience with competition law enforcement demonstrates the importance of competition policy in the context of transition towards a market economy and emphasizes the

need to develop an operational competition regime in developing countries.

Competition law and policy together with effectively functioning markets are conducive for enhancing productive capacity, trade and investment as well as improving the use of knowledge in favour of development. In this regard, Section 11 describes the experience of Australia, a country with a stable economy and a well-developed competition law. This Section elaborates on the significant limitations of the *Trade Practices Act 1974* prior to the 1995 amendments. It also describes the broader reforms of Australian competition policy and the quantifiable benefits of these reforms for the economy and consumers. It is worth noting that, in Australia, broad investigative powers of the competition authority have been particularly important for effective enforcement, which brought about outcomes benefiting a large number of consumers. The Australian experience is useful to demonstrate that competition law may require amendments over time so as to respond to the needs of the changing economic conditions at both national and global level.

Section 12 takes us back to the developing world and provides the experiences of China in anti-monopoly practice from 1993 to 2007 and the reforms undertaken to ensure the coherent and consistent application and enforcement of the anti-monopoly law. The author provides his critical approach to past as well as recent developments on competition law and policy in China, with a focus on aspects to be reinforced and revised in the application of the new law. After a long legislative history of about twenty years, the new integrating *Antimonopoly Law* was passed on 30 August 2007, and will take effect on 1 August 2008.

This Section provides recommendations to adopt an approach that is consistent with international standards and to make necessary institutional arrangements to solve the past problems in future practice. The Chinese experience is one from which timely lessons of competition policy and law enforcement can be drawn.

This Part of the publication provides some insights and examples from various countries' practices, from which important lessons of policy integration, legal and institutional design, action on

specific sectors, legal certainty, enforcement enhancement and reform could be learnt.

Addressing Specific Anti-Competitive Practices

Anti-competitive practices have implications for the economic growth and development of nations. Such practices restrict competition and deteriorate consumer welfare by creating entry barriers and price increases, which lead to efficiency and innovation concerns.

Cartels are one of the most harmful anti-competitive practices and cause significant damage to the economy as well as to consumers. Section 13 provides a case example of the Turkish yeast cartel, which was detected and investigated by the Turkish Competition Authority. This Section quantifies the damages caused by this price-fixing cartel in the yeast market in Turkey. Using the optimal deterrence theory, the authors define the optimal fine, which would ideally deter anti-competitive practices, to be equal to the net harm to persons other than the violator. In some cases, even if the fines imposed are at the optimal level, it is not sufficient to deter anti-competitive practices. To ensure that consumers benefit from competition law, private damage actions may also be encouraged by raising awareness among consumers on the adverse impacts of anti-competitive practices (Section 13).

Abuse of a dominant position is another type of anti-competitive conduct, which can be exercised by large firms, both multinationals and state-created monopolies, such as utilities, transport and telecommunications, in relatively smaller markets. Rules on abuse of dominance aim to ensure free competition in markets, which creates incentives for firms to become more efficient and innovative. Such rules are also used to contribute to the equal distribution of wealth among different parts of the society. However, the level of economic development of countries and the size of their economies may create contradicting situations or factors from a competition's perspective. Firstly, developing economies often have smaller markets and, hence, a small number of firms that can benefit from economies of scale and operate efficiently. That is why markets in developing countries are more likely to be concentrated. Second, the established large firms in developing countries play an important role in increasing investment. Therefore, these economies are likely to benefit from relatively lax rules

on abuse of dominance. Thirdly, in countries where the priority is on equal income distribution, policies may be designed to support small firms representing poorer parts of the society *vis-à-vis* large and dominant companies (Section 14). These factors should be considered carefully by developing countries in designing their competition law and policy, in particular the rules on abuse of dominance. Economic efficiency concerns should be weighed against public interest concerns in the best way. The objectives of the competition law should be clearly reflected in the law. Further, there are different approaches to abuse of dominance in developed countries, such as the EU and US, arising from different assumptions as to which types of conduct are harmful and how difficult it is to distinguish harmful types of conduct from others. Regardless of the type of approach to abuse of dominance, the assumptions made and the economic factors dominant in a country should be analysed and grounded on economic reality (Section 14).

Competition law and policy cross-cut many areas, one of which is intellectual property rights (IPR). IPR protection may endow companies with significant market power. While IPR policies increase incentives to innovate in an economy, they may cause efficiency losses due to abuse of market power by companies protected by IPR rules. In this respect, there is a trade-off between competition law and patent policy. This is even more so for developing countries considering the fact that innovating companies are usually situated in developed countries. Developing countries need to strike the right balance between competition and IPR policies, particularly patent policies, depending on their productive, imitative and innovative capacities as well as their openness to attract foreign direct investment from developed countries (Section 15).

Avenues for Future Research

This publication illustrates the adverse effects of anti-competitive practices on developing countries, and touches upon many cross-cutting competition issues. Future studies focusing on the effects on the economy of important decisions taken by competition authorities in the past, particularly in developing countries, may be very useful (Section 14). In this respect, it would be wise to support developing countries to undertake studies to analyse the impact of their decisions

on various actors in the economy, such as consumers and small and medium enterprises, as well as on their development prospects.

Another area of research could be quantitative analysis of the impact of anti-competitive practices and the lack of effective competition regimes, particularly in developing countries, on national economies, in general, and on consumers, in particular (Section 3).

This publication contributes to the illustration of the adverse effects of anti-competitive practices on developing countries and their development prospects as well as to emphasize the benefits of competition law enforcement. Considering that many developing countries have been making efforts to adopt and implement competition law, this field of research will not saturate any sooner and has the potential to absorb further research.

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PART A:

The Interface between Competition and Consumer Policies

COMPETITION LAW AND CONSUMER PROTECTION — INSIGHTS INTO THEIR INTERRELATIONSHIP

*Vinod Dhall**

1. Introduction

Competition law and consumer protection are intricately connected. It is impossible to talk of one without dealing with the other. At a fundamental level, these two are complementary and mutually reinforcing, both being elements of a broader framework of social welfare. Competition law by maintaining and preserving competition enhances consumer interest. On the other hand, consumer policy strengthens competition between firms. Yet the two are not identical areas and their boundaries do not coincide. Nevertheless, they overlap or intersect at various points, reflecting both synergies and tensions. The challenge before authorities is to maximize the synergies and minimize the tensions thereby smoothing the interface between the two disciplines.

This article explores the complex but interesting interrelationship between the two disciplines and offers insights into how the synergies and tensions might be better understood by competition and consumer protection authorities and by law or policy makers.

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2. The economics of competition law[4]

Competition law is an economic law; it is about the behaviour of economic agents. Economics provides a theoretical basis for the law; it also provides the tools with which to analyse markets and competition within them[5]. As J. Brandeis once said "*A lawyer who has not studied economics…. is very apt to become a public enemy*"[6]. Therefore, for a proper appreciation of competition law it is important to have an understanding of the economic concepts inherent in the law.

Competition in the economic sphere denotes the process of rivalry between firms for the patronage of customers. The European Commission defines competition as a situation in which firms or sellers "*independently strive for buyers' patronage in order to achieve a particular business objective, for example, profits, sales, or market share*"[7]. Richard Whish refers to competition in the commercial world as "*a striving for the custom and business of people in the market place*"[8]. In this sense, competition is the equivalent of rivalry between firms; this rivalry may be in different forms such as for price, service, or a combination thereof, or other factors.

Competition is at the heart of the market-based economy. The debate about the relative merits of a market-based economy *versus* a state-controlled, planned economy that raged for decades seems to have been broadly settled in favour of the former. Countries across the globe are reforming their economies, and undertaking privatization and

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[4] This section is based on the chapter "Overview: Key Concepts in Competition Law" by Vinod Dhall in Dhall, Vinod (ed.) *Competition Law Today: Concepts, Issues and the Law in Practice, (2007),* Oxford University Press, New Delhi.

[5] See Doern. G. Bruce and Stephen Wilks (2001): *Comparative Competition Policy – National Institutions in a Global Market*, Oxford University Press.

[6] Quoted in Whish, Richard (2005): *Competition Law, Oxford University Press,* 5th Edition, p. 1.

[7] *Glossary of Terms used in EU Competition Policy,* Director General for Competition, Italy. (2002), available at *http://europa.eu.int/comm./competition/general_info/glossary_en.html*

[8] See Whish, Richard (2005), *Competition Law, Oxford University Press,* 5th Edition. For another definition, see: Consumer International (2003): *The Consumer Guide to Competition: A Practical Notebook,* March 2003.

deregulation. As they do so, the forces of competition come increasingly onto the centre stage of the economy.

A perfectly competitive market requires that there should be a large number of sellers and buyers, each seller, therefore, having only a small share of the market. Further, the product should be homogeneous, there should be no entry or exit barriers or information asymmetries and both the seller and buyer should have access to the market. In such a market, sellers are price takers, not price makers, and the price of a product equals its marginal cost; each supplier makes only a normal profit.

A perfectly competitive market is said to achieve both allocative efficiency and productive efficiency. The combined effect of allocative and productive efficiencies is that society's welfare overall is maximized. Consumer welfare is also maximized in such a situation. Allocative efficiency is achieved when the goods are produced in the quantities desired by society, and it is not possible to make anyone better off without making someone else worse off. Productive efficiency is achieved when goods are produced at the lowest possible cost, that is, as little of society's wealth is expended in the production process as is necessary. Competition also enhances dynamic efficiency in that it spurs innovation, development of new products and technological growth.

If perfect competition is at one end of the spectrum, at the other end is monopoly. Here, there are many buyers but only one seller, who is a monopolist and who is in a position therefore, to increase prices and reduce the volume of supply. In this situation there is allocative inefficiency, which is also referred to as deadweight loss. In economic theory, however, the objection to monopoly is not only that the monopolist is able to charge excessively and reduce production, but also that monopoly is inefficient. The inefficiency arises out of higher costs, for example, through higher remuneration and excessive staff. A monopolist may also waste resources by maintaining excess capacity or indulging in excessive product differentiation. This situation is also referred to as X-inefficiency, the term first used by Liebenstein[9].

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[9] Liebenstein (1966): *Allocative Efficiency vs. X-Efficiency* (1966) 56 American Economic Review 392–415 quoted at p. 5, Whish, Richard (2005) *ibid.* at note 64.

A weakness of the competition theory, however, is that in the real world neither perfect competition nor a perfect monopoly exists. Perfect competition is based on assumptions (mentioned above) that are unlikely, if not impossible, to be found in real life, where the situation is likely to be somewhere between these two poles of perfect competition and a monopoly. Nevertheless, perfect competition is a model that is still useful to demonstrate the concept of productive and allocative efficiency and as a benchmark against which to measure the actual situation in the market. Short of perfect competition, therefore, other more realistic concepts have evolved over the years. For example, some economists have settled for the concept of "workable competition", evolved by Clark in 1940[10]. This concept considers it worthwhile to aim to produce the best competitive arrangements that are practically attainable. Some economists have advanced the theory of "contestable market" according to which firms are constrained by competitive forces, provided entering into the market is free and exit is costless; that is, the incumbent enterprise must be wary of a 'hit-and-run' entry by competitors. The EC competition law uses the expression "effective competition" though what is meant by effective competition does not appear to have been spelt out.

Another weakness in the competition theory is that in certain situations, competition may in fact not yield the best result in terms of efficiencies, as for example, where the economies of scale support the existence of only one enterprise. Further, in the case of certain industries, there exists what is called the "network effect", that is, the utility of a product or service increases with the increase in the number of consumers, e.g. in telecommunications or personal computer operating systems. Thus, the network effect could, in certain situations, indicate that it is more beneficial to have only one or a few producers of products or providers of services.

In the United States, two important economic schools of thought have greatly influenced competition law and policy. In the 1950s, the structure-conduct-performance concept was developed by what has come to be known as the 'Harvard school' of thought, attributed to E.S.

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[10] Clark (1940): *Towards a Concept of Workable Competition* (1940) 30 American Economic Review 241–256 quoted at p. 14, Whish (2005) *ibid.* at note 64.

Mason and J.S. Bain. According to this school, the market structure influences conduct, which, in turn, influences performance. Concentrated markets are regarded as quite susceptible to economic power and its exercise. Antitrust law is regarded as an important tool to protect the market. This school gives to competition law a more interventionist role and places less confidence in the markets. According to this view, competition policy should be mainly concerned with structural remedies rather than with behavioural remedies.

In the 1970s and 1980s, the ascendancy of the 'Chicago school' of thought produced a revolution in antitrust thinking. The 'Chicago school' focuses on the pursuit of efficiency as the sole goal of antitrust, efficiency consisting of allocative efficiency and productive efficiency. According to this view, most markets are competitive, and entry barriers are more imagined than real; a monopolist's position is quickly eroded and firms are rational in their pursuit of profit maximization. The Chicago school believes that antitrust policy should be less interventionist than demanded by the structure-conduct-performance paradigm. The Harvard school saw concentration as the evil. The Chicago school does not worry about concentration so much, and thinks government intervention is usually clumsy and inefficient. Therefore the foundation is not concentration but non-intervention unless the plaintiff can show price-raising outcomes from specific conduct or transactions. But the Chicago school itself spans a spectrum, with some applying more robust market premises than others.

Both the 'Harvard' and 'Chicago' schools have left their stamp on antitrust thinking. However, recent years seem to have witnessed a rapprochement between the two. It is being increasingly recognized that while economics may provide the tools for analysis and it may also indicate what questions to ask, it does not always yield definitive answers, and it does not provide space for society's values to be taken into consideration.

The European tradition of competition law owes a lot to the German ordoliberal school of thought, also referred to as the Freiburg school. This sees competition law almost as part of an 'economic constitution'. It believes that competition is necessary for economic welfare and that economic freedom is necessary for political freedom. It stresses the necessity of dispersing private economic power so as not to influence political power. The ordoliberal school had a profound

influence on the early decisions in European competition law and could account for its greater concern in protecting the freedom of competitors to compete on merits.

Competition law employs a number of economic tools in analysing individual cases; for example, an important starting point in analysing a case is to determine the relevant market, the purpose of which is to identify the products and services that are such close substitutes for one another that they operate as a competitive constraint on the conduct of the supplier of those products and services. The relevant market comprises the relevant product market and the relevant geographic market. An economic tool usually employed in determining the relevant product market is the SSNIP test (Small but Significant Non-transitory Increase in Price, also called the hypothetical monopolistic test) to assess primarily the demand side substitutability of the product. Also, economic tools are used for determining the entry barriers, which may include determining the economies of scale, extent of product differentiation, extent of capital requirement, and predatory behaviour.

Some empirical studies have tried to measure the gains from competition in the markets. In the United States, in a contemporaneous review of the deregulation of natural gas, long-distance telecommunications, airlines, trucking and rail, it was reported that real prices dropped at least 25 per cent and sometimes close to 50 per cent within ten years of deregulation in those industries[11]. The annual value of consumer benefit from such deregulation was estimated to be approximately US$5bn in the long-distance telecommunications industry, US$19.40bn in the airline industry, US$19.60bn in the trucking industry, and US$9.10bn in the rail industry. At the same time, there were improvements in the quality of service. A study by the Australian Productivity Commission, quoted by the OECD, estimates that Australian household "*annual incomes are, on average, around A$7,000 higher as a result of competition policy*"[12]. The same OECD document

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[11] Robert Luke, J. (1997): *Economic Deregulation and Customers Choice: Lessons for the Electricity Industry, George Messing University Centre for Market Process*", quoted in Crampton , Paul (2003) *Competition and Efficiency as Organizing Principles for all Economic and Regulatory Policy Making*, OECD-IADB, April 2003.

[12] OECD (2005): *The Relationship between Competition Authorities and Sectoral Regulators*, Document No. DAF/COMP/GF (2005) 2 for Global Forum

also quotes a study that estimates that pro-competition policy developments in New Zealand and the United Kingdom have added around 2.5 percentage points to their employment rate over the 1978–1998 period; countries with more modest reforms, such as Greece, Italy and Spain added only 0.5–1 per cent to the employment rate[13]. Another study finds that "*reforms promoting private governance (i.e. privatization) and competition tend to boost productivity. In manufacturing, gains to be expected from lower entry barriers are greater the farther a given country is from the technology leader*"[14].

In India, economic reforms comprising, *inter alia*, of liberalization, privatization and pro-competition policies, were introduced since the early 1990s. As these reforms took effect, economic growth surged, and consumer sovereignty has asserted itself. The market-based economy that has emerged is offering to the Indian consumer competitive prices, a wider range of goods and a better quality of products and services.

Two elements are required to maintain competition in the economy: a competition policy and a competition law. Competition policy refers generally to a set of government measures that enhance competition, give primacy to market forces, facilitate entry and exit, reduce administrative controls, and minimize regulations. Competition law refers to a statute to prohibit and penalize anti-competitive practices and regulate potentially anti-competitive mergers. Competition policy and law are mutually complementary, one trying to promote a market-based economy as opposed to a controlled or regulated economy, the other trying to remove impediments that may be placed by private players in the functioning of the market economy, and thereby maintain and preserve competition in the markets.

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on Competition, OECD February, 2005 at p. 3. available at http://www.oecd.org/dataoecd/8/61/237607.pdf.

[13] Nicoletti, Guiseppe and Stefano Scarpetta (2001): *Interaction between product and labour market regulations: do they affect employment? Evidence from OECD Countries* OECD Economics Working Papers, quoted in OECD (2005) *ibid*.

[14] Nicoletti, Guiseppe and Stefano Scarpetta (2003): *Regulations, Productivity and Growth: OECD Evidence*, World Bank Policy Research Working Paper No. 2944, January 2003 quoted in OECD (2005), *ibid*.

3. Anti-competitive practices

Unfortunately, competition in the market can be suppressed or negated through anti-competitive practices by enterprises; these are often referred to as market failures. If competition is to be maintained and its benefits are to be reaped by society, including the consumers, such anti-competitive practices must be restrained, and to do so is the primary purpose of competition law and its justification. Anti-competitive practices are generally considered in three categories: cartels and other anti-competitive agreements, abuse of dominant position (monopolization) by an enterprise, and anti-competitive mergers. These cause harm to consumers and society in varying degrees.

The harm could be even greater in developing countries, because there the markets are generally more fragile as concentration levels are higher, dominant position is more prevalent, entry barriers are higher (regulatory restrictions, capital scarcity, etc.) and competition authorities are relatively less resourced or skilled in disciplining anti-competitive practices. A World Trade Organization (WTO) report[15] observes:

> *"There are reasons to believe that developing economies tend to be more vulnerable to anti-competitive practices than developed countries. The reasons include: high 'natural' entry barriers due to inadequate business infrastructure, including distribution channels, and (sometimes) intrusive regulatory regimes; asymmetries of information in both product and credit markets; and a greater proportion of local (non-tradeable) markets. Thus it may be particularly important to protect, consumers in developing countries against cartels, monopoly abuses, and the creation of new monopolies through mergers. Bid rigging in public procurement markets (i.e. collusive tendering) is also pervasive in many developing economies, and merits vigorous enforcement initiatives".*

Cartels are the most pernicious form of anti-competitive activity. A World Bank Background Paper shows that in 1997 developing countries imported US$81.1 billion worth of goods from industries that

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[15] WTO, Trade Policy Review – Report by the Secretariat: INDIA[2007], WTO Document No. WT/TPR/S/182. p. 96.

had seen a price-fixing conspiracy during the 1990s[16]. Those imports represented 6.7 per cent of the imports and 1.2 per cent of the GDP in the developing countries and an even larger proportion of trade in the poorest developing countries for whom the 16 products in question represented 8.8 per cent of the imports[17]. The OECD's Global Forum on Competition, 2001, contains a list of 26 cartel and bid rigging cases reported by 12 developing countries[18]. However, there are only a few examples of global cartels being successfully penalized in developing countries; the reasons for this are well known, such as limited capacity of the domestic competition agencies to investigate and unearth evidence, difficulty in securing cooperation of the corresponding agencies in industrialized countries, and limitations in the law.

4. Consumer interest as a goal of competition law

Competition law, through the promotion and preservation of competition in markets, enhances consumer welfare. This is, therefore, one of the justifications for competition law and also gives to it wider acceptability in the public eye. Frequently, consumer interest may feature explicitly as one of the goals of competition law.

In the Indian competition law[19], protection of the 'interests of consumers' figures specifically both in the preamble to the Act as well as in the duties of the Commission. The preamble states as follows: "*An Act to provide, keeping in view the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in*

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[16] Levenstein, Margaret and Valerie Suslow (2001): *Private International Cartels and their Effect on Developing Countries*, Background Paper for World Bank's World Development Report 2001, available at http://www.worldbank.org/wdr/2001/bkgroundpapers/levenstein.pdf.

[17] *Ibid*.

[18] OECD (2001): *Global Forum on Competition: Summary of Cartel cases described by invitees*, available at http://www.oecd.org/dataoecd/41/30/2491386.pdf.

[19] *The Competition Act*, 2002, later amended by the *Competition (Amendment) Act*, 2007. May be found on the website of the Competition Commission of India: www.competitioncommission.gov.in

India, and for matters connected therewith or incidental thereto". Section 18 of the Act further states that: "*It shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets, in India.*".

Box 1

Competition advocacy

Competition advocacy is increasingly recognized as an integral and important component of competition law and policy. In many jurisdictions, the competition authority undertakes competition advocacy with a view to promoting more competition-friendly policies and regulations. In some countries, such a rule is mandated by the competition law itself.

India's *Competition Act*, 2002 provides a statutory base for the Commission to undertake competition advocacy with the government, regulations and other statutory bodies. Section 49 of the Act provides that the government, central or state, may refer a competition policy matter to the Commission for its opinion on its possible effect on competition. The Commission is required to give its opinion within 60 days, which will be considered by the government, but the opinion is not binding on the government. However, the Act also provides that "*the Commission shall take suitable measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues*". This provision, therefore, allows the Commission to undertake advocacy even where a reference is not received from the central or state government. Accordingly, the Commission has offered its opinion about the possible adverse effect on competition of a number of proposed government laws or policies. Some examples are given below:

(i) The Department of Posts proposed to introduce a law giving a monopoly to India Posts over delivery of mail below 300 g (later reduced to 150 g), providing for mandatory registration of private service providers, introducing a USO contribution by private service providers to India Posts, and setting up a mail regulation to regulate the private service providers. In the view of the Commission, certain aspects of the proposal could likely adversely affect competition in the markets and

create an uneven playing field between private and public service providers. The Commission also pointed out that this sector had no features justifying economic regulation.

(ii) The Commission interacted with the Department of Telecommunications and the telecom regulation to advocate 'number portability' with the view to reduce consumer switching costs and thereby enhance the level of competition in the telecom market. It also advocated a more competition-based policy for the allocation of spectrum.

(iii) The Commission, through a high-level working group constituted by the National Planning Commission, has recommended the pronouncement of an overarching competition policy by the government. Similar advocacy-based proposals have been made by the Commission in other cases. There is reason to believe that the Commission's recommendations have had a positive effect and the outcomes in a number of cases have coincided with the Commission's views.

There has been a feeling that trade associations in certain industries are being used as a platform for concerted action in respect of prices. Though the Commission's enforcement has not yet commenced, it has, as an advocacy measure, interacted with several associations to draw their attention to the new law and the serious consequences that could follow from a violation of the law once its enforcement begins. The Commission has emphasized the benefits from competition for consumers and the industry and the adverse effect on both from anti-competitive practices. Trade associations and chambers are being urged to adopt a compliance code at their level, for example by excluding certain types of subjects from discussion in association meetings such as prices, tenders and profit margins. These interventions by the Commission have substantially increased the awareness of the associations in respect of the competition law.

Prof. Timothy Muris, while he was Chairman of the US Federal Trade Commission (FTC), has stated: "*Policies that we traditionally identify separately as 'antitrust' and 'consumer protection' serve the*

common aim of improving consumer welfare and naturally complement each other"[20]. The FTC's statement of purpose declares[21]:

"The Federal Trade Commission's Bureau of Competition champions the rights of American consumers by promoting and protecting free and vigorous competition. The Bureau:

- *reviews mergers and acquisitions, and challenges those that would likely lead to higher prices, fewer choices, or less innovation;*
- *seeks out and challenges anti-competitive conduct in the market place, including monopolization and agreements between competitors;*
- *promotes competition in industries where consumer impact is high, such as health care, real estate, oil & gas, technology, and consumer goods;*
- *provides information, and holds conferences and workshops, for consumers, businesses, and policy makers on competition issues and market analysis.".*

Similarly, in the United Kingdom, the Office of Fair Trading (OFT) states as its responsibility: "*The OFT is responsible for making markets work well for consumers. We achieve this by promoting and protecting consumer interests throughout the UK, while ensuring that businesses are fair and competitive*"[22].

The European Commission in its XXXIInd Report on Competition Policy 2002 defines the goal of European competition law: "*One of the main purposes of European competition policy is to promote the interests of consumers, that is, to ensure that consumers benefit from the wealth generated by the European economy. This objective is horizontal in nature: the Commission thus takes the interest of consumers into account in all aspects of its competition policy, namely in countering anti-competitive*

[20] *The Interface of Competition and Consumer Protection*, prepared remarks of Timothy J. Muris, Chairman, Federal Trade Commission, at The Fordham Corporate Law Institute's Twenty-Ninth Annual Conference on International Antitrust Law and Policy, New York City, October 31, 2002.

[21] http://www.ftc.gov/bc/index.shtml

[22] http://www.gov.uk

agreements, in particular hard-core cartels and abuses of dominant positions, but also in the control of concentrations and state aid granted by Member States"[23].

It is interesting to see that this definition became more refined in the recently published Guidelines on the application of Article 81(3) EC. Point 13 of the Guidelines declares the goals of European competition law in very explicit terms: "*The objective of Article 81(1) is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the community for the benefit of consumers*"[24].

5. Trade-offs

Pursuit of efficiencies being a strong feature of competition law, the extent to which the consumer interest is served by competition law depends very much on the efficiency standard that is pursued in its application. In general, it is highly unlikely that the three kinds of efficiencies, i.e. productive, allocative and dynamic, can be achieved simultaneously and, therefore, there have to be trade-offs in assessing the efficiency gains, as pointed out by Cseres[25].

One trade-off is between static and dynamic efficiencies. In today's knowledge-based economy, technological growth and innovation play an increasing role by bringing new products and services continuously to consumers. Knowledge-based assets may constitute a huge proportion of an enterprise's assets, even when these are not reflected in its balance sheet. Accordingly, competition in product or process innovation may be more important than mere price competition. Thus, dynamic efficiency brought about by innovation can be in the long-term interest of the consumer even if in the short term the

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[23] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005*,* Kluwer Law International, The Hague, p. 324.

[24] *Ibid.*

[25] For a treatment of the efficiency trade-offs, see *ibid.* pp. 311–313.

consumers may not gain anything. Competition authorities, therefore, have to be increasingly aware of the welfare-maximizing gains from dynamic efficiency *vis-à-vis* static efficiency.

Similarly, there is a trade-off between allocative and productive efficiencies. This may happen when a more efficient and, therefore, a lower cost firm tries to enhance its market power by increasing its market share. This may lead, on the one hand, to higher productive efficiency as the average cost of production in the industry would decline; on the other hand, it could lead to lower allocative efficiency due to higher prices in the market. Such a trade-off may be particularly compelling in the case of a merger. The merger, through economies of scale or scope or otherwise, may reduce production costs leading to productive efficiency. On the other hand, the merger may increase the enterprise's market power and thereby enable the enterprise to increase prices. If the competition authority gives greater weight to productive efficiency it may lead to the transfer of income from consumers to producers and the opposite would be true if the competition authority gave greater weight to allocative efficiency.

Similarly, as Cseres further explains, the extent to which consumer interest is served depends upon the welfare standard pursued by a competition authority. Some authorities adopt the consumer welfare model, according to which the ultimate goal of competition law should be to prevent increases in consumer prices due to the exercise of market power by dominant firms. The consumer welfare standard is tilted in favour of consumers and considers wealth transfers from consumers to producers as being harmful. Consequently, it assigns less weight to efficiencies unless these directly benefit the consumers through, for example, lower prices or better products. This approach also runs the risk of focusing on short-term consumer welfare and relatively ignoring the long-term benefits to consumers from higher efficiencies.

The other welfare model is based on the concept of total welfare. This looks at the gains to society as a whole, irrespective of whether the gains are to producers or to consumers and whether there is a transfer of wealth from consumers to producers. Efficiencies therefore are desirable, even if the gains from them are not directly passed on to consumers. This approach values the long-term consumer welfare by accepting that higher levels of efficiency today, even if they

directly increase producer welfare, would benefit consumers in the long run, possibly with a lag in time. This approach further acknowledges that a higher level of producer surplus may be necessary for investment in innovation, which in turn would lead to dynamic efficiency and would benefit consumers in the long run.

6. Consumer interest in the application of competition law

According to the theory of competition, consumer welfare is enhanced in competitive markets. Consumer interest also figures frequently as one of the important goals of competition law. However, in the practical implementation of competition law, consumer interest is generally a 'concealed aspect' of competition law, being indirectly served by its application, but not always figuring explicitly or up-front in the analysis of competition law cases. Explicit reference to the consumer is relatively rare and participation of consumers in decision making in competition law is rarer still[26]. Nevertheless, consumer interest remains integral to the theory of competition law, and its presence does surface in different forms in the application of the law.

Box –2

Anti-cartel enforcement

In India, the cement industry, which had been under price and distribution control for many years, was de-controlled in early 1989. Some time thereafter there were allegations that the industry was manipulating prices and indulging in cartelization and that this was being done through the involvement of the trade association, the *Cement Manufacturers Association of India*. An enquiry was initiated by the Monopolistic and Restrictive Trade Practices Commission (MRTPC) under the *Monopoly and Restrictive Trade Practices Act*, 1969.

The MRTPC found direct as well as indirect evidence of concerted price fixing and noted the existence of a common platform in the form of the Cement Manufacturers Association of India; the

[26] Howells, Geraint and Stephen Weatherill, *Consumer Protection Law,* (second ed.), [2005], Ashgate, Hants, p. 568.

Association had a role in determining prices during the control regime and the same apparatus continued after the de-control. The Commission concluded that all the respondents, except three, were indulging in restrictive trade practices and acting in concert. The Commission issued a "cease-and-desist order" and directed the respondents not to indulge in any arrangement directly or indirectly through the instrumentality of the Association, or otherwise, in fixing prices.

The Commission's order was pronounced in December 2007 at a time when the cement prices had been ruling at high levels causing dissatisfaction amongst consumers and others; hence, the order was generally welcomed. However, there was also dissatisfaction over the fact that the order was passed almost 17 years after the proceedings were initiated thereby greatly diluting its remedial effect for consumers.

The MRTP Act suffered from the weakness that it did not give the MRTPC the power to impose penalties and thereby lacked effectiveness. On the other hand, the new *Competition Act*, 2002 contains more effective provisions, particularly against cartels. It provides for a high penalty up to 10 per cent of the turnover or three times the profit for each year of the cartel activity. It also has a leniency provision providing for lenient treatment to a party to a cartel that discloses the cartel activity, provides full, true and vital evidence and cooperates with the Commission in the proceedings against the cartel. The Competition Commission is also vested with sufficient powers of investigation and collection of evidence. It is expected that the *Competition Act* 2002, will thereby provide a more effective framework for action against cartels.

Perhaps the protection of the consumer is most pointedly present in provisions against abuse of dominance. For example, the Indian *Competition Act*, 2002, in Section 4 thereof, states that there shall be an abuse of dominant position if an enterprise or a group:

" (b) limits or restricts

(i) ……

(ii) technical or scientific development relating to goods or services to the prejudice of consumers;".

Further, in the definition of dominant position itself, consumer interest figures prominently; it is defined as a:

> *"position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to:-*
> *(i) ---*
> *(ii) affect its competitors or consumers or the relevant market in its favour.".*

In the factors for the determination of dominant position in Section 19(4) of the Act, amongst other factors, the following, which make specific reference to the consumer, have been included:

> *"(f) dependence of consumers on the enterprise;*
> *(h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical barriers, economies of scale, high cost of substitutable goods or service for consumers.".*

In Sections 19(6) and 19(7) of the Act, the relevant geographic market and the relevant product market are each to be determined on the basis of a number of factors. "Consumer preferences" specifically features amongst the factors for determining both the relevant geographic market and the relevant product market.

Similar references to the consumer are to be found in the definition of abuse of dominant position in Article 82 of the EC Treaty as well as in the definition of dominance itself. Article 82 which prohibits abuse of dominant position states that "*such abuse may, in particular, consist in: (b) limiting production, markets or technical development to the prejudice of consumers*". Howells notes that: "*Indirectly, Article 82 is a consumer policy instrument in its capacity to suppress inefficient practices such as high prices which are not adequately controlled by the market in the absence of effective competition*"[27]. He further notes that Article 82 contains one of the Treaty's rare explicit references to the consumer and the prohibition contained therein has been judicially described as motivated by "*the concern not to cause harm to consumers*"[28].

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[27] Howells, Geraint and Stephen Weatherill, *Consumer Protection Law,* (second ed.), [2005], Ashgate Hants, pp. 549, 550.
[28] *Ibid*. p. 550.

For the determination of dominant position, the test laid down by the European Court of Justice in *United Brands v Commission*[29] has served as the standard ever since and it makes a specific reference to consumers:

> *"65 The dominant position thus referred to by Article [82] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers".*

Determination of the relevant market is one of the essential steps in the investigation of a case. In determining the relevant market an important analytical tool often used by competition authorities is the SSNIP test. Howells[30] notes that this test is based on inspection of consumer behaviour. If a non-transitory increase in price, say by 5 to 10 per cent, does not lead to the switching of a substantial number of consumers to a second product, then the second product is not part of the same market as the first product. For example, in *1998 Football World Cup*[31] the Commission applied this test and found that consumers of tickets for the Finals of the Football World Cup did not treat that product as interchangeable with tickets for other football or sports events or other forms of entertainment. The World Cup tickets therefore constitute a separate market, and the organizers enjoyed a dominant position, even a monopoly, in this market. The determination of the relevant market is primarily an exercise on the demand side to determine whether for the consumer a particular product is substitutable by another product or not, in economics referred to as elasticity of demand.

A dominant firm carries a "special responsibility" not to abuse its market power to set unfair prices or act to segregate the market. Howells notes that a most strikingly interventionist feature of Article 82 is that "*it may be applied in order to require a reluctant dominant firm to*

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[29] Case 27/76 *United Brands v Commission* [1978] ECR 207, [1978] I CMLR.429.

[30] Howells, Geraint and Stephen Weatherill, *Consumer Protection Law,* (second ed.), [2005], Ashgate Hants, p. 550.

[31] Decision 2000/12/EC [2000] 0J.L5/55, referred to in *Ibid.* p. 550.

respond to consumer demand'. For example in *RTE, BBC, ITP* three television companies printed separate guides to future programmes, using copyrights which they held over their own listings to prevent the appearance of a single, integrated publication[32]. A consumer was thus forced to buy three separate guides. The firms were obliged by the courts to make their listings available to third parties, subject to payment of a reasonable fee. The protection of the consumer interest is explicit in this decision, which imposes consumer choice on unwilling firms. The courts observed that the companies had abused the economic power they enjoyed under their copyright by unjustifiably preventing the appearance of a new product for which there was potential consumer demand. The same principle has been reiterated by the European Court of Justice in the *Magill* case[33] and recently reconfirmed in the *IMS Health* case[34] by stating that a new product must not be denied to consumers because of the refusal to license by the dominant enterprise.

Many competition laws include consumers among the entities that can file complaints against an anti-competitive practice or a merger. The UK law in fact has the concept of 'super complaints' that can be brought by recognized consumer associations. Good examples of consumer complaints resulting in major decisions are the *Kawasaki*[35] case and the *BEUC v Commission* case[36]. In *Kawasaki*, a complaint by a frustrated consumer led to a finding that an arrangement that prevented export of motorcycles to Belgium from Britain, where the prices were relatively low, violated Article 81[37]. In *BEUC*, the Court of First Instance annulled the Commission's decision rejecting the complaint of BEUC, a consumer representative organization, as being inadequately reasoned, thus demonstrating that the consumer complaint

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[32] Cases T-69, T-70, T-76/89 [1991] ECR II-485,535,575 referred to in Howells, Geraint and Stephen Weatherill, *Consumer Protection Law* (2nd ed.) [2005], Ashgate Hants, p. 551.

[33] See European Court of Justice Joined cases C-241/91 P and C-242/91 P *Radio Telefís Éireann (RTE) and Independent Television Publications Ltd (ITP) v. Commission (Magill)* [1995] ECR 743.

[34] See European Court of Justice Case C-418/01, *IMS Health GmbH & Co. OHG v. NDG Health GmbH & Co. KG,* [2004] ECR I-5039.

[35] Decision 79/68 OJ 1979 L16/9, [1979] 1 CMLR 448.

[36] Case T-37/92 [1994] ECR II-285.

[37] Howells, Geraint and Stephen Weatherill, *Consumer Protection Law,* (second ed.), [2005] Ashgate Hants. p. 535.

should have been taken seriously[38]. A consumer group may also be permitted to intervene in proceedings before the court. In *Fordwerke AG and Ford of Europe Inc v Commission*[39], BEUC had complained to the Commission about Ford's practices which involved suppression of imports into the UK, and the court upheld the right of BEUC to intervene in support of the Commission's case.

Competition laws in most jurisdictions permit claims for compensation or damages and there are cases where large amounts have been allowed by the courts or authorities as compensation to consumers. In the Indian law (Section 53N), a claim for compensation by the injured party may be filed before the Competition Appellate Tribunal, based on the finding by the Commission or by the Appellate Tribunal itself in an appeal case, and the Appellate Tribunal may pass an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered as a result of any contravention of the Act having been committed by the enterprise.

In the United States, private action for enforcement of the antitrust law is common and in fact constitutes the vast majority of the cases in the courts. Many of these cases of private action constitute consumer-driven complaints. Over 90 per cent of all competition cases in the United States remain private treble damage actions that can be brought under either state or federal law or combined into a single case in federal court[40]. (The US has the principle of treble damages whereby compensation can be claimed up to three times the cost of the injury caused.)

7. Growth of consumer protection law

In sum, it would be seen above that competition law has the indirect effect of protecting consumer interest, even where there is no explicit reference to consumer protection. However, a direct and explicit reference to the consumer interest occurs in specific provisions of the

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[38] *Ibid*.

[39] Case 229 and 288/82R [1982] ECR 3091.

[40] Waller, Spencer Weber, *In Search of Economic Justice: Considering Competition and Consumer Protection Law*, (Vol. 36), [2005], Loyola University Chicago Journal, Chicago, p. 636.

competition law, and is also reflected in several orders passed by the courts or the competition authorities. But competition law is neither designed to, nor can it, protect all aspects of consumer interest. The main thrust of the competition law is to protect and maintain the process of competition in markets so as to make markets work better and thereby result in the benefits of higher efficiencies, innovation and increase in consumer welfare. Competition law has a broader role and is part of the institutional framework for the management of the economy. It is therefore part of the economic reforms process in many economies that are liberalizing and migrating to market-based economies. Competition law may be designed to serve various objectives apart from protecting and maintaining the process of competition. These could be gains in economic efficiencies (productive efficiency, allocative efficiency and dynamic efficiency), preventing a high level of concentration of economic power and its consequent abuse for economic or even for political purposes, maintaining the freedom of trade or occupation and protection of small and medium enterprises. In the EU, an important aim is to protect the common market. In the midst of these various objectives, consumer interest features as one of the elements, albeit an important one, and therefore it would be unrealistic to expect that competition law can protect consumer interest in its entirety.

There are certain aspects of consumer interest where competition law cannot reach at all. These are, for example, aspects relating to safety (for instance in electrical gadgets and toys), health (for instance, in the case of drugs and food items), environment (for instance, air pollution and pollution of drinking water sources), and privacy (which can be breached, for instance, through leakage of credit or other data). For the protection of consumer interest in these areas specialized laws have been enacted in various countries.

In India, for example, consumer protection laws comprise a wide spectrum with specific dimensions and parameters, ranging from the country's constitution to the general or specific consumer-centric laws[41]. In the constitution, there are many provisions that have a direct bearing on the consumer interest particularly in the provisions contained in the 'Directive Principles of State Policy'. The state is required, *inter*

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[41]Verma S.K., M. Afzal Wani, *A Treatise on Consumer Protection Laws,* 2004, Indian Law Institute, New Delhi, 2004, pp. 18–21.

alia, to direct its policy towards securing that the ownership and the control of the material resources of the community are so distributed as best to subserve the common good, and the operation of the economic system should not result in the concentration of wealth and means of production to the common detriment. The state is also obligated to secure for all workers, work, a living usage, and conditions of work ensuring a decent standard of life in the same way as the ILO is promoting the interests of workers as consumers. Regarding public health, the State is required to take steps to raise the level of nutrition and the standard of living to improve public health and to prohibit the consumption of intoxicating drugs or drugs that are injurious to health. As part of the fundamental rights, the constitution guarantees freedom of profession, trade or business, thereby ensuring that a citizen cannot be restrained from carrying on a business except by a law imposing a reasonable restriction in the interest of the general public. For example, restrictions can be placed on a harmful trade or a dangerous trade.

Specific enactments in India dealing with consumer protection include, for example: the *Prevention of Food Adulteration Act*, 1954; *Essential Commodities Act*, 1955; *Prevention of Blackmarketing Act*, 1980; the *Standards of Weights and Measures Act*, 1976; the *Standards of Weights and Measures (Enforcement) Act*, 1985; the *Bureau of Indian Standards Act*, 1986; the *Sugar (Regulation of Production) Act*, 1961; the *Infant Milk Substitutes, Feeding Bottles and Infant Food (Regulation, Supply and Distribution) Act*, 1992; *Drugs and Cosmetics Act*, 1940; the *Drugs and Magic Remedies (Objectionable Advertisement) Act*, 1954; the *Indian Medicine Central Council Act*, 1970; *Indian Telegraph Act*, 1858; the *Jute Packaging Material (Compulsory Use in Packing Commodities) Act*, 1987; *Sale of Goods Act*, 1930; the *Competition Act*, 2002; the *Electricity Act*, 2003, and the *Consumer Protection Act*, 1986[42].

Worldwide, as societies progressed and markets grew, so too did the growth of unfair trade practices by producers or suppliers. On the other hand, the economic position of consumers was weak in comparison with that of producers and suppliers. The consumers had to seek redressal under the common law including the law of torts. But the process of redressal was long and tedious, as well as expensive, and the unequal resources available to the consumer *vis-à-vis* the producers

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[42] *Ibid.*

or suppliers ensured that the balance of advantage continued to lie with the latter.

According to Cseres[43], "*market failures were manifold. Freedom of contract resulted in a weak or inexistent bargaining position for consumers, freedom of competition made price fixing, restrictions of competition and misleading trade practices possible and equality of rights and duties meant that there was no place for special consumer rights or any form of positive discrimination. The asymmetrical and unilateral structure of communication, namely the knowledge and information advantage held by the producer disadvantaged or even damaged consumers. Further, the lack of safety, barriers to access to justice and representation called for some kind of interference to help consumers. The measures which tried to correct and remedy these market failures form an important part of the active consumer protection rules.*".

This weakness in the position of the consumer and the need to protect consumer interest has, in most countries, given rise to not only the specific laws for protection of health, safety, and environment and other similar specific regulations but also to the evolution of generic consumer protection law. Cseres[44], further states "*The aim of the interventionist measures was to re-establish consumers' market power through granting them an equal bargaining power and through safeguarding their sovereignty. The welfare state took over certain duties of economic development in order to create greater economic security and guarantee certain social rights for every citizen. The welfare state modified the classical principles of freedom of contract, freedom of competition and fault liability as these allegedly treated consumers unfairly. It was contended that the state could adjust the effects of externalities, provide the market with information and contest monopolies. The state was seen as being able to distribute welfare in a just way and to guarantee allocative efficiency. State intervention was justified by its task to correct and remedy market failures. Consumer law was actually brought into being because of the presence of market failures. The state was believed to be able to prevent loss or damage*

[43] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 153.

[44] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, pp. 154–155.

caused by market failures and to provide remedies. This was realized through granting consumers certain basic rights".

In consumer law, the focus is on the consumer and on protecting consumer interest. Consumer law consists, first of all, of mandatory rules that guarantee that parties will not depart from the legislative rules to the detriment of the consumer. It further comprises an obligation to disclose information as information plays a significant role in consumers' lives. Only well-informed market parties can exercise their buying power and activate competition. Consumer law measures address the safety and quality controls of consumer goods and services, and consumer' ability and willingness to exercise choice. Generic consumer law is aimed at the improvement of existing substantive law, such as liability, standard form contracts, competition or advertising[45].

The manner in which the generic consumer protection law protects consumer interest depends very much on the perception of the consumer's position as an economic actor. There are broadly two approaches to consumer protection: the paternalistic approach and the liberal approach. Cseres explains[46] that the paternalistic approach regards the market as being non-transparent through product differentiation and multiplicity of package and distribution methods and that the competitive market is unable to transport the necessary information to the consumers. Furthermore, consumers are believed to decide in an irrational way and are uninformed because of non-transparency on the market. This approach relies heavily on state intervention in order to realize its policy goals: disclosure and provision of information in understandable ways, regulation of the substance of transactions, statutorily mandated contract terms or standard form consumer transactions in order to strengthen the market to adjust the environment of consumers.

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[45] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 320.
[46] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 321.

An OECD paper[47] points out that recent advances in "behavioural economics" have argued that even when markets are reasonably competitive and search and information costs are not especially high, the consumer is not always able to make a rational choice suggesting that increased competition to the extent to which it leads to a proliferation of choices available to consumers, could yield only small, or in some instances even negative, welfare gains[48]. "Behavioural economics" argues for an even more "paternalist" approach in respect of consumer protection policy. The OECD paper, however, argues against this approach and in favour of primary reliance on competitive markets as the means of empowering consumers, further stating that a more interventionist approach to consumer policy could involve substantial costs including the costs of regulatory errors that are inevitable under a paternalistic approach. Thus, competition and market forces may be important ways of addressing concerns about the efficacy with which consumers make complex choices, because firms in competitive markets have incentives to offer consumers "solutions" that allow potential gains from trade to be more fully realized.

The other approach to consumer protection law is the liberal approach. This approach is less interventionist and has greater faith in the disciplining effects of competitive markets and the ability of the consumers to take rational decisions. Furthermore, it believes that competition law itself is able to rectify market failures and it strengthens the position of the consumer. Competition law, coupled with providing greater information to consumers and consumer education and counselling, could ensure that those goods and services most wanted by consumers would be provided to them at affordable prices. The liberal model sees less need for direct intervention by the state on behalf of the consumers, and therefore finds a patronizing approach unnecessary.

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[47] Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF(2008) 4.

8. The interface between competition law and consumer protection

8.1. Synergies

As a general proposition, competition law and consumer law are complementary and even mutually reinforcing, though their perspectives may differ and they may apply different tools to correct market failures. Competition law functions primarily at the interface between firms – in a sense on a horizontal plane – preventing structural or behavioural patterns that would damage competition, and it tries to restore effective competition in the market. On the other hand, consumer law generally functions at the interface between the enterprises and consumers – in a sense on a vertical plane – trying to address the unequal relationship between the two and ensure that conditions prevail in this relationship that will enable consumer choice to be effectively exercised. Cseres[49] observes that

> *"Although the two legal disciplines focus on different market failures and offer different solutions and apply different techniques to correct market failures they are both aimed at keeping the market competitive and try to bring market performance close to the model of perfect competition…… These are actually two different approaches to achieve the same goal: a competitive market where consumer sovereignty is safeguarded and welfare is maximized. Competition law and consumer protection are thus mutually reinforcing disciplines.".*

Competition in the market brings for firms the risk of losing customers to rival firms. There is therefore pressure on them to provide the best 'value for money' to the consumer in the products or services offered by the firms. A satisfied consumer will bring repeat business and will reduce the marketing costs. Thus, effective competition, when present in the markets, will compel firms to address consumer problems and find market solutions to the same. The OECD paper[50] cites several

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[49] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 326.

[50] Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF [2008] 4.

examples to support this argument. It refers to the case of "confusopoly" – apparently deliberate attempts by firms to offer consumers choices that are confusing, for example by offering prices that are difficult to compare. But other firms may compete by cutting through the maze and offering price packages that are simple and easy to understand. The telecommunications and airlines industries are examples where "confusopoly" abound. In the telecommunications industry, firms have been announcing pricing plans that are both difficult to understand and to compare with each other. In the airlines industry, firms offer low fares, but these may be bounded by restrictions on days of use or minimum stay restrictions. But recent trends demonstrate the incentive for competing firms to announce simpler, easier to understand price packages.

According to the OECD paper[51] "*This reduces the burden that would otherwise fall on consumer policy in terms of enforcing product and service standards, as firms will have incentives of their own to meet and exceed customer expectations. In that sense, ensuring that a market is effectively competitive can help one of the central concerns of consumer policy*". It further states that firms that operate in effectively competitive markets, and hence can hope to attract the customer away from rivals, will have incentives to reduce those customers' switching costs, both by informing them of the gains from shifting and by helping them to bear the one-off costs that shifting involves. The result of firms investing in reducing the switching costs incurred by each other's customers can be both to make competition more vigorous and to diminish the need for consumer policy interventions aimed at reducing switching costs.

Just as competition law can benefit consumers and can reduce the need for direct consumer policy interventions, consumer policy can also strengthen competition in markets. Policies that ensure that advertising and product descriptions are honest and informative, that contract terms and the obligations they involve are understandable and not disproportionate, and that consumers can reasonably expect products to be safe and fit-for-purpose, will both make consumer choice

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[51] Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF [2008] 4.

a more effective discipline (thus directly strengthening competition) and will force firms to compete on their merits (rather than on the basis of fraudulent or misleading claims or of unfair contract terms)[52]. Equally, product standards, by facilitating comparisons between products, increasing the ease with which products from one supplier can be replaced by products from another, and concentrating competition on performance rather than on features that are inessential to it, can directly improve both consumer choice and the competitive process.

In short, each of these two policy instruments can be used to advance the goals also pursued by the other; competition policy, by keeping markets effectively competitive, can reduce the work that needs to be done by consumer policy, and consumer policy, by enhancing the ability of consumers to exercise choice, can help make markets more effectively competitive and force firms to compete on their merits, thereby supporting the ends of competition policy. Averett and Lande have observed very insightfully that competition law provides consumers with a choice of competing products and services and consumer protection law allows consumers to exercise that choice free from fraud, coercion, deception, or demonstrably false information[53].

Since consumer policy protects and strengthens the position of the consumer, the consumer has greater confidence in the markets and is encouraged to participate therein. Being better informed, the consumer will be able to make rational choices amongst the available products and services. In this way, consumer protection will facilitate greater competition between firms. Cseres makes the interesting

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[52] European Commission (2004), *Identifying and tackling dysfunctional markets*, Note submitted to OECD for discussion at the joint meeting of the Competition Committee and the Committee on Consumer Policy, 13 October 2004, at pp. 2–3. referred to in Background Note Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF [2008] 4. p. 5.

[53] Neil W. Averett & Robert H. Lande *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 ANTITRUST L.J.713 [1997], referred to in Waller, Spencer Weber, *In Search of Economic Justice: Considering Competition and Consumer Protection Law,* (Vol. 36), [2005], Loyola University Chicago Journal, Chicago, p. 632.

observation[54] that "*Many consumer problems are actually micro-competition problems. A poorly informed consumer who is not aware of alternative choices and who might be subject to the seller's discrimination is in fact subject to monopoly power. Or a consumer entering a contract with unfair contract terms is subject to the exploitation of market power*"[55]. Deceit by one group of sellers may lead consumers to doubt the integrity of an entire industry or to distrust markets generally. Therefore, competition is not simply fundamental to consumer policy but, as the chairman of the OFT remarked, "*much consumer policy is competition policy*"[56]. Thus competition and consumer policy seem to be truly complementary.

8.2. Tensions

While competition law and consumer protection are complementary in many ways, their interface also creates various challenges due to the tensions that arise between the two disciplines. The above analysis demonstrated that in the implementation of competition law certain trade-offs are involved and this may determine the extent to which competition law serves consumer interest. If the competition agency gives greater weight to total welfare as against consumer welfare or if it gives greater weight to productive efficiency as against allocative efficiency, to that extent it would provide less satisfaction to consumer interest. Similarly, if it gives greater weight to dynamic efficiency as against static efficiency, to that extent it would provide less satisfaction to short-term consumer interest.

According to Cseres[57] "*The economic arguments of competition may lead to outcomes which are not always acceptable to consumers, like high switching costs. More competition might result in the restriction of outlets and, therefore, more difficult access for consumers. Lower*

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[54] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, pp. 326–327.

[55] Vickers, J. *Economics for Consumer Policy,* British Academy Keynes Lecture, 29 October 2003, pp. 7, 16.

[56] *Ibid*. p. 17.

[57] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 327.

prices might be realized at the expense of quality or creating information problems". Cseres cites the examples of telecommunications and energy markets where deregulation and liberalization have increased competition and lowered prices for consumers, but have also led to additional costs, for example, the difficulty in coping with the complex calculations involved in making product choices. In electricity, while it has provided better prices and choices for large users, it has raised difficulties for consumers to exercise their choices.

The opening of previously highly regulated markets to competition may well raise new issues for consumer protection[58], for example following the liberalization and introduction of greater competition in financial markets, utility markets and professional services. In financial markets, this has exposed consumers to new risks and difficulties in making complex choices; in utility markets (such as electricity and telecommunications) it has created challenges in respect of service, quality, management of customer complaints and of disconnection for non-payment, as well as consumer choice in the face of complex pricing schemes. In professional services, it has raised complex issues of balancing competitive pressures (for example, in terms of pricing and marketing, including advertising) with consumer protection in situations characterized by potentially large information asymmetries and substantial error costs. When a market becomes more exposed to competition than it was previously, the incentives of market participants may change in ways that raise consumer protection concerns. For instance, it may attract "fly-by-night" operators whose unscrupulous practices undermine consumer confidence in the market as a whole or incumbent firms may seek ways of locking customers in and taking advantage of them[59].

In the case of the professions, such as legal, medical, accounting, engineering and health, regulatory restraints are placed on these occupations with a view to protect consumers in the face of information asymmetries. These services are complex and it is generally difficult for an ordinary consumer to assess their quality, more

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[58] See Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF(2008) 4. p. 14

[59] See *Ibid*.

particularly to assess the quality before the service has been delivered. For the consumer, the result of making a wrong selection can be serious damage in certain cases, for example in selecting a wrong surgeon for a brain surgery or selecting a wrong architect or engineer for a complex bridge. Thus, regulatory rules are imposed to assure consumers of adequate quality of service, such as by prescribing minimum qualifications for surgeons who can perform brain surgery or for architects and engineers who can provide architectural or engineering designs for complex bridges. These regulatory rules substitute the need for information gathering and assessing by consumers themselves. However, such regulations also reduce competition within the professional services. This may be even more true in the case of restrictions such as those placed on advertising, restrictions on the number of professionals who shall be allowed to qualify each year, restrictions on professionals having foreign degrees who will be allowed to practise and so on. In some cases, these restrictions may actually extend into areas such as price fixing and collective boycott, which are patently anti-competitive.

9. Coordination between competition law and consumer protection

Considering that the aims of competition law and consumer protection law are mutually complementary and reinforcing, but that they have different approaches to similar problems and there are clearly areas of tension between them, the question arises as to how best to maximize the synergies and minimize the tensions.

An economics-based approach could smooth the interface between the two disciplines. Competition law is an economic law, with economics providing the theoretical underpinning for the law as well as the analytical tools used in the application of the law. Over the last several decades, the economics of competition law has expanded immensely with enormous research and study enriching the field. On the other hand, the role of economics in the field of consumer law has been much less obvious. Nevertheless, economic insight would facilitate a better analysis of the problems arising from market failures and would also provide a better understanding as to which problems can be addressed by the market itself and which cannot be so addressed and

therefore, require the specific tools provided by consumer protection law. This would provide for a more cost-effective approach towards the solution of problems and would avoid unnecessary or excessive intervention in the market through the medium of the consumer law. The OECD paper[60] recommends a tightly coordinated combination of the two disciplines: consumer policy tools while seeking approaches that effectively protect consumers should not unduly or unnecessarily restrict competition, and competition policy should be brought to bear to ensure that, subject to appropriate consumer protection safeguards being in place, competition should be allowed to work where it can, including by the elimination of any unjustified restriction on entry and on competitive conduct.

Another issue that arises is about the implications of the interface between the two disciplines on the institutional design for their implementation. Specifically, a practical question that arises is whether the two disciplines are better located in the same institution or in separate institutions. There is no uniform pattern in this regard.

While in most countries, separate agencies handle competition law and the generic consumer protection law, in a few countries the same institution is responsible for both laws. For example, in the United States, the responsibility for enforcement of competition law lies with two agencies, the United States Department of Justice (DOJ) and the United States FTC. While the DOJ enforces only competition law, the FTC enforces both competition law and the consumer protection laws through Section 5 of the *Federal Trade Commission Act*, which prohibits both unfair methods of competition and unfair or deceptive acts and practices. Though the FTC was set up in 1914 under the *Federal Trade Commission Act*, the responsibility for consumer protection was added subsequently in 1938. The FTC has a Bureau of Competition and a separate Bureau of Consumer Protection. Its regional field offices originally handled both competition and consumer protection cases but over time most regional offices have come to specialize entirely in consumer protection matters with competition cases being only a small

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[60] Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF(2008) 4. p. 14

part of their agenda. Waller has observed that, though the FTC has a dual responsibility, it is organized in a way that tends to emphasize the separateness of the two fields rather than their common elements[61].

In the UK, the OFT and in Australia the Australian Competition and Consumer Commission (ACCC) have responsibility for enforcement of both the laws. In India, the MRTPC has responsibility against both anti-competitive practices ("restrictive trade practices") and anti-consumer practices ("unfair trade practices") both of which are prohibited under the *Monopolistic and Restrictive Trade Practices Act*, 1969. In fact, although the MRTP Act was enacted in 1969, the provisions against unfair trade practices were added only several years later in 1984. Since then the unfair trade practices have tended to account for the larger number of cases before the Commission, to that extent distracting it from restrictive trade practices. However, given the seriousness of the issues of consumer protection, India enacted a dedicated consumer protection law, the *Consumer Protection Act*, 1986. Under this Act a separate mechanism altogether was set up for redressal of consumer disputes. This mechanism consists of District Forums in each district of the country, State Commissions in each state of the country and a National Commission at the apex level. The jurisdiction for hearing consumer disputes has been divided between the three levels of redressal agencies according to the value of the goods or services and compensation claimed, if any, the bigger cases going to the higher-level agencies. The State-level Commissions also hear appeals against the orders of the District Forums and the National Commission hears the appeals against the orders of the State Commissions. Appeals against the orders of the National Commission are heard by the Supreme Court. This extensive machinery, having a network spread all over the country was found to be necessary in view of the large size and population of the country and to provide easy access to the redressal forums for individual consumers and consumer organizations. The Supreme Court of India has observed that "*…the regulation is a milestone in the history of socio-economic regulation and is directed towards achieving public benefit…*"[62]. In case of competition-

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[61] Waller, Spencer Weber, *In Search of Economic Justice: Considering Competition and Consumer Protection Law*, (Vol. 36), [2005], Loyola University Chicago Journal, Chicago, p. 634.

[62] Case *Lucknow Development Authority v M.K. Gupta*, (1994) 1 Supreme Court Cases 243.

related cases it is neither necessary nor possible to replicate a mechanism of this size and reach.

Box –3

Consumer Protection Act, 1986 in India

The Supreme Court of India in its judgement under the *Consumer Protection Act*, 1986 described the Act as a milestone. The *Consumer Protection Act*, 1986 is a dedicated consumer protection law with a comprehensive mechanism for receiving and deciding consumer complaints. This Act does not address competition-related issues. In a far-reaching judgement *Lucknow Development Authority v. M.K. Gupta*, the Supreme Court observed that even government bodies or development authorities that develop/allot land and/or construct houses for the common man in discharge of their statutory functions render a 'service' and, hence, are subject to the provisions of the *Consumer Protection Act*. Therefore, any defect or deficiency in such services would be an unfair trade practice and would amount to denial of service. The court observed that a complaint regarding use of sub-standard material or delay in the delivery of a house could not be rejected as being not maintainable under the Act. The court went on to observe that the Commission under the *Consumer Protection Act* had the power to award compensation not only for the loss or damage suffered but also for injustice, harassment and distress suffered by the consumer. Where the suffering is due to proven *mala fide*, an oppressive or capricious act of a public servant, the Commission is obliged to direct the Department concerned to pay the amount of compensation from the public fund immediately and later recover the same from the public servant responsible for such act. In such cases, the state or its instrumentality is duty-bound to later recover the amount of compensation so paid from the public servant concerned.

The new *Competition Act*, 2002 in India provides that the MRTP Act, 1969 would be repealed and the MRTPC would be dissolved. It would continue for two years to dispose of pending cases but no new cases under that Act would be entertained as once the enforcement provisions of the *Competition Act*, 2002 were brought into force, new competition-related cases would be entertained only by the Competition Commission of India, and new consumer complaints would be heard

only by the redressal agencies set up under the *Consumer Protection Act*, 1986, thus effectively separating the two institutional bodies.

In the EU, the DG Competition is responsible for the application of the competition law and has been a very vigorous and proactive competition agency. There has been a perception that consumer protection issues have not figured sufficiently in actual practice in the enforcement of the EC competition law. Some observers have felt that it seemed as if consumer protection is still the little sister and competition law the big brother in the overall EC policy making and while both legal areas have their own DGs within the Commission, there seems be little cooperation and discussion between the two[63]. To handle better the integration of the two disciplines, in December 2003 the Commission announced the appointment to a new post called the Consumer Liaison Officer designed to raise the profile of the consumer interest in the administration of the competition law. The Consumer Liaison Officer has the task of liaising between the DG Competition and consumer organizations at the national and EC levels as well as between the DG Competition and other DGs in the Commission[64].

There are both pros and cons of integrating the two disciplines into one authority. The obvious advantage of the integration is that the knowledge of both domains can be jointly brought to bear in dealing with a particular case. A broader range of tools would be available to the authority and it could select the application of that particular tool that is the least costly and most effective. Thus, if in a particular case the economics-based approach indicates that the issue can be resolved by the markets themselves, no intervention may be necessary. If the issue can be addressed through the remedies provided by the competition law then a remedy can be found under that discipline. But if the issue is such that it could be remedied only through the application of the consumer law then the agency could do so.

As a general rule, competition policy, other than by prohibiting anti-competitive conduct, has relatively little scope to make markets

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[63] Cseres, Katalin Judit, *Competition Law and Consumer Protection,* 2005, Kluwer Law International, The Hague, p. 343.

[64] Howells, Geraint and Stephen Weatherill, *Consumer Protection Law,* (second ed.), [2005], Ashgate, Hants, p. 534.

more structurally competitive than they would otherwise be; moreover, policies that seek to "de-concentrate" oligopolistic markets, either through forced divestments or by subsidizing or otherwise assisting entry, are often contentious and seem likely to impose costs that are considerably greater than the benefits. In that sense, competition authorities may have few means to alter the supply side of markets so as to make rivalry a more effective discipline. However, in those cases, action on the demand side of the market may provide an effective alternative: for example, if better consumer information, or reduced switching costs, make the demand each firm faces more elastic, that will usually create incentives for each firm to price more aggressively for any given market structure[65]. Thus, by making available a broader range of remedies to the integrated authority responsible for both laws, this institutional arrangement will enable a more cost-effective choice of remedy.

According to the OECD paper[66], there may also be benefits of integration in terms of public support and public accountability. By linking the authority's competition policy activities to its consumer protection agenda and extending the linkages between its competition policy decisions and the promotion of consumer interest, the authority can enhance public acceptance of competition policy. This may be especially important in countries where competition law is a recent development and its importance, role and substance have not yet been fully understood. In respect of accountability, it notes that competition policy is economy-wide in its reach and the individual actions and decisions of the competition authority are of broad interest to the business, legal and academic communities, as they are seen as precedents that may extend beyond the firms and industries directly at issue. Hence, the decisions of the competition authority are subject to greater outside scrutiny. On the other hand, consumer law is seen as more industry specific and involves decisions that individually have low stakes in absolute, economy-wide terms. This results in lower public interest and less monitoring of consumer law authorities. The absence of close monitoring could lead to regulatory failure, with the agency

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[65] See Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF(2008) 4. p. 17.

[66] *Ibid.*

being captured either by the ideology of consumer protection without a proper appreciation of the costs regulation can impose or by the regulated firms or entities, which have an interest in using consumer protection to create barriers to the entry and expansion of new players. These risks are likely to be less if the consumer protection authority were integrated with the competition law authority which is subject to greater scrutiny.

Equally, there are also negative aspects to the integration of the two disciplines into one authority. The two disciplines rely on different sets of instruments in the pursuit of their work and the contexts in which the instruments are applied also differ. Competition law is steeped in economics whereas consumer law could be more ideology driven. The casework of competition law would generally consist of a smaller number of cases, but with each case being large in absolute terms. On the other hand consumer law casework would generally consist of a large number of smaller cases. Geographical reach may be of critical importance for consumer protection agencies with a view to providing early access to complainants but in the case of competition law a multiplicity of benches or offices of the competition authority could give rise to the problem of inconsistencies in the orders placed or approaches adopted in similar cases; considering the economy-wide reach of competition law cases, such inconsistencies could lead to considerable uncertainties in the eyes of enterprises. In this respect, therefore, there is a mismatch between the nature of the work involved in the two disciplines and this may not be conducive to their integration into a single agency. On balance, there appears to be little overall advantage in integrating the two agencies, particularly in countries large in terms of size or population.

The OECD paper[67] notes that while there are both upsides and downsides in integrating the two agencies, in practical terms what is most important is that the competition authority should have in-house access to the skills involved in the formulation of consumer policy and that it should have the ability to watch and intervene in the consumer

[67] Background Note for Global Forum on Competition 2008, *Round Table on the Interface between Competition and Consumer Policies,* OECD document No. DAF/COMP/GF [2008] 4. p. 22.

policy developments that have material competition implications, and within the government there should be an entity that has a comprehensive oversight of consumer protection.

10. Conclusions

Competition in the markets brings various benefits by enhancing efficiencies, incentivizing innovation and increasing consumer welfare. The consumer also benefits through wider choice, better products and services and more competitive prices. Competition law through promotion and preservation of competition in markets thereby enhances consumer welfare. This is, therefore, one of the aims and justifications for competition law. Accordingly, consumer interest may feature explicitly as one of the goals of competition law, examples of which may be seen in the laws of various jurisdictions. However, the extent to which competition law can serve consumer interest depends upon the efficiency and the welfare standards pursued in its application, and there are certain trade-offs that cannot be avoided.

In the application of the competition law, consumer interest is generally a concealed aspect and it may not figure explicitly in the analysis of individual competition law cases. But its presence does surface in different forms in the application of the law.

However, competition law is neither designed to, nor can it, protect all aspects of consumer interest. Competition law has a broader remit and it is part of the institutional framework for the management of the economy. Consumer interest features as just one of the elements in competition law, albeit an important one. Therefore, it would be unrealistic to expect that competition law can protect consumer interest in its entirety. Certain aspects of consumer interest cannot be reached at all by competition law such as safety, health, environment and privacy; there are, therefore, specialized laws in various countries for the protection of these aspects of consumer interest. In addition, to protect consumers against unfair trade practices by producers or suppliers, generic consumer protection laws have come into existence in various countries.

Generic competition law may be based on one of two approaches: (i) the paternalistic approach that considers the consumer as a relatively helpless entity requiring an interventionist approach from the state for protecting his interest; or (ii) the liberal approach which is less interventionist and has greater faith in the ability of well-informed consumers to protect their own interest. The competition law and the generic consumer protection law, each serves consumer interest but in different ways and through different instruments. Generally, the two laws are complementary and even mutually reinforcing. Competition law creates a pro-consumer environment and provides consumers with a choice of competing products and services, while consumer protection law enables the consumers to exercise that choice effectively free from inhibiting factors such as fraud, coercion, deception or false information.

Competition, when present in the markets, will compel firms to address consumer problems and find market solutions to the same. Thus, if competition policy is allowed to fully operate, firms would be under pressure to find market-based solutions to consumer problems and to that extent intervention through the instrument of consumer policy would be less necessary. On the other hand, consumer policy, by protecting and strengthening the position of the consumers and better informing them, enables them to make rational choices and thus strengthen competition in markets.

On the other hand, there are tensions in the interface between the two laws. Competition can sometimes lead to outcomes that are not always acceptable to consumers such as high switching costs, trade-offs between price and quality and difficulties in coping with complex calculations in making choices. These tensions are more particularly visible in recently liberalized areas such as the utilities and the professions.

By adopting an economics-based approach, the interface between the two disciplines can be better smoothed out. Economic insight would provide a better understanding as to which consumer problems can be addressed by the markets themselves and which problems require specific tools provided by the consumer protection law.

In respect of the institutional machineries for the implementation of the two laws, there are both advantages and disadvantages in integrating them into a single institution. Both kinds of systems seem to exist in

different countries; however, more countries appear to have separate institutional machineries. Whatever be the institutional design, a more tightly coordinated approach in the application of the two laws would be beneficial. Competition law authorities should remain alert to developments in consumer protection policies that impact competition, and as part of their competition advocacy role should suggest changes that will have minimal adverse impact on competition. On the other hand, consumer protection authorities need to have a better appreciation of how competition itself can resolve many consumer problems, thereby reducing the burden on competition policy to make direct interventions on behalf of the consumer, which can sometimes be quite costly.

COMPETITION POLICY AND CONSUMER POLICY: COMPLEMENTARITIES AND CONFLICTS IN THE PROMOTION OF CONSUMER WELFARE

Pradeep S. Mehta[68], Siddhartha Mitra[69] and Cornelius Dube[70]

1. Introduction

The adverse impact of anti-competitive practices on consumer welfare is widely acknowledged. Thus, more and more countries are adopting competition laws and policies aimed at controlling such adverse impact. Consumer policies and laws are also being adopted in many developing countries, with consumer movements becoming increasingly more visible, advocating for the protection of consumers against anti-competitive practices and other sources of harm. The ultimate objective behind having both a competition policy and a consumer policy is maximization of consumer welfare in the face of anti-competitive practices in both developed and developing countries. However, competition policy also has the additional objective of providing a level playing field for all producers.

Given that both competition policy and consumer protection policies share a common ultimate objective of promotion of consumer welfare, are the two policies perfectly complementary? The question is a complex one as competition policy simultaneously addresses the needs of both producers and consumers. It results in marginal cost pricing which implies that producers are not wiped out through predatory pricing and consumers are not hurt through collusive price setting. Consumer policies on the other hand may also not be quite as effective in assisting the competitive process, particularly if the emphasis is to get the lowest possible prices for the consumer. Given the imperfect complementarities between the two types of policies, the interface between competition

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and consumer protection policies is explored from a developing country perspective. It analyses areas of potential conflict and complementarities between the two, discusses methods for measurement of costs to the consumers from anti-competitive practices and the impact of competition policies on such costs.

Section 2 presents a brief discussion on the basics of competition law and policy, while an overview of consumer policy is provided in Section 3. The interface between the two policies is discussed in Section 4. Section 5 discusses the conflicts between the attainment of competitive markets and consumer interests. Costs of anti-competitive practices, possible methods that can be used to quantify the damage to consumers and the estimation of benefits conferred by competition laws are discussed in Section 6. Section 7 looks at the efforts by consumers in developing countries to further their interests. Concluding remarks and observations are reserved for Section 8.

2. Overview of competition policy and law

Competition policy can be briefly defined as those government measures that directly affect the behaviour of enterprises and the structure of industry. Competition policy basically covers two elements. The first involves putting in place a set of policies that promotes competition in local and national markets, such as a relaxed industrial policy, a liberalized trade policy, easy exit and entry conditions, reduced controls, curbing unnecessary government interventions and greater reliance on market forces. The second, known as competition law, is the more critical component and comprises legislations, judicial decisions and regulations specifically aimed at preventing anti-competitive business practices, and the concentration and abuse of market power. It generally focuses on three measures: control of mergers and acquisitions, control of restrictive business practices and control of unfair trade practices. All of these measures result in benefits to the consumer.

The ultimate objective of competition policy has generally been identified as the promotion of efficiency and maximization of welfare, defined as the sum of consumer and producer surpluses.

2.1. Merger control

Firms may use mergers and acquisition as a means of engaging in anti-competitive practices, especially if the merger results in firms acquiring market power. Competition law is aimed at establishing whether a merger or acquisition results in a substantial reduction in competition in the market. Mergers that have such an outcome are normally prohibited, or approved subject to conditions that ensure minimization of damage if there are some benefits to the public generated by such mergers.

2.2. Restrictive business practices

Restrictive Business Practices (RBPs) are of two types: anti-competitive agreements and abuses of dominance. Anti-competitive agreements can be further classified into horizontal agreements and vertical agreements; similarly abuse of dominance practices can be classified into exploitative abuses and exclusionary abuses. Conduct under RBPs is sometimes subjected to a cost-benefit analysis before being prohibited; in other cases proof of occurrence is enough for ensuring illegality.

Horizontal agreements or cartels have traditionally been considered the most damaging of all anti-competitive practices and therefore are most susceptible to punitive action. Cartels are arrangements among firms that produce and sell the same product for the purpose of exacting and sharing monopolistic rents. Most commonly, they accomplish this by agreeing on a relatively high benchmark price for their product that none of the member firms are permitted to underbid (i.e. price-fixing cartels), by dividing the market by geographic territory or customer segments and granting each other monopoly power in separate localities/segments (i.e. market-allocating or customer-sharing cartels), agreeing to restrict output (output-restriction cartels) or by conniving on tendering bids (bid rigging), etc.

Vertical agreements, which also come under competitive scrutiny, are usually contractual arrangements between suppliers (manufacturers) and distributors (retailers), which extend beyond simple arms-length pricing. They are usually motivated by the desire for vertical control within a principal–agent relationship, where the principal (the

manufacturer) imposes contractual obligations on its agent (the retailer) when delegating responsibility for selling its goods[71]. This includes resale price maintenance (where a manufacturer and its distributors agree that the latter will sell products of the former at certain prices at or above/below a price floor/ceiling) and exclusive dealing (where a retailer or wholesaler is 'tied' to purchasing from a supplier).

The term 'abuse of dominance' refers to anti-competitive business practices that a dominant firm may engage in to maintain or increase its market power. "Exploitative conduct" under abuse of dominance covers certain practices in which the dominant firm uses its market power to exploit other market participants without directly affecting the structure of the market, i.e. through price discrimination, and by paying low prices to suppliers. "Exclusionary conduct" is aimed directly at preserving or exacerbating anti-competitive aspects of the structure of the market, i.e. the firm creates or maintains monopoly power by refusing to deal with a competitor, through predatory pricing, or by engineering an increase in the costs faced by rivals. Both exploitative and exclusionary conducts are regarded as anti-competitive practices and are regulated by competition law.

2.3. Unfair trade practices (UTPs)

UTPs are practices that directly disadvantage the consumer such as misleading claims and advertising, conditional selling, excessive pricing, discriminatory pricing and other misrepresentations. These are *per se* illegal under most competition laws, and only proof of occurrence is required to justify punitive action. However, many countries with consumer laws do not have competition laws dealing with UTPs. The competition law of many countries, such as the USA, Australia, Canada, Zambia, Tanzania and Korea covers UTPs. In India, these have existed under both the consumer law and the competition law. However, under a new competition law which came into effect in 2007, UTP provisions have been deleted, and are dealt with forthwith under the consumer law.

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[71] For further reading, see Verouden (2005).

3. Basic tenets of consumer policies

Consumer policy refers to actions taken by the government to provide and ensure the attainment of consumer rights. This may be in the form of a comprehensive consumer law, or various sector-specific rules and regulations that govern the conduct and standards of firms so that consumers are protected. It takes into account consumer concerns, ranging from product quality and safety issues, weights and measures, availability of choices in the market to fair prices of products. Consumer protection policy aims to provide for protection to consumers from defective, dangerous or inferior goods, fraudulent and other unfair selling practices and to ensure quality and safety, fair pricing and advertising, availability of credit, etc.

Consumer policies for all countries are generally constructed in terms of the 1985 United Nations Guidelines for Consumer Protection (as expanded in 1999)[72]. The Guidelines call upon governments to develop, strengthen and maintain a strong consumer policy and provide for enhanced protection of consumers around eight themes, namely:

(i) physical safety;
(ii) promotion and protection of consumers' economic interests;
(iii) standards for the safety and quality of consumer goods and services;
(iv) distribution facilities for essential goods and services;
(v) measures enabling consumers to obtain redress;
(vi) education and information programmes;
(vii) promotion of sustainable consumption; and
(viii) specific areas concerning health.

Salient features under the themes include the following issues that form the basis upon which consumer interest can be maximized:

(i) Appropriate policies should ensure that goods produced by manufacturers are safe for intended use, with distributors ensuring their proper handling and storage. Consumers should also be informed about the proper use of goods and the risks involved in their use, with the government adopting

[72] See United Nations Guidelines for Consumer Protection (as expanded in 1999) at http://www.un.org/esa/sustdev/publications/consumption_en.pdf.

policies through which manufacturers recall defective and hazardous products for replacement or modification, as well as provide for adequate compensation to the consumer.

(ii) Government policies should seek to enable consumers to obtain optimum benefit from their economic resources by resulting in adherence to satisfactory production and performance standards and the use of adequate distribution methods, fair business practices, informative marketing and effective protection against practices that adversely affect consumer welfare and freedom of choice in the market place.

(iii) Governments should encourage and ensure the availability of facilities to test and certify the safety, quality and performance of essential consumer goods and services.

(iv) Governments should consider adopting specific policies to ensure the distribution of essential goods and services where this distribution is endangered, as could be the case in rural areas. Such policies could include assistance for the creation of adequate storage and retail facilities in rural centres, incentives for consumer self-help and better control of the conditions under which essential goods and services are provided in rural areas;

(v) Governments should undertake legal and/or administrative measures to enable consumers to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible. Enterprises should be encouraged to resolve consumer disputes in a fair, expeditious and informal manner and to make information on redress and other dispute-resolving procedures available to consumers.

(vi) Governments should develop or encourage the development of general consumer education and information programmes, including information on the environmental impact of consumer choices and behaviour and the possible benefits and costs of changes in consumption. In this exercise the government should take into account the cultural traditions of the people concerned. The aim of such programmes should be to enable consumers to be capable of making an informed choice of goods and services, and become conscious of their rights and responsibilities.

(vii) Governments, in partnership with business and relevant organizations of civil society, should develop and implement

strategies that promote sustainable consumption through a mix of policies that could include regulations, economic and social instruments, sectoral policies with regard to land use, transport, energy and housing, information programmes to raise awareness of the impact of consumption patterns, removal of subsidies that promote unsustainable patterns of consumption and production, and promotion of sector-specific environmental management best practices.

The Guidelines have implicitly recognized eight consumer rights that were made explicit in the Consumers International's Consumer Charter for Global Business:

(i) right to basic needs;
(ii) right to safety;
(iii) right to choice;
(iv) right to redress;
(v) right to information;
(vi) right to consumer education;
(vii) right to representation; and
(viii) right to a healthy environment.

These eight rights by and large cover the framework of what a consumer needs for optimal protection and satisfaction, but in relation to a market where the consumer has buying power and is an economic participant. In countries, poor ones particularly, where the consumer does not have purchasing power, opportunities to be able to acquire goods must be made available. This has been covered somewhat in the right to basic needs, but the manner in which this right is defined under the above charter is more in terms of access, rather than ability. Quite often access too can be thwarted by anti-competitive practices or policy distortions. Therefore the Consumer Unity and Trust Society (CUTS) has added the Right to Opportunities as the ninth right.

On another one, CUTS has also added the Right to Boycott as the tenth right as an explicit declaration of something that is recognized implicitly under the right to choice, but is not proactive in putting meat on sinews of what a consumer needs. The consumer does practice the right to boycott in situations when legal redress is not forthcoming or the opposing party does not accede easily (see Section 6.1 below). In many reported cases of anti-competitive practices, boycott by customers has

often been used successfully, when redress was either not forthcoming or was protracted.

4. Interface between competition and consumer laws

The interface between competition and consumer policies can best be understood by looking at how competition policy, in addition to ensuring a level playing field for all participants, can also help achieve consumer objectives and how consumer policies can assist in achieving competitive markets.

4.1. How does competition law protect the consumer?

As discussed in Section 2, competition law basically covers control of mergers and acquisitions, control of restrictive business practices and control of unfair trade practices, all of which can lead to an adverse impact on the consumer through higher prices or suboptimal quality. However, it is only the control of UTPs (misleading advertising, conditional selling, excessive pricing, discriminatory pricing, etc) that has a direct impact on consumer welfare whereas the impact of restrictions on other practices is more indirect. Thus, often actions by competition authorities on UTPs get better publicity and public buy-in.

Although following an indirect route, merger control and taking action on restrictive practices also aim at serving the interest of the consumer by ensuring competitive markets. Merger control is undertaken to ensure that firms do not attempt to use mergers to enhance concentration in the industry and gain market power, which could result in them being able to get away with practices that oppose the interest of the consumer, such as excessive pricing, restricting availability of products in the market and poor quality.

By controlling restrictive business practices, competition law ensures that firms in dominant positions do not engage in practices aimed at consolidating their market positions by eliminating competition through conduct that is incidentally also contrary to the interest of the public, such as the maintenance of reasonable prices and consumer freedom. Thus competition law is generally designed to promote the welfare of the consumer, albeit indirectly through the generation of competition in markets.

Competition law can also help consumers to attain most of their basic rights. With the aim of ensuring fair competition, competition law ensures lower prices than those obtained under unregulated conduct. This implies that competition can make basic needs more accessible to the poor[73]. Moreover, it also ensures the right to choice. In pure and simple terms, the right to choose means there should be a range of varieties available to consumers, which is precisely what competition law aims at through the removal of behavioural and structural barriers to entry.

4.2. Can a consumer policy ensure competitive markets?

Just as an effective competition policy can be used as a tool to ensure the existence of competitive markets, an effective consumer policy can also assist in both the creation and maintenance of the competitive process. An effective consumer policy for any country is not only one that has a comprehensive consumer law enacted in terms of the UN Guidelines and Consumer International's Consumer Charter for Global Business, but one that also has sector-specific consumer laws and standards structured to suit the social, economic and political milieu in that particular country. Such an effective consumer policy will assist in the competition process in several ways, and these include the following.

First, by ensuring that measures are put in place that facilitate consumer safety in the use, distribution and handling of goods, ensure replacement and compensation to the consumer in the case of defective products and facilitate provision of information to the consumer about product availability, consumer policies in many cases not only facilitate the attainment of competitive prices but also competitive quality.

Second, by advocating for an extensive consumer awareness programme with regard to their rights as well as best buying practices, consumer policies ensure that all consumers make informed purchases. With consumers making such informed decisions, firms would have to ensure that their products have the necessary attributes to attract consumers. One way of doing this is through price competition, where each firm tries to work on the lowest possible profit margins to gain an

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[73] See Mehta (2005).

advantage over rivals. This is a major characteristic of a competitive market, which consumer policy can help to attain.

Third, an effective consumer policy that aims for the achievement of the right to access essential goods and services (adequate food, clothing, shelter, health care, education, public utilities, water and sanitation) and the right to choose (to be able to select from a range of products and services, offered at competitive prices with an assurance of satisfactory quality) should also provide means through which consumers can seek these rights. This implies that the policy should *inter alia* try to ensure a contestable market, where there are more producers of a given class of products so that product variety is enhanced. This also leads to an increase in market supply and stimulates competitive prices.

Fourth, by instituting a process that tries to prevent anti-consumer practices by manufacturers, distributors and others and empowers consumer organizations to self-monitor adverse practices (such as false or misleading claims in marketing as well as other abusive business practices) consumer policy gives rise to the generation of information that facilitates the implementation of competition policy.

Thus, we can conclude that consumer policy is in many ways complementary to competition policy: in trying to protect consumers equally from producers' malpractices it ensures a level playing field for all producers. Similarly, competition policy in trying to ensure a level playing field for producers has to ensure that no producer attains an advantage through anti-consumer practices.

4.3 What are the sources of conflict between the two policies?

However, even though the two policies may be complementary, there may also be areas where these may be in conflict. Although cases of conflicts between competition authorities and institutions that oversee the implementation of consumer protection may be few, it is not too difficult to understand in theory the sources of potential conflict between the two policies. As has already been pointed out, competition policy aims at ensuring that both producer and consumer surpluses are maximized, while consumer protection policy generally focuses on

consumers. Competition policy is concerned with the supply-side structure of markets and the behaviour of firms, while consumer policy focuses on a well-informed understanding of what's happening on the demand side (Sylvan, 2006). Producer surplus in isolation can be maximized through the minimization of consumer surplus, while the reverse is equally true for the maximization of consumer surplus. Thus, competition laws have to be flexible to allow for a balance between the two objectives, which can work at variance with the expectations of consumers.

The other source of conflict stems from the fact that competition also caters for a market that is not normally a focus under consumer laws – the market for intermediate goods. In addition to considering the market for final goods, competition law also deals with intermediate markets that have little direct relationship to the final consumer. In such markets, the customer is often a firm or retailer who has to further add value to the product before it is made available to the consumer. Testing competition law objectives against consumer welfare as a deciding factor for the benefit of the law may not be appropriate in this case.

The third area of conflict is when competition interest is weighed against public interest, i.e. when competition law adjudication needs to take into consideration social objectives such as the environment, employment, small industries, etc., when arriving at a conclusive position. For example, small and medium enterprises get preferential treatment under various competition laws, which is mainly to give them an advantage over larger enterprises and pure application of the competition law may not be undertaken. Employment gains and losses may also override efficiency considerations (consumer/economic interest) in adjudicating a case on a merger, as under the South African competition law. Affirmative action, i.e. preferential treatment to historically disadvantaged persons, under the South African competition law may also override efficiency considerations.

Broadly speaking, while competition policy is more of a proactive policy for ensuring efficient production and resulting consumer benefits, consumer protection policy puts forward mainly a reactive agenda to protect the interests of consumers[74]. Interventions by

[74] Sahebdin (2006).

consumer protection authorities often result in anti-competitive outcomes as compliance may result in significant operation costs affecting the viability of firms. This is particularly true for interventions on prices; although based on the noble realization that allowing market forces to determine prices in most developing countries often results in monopolistic prices due to the high incidence of market failure. Most price control structures unfortunately have a huge bias against producers in favour of consumers. Prices are often controlled to levels that are below the competitive level, thereby reducing incentives for expansions and entrance into the industries. This may be at variance with the objectives of competition policy.

5. Conflicts between competitive markets and consumer interest objectives

The discussion in this section deals mainly with the impact of naturally competitive markets (those in which there is no intervention by the government or any quasi-governmental agency in the free play of market forces) on consumer interest. In this context, it is important to distinguish between naturally competitive markets and those for which we need a competition regime. Competition policy and law provide for artificial interventions if impediments to free and fair competition among firms prevail in markets. Naturally competitive markets are characterized by minimal or non-interference by government or regulatory authorities as the interaction of the forces of supply and demand is expected to result in an efficient allocation of resources. However, competition law and policy can simulate a naturally competitive market (referred to as just “competitive market” from here on in this section) provided government interference does nothing other than remove the barriers to the free play of market forces.

There can be cases where competitive markets do not promote consumer interest. Some such prominent cases are those of externalities, common property resources and public goods.

An externality occurs when one party's actions impose uncompensated benefits or costs on another party. Environmental problems are a classic case of externality. For example, even though a manufacturer may operate in a competitive market, the smoke from a factory may adversely affect the health of local residents while soiling the property in nearby neighbourhoods. If bargaining was costless and

all property rights were well defined, people would eliminate externalities through bargaining without the need for government regulation. From this perspective, externalities arise from high transactions costs and/or poorly defined property rights that prevent people from reaching efficient outcomes through market transactions[75]. Thus, competitive markets may not necessarily result in promotion of consumer interests.

Second, competitive markets might not result in due care of common property resources. Resources that may become congested or overused, such as fisheries or the broadcast spectrum, represent common property resources that may not be serviced under competitive markets despite being critical for the welfare of consumers Thus, intervention in the competitive market system for the achievement of consumer interest objectives is required.

Third, consider a public good, such as defence, basic scientific research or roads, the provision of which to an individual cannot occur without providing the same level of benefits free of charge to other individuals. For example the use of pavements in cities cannot be limited to pedestrians who pay municipal taxes. In competitive markets, the amount a private consumer is willing to pay for an extra unit of the good is only a fraction of the total benefits derived by society, the latter being equal to the sum of individual benefits. If the production of an extra unit of the good costs more than an individual's private willingness to pay for it but less than what society benefits from it, no individual will be willing to pay a price in the market that covers the cost. Thus, the extra unit will not be produced. Therefore, in competitive markets these goods are not produced in quantities that are required for the maximization of consumer welfare. This implies that there is a limit to the extent to which competitive markets may promote the interest of consumers. Consequently, consumer interest movements may resist the allocation of resources through competitive markets and call for government provision of such goods funded by subsidies and other means.

Fourth, inadequate or asymmetric information might hinder the working of competitive markets to the detriment of consumers. This refers to a state in which producers know much more about the

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[75] See *Organisation for Competitive Markets* newsletter, March 2005 at http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf.

characteristics of the product than consumers. Examples are restaurant food or used cars. Because information is costly to produce and disseminate it is difficult to safeguard consumer interests under such conditions in competitive markets, particularly in the case of developing countries. Given that it is time consuming or costly for consumers to evaluate complex information about products or services (e.g. medical therapies) they expect the government to intervene and regulate to ensure that minimum quality standards are met. As a result, competitive markets are not highly regarded as far as consumer interest issues are concerned.

Thus, we have seen that in some cases naturally competitive markets or competition policy/law, which stimulates such markets, do not result in outcomes consistent with maximization of consumer welfare.

6. Costs of anti-competitive practices to consumers

6.1. Estimated costs of anti-competitive practices to consumers

It is a generally accepted that anti-competitive practices are costly to consumers, largely in terms of the increase in prices faced by them. The most prevalent of the practices is conduct relating to collusion among competitors (often referred to as 'hard-core' cartels) which results in price fixing, output restrictions, market sharing and bid rigging. Cartels harm consumers and have pernicious effects on economic efficiency. A successful cartel raises prices above the competitive level and reduces output. Consumers (which may also include businesses and governments) choose either not to pay the higher price for the cartelized product, thus foregoing the product, or pay the cartel price and thereby unknowingly transfer income to the cartel operators. Further, a cartel shelters its members from full exposure to market forces, reducing pressures on them to control costs and to innovate. All of these effects harm efficiency in a market economy.

Although it is not easy to impute monetary value to the costs, there is a general prevalence of anti-competitive practices, particularly in developing countries. Most of these practices may continue to prevail undetected due to various constraints faced by competition authorities.

By drawing on some empirical studies however, various estimates can be made regarding the costs of cartels to consumers. Recent research has indicated that the harm caused by cartels, particularly international cartels amounts to billions of dollars annually[76]. For example, the median cartel overcharge was 17-19 per cent for domestic cartels, and 30-33 per cent for international cartels. For most types of cartels there have been modest downtrends in cartel mark-ups over time. In particular, it should be emphasized that since 1990 the average overcharges of discovered cartels has fallen to 25 per cent for international cartels. However, anti-competitive practices discovered in different countries around the world have reaffirmed the significant damage caused by them to consumers.

Through a study combining trade data with a sample of US and European prosecutions of international cartels in the 1990s, Levenstein *et al.* (2003) quantified the effects of international cartels on developing countries. They found that in 1997, developing countries imported US$54.7 billion of goods from a subsample of 19 industries with previous cartel experience during the 1990s. These imports were 5.2 per cent of the total imports and 1.2 per cent of the gross domestic product (GDP) in developing countries, which in turn implies that the damage to consumers through importing cartelized products could be significant.

An early study by Eckbo (1976) also proved the profitability of cartels at the expense of consumers. Using international data of 51 cartel agreements in 18 industries, Eckbo found that about the 30 per cent of the agreements analysed (19 of the 51 cartel agreements) were able to raise the price 200 per cent above the unit cost of production and distribution. Another international cartel impact study was done by Yu (2003). Using import data based on the Harmonized System (HS), Yu calculated overcharges in the vitamins cartel (1990–1999), the citric acid cartel (1991–1995), the bromine cartel (1995–1998), the seamless steel tubes cartel (1990–1995), the graphite electrodes cartel (1992–1997), and the lysine cartel (1992–1995). The results indicate that the overcharges to developing countries generated through collusion by these cartels are large: US$1.71 billion, US$67 million, US$8 million, US$1.19 billion, US$975 million and US$43 million, respectively. There are many other examples that can be found in the literature to give

[76] Sweeney (2006).

estimated costs of cartels for consumers, with the conclusion that consumers spread across the globe have lost billions of dollars as a result of cartel activities.

Without quantifying the costs, it is also possible to demonstrate the costs of cartels for consumers by focusing on their prevalence in the domestic economies of many developing countries in Africa, Asia and Latin America. The following examples are going to demonstrate not only the existence of cartels in developing countries, but also their prominence as a source of economic harm to consumers[77].

To begin with, concentration of market power in the trade of a number of agricultural products and price-fixing agreements often limit the income of small farmers in developing countries. Such concentration confronts coffee producers in Kenya and Latin America, cotton farmers, and tea and tobacco growers in Malawi, fish processors and exporters in the Lake Victoria region, and milk processors in Chile. Price fixing in the production or the distribution of basic food products is prevalent in many developing countries. For example, in Peru poultry firms and their associations engaged in what amounted to price fixing by agreeing to prevent new entry, exclude some existing competitors, and limit the availability of live poultry for sale in order to raise or maintain prices. It was also the case in Zambia where the dominant producer of day-old chicks (60 per cent market share), Hybrid Poultry Farm (HPF) and Galaunia Holdings Limited (GH), the largest buyer in the poultry sector, entered into sales and purchase agreements which included provisions foreclosing competition on day-old chicks, table birds (broilers) and frozen chickens as well as an agreement that GH could not begin to sell day-old chicks in competition with HPF.

The milling industry is also frequently cartelized, resulting in high prices for basic staples, which consumers can hardly afford to boycott. For example, in Peru, Indecopi's (Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual) first important cartel case was the 1996 "Bread Case" against wheat flour

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[77] Unless otherwise specified, the examples have been extracted from Jenny (2006). The report had also extracted the cases from databases dealing with African countries, Asian countries and Latin American countries, prepared by Fredric Jenny, Simon Evenett and Julian Clark.

producers and their association. Eleven producers were found to have ended a price war through a price-fixing agreement and the association had made recommendations about the price of bread. In Malawi, where the industry consists of a few giants (notably Press Bakeries and Portuguese Bakeries) and many small baking firms, the Master Bakers Association fixed prices, and hence there was no competition until consumer organizations started a boycott and the Minister of Trade intervened to prohibit price collusion among the bakeries. In Turkey, several price-fixing cases among bakers were investigated by the General Directorate of Consumer and Competition Protection before 1997 and since then by the Competition Authority.

The transport sector is also known for cartelized behaviour. Examples include Kenya, where in November 2003 two members of the Matatu Owners Association (MOA) gave an insight into the operations of the cartel. According to them, "*the cartel comprises a group of city matatu owners who want monopoly over lucrative routes*". Along the same lines, a report from South Africa in 2001 indicates that in the Cape Town area taxi associations are organized into territories and taxi associations have come to "own" the routes they serve. Huge profits are being made with passengers left with no choice. In Turkey, the competition authorities prosecuted offenders involved in cartel cases against bus companies. In India, in only about 2-3 per cent of cases do customers directly access truck owners and book their goods for transit. The cargo operators cartelize and decide the freight, and there is no competition at their level. Instances of cartelized operations of the truckers' unions around major production sites and factories are also rampant[78]. In Nepal, bus syndicates operate as cartels and ironically the Government created a provision in the Transportation Act for syndicates[79]. In the air transport sector, the Brazilian competition watchdog, CADE (Conselho Administrativo de Defesa Economica), ruled that carriers Varig, TAM, Vasp and the now-defunct Transbrasil had formed an illegal cartel in the mid-1990s covering the Sao Paulo–Rio de Janeiro market, the country's busiest sector.

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[78] Jain, Sunil (2005) in chapter on "Competition Issues in Transportation Sectors" in *Towards a functional competition policy for India*, CUTS and Academic Foundation, Mehta, P.S. (Ed.).

[79] Adhikari, Ratnakar and Dhrubesh Regmi (2001) in "Anticompetitive Practices in Nepal", CUTS and SAWTEE referred to in the Chapter on Nepal by Navin Dahal (2006) in *Competition Regimes in the World – A Civil Society Report*, CUTS and INCSOC, Mehta, Pradeep S. (Ed.).

The oil sector is also not spared from cartelization. In Zambia, in 1999, nine oil-marketing companies were prosecuted for participating in a price-fixing conspiracy involving the supply of refined petroleum products. The companies had acted collectively in making price adjustments since 1997, after holding regular meetings where exchanges of information regarding sales volumes and prices took place. The cartel leaders also forced other companies to comply with standard behaviour on prices. In Malawi, when the government eliminated price controls on petroleum products, all or most of the oil companies concerned formed a joint company called Petroleum Importers Limited, through which they jointly monopolized the importation of all oil products into Malawi, and colluded on prices. When a new petroleum importer emerged on the market and introduced new fuel prices different from (and lower than) those of the cartel it was persuaded to join the cartel.

Finally, the cement industry, which provides a major input into low-cost housing, has also witnessed an incidence of cartels in developing economies. In Egypt, in December 2002, Al Arham newspaper reported that representatives of almost all local cement producers had met and set a price range for cement between LE167 and LE176 per ton. Just hours before the meeting, the price had been as low as LE125 per ton. According to the press report, the cement manufacturers involved had considered the possibility of entering into a market-sharing agreement if the price-fixing agreement did not succeed in keeping the prices up. In South Africa, the largest cement companies at the time (PPC, Anglo-Alpha and Blue Circle) operated as an officially sanctioned cartel until 1996, when the Competition Board forced the companies to discontinue the practice. In Turkey, between 1997 and 2002, the Competition Board announced decisions against anti-competitive agreements among cement producers, including a 1999 case in which five cement companies were fined nearly 900 billion Turkish Lira (TRL) (US$603,000) for a price-fixing and market-division agreement in the Aegean region.

The above examples demonstrate that consumers indeed continue to be subjected to an extra cost in terms of cartel activities, particularly price-fixing agreements in critical sectors of the economy. The estimated costs for end consumers in such instances will amount to

a very significant portion of their budget, given the multiplier effect on the production and value chains

6.2. Methods of measuring costs of cartelization

Although the damage caused by cartels may be indisputable, the procedure for measurement of costs inflicted by them on consumers may be a source of debate. Moreover, the measures may tend to underestimate the damage, as there are undiscovered cases. Most of the methodologies used to determine the impact of cartels use cases that have been discovered, and the discovery rate is highly dependent on the competencies of regulatory authorities, as well as on the competition laws being used. The most common method used is the one that tries to provide an estimate of the value of the damage caused by a cartel by determining the overcharge that resulted from it.

Overcharge is an economic term that refers to the difference between an observed market price and a price that would have been observed in the absence of collusion. The latter is often called a "but-for price" or a competitive "benchmark price". Overcharge is therefore the difference between the price charged by cartel members and the prices that they could have charged "*if the cartel was not present*". Given that the price that should have been paid is not observable, it has to be estimated. Estimating total overcharge involves using this estimated price to calculate total damages caused by the cartel. This can be done by using the following approaches:

6.2.1. Direct proof of damages

In some cases, direct proof of damages may be available. This could, for example, include evidence of side-payments or scorecards in bid-rigging cases where cartel members make side-payments or keep records of obligations to each other. However, this type of evidence may potentially understate damages incurred by customers of the cartel. This is because cartel behaviour often increases costs that are avoidable (and competed away) in the absence of coordination.

Another method of calculating overcharge is to simply observe the price decreases that result in the market of a cartelized product

following a price-fixing cartel's demise on being discovered by the regulatory authorities. This reveals the price increases that can be attributed to the cartel by simply subtracting the new price after the demise from the price before detection of the cartel. Estimation of the total damage caused by international cartels in developing countries involves determination of the total value of exports of the cartel to developing countries. The total overcharge can be calculated by following the approach used by Yu (2003):

$$\text{Total Overcharge} = Imports * \frac{Cartelprice - Actualprice}{Cartelprice}$$

where Cartelprice is the actual price paid with the cartel being present, Actualprice is the estimated price that should have been obtained in the absence of a cartel, and Imports refer to the total value of imports from the cartelized industry.

The same formula can also be used to calculate the overcharge from the domestic cartels but one would need to substitute local sales or turnover by the cartel for imports in the formula. This would give us an estimate of damage to consumers.

Consider the following demonstration of Yu's procedure. Let us consider a country where a cartel has existed since 1990. While calculating the overcharge for 1994 it is necessary to adjust for the secular trend in competitive prices while defining the *Actualprice* in 1994. Let us assume that the price in 1990 before a cartel came into existence was $100 and the price in 1994, after a cartel arrived, is $140. The overcharge per unit should not be calculated as 140–100= $40. This would be an overestimate of overcharge per unit (for rising price) because, even in the absence of cartel formation, prices would have increased at their long-run rate. Thus, if we find that the long-run secular trend for the product price is an increase of four per cent *per annum* then for the four-year period from 1990 to 1994 we can conclude that prices would have risen by 17 per cent in the absence of the cartel to $117. Thus, the per unit overcharge is $23 instead of $40 as we had calculated earlier. Let us assume that the value of the imports of the developing country from the cartelized industry is $1,000,000. In this case we have

Total Overcharge= $1{,}000{,}000 * \frac{23}{140} =$ $ 164,000

Direct proof of damages can also be used in a different context in determining the damages from bid-rigging cartels. What is required here is to identify two similar contracts that are made from a cartelized bid and a non-cartelized bid, and then make a cost/price analysis of the two bids. The bids must be similar enough to allow for comparison. The difference in the bids would constitute the damage to the consumers. The method can also be extended to other types of cartel behaviour and anti-competitive practices.

6.2.2. Statistical evaluation of damages

Two approaches can also be used under this method. The first involves taking the price as an independent variable and regressing it using ordinary least squares and a dummy variable, which indicates the presence of a cartel. Thus, if we have time series data for a country we can run the econometric model

$$\ln P_t = \alpha + \beta t + \lambda D_t + u_t \quad (1)$$

where the variable "t" denotes the time period and D_t equals 1 for any year in which a cartel exists and 0 for others. The coefficient β gives the long-run secular rate of change of prices without the effect of cartels and e^{λ} denotes the "overcharge per unit". These two coefficients can be estimated by the ordinary least squares method. If we have a panel data set (multiple countries and multiple time periods) then we can use a fixed effects model which can be presented as follows:

$$\ln P_{it} = \alpha_i + \beta t + \lambda D_{it} + u_{it} \quad (2)$$

where the notation is the same as that before except that the subscript *i* is used to depict data pertaining to country *i*. By permitting a different intercept for each country we are allowing for the fact that the starting competitive price (i.e. price at t=0) is different for each country. Such panel regressions enable the use of data across countries. This results in an increase in the number of observations used. Such an increase in the data used greatly enhances the reliability of regression results.

In both cases the researcher needs to check for the statistical significance and positive sign of λ in order to establish that cartels do give a significant upward push to prices. It is only then that the magnitude of e^{λ} can be considered to be a measure of the "overcharge per unit". Of course, it must be kept in mind that the reliability of any statistical method is conditional on the use of a sufficient number of observations. In this case we require at least 20 observations on prices.

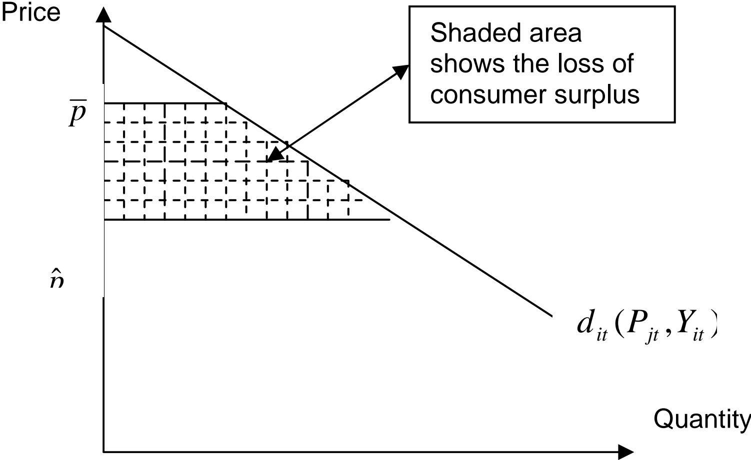
Instead of looking at the secular trends of prices the alternative would be to do a joint estimation of the demand and supply functions using data from time periods in which competition had existed. From the demand and supply functions reduced form equations providing price and quantity demanded in terms of independent variables (such as input prices, income) can be calculated. In any year in which there is a cartel the corresponding competitive price can be calculated by substituting that year's value for input price and income. The rest of the method is the same as that explained previously

The more direct method of calculating loss in consumer welfare due to cartelization comes from the measurement of consumer surplus which is defined as the maximum that consumers are willing to pay for the marketed quantity of a product less the amount they actually pay. Cartelization leads to an increase in the price and a reduction in quantity – there is not only an increase in the price but also a reduction in quantity transacted which is a positive determinant of consumer surplus. In Figure 1 $\hat{p}$ is the competitive price and $\bar{p}$ is the cartelized price. The triangle defined by the horizontal line from point $\hat{p}$, the vertical axis and the demand curve is the consumer surplus under competition whereas the triangle corresponding to $\bar{p}$ is the consumer surplus at the cartelized price. The difference between the two is the shaded area shown in Figure 1 and is equal to the loss in consumer surplus due to cartelization.

How do we estimate this loss in consumer surplus? This is easily done by using the estimates of the demand curve mentioned earlier and finding the area enclosed by the demand curve (as obtained

by substituting the present values of independent variables) between the competitive and cartelized price. This area gives a measure of the loss in consumer welfare due to anti-competitive practices.

Figure 1: Loss in consumer surplus due to the presence of a cartel



In Equations (1) and (2) we can introduce a dummy variable that equals 1 when there is a cartel constrained by a competition law but equals 0 otherwise (competition without law and cartel without law) The coefficient of the dummy can be used to calculate the reduction in overcharge per unit of output caused by the introduction of competition laws. The product of the quantity transacted[80] and the reduction in overcharge per unit gives the decrease in total gains from cartelization (at the expense of the consumer) attributable to the competition law. When divided by the expenses of the competition commission that implements the competition law we get the rate of return on expenses incurred to facilitate competition. This procedure was used by Clarke and Evenett (2002) for the international vitamin cartel and reveals a significant rate of return.

[80] We might be able to get market data on the quantity transacted.

Alternatively, the estimated reduction in the overcharge and the given cartel price in the presence of competition law can be used to predict the cartel price in the absence of competition law. The latter price is higher and the difference in the consumer surpluses corresponding to the former and latter price should be an estimable positive amount that shows the increase in consumer welfare brought about by the introduction of a competition law. This amount divided by the expenditure of the competition enforcement agency yields the consumer surplus saved per unit expenditure on competition facilitation and is an indication of how useful competition laws and related expenditures are in promoting consumer welfare.

A similar method of cost–benefit analysis (benefits in terms of consumer welfare increase weighed against the costs of competition law enforcement needed to achieve that increase) can be illustrated by the results of an exercise performed by the Korean Fair Trading Commission (KFTC) which are shown in Table 1. In 2000, each dollar spent on competition law enforcement yielded US$20.57 in terms of consumer welfare gains. In 2001, this number increased to 28.64, suggesting even better implementation of competition law. The researcher needs to be aware that such a rosy picture of the efficiency of competition law enforcement might not emerge if we study countries that are less developed. Powerful monopolistic business lobbies might influence a government to sabotage, slow down or render ineffective the implementation of competition laws. This might result in low benefit/cost ratios, which symbolize the subordination of economic considerations to the interests of monopolistic business and their political allies.

Table 1: Costs and benefits of competition law enforcement (millions of US dollars)

		2000	2001
Cost	Budget	15.9	18.4
Benefit	Consumer welfare increase	327	527
Benefit/Cost Ratio		20.57	28.64

Source: Adapted from Chapter 17 on Korea by Dr Joseph Seon Hur in *Competition Regimes in the World – A Civil Society Report*, CUTS and INCSOC.

7. Consumer participation in developing countries

The extent to which consumers also have an influence on the market outcomes plays a part in determining the extent to which companies may successfully engage in anti-competitive practices. However, in developing countries, consumers are an unorganized group. They usually transact on an individual basis with business people, and hence have very little bargaining power. They are also not fully aware of their legitimate rights and obligations, as well as the legal tools that can be used to promote their interests. The existence of various market failures and the common information asymmetries make consumers a vulnerable lot.

Given their very weak countervailing power in the market, consumers cannot always boycott products that are excessively priced as a result of cartels. They cannot lobby for an improvement in the quality of products or successfully complain about practices by the companies that are harmful to their interest. Most importantly, most consumers are not even aware that some of the practices by companies are anti-competitive, due to a lack of awareness initiatives. Consumer movements are very weak in most developing countries, and the consumers generally have to be their own representatives. The end result is that companies take advantage, and production and marketing decisions are generally one sided, with little regard given to consumer reactions.

Some developing countries have gone a step further and enacted some consumer laws to ensure consumer participation in the market. However, implementation of such laws continues to be a problem. Most of the laws define general principles rather than provide for any specific measures, and are generally ineffectual. Sub-standard and unsafe products have become the order of the day because of weak mechanisms and tools for policing market behaviour of firms; fake and imitated goods are quite prevalent.

Consumer regulation of the ills of the market system is crucial, as it forms a countervailing force against anti-competitive behaviour. Consumer associations are normally formed to ensure participation of consumers in activities that oppose anti-consumer and anti-competitive practices. The initiative for these should start from the government, which should put in place conducive policies and measures that can

ensure the sustained existence of such associations. It has generally been observed that consumer issues cannot be best handled by competition authorities alone. A need for a separate consumer body, enacted in terms of consumer protection laws to safeguard the interest of consumers, therefore, exists. Consumer movements may be present, but with no consumer body to attend to grievances, their concerns are not normally taken care of.

The existence of competition laws but without complementary consumer laws has failed to protect the consumers against harm by companies, given that competition laws may not comprehensively cover consumer issues. This is typically the case in countries such as Zambia, (consumer issues are not adequately covered under the *Competition and Fair Trading Act*, 1994), Zimbabwe (the *Competition Act*, [Chapter 14:28] is not comprehensive as far as consumer issues are concerned), Tanzania (the *Fair Competition Act*, 2003 does not provide for the adjudication of direct consumer-related issues; these are dealt with by the Civil Courts[81]), Jordan (the *Competition Law* No. 33, 2004 has provisions that try to ensure fairness in the economy, but is very inadequate as far as consumer protection is concerned), Kazakhstan (the *Anti-monopoly Law*, 2001 has provisions for the "*protection of the interest of the consumer*", but the law is hardly sufficient), etc.

8. Conclusion

The conclusion that emerges is that competition and consumer welfare are symbiotically linked though cases of conflict may persist. Competition policies promote efficiency in production, which in turn leads to lower prices for consumers. This is consistent with the maximization of consumer welfare. On the other hand, consumer laws while pursuing the objectives of maintaining prices at the lowest possible level might make it cost-ineffective for producers to undertake production. This introduces a conflict of objectives.

Also noted is that both market-friendly reforms and market failures have become common across developing countries. This implies that efforts should be made to ensure the co-existence of the two policies, with minimal or no conflicts resulting. In order to do that,

[81] Mehta (2006).

the first step should be to ensure that the competition and consumer policies are designed to try and meet the expectations of all stakeholders rather than being biased towards one particular player, i.e. business or consumers. Consumer interests should be explicitly recognized in the designing of competition policy, and advocacy should be included as a tool for awareness promotion among consumers. At the same time, however, the promotion of efficient markets as an objective need not be necessarily compromised.

Creation of a competition culture in the economy with the simultaneous involvement of consumers in the entire process can ensure that the advantages of market-based competition are fully realized. This exercise of ensuring participation of all stakeholders in the reforms ensures a reconciliation of the perceptions of various players by taking into account their different characteristics and expectations. However, it may be difficult to coordinate between the government's objective of promoting public interest and competition authority's objective of promoting efficient markets. The government’s commitment to growth as a political objective and the overall political climate matter for a competition culture to prevail in the economy. Ensuring that the adoption of competition laws gets a political buy-in is therefore crucial, and there is a need to properly align competition policy outcomes with political incentives for this to succeed. This might not be difficult as politicians themselves are involved in the law-making process and have vested interests in keeping prices as low as possible in order to win cheap popularity and votes. It is through these measures that the conflicts between competition and consumer policy highlighted might be overcome[82].

Anti-competitive conduct such as the formation of cartels or exploitative pricing by dominant firms is seen to inflict a huge loss on consumers and this makes the enactment of competition laws and their implementation a must for protecting consumers. The magnitudes of welfare improvements brought about by these laws have been measured in the past and found to be extremely significant in many cases. The quantitative literature cited supports this point and suggests new estimation procedures in this regard which can make the estimation more robust. What is of great importance, especially in the case of developing countries, is the existing diversity in political will to

[82] For more information on this, see Mehta *et al.* (2007).

implement competition laws and have successful competition commissions. Such differences in political will can lead to diversity in efficiency and welfare outcomes emanating from the same set of competition laws. Big businesses in developing countries might also exercise their lobbying powers with political groups to paralyse the working of competition commissions in some cases, thus contributing to diversities. Any econometric cross-country exercise carried out exclusively for developing countries that reports a statistically insignificant effect of competition laws on consumer welfare should not be taken at face value, i.e. it should be interpreted as meaning that there are implementation problems, due to poor political will or political capture, in most countries.

Finally, gains facilitated by competition laws have to be weighed against the costs required to implement them. The literature on cost-benefit analysis is reviewed for this purpose to suggest a methodology that is both theoretically robust and quantitatively feasible. Here again, developing country experience might suggest a cost-benefit ratio that is higher for developing countries than for developed countries because of poor implementation and large leakages from the system.

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ANTI-COMPETITIVE PRACTICES AND THEIR ADVERSE EFFECTS ON CONSUMER WELFARE: THE ZIMBABWEAN EXPERIENCE

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1. Introduction

The socio-economic impact of the implementation of competition policy and law in developing countries has been most intense on consumer welfare and protection. This has been because of the proven adverse effects of restrictive business practices (RBPs) on the general welfare of consumers, which competition policy and law aims at preventing or controlling. A recent study undertaken in Zimbabwe on the impact of the implementation of competition policy and law in that country clearly showed the positive relationship between effective competition and consumer welfare. The findings in Zimbabwe in this regard are representative of the impact of competition policy and law in most other developing countries.

That there is a symbiotic relationship between the effective implementation of competition policy and law and consumer welfare and protection is no longer in doubt from the many empirical studies on the subject that have been undertaken by various competition experts/practitioners worldwide. From the studies undertaken, it is now a generally accepted fact that the ultimate objective of competition policy and law is consumer welfare. It has also been found that competition and consumer welfare are mutually enhancing. Consumer satisfaction that arises and flows from the protection and benefits of competition leads to increased public appreciation and acceptance of the implementation of competition policies and laws, which in turn facilitates the creation of a healthy culture of competition in society.

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What might still need further study, particularly in developing countries, is the extent in quantitative terms of the adverse effects on national economies, in general, and on consumers, in particular, of the lack of effective competition regimes.

The term 'consumer' can be defined in both its narrow and broad sense. In its narrow sense, the term has been defined as to "include any person: (a) who purchases goods other than for the purpose of resale but does not include a person who purchases any goods for the purpose of using them in the production and manufacture of any goods or articles for sale; and (b) to whom a service is rendered"83. Similar definitions of the term are found in the competition legislations of Kenya, Malawi and Zambia. This narrow definition of a consumer excludes companies that buy and consume raw materials or intermediate products in their production processes. In its broad sense, the term has been defined to include both individuals and organizations that consume finished goods or raw materials. The *Consumer Protection Act* of Nepal defines the term in the following manner: "*(a) Consumer means an individual or institution consuming or using any consumer good or service. (b) Consumer goods mean goods or materials made through the admixture of several goods which are consumed or used by consumers; the term includes raw materials, colours, flavours or chemicals used in the production of such consumer goods*"[84]. The broader definition of the term 'consumer' supports the notion that the term should refer to all categories of consumers and not only to the ultimate user of goods and services. The meaning of consumer in this essay will be based on the broader definition of the term since the consumption of goods and services used in the production of final products ultimately affects the consumer as defined in the narrower sense.

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[83] Definition of 'consumer' in terms of Article 1 of the Competition Regulations of the Common Market for Eastern and Southern Africa (COMESA).
[84] Consumer Protection Act, 1998.

According to Rachagan (2003)[85], the term 'consumer welfare' refers to the benefits that are derived by individuals from the consumption of goods and services. Rachagan also noted that individual consumers are not only concerned with product price, choice and quality, but also more critical to them are issues of employment, sustained development and equity. Consumer welfare therefore means the same as 'consumer interests'. In this essay therefore, consumer welfare includes everything that the consumer desires for his/her well-being.

This study aims at analysing anti-competitive practices and their adverse effects on consumer welfare. Following this introductory section, competition and its socio-economic effects are briefly analysed, and then RBPs are explained. Then, the interface between competition and consumer laws and policies is discussed before exploring the main topic of anti-competitive practices and their adverse effects on consumer welfare. The practical experience of Zimbabwe in using competition policy and law for consumer welfare and protection purposes will also be explored in some detail. In conclusion, some thoughts are expressed on whether or not there are any conflicts between the attainment of competitive markets and consumer interests.

2. Competition and its socio-economic effects

Competition is the process by which sellers strive to gain the patronage of buyers in achieving their primary objectives of increased sales, larger market shares and greater profits. Sellers are more likely to attract and retain buyers if the quality of their goods or services is higher and the prices lower than those of their rivals, or if they are innovative in their production processes and marketing techniques.

The theory of competition is however a difficult and complex one and has been conceptualized in a number of different ways. It is therefore no wonder that the term 'competition' is rarely defined in competition legislation of either developing or developed countries.

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[85] S. Sothi Rachagan, *Competition Policy and Law in the Consumer and Development Interest*, a paper presented as a communication from Consumers International to the Fifth Session of the Intergovernmental Group of Experts (IGE) on Competition Law and Policy, held in Geneva, Switzerland, on 2–4 July 2003.

According to Fourie and Smit (1999)[86], there are a number of different uses, definitions and concepts of the term 'competition' depending on who one is and for what purpose one wants to use the definition. The ordinary consumer view of competition is that of rivalry between contestants, as in sport. Under this view, there is a winner, and someone "gets the bone". This view is sometimes referred to as the intuitive view. The typical business person's view of competition is similar to the intuitive view of rivalry, but with more intense challenges of trying to gain an advantage over other competitors. Competition is taken as a process whereby firms strive against each other to secure custom for their products, i.e. it represents the active rivalry of firms for customers: thus the nature of competition is such that enterprises compete to outsmart their competitors[87].

Economists have developed different schools of thought on competition, such as: (i) the structural approach (which defines different states of competition in terms of structural conditions, i.e. number of firms, conditions of entry, etc.); (ii) the process approach (which views competition in terms of behaviour and conduct of the market participants without much reference to market structure, i.e. how a firm behaves towards its competitors, or responds to new entrants, in order to protect its market position); and (iii) the efficiency approach (which refers to neither market structure nor behaviour of firms, but only considers the outcome or performance in terms of efficiency: competition under this approach is seen as any state of affairs that maximizes consumer welfare, or any efficient state of affairs regardless of market structure or conduct of firms).

While the above schools of thought on competition were developed separately and under different conceptual assumptions, a hybrid concept based on the schools has emerged. This is the structure-conduct-performance approach. Under this approach, the hypothesized

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[86] Frederick C.v.N. Fourie and Minette Smit, *Industrial Economics for Competition Policy,* lecture delivered at the Competition Policy and Law Inaugural Southern Africa Course, organized by the Competition Commission of South Africa and held in Pretoria, South Africa, during the period 14–25 June 1999.

[87] CUTS Monograph on Investment and Competition Policy #6, *All About Competition Policy & Law For the Advance Learner,* CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 2000.

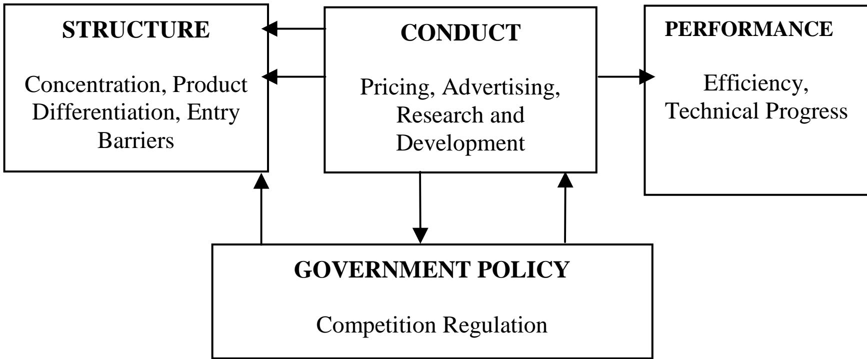
linkage between the three different concepts of structure, conduct and performance is that the structure (i.e. the number of players, ease of entry, etc.) of a market explains or determines to a large degree the conduct (e.g. pricing policy, advertising, etc.) of the participants in the market, and the performance (i.e. efficiency, technological progress) of the market is simply an evaluation of the results of the conduct[88]. The structure-conduct-performance relationship has been further developed to take into account the reverse effect of conduct on the structure since it has been found that conduct can sometimes "feedback" to change structure. For example, a firm can reduce its production costs to a point where it can profitably price its competitors out of the market. Shepherd (1997)[89] also noted that a firm that is superior in efficiency or innovation so that it obtains high profits will generally increase its market share, thus affecting the market structure. A firm can also strategically engage in exclusionary practices (e.g. predatory pricing) that drive its weaker competitors out of the market. Decisions by firms in direct competition to merge also alter market structures. Government policies also can affect both market structure and conduct. Conduct in a market can also influence government policies.

Figure 1 shows a schematic representation of the structure-conduct-performance model as discussed above.

[88] W. Kip Viscusi, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust*, Second Edition, The MIT Press, Cambridge, Massachusetts, 1998.

[89] William G. Shepherd, *The Economics of Industrial Organisation,* 4th Ed., Prentice Hall, Upper Saddle River, New Jersey, 1997.

Figure 1: The structure-conduct-performance model



Source: Viscusi *et al.*[90].

The usefulness of the structure-conduct-performance model is that it brings from the abstract the understanding of the functioning of real-life markets and firms. While each of the separate concepts of structure, conduct and performance is conceptually sound, it fails to appreciate how firms operate as corporate entities. As observed by Shepherd (1997), "*firms are organisations of humans, with much room for variety, historical change, and contrasting motives*".

The Organisation for Economic Co-operation and Development (OECD) in its *Glossary of Industrial Organisation Economics and Competition Law* provides a comprehensive definition of competition, which is reproduced in Box 1.

[90] W. Kip Viscusi, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust*, Second Edition, The MIT Press, Cambridge, Massachusetts, 1998.

Box 1: OECD definition of competition

Competition is a situation in a market in which firms or sellers independently strive for the patronage of buyers in order to achieve a particular business objective, e.g. profits, sales and/or market share. Competition in this context is often equated with rivalry. Competitive rivalry between firms can occur when there are two firms or many firms. This rivalry may take place in terms of price, quality, service or combinations of these and other factors which customers may value.

Competition is viewed as an important process by which firms are forced to become efficient and offer a greater choice of products and services at lower prices. It gives rise to increased consumer welfare and allocative efficiency. It includes the concept of 'dynamic efficiency' by which firms engage in innovation and foster technological change and progress.

Source: OECD *Glossary of Industrial Organisation Economics and Competition Law*.

Vigorous competition between firms is the lifeblood of strong and effective markets. Competition helps consumers to get a good deal. It encourages firms to innovate by reducing slack, putting downward pressure on costs, and providing incentives for the efficient organization of production. When working effectively, competition involves a process of rivalry between firms that strive to win customers by achieving the lowest level of costs and prices, developing new products or services or exploiting particular strengths, skills or other advantages to meet customer needs more efficiently and effectively than competitors.

Competition thus forces firms to become efficient and to offer a greater choice of goods and services at lower prices. In a competitive market economy, price signals tend to be free of distortions and create incentives for firms to redeploy resources from lower to higher-valued uses. The benefits that flow from competition therefore include increased economic efficiency, innovation, and consumer welfare. Economic efficiency generated by competition includes both 'productive' efficiency (i.e. producing without waste) and 'allocative' efficiency (i.e. producing the goods and services that society values most highly).

It has however been found that firms have natural inclinations to acquire market power, that is to obtain discretionary control over prices and other related factors determining business transactions. Such market power may be gained by limiting competition through: (i) the erection of barriers to commerce; (ii) the conclusion of collusive agreements and arrangements to restrict output and increase prices; and (iii) engagement in other anti-competitive business practices. This imperfect competition is generally viewed as market failure that results in inefficient allocation of resources, and adversely affects industry performance and economic welfare. Such market failures enable sellers to deliberately reduce output and charge higher prices at the expense of consumers and society in general, hence the need for regulation in the form of competition policy and law.

The term competition policy is used to cover policies adopted by governments to address the anti-competitive behaviour of enterprises, whether private or public[91], and to influence competition in markets. Competition policy is therefore a regulatory tool that is employed by governments to address market failures caused by engagement of firms in RBPs by maintaining or creating a foundation for effective functioning of markets. In this connection, the effective implementation of competition policy requires appropriate legislation that gives the policy legal force and the establishment of regulatory authorities to enforce the law and ensure a level playing field for all competing firms in order to stimulate efficiency and protect consumers. Competition law, on the other hand, and as implied in the foregoing, is a set of rules that firms must follow in ensuring that the market does not fail from anti-competitive practices. The use of competition law reflects a country's wish to harness the power and efficiency of the market mechanism. This power can be blunted or lost if firms can avoid competing with each other by colluding, or if firms in dominant positions abuse their dominance by preventing competition. Competition law is therefore a subset of competition policy since it is the legal framework that gives effect to that policy.

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[91] As observed by Vinod Rege in his presentation on *Trade and Competition Policy Issues Facing Commonwealth Developing Countries* at the Commonwealth Working Group Meeting on Trade, Competition Policy and Law, held in London, United Kingdom, on 25 July 2000.

As stated by CUTS International (2000)[92], the main objective of competition policy is to preserve and promote competition as a tool to ensure efficient allocation of resources in an economy. This would result in the maximization of real income in an economy. Further, from the consumer perspective, it would result in the best possible choice of quality, reasonable prices and adequate supplies. The pursuit of these objectives would lead to controlling the concentration of economic power, encouraging innovation, protecting and promoting social welfare and in particular the interests of consumers.

The World Trade Organization (WTO) summarized some socio-economic objectives of competition law, as listed in Box 2.

Box 2: WTO list of some socio-economic objectives of competition law

- Protecting consumers from the undue exercise of market power.
- Promoting economic efficiency, in both a static and dynamic sense.
- Promoting trade and integration within an economic union of free trade.
- Facilitating economic liberalization, including privatization, deregulation and the reduction of internal trade barriers.
- Preserving and promoting the sound development of a market economy.
- Promoting democratic values, such as economic pluralism and the dispersion of socio-economic power.
- Ensuring fairness and equity in marketplace transactions.
- Protecting the 'public interest', including considerations relating to industrial competitiveness and employment.
    - Minimizing the need for more intrusive forms of regulation or political interference in a free market economy.
    - Protecting opportunities for small and medium-sized businesses

Source: Annual Report of the WTO Secretariat, 1997.

[92] CUTS Monograph on Investment and Competition Policy #6, *All About Competition Policy & Law For the Advanced Learner,* CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 2000.

Competition laws of most countries deal with enterprise behaviour by prohibiting such RBPs as monopolization and anti-competitive agreements and mergers.

3. Restrictive business practices

Broadly speaking, there are four main types of business practices that can have restrictive or anti-competitive effects. These are: (i) horizontal restraints; (ii) vertical restraints; (iii) abuse of dominant position; and (iv) anti-competitive mergers and acquisitions.

Horizontal restraints are agreements or arrangements between competing firms producing identical or similar goods or services to restrict competition through price-fixing arrangements, collusive tendering and market or customer allocation agreements. Such agreements or arrangements are sometimes referred to as 'hard-core cartels' and are considered to be the most serious of anti-competitive practices because of their harmful effects on economies and consumers.

Vertical restraints are agreements or concerted practices entered into between two or more companies each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services. Such restraints include tie-in arrangements (whereby downstream firms are required to purchase a certain range of products before being allowed to purchase a particular product), exclusive dealing arrangements (whereby distributors are assigned exclusivity within a geographic area, or over specific products or particular types of customers), and resale price maintenance (whereby retail price is fixed by the producer or price floors or ceilings are imposed on the distributors).

Dominance and its abuse is a very interesting subject in competition policy and law, mainly because this is the area where the use of the 'rule of reason' approach is most justified. According to Viscusi *et al.* (1998), "*the standard dominant firm model assumes that there is one big firm and a large number of small price-taking firms, typically referred to as the 'competitive fringe', (and) because of its position, the dominant firm is modelled as selecting a price that the*

fringe firms take as given in deciding how much to supply"[93]. A firm is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or other market conditions without significant constraint from competitors or consumer reaction. He/She will thus be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long term.

Dominance therefore comes with market power. Anderson *et al.* (1999)[94] explained the concept of market power as follows: "*the concept of market power refers to the ability of a firm (or a group of firms acting jointly) to profitably maintain prices above competitive levels for a significant period of time. The qualifier 'profitably' is important – it denotes the fact that in order to exercise market power, a firm must be in a position to raise prices without losing sales so rapidly that the price increase is unprofitable and must be rescinded, as would be the case in a competitive market. In addition to higher than competitive prices, the exercise of market power can be manifested through reduced quality of product or service or a lack of innovation in the relevant market(s)*".

It has however been generally accepted that dominance *per se* is not anti-competitive since firms may legitimately achieve a dominant position in the market through, for example, innovation, superior production or distribution methods or greater entrepreneurial efforts, i.e. conduct that is encouraged under competition. It is its abuse, or the exercise of the market power that comes with the dominance, that is cause for competition concern. A firm enjoying a dominant position in the market may not only exercise its market power by exerting a significant influence on the market price or restrain the market output of a specific commodity or service, but may also create barriers thus restricting entry or the freedom of other enterprises to operate in the market. Two broad types of business conduct by dominant firms have traditionally been recognized as abusive under competition law. These

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[93] W. Kip Viscusi, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust,* 2nd Ed., The MIT Press, Cambridge, Massachusetts, 1998.

[94] Robert Anderson, Timothy Daniel and Alberto Heimler, "Abuse of Dominance", in *A Framework for the Design and Implementation of Competition Law and Policy,* The World Bank, Washington D.C., and Organisation for Economic Co-operation and Development (OECD), Paris, 1999.

are: (i) exploitative abuses (in which a firm takes advantage of its market power by charging excessively high prices to its customers, discriminating among customers, paying low prices to suppliers, or through related practices); and (ii) exclusionary abuses (in which a firm attempts to suppress competition, for example by refusing to deal with a competitor, raising competitors' costs of entering a market, or charging predatory prices)[95]. Abusive practices also include raising rivals' costs, and various forms of vertical restraints.

The abusive practices of a firm in a dominant position, or monopolization, are particularly anti-competitive because the market would not offer alternatives for consumers.

Regarding anti-competitive mergers and acquisitions, it has been found that most mergers pose little or no serious threat to competition, and may actually be pro-competitive. Such benevolent mergers have a number of economic advantages such as resultant economies of scale, reduction in the cost of production and sale, and gains of horizontal integration, all of which can lead to increased efficiency and lower prices to the consumer. Other mergers however seriously harm competition by increasing the probability of exercise of market power[96]. In this regard, concerns about vertical restraints and abuse of dominance come to the fore. Mergers can also sometimes produce market structures that are anti-competitive in the sense of making it easier for a group of firms to cartelize a market, or enabling the merged entity to act more like a monopolist.

All of the three main types of mergers (i.e. horizontal mergers, vertical mergers and conglomerate mergers) may have anti-competitive elements. Horizontal mergers present the greatest danger to competition by the mere fact that they reduce the number of competing firms in the relevant market. Such mergers most directly lead to market concentration, which could in turn create dominant or monopoly situations that reduce or eliminate competition. Some analysts have gone as far as viewing horizontal mergers as attempts at legitimizing

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[95] *Ibid.*

[96] Peter Bamford, David Elliot, Russell Pittman and Margaret Sanderson, 'Mergers', in *A Framework for the Design and Implementation of Competition Law and Policy*, The World Bank, Washington, D.C., and the Organisation for Economic Co-operation and Development (OECD), Paris, 1999.

collusive and cartel-like behaviour between competing firms. Since vertical mergers combine firms at different stages in the production and distribution process, they may also have harmful effects on competition if they give rise to risk of markets becoming foreclosed to third parties. Conglomerate mergers present the least danger to competition since in the case of pure conglomerates there is no functional link whatsoever between the merged firms[97]. Such mergers can however be potentially anti-competitive if they are considered in the context of the additional financial strength (or 'deep pockets') they give to the parties involved, which the parties can use against actual or potential competitors in their combined markets through cross-subsidization.

4. Interface between competition and consumer laws and policies

It has been demonstrated above that the main goals of competition policy and law are, or should be, economic efficiency, a check on concentration of economic power, and consumer welfare. In most countries that have adopted competition policy and law, therefore, the objectives of such policies and laws are aimed in one way or another at enhancing the welfare and/or ensuring the protection of the consumer through the prevention and control of RBPs.

The common objectives of competition policy and law as enshrined in competition legislation of many countries include: (i) prohibiting RBPs; (ii) controlling monopolies and concentrations of economic power; (iii) regulating mergers and acquisitions; (iv) strengthening the efficiency of production and distribution of goods and services; (v) ensuring the best possible conditions for the freedom of trade; and (vi) encouraging innovation. In protecting the process of competition, competition law becomes a very important consumer protection law. The primary objective of competition law is to prohibit those business practices that unreasonably deprive consumers of the benefits of competition, resulting in higher prices for inferior products and services. Some competition laws also prohibit unfair trade practices that mislead or deceive consumers, and include provisions relating to

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[97] Richard Whish, *Competition Law* (Fourth Edition), Butterworths, London, UK, 2001.

product safety and product information and unconscionable (or grossly unfair) conduct.

A number of countries worldwide have hybrid laws that deal with both competition and consumer protection. The country that has the most comprehensive law in this regard is probably Australia. Australia's *Trade Practices Act* 1974 is the country's competition and consumer law. The Act promotes efficient markets and fair-trading practices which seek to maximize consumer welfare. Its stated object is "*to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection*", which thus recognizes the Act's dual role of promoting competition and efficiency together with consumer protection. The Act has provisions on 'restrictive trade practices', which are defined as "*contracts, arrangements or understandings that restrict dealings or affect competition*"[98]. Such practices include price-fixing arrangements (between competitors which have the purpose or effect of fixing, controlling or maintaining prices for goods and services supplied or acquired by the parties), exclusionary provisions (also known as collective boycotts, which are arrangements between two or more persons who are competitive with one another where the arrangement has the purpose of restricting the supply of goods or services to or the acquisition of goods or services from particular persons or classes of persons, or the supply of goods or services to or the acquisition of goods and services from particular persons or classes of persons in particular circumstances or on particular conditions), and anti-competitive agreements (or arrangements, which have the purpose or effect of substantially lessening competition in a market).

The Act also has provisions on the prohibition of unconscionable conduct, and a whole section on consumer protection, whose object is to protect the consumer by eliminating unfair trade practices. Unfair trade practices include misleading or deceptive conduct (conduct aimed at misleading or deceiving consumers), unconscionable conduct (conduct that can be seen in accordance with the ordinary concepts of mankind to be so unfair as to be against conscience), false or misleading representations (on the quality, value, condition or grade of goods, etc), bait advertising (advertising for supply

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[98] Ray Steinwall, *Annotated Trade Practices Act 1974,* 2002 Edition, Butterworths, Australia, 2002.

of goods and services knowing that the firm would not be able to supply the goods and services), harassment and coercion (using physical force or undue harassment or coercion in connection with the supply or possible supply of goods or services, and pyramid selling (e.g. purchase of certificates for a particular dollar value, with the newest entrant starting at the bottom of the pyramid and obliged to sell the certificates to progress up the pyramid).

In the east and southern African region, an increasing number of countries are also adopting hybrid laws that deal with both competition and consumer protection. The situation in some of these countries is shown in Table 1.

Table 1: Competition-consumer protection laws in selected east and southern African countries	
Kenya	The objective of the *Restrictive Trade Practices, Monopolies and Price Control Act*, 1988, Chapter 504 is "*to encourage competition in the economy by prohibiting restrictive trade practices, controlling monopolies, concentrations of economic power and prices and for connected purposes*". The Act provides for the appointment of the Monopolies and Prices Commissioner for its administration. The Act has provisions on the control of monopolies and concentrations of economic power, including mergers and takeovers. Prohibited restrictive trade practices include agreements or arrangements: (i) hindering or preventing the sale or supply of goods and services; (ii) restricting the terms and conditions of sale or supply; (iii) fixing prices; and (iv) limiting or restricting the output or supply of goods. It also has provisions relating to the control and display of prices.
Malawi	The objective of the *Competition and Fair Trading Act*, 1998, (Cap. 48.09) is "*to encourage competition in the economy by prohibiting anti-competitive trade practices; to establish the Competition and Fair Trading Commission; to regulate and monitor monopolies and concentrations of economic power; to*

	protect consumer welfare; to strengthen the efficiency of production and distribution of goods and services; to secure the best possible conditions for the freedom of trade; to facilitate the expansion of the base of entrepreneurship ...”. The Act prohibits “*any category of agreements, decisions and concerted practices which are likely to result in the prevention, restriction or distortion of competition to an appreciable extent in Malawi or in any substantial part of it*’. Abuse of dominance practices prohibited include: (i) predatory behaviour towards competitors; (ii) discriminatory pricing and discrimination, in terms and conditions, in the supply or purchase of goods and services; (iii) making the supply of goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods; and (iv) resale price maintenance. Trade agreements and arrangements prohibited include: (i) colluding in settling uniform prices in order to eliminate competition; (ii) collusive tendering and bid rigging; (iii) market or customer allocation; (iv) allocation by quota as to sales and production; (v) collective action to enforce arrangements; (vi) concerted refusals to supply goods or services to potential purchasers; and (vii) collective denials of access to an arrangement or association which is crucial to competition. The need to enact consumer protection legislation to work hand in hand with Malawi’s competition legislation under the administration of the competition authority was recognized early in Malawi. Accordingly, a Consumer Protection Bill was drafted in 2001 to address the specific interests and needs of consumers[99]. The Bill was sponsored and promoted by the Consumer Association of Malawi (CAMA), and provided for the establishment of a Consumer Protection Council whose functions include the identification of price mechanisms and the determination of whether the quality and prices of goods and services are justifiable. The Council would also carry out, promote or participate in consumer education programmes and activities and disseminate consumer information to the public. The Bill also provided for the establishment of Small Claims

[99] *Why is a Competition Law Necessary in Malawi?,* CUTS Centre for Competition, Investment & Economic Regulation, Jaipur, India, 2003.

	Courts.
Tanzania	According to a consultants' report on a competition policy model for the Southern African Development Community (SADC) region[100], the *Fair Competition Act* of Tanzania, 2003, prohibits anti-competitive agreements that have the effect of preventing, restricting or distorting competition in Tanzania. It is prohibited for a business in a dominant position to use its dominance with the object or effect of preventing, restricting or distorting competition. A merger that creates or strengthens a dominant position is prohibited but can be approved if benefits attributable to it more than offset any adverse effects. The Act established the Fair Trade Commission as an independent unitary competition authority. It also established the National Consumer Advocacy Council to represent the views of consumers to the Fair Trade Commission (as well as to Government Ministries and other regulatory authorities).
Zambia	The objectives of the *Competition and Fair Trading Act*, 1994, Chapter 417 are "*to encourage competition in the economy by prohibiting anti-competitive trade practices; to regulate monopolies and concentrations of economic power; to protect consumer welfare; to strengthen the efficiency of production and distribution of goods and services; to secure the best possible conditions for the freedom of trade; to expand the base of entrepreneurship; and to provide for matters connected with or incidental to the foregoing*". The Act is administered by the Zambia Competition Commission (ZCC). The Act has provisions on anti-competitive agreements, abuse of dominance and anti-competitive mergers. It also has provisions directly aimed at protecting consumers. In this regard, it prohibits: (i) withholding or destroying producer or consumer goods with the aim of bringing about a price increase; (ii) excluding liability for defective goods; (iii) making false and misleading representations; and (iv) supplying products that are likely to cause injury to health or physical harm to consumers.

[100] *A Competition Policy Model for the Southern African Development Community,* a report by Dr Arthur Pryor and Dr Martin Howe, consultants to the Commonwealth Secretariat, 2006.

Zimbabwe	The *Competition Act*, 1996, [*Chapter 14:28*] has the objective "*to promote and maintain competition in the economy of Zimbabwe; to establish an Industry and Trade Competition Commission and to provide for its functions; to provide for the prevention and control of restrictive practices, the regulation of mergers, the prevention and control of monopoly situations and the prohibition of unfair trade practices; and to provide for matters connected with or incidental to the foregoing*". As in most other countries' competition legislations, anti-competitive practices prohibited in the Act include restrictive horizontal and vertical agreements (price-fixing arrangements, market-sharing agreements, bid rigging, resale price maintenance, etc.), abuse of dominant position (predatory pricing, tied and conditional selling, exclusive dealing, etc.), and anti-competitive mergers (covering horizontal, vertical and conglomerate mergers). The Act also has provisions directly aimed at consumer protection. These provisions prohibit unfair trade practices such as "*misleading advertising, false bargains,* and *distribution of commodities or services above advertised price*".

Source: Compiled by the author from indicated sources.

At the regional level, countries that belong to the Common Market for Eastern and Southern Africa (COMESA)[101] have agreed on the formulation and adoption of a regional competition policy and law to deal with cross-border competition and consumer protection concerns.

The COMESA competition law prohibits as incompatible with the Common Market all agreements between undertakings, decisions by associations and concerted practices that may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Common Market. Collusive agreements such as price-fixing, market-sharing and bid rigging are prohibited *per se*. Exploitative and exclusionary abuses of dominant firms are also prohibited. Merger control is also comprehensively provided for in the law.

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[101] COMESA Member States include Angola, Burundi, D.R. Congo, Djibouti, Egypt, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

The regional competition law also deals extensively with consumer protection, since it was recognized that competition law and consumer protection law are complementary in that they deal with different kinds of market failure. A variety of practices that can be detrimental to consumers are prohibited. These include "*false or misleading representation of goods or services, unconscionable conduct in consumer and business transactions, and supply of unsafe goods*". Product safety and product information is also of primary concern in the law.

5. Anti-competitive practices and their adverse effects on consumer welfare

It is a proven fact that free and open competition benefits consumers by ensuring lower prices and new and better products. Competition among enterprises benefits consumers whether it comes in the form of price competition or non-price competition. Price competition benefits consumers since it involves an attempt to win customers by offering them a product at a lower price than the competitors. The consumer therefore benefits from the resultant lower prices. Non-price competition benefits the consumer since competitors go for sales promotion, advertising, quality upgrading, offer after-sales service and so forth to increase their share of the market. Again, consumers benefit from better quality products and after-sales service.

In addition to generating consumer benefits, competition policy and law also directly contributes to consumer protection. In this regard, it is noted that consumers are the main losers of anti-competitive activities in a market since they are most vulnerable to the abuses of big business because of their atomistic nature. Consumers therefore require the protection of competition law the most since the adverse effects of anti-competitive practices are disproportionately severe for them.

Firms will often be tempted to ensure increased profits by restricting the process of competition. When competitors agree to fix prices, rig bids or allocate customers, or otherwise operate as monopolies, consumers lose the benefits of competition. Consumers also lose the advantage of choice of shopping around and freely choosing the products and businesses that best meet their needs. The

prices that result when competitors agree to collude are in most cases artificially high. Such prices do not accurately reflect the cost of production and distribution, and therefore distort the allocation of society's resources. The result is a loss not only to individual consumers but also to the economy as a whole.

All types and forms of RBPs that are prohibited or controlled by competition law have adverse effects on consumer welfare.

Evenett and Jenny (2004)[102] assembled a comprehensive database of allegations of anti-competitive practices made in Sub-Saharan African publications, principally in newspapers and other periodicals. They located 120 distinct allegations of anti-competitive practices in 68 lines of business in 12 African countries[103] over a period of ten years. The most frequent allegation by a large margin concerned cartels, especially outside of South Africa. Allegations against foreign firms, some of which were African, ranged between a quarter and two-fifths of the total number of allegations, suggesting that many domestic firms were the subject of allegations as well. There were 12 lines of business where allegations were made in more than one Sub-Saharan African country. Many of those lines of business directly affected the well-being of the poor, those employed in the agricultural sector, and small business.

It should however be noted that virtually all the allegations of anti-competitive practices in Sub-Saharan Africa that were analysed in the Evenett and Jenny study were picked from newspapers and other publications. The actual number of the allegations made and investigated by the competition authorities in the respective countries is definitely much higher.

The anti-competitive practices were divided into three categories: (i) those that hurt consumers directly; (ii) those that hurt

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[102] Simon J. Evenett and Frederic Jenny, in a presentation titled *An Inventory of Allegations of Anti-Competitive Practices in Sub-Saharan Africa* delivered at the Centre for Regulation and Competition (CRC) 3rd International Conference: Pro-Poor Regulation and Competition: Issues, Policies and Practices, held in Cape Town, South Africa, 7–9 September 2004.

[103] Ghana, Kenya, Madagascar, Malawi, Mozambique, Namibia, Nigeria, South Africa, Tanzania, Uganda, Zambia and Zimbabwe.

farmers; and (iii) those that excluded and hurt other businesses. Examples of such practices are given in Table 2.

Table 2: Some anti-competitive practices in Sub-Saharan Africa

Anti-competitive practices that hurt consumers directly	• Vertically integrated monopoly in the sugar industry in Malawi. • Millers' cartel in Zambia. • Anti-competitive merger in the beer sector in Malawi. • Price fixing in the distribution of oil in Kenya. • Cartel in the oil sector in Uganda. • Cement monopoly in Malawi. • Taxi cartels in South Africa. • Private monopolies in the rail and transport sectors in Malawi.
Anti-competitive practices that hurt farmers	• Price fixing and market sharing in the fertilizer industry in Kenya. • Collusion among tea buyers in Malawi. • Buyers' cartel in the cotton industry in Zimbabwe. • Price fixing by purchasers of cotton in Malawi.
Anti-competitive practices that excluded or hurt other businesses	• Sugar cartel in South Africa. • Margin fixing in the banking sector in Uganda. • Exclusionary practices in the cable television sector in Nigeria. • Abuse of dominance in the telecommunications sector in South Africa. • Price fixing and trade associations in the freight transport sector in Malawi. • Franchise arrangements in the soft drinks industry in Zambia. • Jet fuel cartel in South Africa.

Source: Compiled from a Simon Evenett and Frederic Jenny presentation on *Anti-competitive Practices in Sub-Saharan Africa: Myths, Reality and Perspectives*.

While it is extremely difficult to accurately quantify the adverse effects of most anti-competitive practices on the consumer because other economic factors may simultaneously be involved, considerable progress has been made in quantifying the effects of cartel behaviour.

A cartel has been defined as a formal agreement among competing firms in an oligopolistic industry on such matters as total industry output, market shares, prices, allocation of customers and/or territories, bid rigging, or a combination of these and other matters. The mutual benefit of members is the primary aim of cartels. Generally, a cartel attempts to emulate a monopoly by restricting industry output, raising or fixing prices in order to earn higher profits[104]. A paraphrased definition of a cartel provided by the OECD is that "*a cartel is an agreement, practice, or arrangement by competitors to collude and fix prices, rig bids, allocate quotas, or divide markets*"[105]. Cartels are considered the most harmful anti-competitive conduct prevalent the world over, and are outlawed in most countries.

There are different types and kinds of cartels. A *private cartel* exists between two or more firms that are not controlled by a government. The main objective of a private cartel is to raise prices above competitive levels, thus harming the customers. Within this category of cartels, there are *international private cartels* and *domestic private cartels*. International private cartels exist when members of a private cartel are based in different countries, or when the cartel's agreement affects the markets of more than one country. Domestic private cartels, as the name implies, exist between firms in the same country and whose agreements only affect the market of that country. Cartels that involve state enterprises, as in the case of the Organization of the Petroleum Exporting Countries (OPEC), and other commodity agreements on sugar, coffee, etc., are not covered under competition enforcement rules. Such cartels are sovereign cartels and therefore immune from the law.

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[104] S. Sothi Rachagan, *Competition Policy and Law in the Consumer and Development Interest*, a paper presented as communication from Consumers International to the Fifth Session of the Intergovernmental Group of Experts (IGE) on Competition Law and Policy, held in Geneva, Switzerland, on 2–4 July 2003.

[105] As reported in CUTS Briefing Paper No. 5/2006 on *Private International Cartels – An Overview*. CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 2006.

The term collusion, on the other hand, has been used to refer to informal agreements, arrangements or conspiracies that seek to achieve what cartels do. The economic effects of cartels and collusive behaviour are however the same.

The costs to the consumer of cartelization, particularly from private international cartels, have been calculated with some degree of accuracy. Evenett (2003)[106] noted that attempts to quantify the impact of private international cartels have grown in sophistication over the years. Studies initially focused on the price reductions observed after a cartel collapsed, and most studies pointed to a 20–40 per cent fall in prices. Therefore, if total sales of a cartelized product during a particular period amounted to US$10 billion, it could be calculated that the prejudice to consumers who bought the product in terms of price overcharges was US$2–4 billion. More sophisticated empirical techniques have been used in analysing the effects of certain individual private international cartels. Evenett observed that an analysis of the international vitamins cartel, which divided up the world markets for various types of vitamins from 1989 until 1999, was able to recover estimates of the overcharges paid by 90 vitamin-importing nations throughout the 1990s. The total overcharges in India amounted to US$25.71 million. The total overcharges for ten European Union Member States were estimated to be US$660.19 million.

Reporting on the effects of the graphite electrodes cartel (1992–1997), Evenett quoted the OECD as having estimated that the cartel affected US$5–7 billion in sales worldwide, and that throughout the world the cartel resulted in price increases from roughly US$2,000 per metric tonne to US$3,200–3,500 in various markets. In Korea, the damage incurred by the companies importing graphite electrodes was estimated by the Korea Fair Trade Commission at approximately US$139 million. The lysine cartel (1992–1995), under which cartel members engaged in price fixing, allocation of sales quotas and monitoring of volume agreements, is estimated to have resulted in overcharges to customers in the United States as high as US$141 million.

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[106] Simon J. Evenett, *Can Developing Economies Benefit from WTO Negotiations on Binding Disciplines for Hard Core Cartels?*, UNCTAD Series on Issues in Competition Law and Policy, United Nations, Geneva, 2003.

Jenny (2004)[107] reported on how Brazil lost US$500 million to an international cartel from its privatization of Eletropaulo Metropolitana, a Government-owned electricity distribution company. The privatization of the electricity company was done through floating a tender, with the reserve price that was publicly announced before the bids being US$1.78 billion. Three bidders were allowed to participate in the auction: (i) Enron, a US energy trader; (ii) the Light Energy Consortium (comprising AES, a large US energy group, Electricité de France, Houston Industries, and CSN, a Brazilian steel company); and (iii) VBC, a Brazilian group. Just before the auction took place, AES, a member of the Light Energy Consortium, approached Enron with an offer that for not bidding for Eletropaulo Metropolitana, Enron would be allowed to build a power plant with AES to supply Eletropaulo, as well as operate the plant and provide all the fuel (the Light Energy Consortium had considered a similar deal with VBC but had decided against it on advice from its lawyers). At the auction, the Light Energy Consortium came armed with two bid envelopes: one offering US$1.78 billion and another offering an extra US$500 million. When it became apparent that Enron and VBC, who were both at the auction, were not submitting bids, the Light Energy Consortium submitted the lower bid for US$1.78 billion.

If Enron or VBC had submitted bids, the Light Energy Consortium would have submitted the higher bid with an extra US$500 million. That was the amount that Brazil directly lost through the rigging of the bid. It was also estimated that Brazil could have lost up to US$1 billion, being the difference between the bid of US$1.78 billion deposited by the Light Energy Consortium and the maximum value of Eletropaulo Metropolitana as estimated by Enron when it was considering bidding. There were however other indirect costs to Brazilian consumers of electricity that arose from the bid rigging. Under the bid rigging agreement between Enron and the Light Energy Consortium, Enron would be granted a contract for the production of electricity, and part of the increase in the cost of electricity due to the contract would naturally be passed on to electricity consumers.

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[107] Frederic Jenny, *Detection and Repression of Anti-competitive Practices in Developing Countries: A Case Study*, a presentation at the Sixth Session of the Intergovernmental Group of Experts (IGE) on Competition Law and Policy, held in Geneva, Switzerland, on 8–10 November 2004.

It has also been observed that businesses will have less incentive to trade fairly when competitors can obtain a short-term advantage by misleading consumers, supplying unsafe goods or acting in a grossly unfair way. The costs of such short-term advantages will fall on both consumers and legitimate traders, often to the long-term detriment of consumers as the increased risks of doing business discourages changes to entrenched buying and investing behaviour.

Consumers are indeed the biggest beneficiaries of the effective implementation of competition policy and law, not only from lower prices, better quality of goods and services, and greater choice of goods and services that result from competition-induced economic efficiency and innovation, but also from the protection that they get from the prohibition and control of anti-competitive practices.

6. The Zimbabwean experience

As in most other developing countries, the adoption of competition policy and law in Zimbabwe was a direct result of the introduction of economic reforms in the country. In 1991, the Government of Zimbabwe concluded consultations on its “Framework for Economic Reform”, which led to the adoption of both a stabilization and structural adjustment programme under the Economic Structural Adjustment Programme (ESAP). The programme’s central components were: (i) fiscal deficit reduction combined with prudent monetary policy; (ii) trade liberalization; (iii) domestic deregulation; (iv) public enterprise reform; and (v) measures to alleviate the impact of the reforms on vulnerable groups.

Within the structural adjustment program, the Government was specifically concerned with competition and monopoly regulation issues. This was partially derived from the concern to protect consumers, as well as the need to ensure that exports are effectively promoted, and to encourage indigenous entrepreneurs. While it was noted that competitiveness would be greatly enhanced by the economic reforms, explicit competition policies were still needed in the context of the ESAP since it was noted that markets are not perfect, business behaviour is not automatically pro-competition, and public policy measures may be

unintentionally inconsistent[108]. Competition policy within the context of the structural adjustment program should thus be designed to: (i) provide government and citizens with confidence that the ESAP would not be manipulated by special interests; (ii) ensure that the benefits of the ESAP are broadly shared among both businesses and consumers; and (iii) further promote a switch to production for export markets. Consequently, the main principles of competition policy were to lower barriers to entry, and reduce RBPs, particularly monopolistic tendencies.

In a minute to the then Ministry of Finance, Economic Planning and Development, the then Ministry of Industry and Commerce in May 1991 officially mooted the idea of seriously considering the adoption of competition policy and the establishment of a competition authority in Zimbabwe. The submissions made in that minute clearly laid out the *raison d'être* and the basic parameters for competition policy in Zimbabwe, as shown in Box 3.

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[108] Report on *Study of Monopolies and Competition Policy in Zimbabwe*, prepared for the Government of Zimbabwe by Implementing Policy Change (IPC), September 1992.

Box 3: Initial Government suggestions on the adoption of competition policy and establishment of a competition authority in Zimbabwe

Monopolistic conditions in the Zimbabwean market are the result either of Government granting a parastatal the sole rights to a product, franchising, or the size of the market which restricts competitors from entry. In the case of parastatals, Cabinet in essence controls the prices the monopolies can charge with the stated principle of allowing them to break even. Until now Government has controlled the potential monopolistic tendencies of other firms through the price control mechanism. As price controls are lifted, monopolies will tend to improve their profit picture. In the absence of a regulatory body, the end result will probably be lower output levels and higher prices for those products that enjoy a truly monopolistic market. The following are the issues, among others, which a study team will have to address:

1. Defining a monopoly

   Ground rules of what constitutes a pure monopoly have to be established. There may be only one producer of a good but it may be incorrect to describe the company as a monopoly because there are substitute products. The definition of what a product is and how far the Government is willing to consider substitutes will be important in the application of the rules. This should therefore be explicitly determined.

2. Monopoly power

   There are known cases of dominant price leadership in Zimbabwe, i.e. the largest firm sets a price and the others proceed to agree on it. An example of that, prior to controls, was petrol. There are other forms of collusion that result in a monopoly situation even though there may be more than one producer. There is need for an appropriate legal framework and practical guidelines to deal with this issue.

3. Pricing goals

   As direct price controls are removed there is a need to establish guidelines for determining pricing decisions. In the case of monopolies, the impact of various pricing methods (cost plus mark-up, average or marginal cost pricing) needs to be examined so that

the Commission has clear directions on how to set prices.

4. Price determination

There is a need to establish a mechanism whereby monopoly prices are regulated. In some countries the Monopoly Commission would not act until a monopolist had set prices. The Commission then reviews those prices (by holding hearings) to decide on their appropriateness. In still other cases (particularly for public utilities) the corporation would have to apply to the Commission for any rate change. Given that the definition of monopoly is yet to be decided, it is necessary to establish the most appropriate approach to pricing. Such issues as how costs and the appropriate rate of return on capital, as well as the capital base to be used in such computations, have to be fully explored.

5. Any other pertinent issues

The approach envisaged is in two stages. First, there is need for a team to study the Zimbabwe situation in light of the above issues. Its report should take, say, four months to complete and should provide information on what exactly are the current monopoly areas and how best to deal with them while maintaining efficiency. The personnel required is a team of three experts in regulation of industry.

The team's report, when approved, should be the basis for constituting the Commission's terms of reference, scope of work and operational method as well as preparing the necessary legal framework. Because of its importance, the Government would retain the right to ask for a proposal submission from the team put forward to do the study. It is suggested that the Government moves expeditiously.

Source: Ministry of Industry and International Trade, Zimbabwe.

The need to protect the consumer against the exploitative practices of large firms in monopoly or dominant positions was therefore foremost in the mind of the Ministry of Industry and Commerce when it mooted the idea of the adoption of competition policy and law in Zimbabwe. The initial suggestions within Government circles were therefore that competition policy in Zimbabwe should specifically deal

with monopolistic practices, particularly those that lead to high prices of consumer goods[109].

It was therefore not surprising that one of the strongest lobbyists for the adoption of competition policy and law in Zimbabwe was the Consumer Council of Zimbabwe (CCZ). While the CCZ has the mandate of consumer welfare and protection, it does not have the necessary legal powers of enforcement since Zimbabwe does not have a comprehensive consumer law under the administration of that consumer watchdog[110]. The CCZ therefore saw the adoption of competition policy and law and the establishment of a competition authority in Zimbabwe as providing the necessary "teeth" in protecting consumers.

Zimbabwe formally adopted competition policy and law in 1996 with the enactment of the *Competition Act* [Chapter 14:28]. The Act however only came into force in 1998, the same year that its implementation authority, the then Industry and Trade Competition Commission, was established.

The *Competition Act* of Zimbabwe covers all the four main forms of RBPs: (i) horizontal restraints; (ii) vertical restraints; (iii) abuse of dominant position; and (iv) anti-competitive mergers. It prohibits any business practice that "*restricts competition directly or indirectly to a material degree*". As a general rule, therefore, restrictive practices are considered under the Act using the 'rule of reason' since the materiality of the practice on competition has to be determined. Certain restrictive practices that are termed 'unfair business practices' in the Act are however outrightly, or *per se*, prohibited and are considered to be criminal offences subject to fines and/or imprisonment. Such practices include: (i) misleading advertising; (ii) false bargains; (iii) distribution of commodities or services above advertised price; (iv) undue refusal to distribute commodities or services; (v) bid rigging; (vi) collusive

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[109] The idea of having a 'Monopolies and Prices Commission' in Zimbabwe along the lines of the Kenyan model was later dropped for an 'Industry and Trade Competition Commission' with a wider mandate of dealing with all forms of restrictive business practices at the recommendation of the IPC Study Team on monopolies and competition policy in Zimbabwe.

[110] Zimbabwe however has a number of consumer protection legislations that address particular concerns, such as the *Consumer Contract Act* [Chapter 8:03], and which are not under the direct administration of the CCZ.

arrangements between competitors; (vii) predatory pricing; (viii) resale price maintenance; and (ix) exclusive dealing.

It is worth noting that a number of *per se* prohibited unfair business practices under Zimbabwe's competition law (such as misleading advertising, false bargains and distribution of commodities or services above advertised price) are typical unfair trade practices that are aimed at directly protecting consumers against exploitative practices of business firms.

The competition authority of Zimbabwe has, since it effectively commenced its operations in 1999, handled over 450 different competition cases, involving both restrictive and unfair business practices and mergers and acquisitions. The impact in Zimbabwe of the competition cases handled by the authority was recently analysed in a study on the *Socio-Economic Impact of Implementation of Competition Policy and Law in Zimbabwe*[111]. The study confirmed for Zimbabwe what had been proved elsewhere, i.e. that the effective implementation of competition policy and law positively contributes towards general economic development. Its revelations on the effects of anti-competitive practices on consumer welfare in Zimbabwe are discussed below in the context of mergers and acquisitions and restrictive and unfair business practices as they are provided for under the *Competition Act* [Chapter 14:28].

6.1. Mergers and acquisitions

The study found that merger control in Zimbabwe produced immense benefits to the economy and society. Specific benefits that accrued, and are still accruing, from the mergers examined by the competition authority included: (i) generation of economies of scale or scope, and other synergic efficiencies; (ii) reduction of management inefficiencies; (iii) facilitation of research and development; (iv) creation and/or retention of employment; (v) development of export markets and

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[111] Part I of the study dealt with the impact of the examination of mergers and acquisitions. The report on that part of the study was released in November 2006. Part II of the study, the report of which is currently at the final stages of drafting, deals with the impact of the investigation of restrictive and unfair business practices.

generation of increased export earnings; (vi) promotion of foreign direct investment; (vii) continued availability of goods and services on the domestic market; and (viii) indigenization or localization of control of strategic economic activities.

In particular, it was found that the consummation of those mergers that were approved by the competition authority with certain conditions aimed at alleviating the identified competition and public interest concerns, contributed most to the socio-economic benefits accruing to the consumer. By implication therefore, had the mergers been allowed to proceed with the identified competition and public interest concerns, consumer welfare would have been compromised, and even adversely affected. These findings are outlined in Table 3.

Table 3: Mergers and acquisitions conditionally approved by the competition authority of Zimbabwe	
Merger of Rothmans of Pall Mall and British American Tobacco	This transaction involved the horizontal merger of Zimbabwe's then only two cigarette manufacturers, Rothmans of Pall Mall (Zimbabwe) and British American Tobacco Zimbabwe Limited to form BAT Zimbabwe, and was necessitated by the global merger of the international tobacco businesses of British American Tobacco Plc, Rothmans International, Compagnie Financière Richemont AG and Rembrandt Group Limited. It was noted that the merger would create a monopoly situation in the cigarette making industry of Zimbabwe and that, as in any other monopoly situation, consumers would be adversely affected through higher prices and/or reduced supply of the product, if the monopolist exercises its market power. It was however also noted that the merger was necessary to save British American Tobacco Zimbabwe from collapse since that company was evidently failing. Exit from the market of that company would have had adverse effects on the consumer due to the disappearance from the market of its cigarette brands and reduced choice. Other adverse effects would have included increased unemployment and reduced export earnings. The merger was therefore approved on the following conditions:

- that the merged party should dispose of its surplus cigarette making machinery to third parties interested and able to enter the cigarette manufacturing industry within a reasonable period of time; and also
- that the merged party should not increase the prices of its cigarettes without first justifying the price increases to the competition authority, as long as the monopoly situation created in the cigarette manufacturing industry remained in existence.

The conditions were accepted by the merging parties, who signed a formal undertaking to that effect with the competition authority. The disposal of the merged party's surplus cigarette making machinery was done within six months of the signing of the undertaking, and the purchaser of the machinery started producing cigarettes for both the domestic and export markets within 12 months. That broke the monopoly situation created by the merger, and accordingly released the merged party from the price surveillance condition.

The Competition Commission's price monitoring and surveillance role in the cigarette manufacturing industry, though short-lived since the monopoly situation created by the merger was eliminated within two years by new entrants, helped in ensuring that consumers were not exploited by the merged party's excessive pricing of its products. Four requests for cigarette price increases were submitted to the Commission for approval during the two-year period and two were rejected for lack of justification.

The merged party's surplus cigarette making machinery was purchased by a company called Cut Rag Processors (Pvt) Limited, which used the machinery to start producing new *Remington Gold* and *Oxford* cigarette brands for both the local and export markets in 2001. The brands are in four variations: the 'Virginia Blend', the 'American Toasted', the 'Light' and the 'Menthol' varieties. During the first five years of its existence, the production capacity of the company grew by more than 20 times through the procurement of additional machinery. The company now produces about 120 million cigarettes per month, of which about 10 million are for the local market. The company also employs 295 permanent employees.

	The introduction of the new *Remington Gold* and *Oxford* cigarette brands on the local Zimbabwean market gave consumers a wider choice of products. It also brought fierce competition to the dominant BAT Zimbabwe cigarette brands, which was to the benefit of consumers, such that BAT Zimbabwe lodged a complaint to the Competition Commission that its market share was being eroded by Cut Rag Processors' engagement in unfair business practices (see outline of the case in Box 6 below on preliminary investigation into allegations of restrictive and unfair business practices in the cigarette distribution industry). A review of the merger in 2006 also revealed that the transaction had ensured the continued existence on the market of the former British American Tobacco Zimbabwe Limited's *Kingsgate* and *Berkeley* cigarette brands, which are very popular with the smoking consumers but whose disappearance from the market was imminent before the merger. BAT Zimbabwe also confirmed the attainment of economies of scale in production as a result of the merger as evidenced by increased production efficiencies and machine utilization due to the use of one plant for the two companies. The merger however did not result in the stability of cigarette prices on the local market as had been envisaged, but this was mainly because of other macroeconomic constraints. The merger also directly resulted in 4,061 job losses (255 managerial employees, 3,643 non-managerial employees, and 163 contract workers), but that was not unexpected given the horizontal nature of the transaction. More importantly for future competition in the relevant market, and thus increased consumer welfare and protection, entry barriers into the cigarette making industry were removed. As a result, another new entrant other than Cut Rag Processors, a company called Savanna Tobacco Company, started producing the *Pacific* brands of cigarettes, which are becoming increasingly popular with consumers, in competition with both BAT Zimbabwe and Cut Rag Processors.
The Coca-Cola/Cadbury-Schweppes	This transaction involved the acquisition of Cadbury-Schweppes beverage brands by The Coca Cola Company. The Cadbury-Schweppes beverage brands acquired

Merger	included international brands and local brands such as the *Mazoe* and *Calypso* brands. It was noted that The Coca Cola Company was only interested in the Cadbury-Schweppes beverage brands, and not in the Schweppes' bottling plant in Zimbabwe, which would have been allowed to disintegrate after the merger, resulting in loss of jobs. The future of the local *Mazoe* and *Calypso* beverage brands was also in doubt since the practice of The Coca Cola Company elsewhere had been to 'cold store' the local beverage brands it acquired so as to remove competition to its international brands. Removal from the market of the local *Mazoe* and *Calypso* brands would not only have adversely affected the consumer because of the popularity of the brands but would also have prejudiced the local suppliers of the raw materials used in the production of those brands of beverages. The merger was therefore approved on the following conditions, which were accepted by The Coca Cola Company and formalized in an undertaking: • that The Coca Cola Company also acquire the Schweppes bottling plant in Zimbabwe as a going concern, modernize it, and establish an appropriate local shareholding structure to oversee the operations of the new company to be formed before disposing of it to interested indigenous entrepreneurs; • that The Coca Cola Company maintain the local *Mazoe* and *Calypso* beverage brands on the Zimbabwean market and develop them into regional brands with wider distribution; and • that The Coca Cola Company promote and develop Zimbabwean suppliers of raw materials required to produce the local beverages brands. As per the Competition Commission's condition, The Coca Cola Company acquired the Schweppes bottling plant in Harare and modernized it to state-of-the-art condition, thus prevented it from imminent closure and loss of employment. That also not only ensured the continued availability on the domestic market of the local *Mazoe* and *Calypso* beverage brands, which are immensely popular with the consumers, but also facilitated the expansion of the market into neighbouring countries such as Zambia, South Africa,

	Botswana and Malawi. The continued operation of the Schweppes bottling plant also guaranteed the viability of local raw material suppliers such as Mazoe Citrus Estates with resultant employment savings. It has also provided the necessary countervailing power against the possible exploitative and exclusionary practices of the dominant players in the beverages industry such as Delta Beverages.
Acquisition of Portland Holdings Limited by Pretoria Portland Cement Company	This transaction involved the acquisition of Portland Holdings Limited (Porthold), the holding company of Zimbabwe's largest cement manufacturers, by the Pretoria Portland Cement Company Limited (PCC) of South Africa. It was noted that the cement manufacturing industry in Zimbabwe was highly concentrated, with only two other players, Circle Cement and the Sino-Zimbabwe Cement Company. Local production of cement was failing to meet demand, resulting in product shortages and high prices. There were strong suspicions that the intentions of PCC after acquiring Porthold were to close down the cement plant to supply the Zimbabwean market from its operations in South Africa. That would have exacerbated the cement supply situation in Zimbabwe with adverse effects on the consumer. Job losses would also have been substantial. It was however also noted that the merger had substantial pro-competitive elements. Circle Cement, the second largest cement manufacturer in Zimbabwe, had recently been acquired by Lafarge of France in an offshore deal with the Blue Circle Group of the United Kingdom. Lafarge had also acquired cement plants in Zambia and Malawi, and was thus becoming a dominant player in the regional cement market. The acquisition of Porthold in Zimbabwe by PCC, also a strong regional player, was therefore seen as providing the necessary countervailing check against the exercise by Lafarge of its market power and any abusive practices on the Zimbabwean cement market. The merger was therefore approved on condition that PCC gave the competition authority an undertaking to honour its commitment to maintain Porthold's cement plant as a going concern and to continue producing cement in Zimbabwe.

	The major post-merger benefit of the transaction to the consumer is that Porthold's *Unicem* brand of cement is still being offered to the Zimbabwean consumers as a competitive choice to the Lafarge cements. In the five years from the time of the merger in 2001, Porthold increased its cement production from about 260,000 metric tonnes to about 350,000 metric tonnes, of which 70 per cent is for the domestic market. The employment levels in the company however decreased from 730 to 620, a direct consequence of the horizontal nature of the merger and other macroeconomic constraints facing Zimbabwean companies as a whole. The merger did not alter the structure of the Zimbabwean cement industry since the acquiring party, Pretoria Portland Cement Company Limited of South Africa, was not a player in that industry before the merger. Basically, there are still three major players involved in the production of cement in Zimbabwe: Porthold, Lafarge Cement (formerly Circle Cement) and the Sino-Zimbabwe Cement Company. The merger did not change much in terms of local competition – Porthold is still the largest player in the market, with Sino-Zimbabwe being the smallest. Regardless of the highly concentrated nature of the industry, no complaints of anti-competitive practices or conduct in the industry, either of a unilateral or coordinated nature, have been referred to the Competition Commission for investigation since the conclusion of the merger.
Acquisition of Zimtile by PG Merchandising	This transaction involved the acquisition of the operating assets of Gestap (Private) Limited, trading as Zimtile, by PG Merchandising. Zimtile was a concrete roof tile manufacturing and supply company. PG Merchandising is part of the PG Group, which is involved in the manufacture and supply of various building materials, including roofing timber. While it was noted that the transaction did not raise serious competition concerns in the form of substantially lessening competition in the relevant markets, it was however also noted that Zimtile had a practice of tying its supply of roof tiles to the consuming public to the use of its own tile-mounting enterprise. The consumer was therefore prevented from using other cheaper tile mounters of his/her choice. It was therefore felt that if that practice was to be extended after the merger to include the supply of PG Merchandising's

	roof timber, the consumer would be vulnerable to exploitation. The merger was therefore approved on condition that the merging parties give the Competition Commission a formal undertaking not to engage in tied or conditional selling involving their products following the merger. A number of stakeholders that were consulted by the Commission during its examination of the merger had expressed serious concerns over the transaction. The concerns included the possibility of PG Merchandising, a major manufacturer and distributor of roofing trusses, controlling and monopolizing the roofing market through its acquisition of Zimtile, a leading manufacturer and distributor of concrete roofing tiles, and the merged entity perpetuating Zimtile's practice of tied and conditional selling on a wider scale. Within three years of the implementation of the merger, however, Turnall Fibre Cement, a competitor of Zimtile and a major supplier of asbestos roofing sheets to PG Merchandising, which had expressed major concerns over the merger, submitted that its earlier fears of monopolization and conditional selling on the part of the merged entity had been allayed since no serious competition concerns had arisen. Costain Zimbabwe (Pvt) Limited, a construction company that had also expressed concerns over the dominance to be created by the merger, submitted that the concerns it had expressed then were largely mitigated by the entry of new players into the roofing material industry. The review of the merger in 2006 also confirmed that most of the perceived benefits of the merger were realized: (i) Zimtile was now involved in exporting, selling 10 per cent of its production of roofing tiles in regional markets, due to PG leadership and a 30 per cent increase in the production of the tiles was achieved as a direct result of the merger; (ii) employment had remained stable; (iii) roofing tiles were now available on all PG distribution sites nationwide instead of just from Zimtile's two distribution centres in the country's major towns of Harare and Bulawayo; and (iv) consumers were now being offered a wider range of roofing materials and a full roofing package, comprising roofing timber and trusses and roofing tiles, under one roof. Zimtile's previous anti-competitive practice of tied and conditional selling was also stopped, as confirmed by the Competition

	Commission's undercover monitoring of the practice.
Proposed merger of Colcom Holdings and Cattle Company Holdings	This transaction involved the proposed merger of Colcom Holdings Limited, a meat processing company, and Cattle Company Holdings Limited, a cattle auctioning and slaughter company, to create a new company called CC Holdings. Colcom Holdings controlled a number of subsidiary companies in the meat processing industry, which operated businesses such as pig breeding and rearing, abattoirs, meat wholesaling and retailing, production of smoked and canned meat products and manufacture of sausages and pies. The Cattle Company Holdings also had a number of subsidiary companies operating in businesses such as cattle auctioning, cattle slaughter and retailing of beef, and processing of cattle hides to wet-blue state. Even though the transaction affected a number of different relevant markets, only the animal slaughter market and the meat processing market raised serious competition concerns. Colcom Holdings was dominant in the slaughter pigs market, with a 60 per cent share of the market, as well as in the processed pork market, with 90 per cent of the market. Cattle Company Holdings also dominated the slaughter cattle market. The issue of joint dominance to be created by the merging parties in the supply of beasts for slaughter was of particular concern to both the competition authority and the stakeholders consulted. Previous attempts by both merging parties to eliminate effective competition in their respective markets by acquiring their closest competitors were noted with concern. The likelihood was therefore high that the merged entity could engage in anti-competitive practices, such as: (i) manipulating prices in the meat industry, and unilaterally raising them to levels not related to market forces; (ii) foreclosing the supply of cattle to competitors; and (iii) preventing new entrants or creating barriers to entry into the relevant markets; all to the detriment of the consumer. The competition authority therefore made it a condition that the merging parties should divest from the cattle auctioneering business if the merger was to be approved. The merging parties could not accept that condition and decided not to proceed with the transaction.

	It can be assumed that by not accepting the Competition Commission's merger approval conditions, which were aimed at removing the likely anti-competitive practices that were inherent in the transaction, the merging parties were bent on increasing their market share through engagement in such practices. It is therefore highly likely that had the merger been allowed to proceed without the intervention of the Competition Commission, its likely competition concerns could have adversely affected consumer welfare and protection: (i) the merged entity could have unabatedly exploited its acquired market power in the vertically integrated market, from cattle selling to cattle slaughter to meat processing and retailing, by excessively pricing its goods and services to the disadvantage of the consumer; (ii) the merged entity could also have foreclosed supplies of cattle and processed meats to its competitors, again to the disadvantage of the consumer; and (iii) the merged entity could have abused its dominance of the integrated market by engaging in exclusionary practices aimed at removing or deterring competition to the disadvantage of the consumer.
Acquisition of Shashi Private Hospital by Premier Services Medical Investments	This transaction involved the acquisition by Premier Services Medical Investments (PSMI) of a private hospital in the town of Bindura, the capital of the Mashonaland Central Province of Zimbabwe. PSMI is the investment arm of the Premier Service Medical Aid Society (PSMAS), Zimbabwe's largest medical aid society in terms of members. The target firm, Shashi Private Hospital, was the only private hospital in Bindura. It was found that Shashi Private Hospital was failing, mainly due to lack of adequate capital and an exodus of qualified medical personnel from Bindura to Harare, Zimbabwe's capital city. The hospital's exit from the market was therefore imminent. Its acquisition by the better resourced PSMI would therefore save it from closure, to the benefit of the consumers in Bindura. Serious concerns were however expressed over the vertical relationship to be created between a health-care provider and a health insurer, which could be abused by PSMAS to the detriment of the consumer. PSMAS had a history of directing its members to health institutions owned by PSMI at the threat of reduced service provision if the members did not do so. That had left members of PSMAS with no choice

	of health-care providers. The merger was therefore approved on condition that PSMAS, the parent company of the acquiring firm, give an undertaking that it would not abuse its dominant position in the health insurance services sector by engaging in restrictive practices of an exclusionary and/or exploitative nature, such as directing its members to Shashi Private Hospital and favouring Shashi Private Hospital in the handling of its members' claims. The conditions placed by the Competition Commission on the approval of this merger achieved the desired results of checking the discriminatory behaviour of PSMAS through the use of its PSMI-run medical centres. Soon after the conclusion of the merger, PSMI instructed all its medical centres throughout the country not to engage in discriminatory practices against non-PSMAS members. A competing medical centre in the Bindura area, Ponai Medical Centre, which had expressed concern over the merger that there could be delays in the processing by PSMAS of the Centre's medical aid claims to discourage the Centre from accepting PSMAS members so that they would patronize Shashi Private Hospital, confirmed that neither PSMAS nor PSMI were engaged in such anti-competitive practices. The conditional approval of the merger therefore enhanced consumer choice of medical centres, which choice had been limited by PSMAS' anti-competitive practices. Ponai Medical Centre did submit that the merger resulted in a noticeable drift of consumer patronage from the Centre to Shashi Private Hospital of about 50 per cent. That was however because of the much improved post-merger services offered by Shashi Private Hospital, which Ponai Medical Centre had to match in order to remain competitive. The same sentiments were expressed by Shamva Rural Hospital and Trojon Mine Clinic, which operate in the same geographic market as Shashi Private Hospital. The merger therefore intensified competition in the relevant market, which resulted in better and improved service to the consumer by all the market players. For Shashi Private Hospital, which was failing before its acquisition by PSMI, the merger resulted in the setting up of an X-ray facility at the institution, which was the only one in the entire Mashonaland Central Province. A pharmaceutical

	drug dispensing facility was also set up at the institution such that there is now access to medicinal drugs from within compared to the period before the merger when patients had to source the drugs from as far away as Harare, which is about 90 kilometres from Bindura. Also due to economies of scale in the production using PSMI facilities, it has been established that the drugs are relatively cheaper at Shashi Private Hospital than in other medical centres in the relevant market. Laboratory services were also put in place at Shashi Private Hospital with new machinery installed. Unlike the situation before the merger when blood samples had to be taken to Harare for analysis, the whole process is now being conducted at the institution. Blood samples from Ponai Medical Centre and Trojan Clinic are now also being analysed at the Shashi Private Hospital laboratory services centre. In terms of employment, the merger resulted in two additional doctors being engaged at Shashi Private Hospital to bring the total number of doctors to three. A number of jobs of other medical staff were also saved as there was an imminent retrenchment at the time of the takeover. All the above benefited the consumer. However, of more direct benefit to the consumer, the merger helped patients that are members of the medical aid insurance scheme under PSMAS in as far as the eradication of the cash up front practice by health-care providers was concerned. Patients at Shashi Private Hospital are no longer being required to pay cash up front for their treatment, and this has acted as a cost-saving buffer for complicated cases. For example, a caesarean section would cost a patient a shortfall of over Z$100 million even on medical aid at some centres in Harare but at Shashi Private Hospital, where the doctor and the anaesthetist are employees of PSMI, there is no need to pay such cash up front.
Acquisition of Zimboard by PG Bison (Mauritius)	The transaction involved the disposal by PG Industries (Zimbabwe) Limited of one of its subsidiaries, Zimboard Products, which made timber products, particularly particle board, for the furniture manufacturing industry, to a new wholly-owned subsidiary and the invitation to PG Bison (Mauritius) Limited to take up equity in the new subsidiary. It was noted that the merger would result in the injection by PG Bison of foreign capital that was critical for the continued viability of Zimboard's operations. Discontinuation of those

	operations would not only result in reduction of competition in the relevant market, but would also have serious effects on employment and export earnings. It was however also noted that PG Bison is linked to Steinhoff Africa Limited of South Africa, a furniture manufacturing and distribution company that had recently entered into a furniture making joint venture in Zimbabwe with one of Zimbabwe's major furniture manufacturers. The vertical relationship to be thus created between the local furniture manufacturing concern associated with PG Bison through Steinhoff Africa and PG Industries' new subsidiary to take over the operations of Zimboard could be used to exclude competition in the furniture manufacturing industry through the discriminatory supply of particle board. This could lead to higher furniture prices to the consumer. The merger was therefore approved on condition that the merging parties gave an undertaking that the merged entity would not discriminate against local furniture manufacturing companies and enterprises other than those associated with PG Bison/Steinhoff Africa in the supply of particle board or any of its other products used in the furniture manufacturing industry. Concerns over the merger that led to the imposition of the conditions on its approval had been expressed by furniture manufacturers, notably Bowline Furniture and J W Wilson (Pvt) Limited. The concerns had stemmed from the fact that PG Bison was part of the Steinhoff Group of South Africa that already had an interest in Zimbabwe in the form of Lifestyle Furnishers, a rising furniture manufacturer, with fears that competitors in the downstream furniture manufacturing industry could be denied supplies of essential particle board and fibreboard from Zimboard in favour of Lifestyle Furnishers. In the event of that happening, consumers would be harmed from lack of effective competition in the market. Two years into the merger, both Bowline Furniture and J W Wilson confirmed that the market for particle board and fibreboard was not foreclosed to them, and that Lifestyle Furnishers is not receiving any unfair favours from Zimboard in terms of raw material supplies. The parties to the merger had a natural incentive to give preferential treatment to companies in their group of companies to ensure the Group's viability and profitability.

	The Competition Commission's approval condition of the merger was therefore effective in ensuring that Zimboard does not unfairly favour Lifestyle Furnishers, and its associated company, against its competitors. That maintained and protected competition in the relevant market to the benefit of the consumer. Most of the other perceived benefits of the merger were also realized. Plant uptime, product quality and capacity utilization at Zimboard were substantially increased. Interested stakeholders confirmed that there was a noticeable improvement in terms of quality of the products offered by Zimboard following the merger. Production levels also increased by about 100 per cent, resulting in more products for both the domestic and export markets. In just a year, Zimboard's turnover increased from Z$23 billion to Z$266 billion. The company's operating profit also increased to Z$15 billion, all thanks to its partnership with the PG Bison Group.
Merger of Total Zimbabwe and Mobil Oil Zimbabwe	This transaction involved the horizontal merger of Total Zimbabwe and Mobil Oil Zimbabwe through the acquisition of Mobil Oil by Total Zimbabwe. It was noted that there were larger players than the merging parties in the relevant market in the likes of BP&Shell and Caltex. The merger would therefore not reduce or lessen substantially the degree of competition in the relevant market. It was however also noted that stakeholder concerns had been expressed over the fate of the business arrangements that Mobil Oil had with other small players in the industry, such as hospitality/supply/dealership arrangements, whose termination as a result of the merger would not only prejudice the affected small players but would also have adverse effects on the consumers. The fate of excess depots and service stations to arise from the merger was also of great concern to stakeholders, who felt that they should not be scrapped but should be used to maintain competition in the industry for the benefit of the consumer. The merger was therefore approved on condition that Total Zimbabwe gave the competition authority a written undertaking that: (i) it would honour all current agreements that Mobil Oil had with other industry players, including hospitality arrangements, supply arrangements, and

	dealership arrangements, to ensure the maintenance of competition in the relevant market; and (ii) it would dispose of all excess depots and service stations to arise from the merger to interested entrepreneurs. The Commission's conditions on the approval of the merger were accepted and executed by Total Zimbabwe. All the hospitality, etc., agreements and arrangements between Mobil Oil and other industry players were maintained, thus preventing the affected players from exiting the market. The process of disposing of the merged entity's excess depots and service stations is still ongoing, but over 20 service stations countrywide have so far been disposed of to interested entrepreneurs. The benefit to the consumer is that the service stations are still offering an essential service to the motoring public, and distributing a wider choice of petroleum products than just Total/Mobil products.

Source: Competition and Tariff Commission, Zimbabwe.

6.2. Restrictive and unfair business practices

The report on the second part of the study on the socio-economic impact of the implementation of competition policy and law in Zimbabwe, dealing with the impact of restrictive and unfair business practices, is still to be released but its findings are relevant. The study found a lot of evidence confirming the adverse effects of anti-competitive practices on consumer welfare, which are discussed using case studies on some of the investigations undertaken by the competition authority into the practices.

The competition authority of Zimbabwe, like most other such authorities in developing countries, has found it extremely difficult to prove the existence of private domestic cartels, even when the adverse effects on consumers of such conduct are evident on the market. The main reason has been failure by the competition authority to obtain concrete documentary evidence of the existence and conduct of the cartels. Zimbabwe also does not have a leniency program in place to entice cartel members to break rank and supply the requisite evidence. However, in one case involving unfair business practices in the dry-cleaning and laundry services sector, the competition authority was

lucky in that the relevant association of dry-cleaners, the Dry Cleaning and Laundry Employers Association of Zimbabwe, actually admitted during the investigation's public hearings that it set prices for its members and periodically circulated to the members detailed price lists on the various items of clothing and fabric that require dry-cleaning or laundry. The Association also supplied copies of minutes of its meetings, which gave details of workings and formulae used in arriving at the uniform prices. The competition authority was lucky in that case to have easily obtained the evidence proving the existence of the cartel from the perpetrators themselves only because the Association thought that what it was doing was normal business[112], and was not aware, at that stage, that the practice of price fixing was in serious breach of the country's competition law.

The problem of collusive and cartel-like behaviour, rather than of pure cartelization, is however prevalent in Zimbabwe. The relative smallness of the economy breeds the creation of oligopolistic structures and facilitates conscious parallelism, or tacit collusion[113], which lead to price leadership. The competition authority has dealt with a number of cases involving collusive and cartel-like behaviour in various areas, such as the financial services sector, particularly the banking sector, the cement industry, the legal services sector, and the medical services sector, with limited success. One such case is outlined in Box 4.

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[112] That was hardly surprising since during the pre-ESAP times of price controls, the Government of Zimbabwe actually encouraged industries to form associations for the purposes of members agreeing on uniform prices for price control determination.

[113] As noted by R.S. Khemani and D.M. Shapiro in *Glossary of Industrial Organisation Economics and Competition Law*, compiled for the OECD in 1991, "*Collusion does not necessarily have to involve an explicit agreement or communication between firms. In oligopolistic industries, firms tend to be interdependent in their pricing and output decisions so that the actions of each firm impact on and result in a counter response by the other firm(s). In such circumstances, oligopolistic firms may take their rivals' actions into account and coordinate their actions as if they were a cartel without an explicit or overt agreement*".

Box 4: Full-scale investigation into complaints of restrictive and unfair business practices in the cement industry

In March 2000, the Competition Commission concluded a full-scale investigation into complaints from the trade and the general public that restrictive and unfair business practices in the cement industry were leading to shortages and excessive prices of cement in the Zimbabwean market.

At that time, four companies were involved in the production and distribution of cement in Zimbabwe: (i) Portland Holdings Limited (Unicem) of Bulawayo; (ii) Circle Cement Limited of Harare; (iii) Zimbabwe Cement Company (ZimCement) of Norton; and (iv) Techniks (Pvt) Limited of Gweru. Only Unicem and Circle Cement were involved at all stages of cement production, from the quarrying of limestone to the production of cement clinker to the final product. The other two companies were more involved in blending operations. The construction of new cement plant under a joint venture between the Industrial Development Corporation (IDC) and a Chinese company was nearing completion in the small Midlands town of Lalapanzi.

The cement industry was highly concentrated, with a Herfindahl-Hirschman Index (HHI) of 4,602. The combined market share of the two largest players in the industry, Unicem and Circle Cement, was over 90 per cent, with Unicem controlling 60 per cent of the market and Circle Cement controlling 31 per cent.

Preliminary investigations into the complaints that had established a *prima facie* case for the full-scale investigation had found circumstantial evidence pointing to the following: (i) that there seemed to be a price-fixing and market-sharing arrangement between Unicem and Circle Cement; (ii) that both Unicem and Circle Cement were hindering the construction of the new Sino/IDC cement plant in Lalapanzi by refusing to supply cement for the construction; (iii) that Circle Cement insisted on using its own trucking subsidiary company to transport cement bought by its customers; (iv) that Circle Cement demanded cash up front from its customers on placement of orders, yet it took a long time in delivering the product; (v) that Circle Cement levied its customers to fund its expansion project; (vi) that Unicem discriminated among its customers in the supply of cement, a commodity then in short supply on the local market; and (vi) that while cement was in short supply on the formal market, large quantities were being sold on the informal market by backyard cement dealers.

Stakeholders consulted during the investigation included the Consumer Council of Zimbabwe. Evidence gathered confirmed that Unicem and/or Circle Cement were engaged in some of the alleged restrictive practices, particularly those of an abuse of dominance nature, such as: (i) distribution of cement in a discriminatory and unfair manner; (ii) imposing unfair and exploitative payment conditions on their customers; and (iii) withholding supplies of cement to the formal market in favour of the informal market. No evidence was however found that the cement companies were preventing or delaying the entry into the cement industry of the Sino/IDC joint venture by withholding supplies of cement.

Also, no evidence was found that Unicem and Circle Cement were colluding in price fixing or market sharing. What was found was that the homogeneous nature of the product made the costs of its production more or less similar amongst the different producers. Unicem, the market leader, also set the price, which was followed by the other market players without covert agreements. Regarding market sharing, it was found that the nature of the product was also such that transport costs effectively restricted its distribution to areas close to its production points. Unicem operated from Bulawayo, and therefore its natural geographic market was the Matebeland Province and the nearby Midlands Province. Likewise, Circle Cement operated from Harare and its natural geographic market was the Mashonaland Province and the nearby Manicaland Province. However, during periods of acute cement shortages in either of the cement company's natural markets, the other company's products were also found to be in short supply in the market.

The Commission issued cease-and-desist orders against Unicem and Circle Cement on the identified restrictive practices in the cement industry.

Source: Competition and Tariff Commission, Zimbabwe.

The anti-competitive practices in the cement industry that were identified by the competition authority's investigation had been adversely affecting the consumer by aggravating shortages of cement, and raising prices of the essential commodity on the market. The adverse effects were either direct to the consumer or through the use of cement for industrial purposes, including construction of roads and bridges under public projects. Cases of abuse of dominance, monopolization, have also been prevalent in Zimbabwe.

The competition impact study found that abusive practices of firms in monopoly or dominant positions have had profound adverse effects on Zimbabwean consumers.

Some of the abuse of dominance cases investigated by the competition authority that illustrate this point are outlined in Boxes 5–7.

The anti-competitive practices in the coal industry had led to serious shortages of coal for both industrial and domestic use. Companies like Hunyani Pulp & Paper Division, in the paper packaging industry, Zimbabwe Iron and Steel Company, in the steel making industry, and Delta Corporation, in the beverages industry, all submitted that the coal shortages that arose from the restrictive practices had caused them serious loss of production on a number of occasions. The coal-induced production problems experienced by various industries impacted negatively on the welfare of the consumers who had to endure the resultant shortages and high prices of the affected basic commodities.

The consumer was directly affected by the anti-competitive practices in the coal industry by being denied normal supplies of coal for household heating and cooking purposes.

Box 5: Full-scale investigation into allegations of restrictive and unfair business practices in the coal industry

The Commission in November 2001 concluded a full-scale investigation into allegations of restrictive and unfair trade practices in the distribution of coal on the Zimbabwean market. The allegations had been referred to the Commission for investigation by a company called RAE (Pvt) Limited that had complained that it was being unfairly prevented by Wankie Colliery Company (WCC), the country's sole coal producer, from entering the coal distribution industry as a Coal Merchant.

The allegations that were brought to the attention of the Commission were that: (i) WCC was putting barriers to entry into the coal distribution industry by not applying its requirements for appointment as a Coal Merchant in a fair and transparent manner; (ii) WCC was unfairly allocating coal, particularly the popular 'washed peas' grade, amongst the appointed Coal Merchants; and (iii) WCC was abusing its monopoly position in the supply of coal on the local market by arbitrarily imposing exorbitant coal price increases.

The investigation found that WCC was indeed abusing its monopoly position in the coal supply industry. While the Colliery had clear criteria and guidelines on the appointment of Coal Merchants, it was allowing the bad blood created between its management and RAE (Pvt) Limited to influence its treatment and determination of that company's application. The requirements placed on RAE's applications were more stringent than those in the guidelines and those placed on the applications of other recently appointed Coal Merchants. WCC had also incorporated zoning provisions in its Memorandum of Agreement with the appointed Coal Merchants that divided the Zimbabwean market amongst the merchants, thus allowing them to effectively operate as monopolists in their allocated markets. It was also selling its popular 'washed peas' coal grade on condition that buyers also buy the other less popular grades that they did not want.

On the basis of its findings, the Commission ordered WCC: (i) to resume and complete within 30 days its consideration of RAE (Pvt) Limited's application for appointment as a Coal Merchant on the basis of its *Requirements for Appointment as Coal Merchant* already submitted to RAE (Pvt) Limited; (ii) to remove the anti-competitive zoning provisions in its Memorandum of Agreement with the appointed Coal Merchants; and (iii) to cease and desist from the restrictive practice of tied and conditional selling of its coal products.

The Commission also made recommendations to the Ministry of Mines and Energy to seriously consider establishing a sector regulator in the coal industry to regulate the monopoly situation in that industry.

Source: Competition and Tariff Commission, Zimbabwe.

Box 6: Preliminary investigations into allegations of restrictive and unfair business practices in the cigarette distribution industry

In October 2001, the Commission received a complaint from British American Tobacco Zimbabwe (Holding) Limited (BAT Zimbabwe) that a new entrant into the cigarette manufacturing industry, Cut Rag Processors, was engaging in restrictive and unfair trade practices in the distribution of its new *Remington Gold* cigarette brands by not printing on its cigarette packs the correct health warning clause that had been agreed with the Ministry of Health in 1995. The health warning clause agreed with the Ministry reads "*Smoking May Be Hazardous To Health*", while that on Cut Rag Processors' cigarette packs reads "*Tobacco Seriously Damages Health: Underage Consumption Prohibited*".

In response to BAT Zimbabwe's complaint, Cut Rag Processors counter-complained that BAT Zimbabwe was attempting to drive it from the market by persuading retailers to remove its products from the shelves on the strength of a written directive to Cut Rag Processors from the Minister of Health to stop selling its cigarettes until it printed the agreed health warning clause on its cigarette packs.

The Commission investigated BAT Zimbabwe's allegations against Cut Rag Processors as constituting 'misleading advertising', which is a prohibited unfair business practice under the *Competition Act*, while Cut Rag Processors' allegations against BAT Zimbabwe were investigated as constituting abuse of dominant position.

The background to the case was that a merger in 2000 of Rothmans of Pall Mall (Zimbabwe) Limited and British American Tobacco (Zimbabwe) Limited to form BAT Zimbabwe created a monopoly situation in the Zimbabwean cigarette manufacturing industry. The otherwise beneficial merger was therefore conditionally approved by the Commission subject to the merged party disposing of its surplus cigarette making machinery to third parties interested in entering the cigarette manufacturing industry. The merged BAT Zimbabwe fulfilled that condition by auctioning its surplus machinery to Cut Rag Processors who, in August 2001, used the machinery to start producing its new cigarette brand called *'Remington Gold'* for both the local and export markets. The entry of Cut Rag Processors into the cigarette manufacturing industry broke BAT Zimbabwe's monopoly position in that industry. The industry was

however still highly concentrated, with an HHI of 9,224. BAT Zimbabwe still dominated the market, with a market share of 96 per cent, while Cut Rag Processors' share of the market was only 2.5 per cent. Imports accounted for the remaining 1.5 per cent of the market.

The Commission found that the health warning on Cut Rag Processors' cigarette packs was not misleading, nor did it place Cut Rag Processors in an unfair competitive position *vis-à-vis* BAT Zimbabwe. The warning was stronger than the one agreed in 1995 between BAT Zimbabwe and the Ministry of Health, and correctly informed the consumer of the health consequences of smoking cigarettes. It was also noted that BAT Zimbabwe itself was distributing on the local market imported cigarettes with a health-warning clause similar to the one being used by Cut Rag Processors, which had been approved for international use.

On the other hand, the Commission found that BAT Zimbabwe was using the Ministry of Health's directive on the health-warning clause, and abusing its position as the major supplier of cigarettes on the local market to persuade retailers to remove Cut Rag Processors' cigarettes from the shelves. That constituted attempts at predation aimed at driving Cut Rag Processors out of the market. The predatory actions against Cut Rag Processors were also seen as BAT Zimbabwe's subtle attempts at nullifying the conditions attached to the Commission's approval of the BAT/Rothmans merger in 2000. In that regard, it was noted that BAT Zimbabwe had reluctantly agreed to the condition. At that time, the Chief Executive Officer of BAT Zimbabwe had been heard to comment that he should "*not be expected to assist in the formation of a competitor*".

Therefore, while the Commission dismissed BAT Zimbabwe's allegations against Cut Rag Processors, it issued a cease-and-desist order on that company against its predatory actions against Cut Rag Processors.

Source: Competition and Tariff Commission, Zimbabwe.

BAT Zimbabwe's anti-competitive practices in the cigarette distribution industry of Zimbabwe had serious implications for consumer welfare. Had that company managed to drive Cut Rag Processors out of the market, the consumer could have been deprived of a cigarette brand, *Remington Gold*, which was gaining popularity in the local market

for its price and quality, and also a strong foothold in the South African export market.

The exit of Cut Rag Processors from the market would also have returned BAT Zimbabwe to the monopoly position it used to hold, thus depriving the consumer of the benefits of competition.

Kadoma Textiles' anti-competitive practices had the effect of: (i) restricting the distribution of textile fabric offcuts to only preferred customers; (ii) increasing the prices of the offcuts through the creation of a distribution chain that had multiple profit mark-up levels; (iii) preventing the distribution of the offcuts by the most economical or efficient means; and (iv) preventing or restricting entry into the fabric offcuts industry. The practices not only denied members of fabric-trading cooperatives a livelihood from loss of business, but also adversely affected the final consumers. It was submitted that at one time, Mutinhimira Fabrics, one of Kadoma Textiles' preferred customers, was supplied with 3,788 kg of offcuts, including the popular 'distorted fents' type, while members of at least three different cooperatives were supplied with only 14 kg of the less popular strip types. It was also submitted that while Mutinhimira Fabrics was able to access the offcuts at Z$260 per kilogram, the material was being sold to the cooperatives at Z$700 per kilogram.

The final consumers of the fabric offcuts, i.e. poor workers who buy the material to make clothes, including school uniforms, and bedding materials for themselves and their children, were therefore short-changed by the resultant higher prices of the otherwise cheap waste product.

The competition authority of Zimbabwe has also investigated a number of cases involving unfair business practices that directly harm the consumer, such as misleading advertising, false bargains and distribution of commodities or services above advertised price. These can also be referred to as 'unfair competition practices' to distinguish them from anti-competitive practices since they may not directly reduce or lessen competition in a relevant market, nor fall under the strict categories of abuse of dominance or anti-competitive agreements. Box 8 gives details of such an investigation.

Box 7: Full-scale investigation into allegations of restrictive and unfair business practices in the textile fabric offcuts industry in the Kadoma area

In September 2006, the Commission concluded a full-scale investigation into allegations of restrictive and unfair business practices in the textile fabric offcuts industry in the Kadoma geographic area. The allegations, which were brought to the attention of the Commission by a cooperative of fabric merchants through the Ministry of Special Affairs Responsible for Anti-Corruption and Anti-Monopolies in the Office of The President and Cabinet, were that there was an exclusive fabric offcuts supply arrangement between Zimbabwe Spinners and Weavers Limited, trading as Kadoma Textiles, and a company called Power Mark (Pvt) Limited, which was owned by the Managing Director of Kadoma Textiles, under which Power Mark had exclusive access to fabric offcuts produced by Kadoma Textiles.

Textile fabric offcuts are by-products from the manufacture of fabric and are regarded as waste material after failing to meet the necessary quality and specification standards. The offcuts however have commercial value since some of them are large enough, or can be sewed together, to make garments or other fabric products.

Kadoma Textiles is the only company that manufactures textile fabric, and therefore produces the fabric offcuts, in Kadoma, a town situated about 150 kilometres west of Harare. Offcuts constitute about 0.1 per cent of the company's entire production of fabrics. Barriers to entry into the textile industry are very high. The production process is very capital intensive, with most of the capital requirements being imported at high foreign currency cost.

The Commission's investigation included stakeholder hearings into the matter. It was confirmed that Kadoma Textiles did have an unwritten arrangement with Power Mark under which all fabric offcuts produced by Kadoma Textiles were sold exclusively to Power Mark. In turn, Power Mark had a written agreement with another company called Mutinhimira Fabrics under which that company acted as Power Mark's exclusive agent in sales to other fabric traders and to the general public of the fabric offcuts obtained from Kadoma Textiles. That created a chain of vertical distribution, whereby fabric offcuts would move from

Kadoma Textiles to Power Mark and to Mutinhimira Fabrics and finally to other traders and the public. At each level in the distribution chain there was a profit mark-up, which resulted in higher prices to traders and consumers. Power Mark subsequently stopped operations but the arrangement that it had had with Kadoma Textiles was continued with Mutinhimira Fabrics.

A consent agreement was negotiated between the Commission and Kadoma Textiles under which the textile manufacturer agreed to: (i) stop the practice of selling exclusively to Mutinhimira Fabrics or to have any other exclusive arrangement with any other enterprise or organization; and (ii) to ensure that there was equal and unrestricted access to textile offcuts by all interested parties through its retail shops. However, while Kadoma Textiles opened up its supply of offcuts to other fabric traders and the general public through its retail outlet in the town of Kadoma, it transpired that certain of its favoured customers, who included Mutinhimira Textiles and some of its senior employees, continued to get preferential supplies of the offcuts from the factory mill in terms of quantity and quality, as well as price, of the material.

The Commission therefore ordered Kadoma Textiles to ensure that there was equal and unrestricted access to textile fabric offcuts by all interested parties at all stages in the distribution chain from the mill to the retail shops in a non-discriminatory manner in terms of prices, quantities and variety.

Source: Competition and Tariff Commission, Zimbabwe.

Box 8: Preliminary investigation into suspected unfair business practices in the cooking aids industry

In September 2005, the Commission undertook an investigation into advertisements placed in the national newspapers by Nestlé Zimbabwe warning the public of the appearance on the market of some relish mix

(cooking aids) packaged in packets purportedly originating from Nestlé. It was indicated in the newspaper advertisements that the fake product was of a poor quality and not suitable for human consumption. The packets used for packaging the product, while bearing Nestlé's *Maggi* relish mix trade name, were also of a small 15 g size, instead of Nestlé Zimbabwe's normal 75 g packet for that product.

The Commission investigated the complaint as 'misleading advertising', an unfair business practice prohibited under the *Competition Act*, since the alleged conduct was aimed at misleading the consumer to believe that the product was a genuine Nestlé product.

In its investigation, the Commission found that while the packaging in question was indeed a Nestlé Zimbabwe packaging that was no longer in use, having been discontinued in 2003, the contents were not a genuine Nestlé product. It was also found that a woman had actually been arrested by the police for producing and distributing the fake product but had been released after paying an Admission of Guilt fine. The woman had confessed that she produced the product at her house in one of Harare's high-density suburbs using her own rudimentary recipe and ingredients, and packed them for distribution in Nestlé Zimbabwe's *Maggi* relish mix packets that she had bought in reels from the streets. Soon after her release, the woman was rearrested for the same offence, and was awaiting trial at the time of the Commission's investigation having been charged under the *Brands Act*.

It was also found that the practice was spreading, with some of the fake products being distributed in other towns throughout the country. Another woman was also arrested by the police for the practice, and again charged under the *Brands Act*.

Since penalties under the *Competition Act* for unfair business practices such as misleading advertising are harsher, and therefore more deterrent, than those under the *Brands Act*, the Commission submitted its findings and the evidence gathered during the investigation to the Attorney General's Office to strengthen the cases against the arrested perpetrators.

Source: Competition and Tariff Commission, Zimbabwe.

The misleading advertising case involving food relish mix that was investigated by the competition authority of Zimbabwe had serious implications for consumer protection and welfare. The investigated practice harmed consumers not only in terms of poor quality product, but also, more seriously, in terms of threats to human health. The fake product was produced in an unhygienic environment using unspecified and untested ingredients. The discarded Nestlé packaging that was used for packing the product was also picked up from the rubbish dumpsites.

7. Conclusion

The effects of anti-competitive business practices on developing countries and their development prospects are serious and can, to some extent, be quantified. This has been done through analysing the adverse effects of anti-competitive practices on consumer welfare and protection. The analysis has largely been based on the practical experience of Zimbabwe, which is a typical developing country whose experiences in the matter can be considered as representative of the situations in most other developing countries.

From Zimbabwe's experience, conditions placed on the approval of mergers can effectively be used to address not only competition concerns but also other public interest concerns, including consumer concerns, which have long-term implications for competition. In the case of Zimbabwe, the merger approval conditions have not only been used to address particular competition concerns in the transaction, to enable the consummation of otherwise beneficial mergers, but have also been used to realize other public interest benefits, including: (i) employment creation and/or maintenance (the Rothmans of Pall Mall/British American Tobacco merger (to some extent), the Coca-Cola/Cadbury-Schweppes merger, and the Zimtile/PG Merchandising merger); (ii) continued availability of goods and services on the domestic market (the Rothmans of Pall Mall/British American Tobacco merger, the Coca-Cola/Cadbury-Schweppes merger, the Zimtile/PG Merchandising merger, the Shashi Private Hospital/PSMI merger and the Zimboard/PG Bison merger); (iii) promotion of foreign direct investment (the Coca-Cola/Cadbury-Schweppes merger, the Porthold/Pretoria Portland Cement merger, and the Zimboard/PG Bison merger); (iv) indigenization and localization of economic control (the Rothmans of Pall Mall/British American Tobacco merger, the Coca-

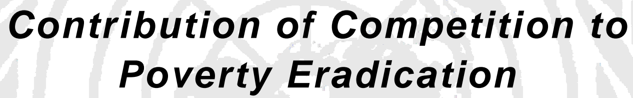
Cola/Cadbury-Schweppes merger, and the Total Zimbabwe/Mobil Oil Zimbabwe merger). Other public interest benefits realized from the mergers included enhanced consumer welfare through better quality and a wider range of products (Rothmans of Pall Mall/British American Tobacco merger, the Zimtile/PG Merchandising merger, the Zimboard/PG Bison merger and various other mergers that have not been outlined in this essay, such as the Innscor Appliances/WRS merger and the Delta Beverages/Mr Juicy merger).

In the area of RBPs, the Competition Commission's remedial orders on the identified anti-competitive practices have also addressed myriad competition and public interest concerns that inhibit development. The orders have included: (i) cease-and-desist orders on the RBPs (the Cement Distribution case, the Coal Distribution case, and the Cigarette Distribution case); (ii) orders on the removal of entry barriers (both of a behavioural and structural nature) (the Coal Distribution case and the Kadoma Textiles case); and (iii) orders to prosecute violators of provisions of the *Competition Act* that are specifically aimed at protection of the consumer (the Cooking Aids case). The Commission has also made recommendations to the relevant Government authorities on the addressing of particular competition concerns in other public policies with the aim of promoting competition, and thus ultimately consumer welfare and protection, for the facilitation of economic development.

Zimbabwe is one of the few countries in Eastern and Southern Africa, together with Kenya, Malawi, South Africa, Tanzania and Zambia, which has a competition law in place, and the authority to implement the law. It has therefore been able to benefit from the effective enforcement of competition rules.

Also shown is that there is a positive interface between competition and consumer welfare and protection, and the analysis undertaken has not identified any conflicts between the attainment of competitive markets and consumer interests.

PART B:



Contribution of Competition to Poverty Eradication

THE ROLE OF COMPETITION LAW AND POLICY IN ALLEVIATING POVERTY – THE CASE OF ZAMBIA

Thulasoni Kaira*

1. Introduction

Definitions of poverty are normally debatable but have increasingly taken an economic rationalization approach where a standard quantifiable figure of "less than a dollar a day" has been used as the rule of the thumb. Arguments may arise as to the determination of poverty levels in a country and the variables thereto, more so when such determination has been done by foreign expertise. Some of the more developed countries refuse to accept the existence of poverty in their countries; while the lesser developed countries usually acknowledge its existence but often tend to argue against higher statistics thereto. This is because poverty is an embarrassing phenomenon to acknowledge. A discourse on causes of poverty would also produce varying answers ranging from wrong Government policies to "laziness" of the poor. Whichever the case and whatever the answers to the many more questions that may be posed about poverty, the presence of some less or extreme levels of poverty is a reality in almost each country and denial in any context and to any extent would likely impede the efforts to address the issue. Inevitably, poverty alleviation and/or eradication is a subject and source of wealth for a lot of other people who study the phenomenon in less developed countries either through research organizations or through personal individual consultancies. For this reason, poverty is big business anywhere, more

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so in Africa. Evidently, the way to a poor man's mouth is through a rich man's hand.

Whatever the causes of poverty, the solution to alleviating them would ordinarily have to lie in pragmatic policy interventions. Precisely, there is a need to know who the poor are and where they are to be found. For example, as far back as 1998, in a report for the Zambia Central Statistical Office (CSO)[114], it was shown that 84.4 per cent of the small-scale farmers (who are concentrated in the countryside) were living in extreme poverty. This was at a time when the overall national poverty levels were at 84 per cent. According to this same study, the population living in the high-cost areas experienced a significant increase in their poverty level between 1996 and 1998, but they continued to have the second smallest incidence of poverty next to the large-scale farmers. On the whole, life was good for the large-scale farmers.

The prevalence of high poverty levels in less developed countries such as Zambia is not only embarrassing but one that requires serious attention in terms of feasible or result-oriented policy formulation as well as realising the intended objectives and/or refocusing the same. Dealing with poverty in the Third World is a mammoth task that often appears to dog the most prudent of policies, competition policy notwithstanding.

A casual observation shows that where there is stable political leadership, there is likely to be sustainable macro-economic indicators, which are a prelude to any meaningful poverty eradication efforts. There would appear to be some indications of such positive strides in countries within the region such as Namibia, Botswana, Mauritius, and to a notable extent, Zambia and South Africa.

The road to poverty reduction in Zambia was ably formulated under the auspices of the Ministry of Finance and National Planning in the *Poverty Reduction Strategy Paper* –PRSP (2002). An outline representation of its implementation is given in Appendix 1. The PRSP considered poverty in the following ways:

[114] *Living Conditions in Zambia*, Zambia Central Statistical Office, 1998.

- *Income perspective:* A person is poor if his/her income falls below a defined moneymetric poverty line, e.g. $1 a day.
- *Basic needs perspective:* A person is poor if he/she falls short of the material requirements for minimal acceptable fulfilment of human needs. This concept goes beyond the lack of income.
- *Capability perspective:* A person is poor if he/she lacks certain basic capabilities to function. Such 'functionings' range from physical ones such as adequate food, clothing, and shelter to more complex social achievements such as participation in the life of the community. The merit of the capability approach lies in its ability to reconcile the notions of relative and absolute poverty. Relative deprivations in incomes and material requisites can lead to absolute deprivation in capabilities.

A truly holistic measure of poverty needs to encompass elements from all three perspectives. The PRSP recognised that the traditional measures (such as the headcount index) that capture only income deficiency are simply not adequate. One such holistic measure is the Human Poverty Index (HPI), developed by the United Nations Development Programme (UNDP)[115]. The HPI, which intends to gauge a broader notion of 'human poverty' as opposed to just income poverty, appears to be a composite index that measures deprivation in three broad dimensions: deprivation of a long and healthy life measured by the percentage of newborns not expected to survive to 40 years of age; deprivation of knowledge measured by illiteracy; and deprivation in economic provisioning measured by the percentage of the population lacking access to health services and safe water as well as the number of children who are moderately or severely underweight.

Even the HPI, however, does not measure all aspects of poverty. It excludes, for instance, lack of political freedom and personal security and the inability to participate in decision making and in the life of the community. Notably, the Government acknowledged in the PRSP that these facets of poverty are of course not easy to measure.

While the PRSP has been implemented in some measure, its success is a subject of continued debate. In an attempt to contribute to this debate, this study analyses the causes of poverty in Zambia and its

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[115] *Human Development Report,* United Nations Development Programme, 1997.

location, what is being done to address poverty, and how competition law and policy has and/or can be used to address poverty, before presenting conclusions.

In the context of competition law and policy, it is essential to hypothesize that any poverty alleviation efforts have to create wealth (i.e. through efficiencies), create jobs (i.e. through new entry), and/or reduce prices (through competition). Where competition enforcement efforts do not lead to these results, then the existence of this law should be questioned and answers given as to why these results are not self-evident. There is a public demand that all institutions that depend on the taxpayer for their existence must be able to demonstrate their benefit to the general public, more so in terms of facilitating the creation of wealth. In the conclusion, there is an attempt to explain any observed failures of competition law and policy to function as an effective tool for poverty alleviation strategies.

2. Literature review on interface between competition policy and law and poverty alleviation

It is now common knowledge in the domain of the average competition student that the primary objective of competition policy is to enhance consumer welfare by promoting competition. Economic efficiency is generally enhanced by encouraging competition, and thus one of the key links between competition policy and development has been the role that competition policy plays in increasing economic efficiency. The efficient use of resources is especially important in the development context where resources are particularly scarce. Less developed countries such as Zambia would fall into this category.

The main static effects of competition are to reduce the ability of firms to raise prices above marginal cost and to ensure that firms produce at the lowest possible costs. The dynamic consequences of competition can include incentives to innovate, to imitate, and to invest in the development of new technologies and know-how. Competition policy reinforces economic efficiency by preventing or providing

remedies for market structures and business practices that weaken the degree of inter-firm rivalry in markets[116].

While the above statements appear quite abstract, there are some scholars and experts who have attempted to actually directly link competition policy and law implementation efforts to poverty reduction *per se*. For instance, Fox (2007)[117] submitted that market tools are a very important part of the panoply of tools needed to address world poverty and that they should be used liberally. These market tools include market-freeing measures that reduce prices. They also include antitrust priority setting that targets conspiracies that raise the price of staples, such as milk, bread, transportation and utilities, helping the poor as well as those who are better off. Perhaps the critical challenge to the traditional efficiency advocacy for competition law and policy was best rephrased by Fox when she asked this pertinent question: If you were a policy maker in a country whose principal economic problem was deep systemic poverty, aggravated by corruption, cronyism, selective statism, weak institutions, and often unstable democracy, what is the foundational perspective on which you would formulate your country's antitrust law? In particular, would you choose a foundational principle that trusts liberalization and free enterprise ("first model") or would you choose a foundational principle that centrally takes account of the opacity, blockage and political capture of your markets, and includes some measure of helping to empower people economically to help themselves ("second model"). In the face of the disparities in wealth and opportunity to the harm of some of the poorest people caused by globalization, Fox considered the second model to be the other path through which developing countries can use competition law to ensure that the free market policies do not disproportionately advantage the already advantaged in every game played. It is clear than even in the face of liberalization, developed countries liberalized where convenient

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[116] OECD Conference, *Investment for Development: Making it Happen*, Background Information in Support of the Global Forum on International Investment *Putting the Policy Framework for Investment into Action* – a Policy Framework for Investment: Competition Policy, 25–27 October 2005, Rio de Janeiro, Brazil, Hosted by the Government of Brazil. Organized by the OECD Investment Committee in partnership with the World Bank.

[117] Prof Eleanor Fox, *Economic Development, Poverty and Antitrust: The Other Path,* New York University Public Law and Legal Theory Working Papers, Paper 57, 2007.

and resisted liberalization where inconvenient. Fox attempted to link deep systemic poverty to inequality in world trade.

Freeing the markets has been shown to hold great economic benefits for developing and transition countries. For this, Fox is convinced that antitrust can help, although she is mindful of the form such an antitrust law should take.

Khemani has observed that the World Bank's *Global Economic Prospects Report* (2003) points to the pro-growth and pro-poor benefits of competitive markets. Research conducted for the report indicates that economies with competitive domestic markets generally tend to have higher levels and rates of growth in *per capita* income. Entry of firms plays an important role in the competitive process and such economies also have lower rates of poverty and attract more domestic and foreign investment. Accordingly, these research findings are considered to be consistent with the theory that barriers to competition impede innovation, growth and prosperity[118]. While enactment of a competition law does not necessarily result in competition, Khemani has acknowledged that with a competition law in place, it signals to firms and markets that certain business behaviours and commercial practices, as defined in the law, are illegal. It confers rights and obligations on transacting parties and provides for due process to resolve disputes and obtain relief from anti-competitive practices. Findings from the World Economic Forum's *The Global Competitiveness Report 2006–2007* provides further evidence of the importance of competition, and competition law and policy, in fostering higher incomes, broad-based markets (less dominant firms) and global competitiveness.

The Department for International Development (DFID)[119] has recognized that fair competition in markets is crucial for economic and social development, and for reducing poverty yet anti-competitive practices diminish the opportunities for innovation and growth, making consumers worse off. Recognition is made (p. 38) of the contribution

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[118] R. S. Khemani, *Competition Policy and Promotion of Investment, Economic Growth and Poverty Alleviation in Least Developed Countries,* Occasional Paper 19, the World Bank, FIAS, 2007.

[119] *Competition Assessment Framework – An operational guide for identifying barriers to competition in developing countries,* Department for International Development, Zambia, January 2008.

that competitive markets can make to economic growth and to poverty reduction.

The development of the micro, small and medium-sized enterprises (MSMEs) may also appear to be one area where competition law and policy may facilitate growth and thus reduce poverty. Hallberg[120] has observed that imperfectly competitive markets for products produced by SMEs are certainly a distortion that creates a bias against small firms. In addition, imperfect competition in markets for products and services used by SMEs (for example, financial markets) can discriminate against them. The first-best solution would be to deal directly with the market failure (e.g. enforcing competition policy).

Hallberg argued that SME promotion is justified on the grounds of the greater efficiency of small firms, their contribution to a more equitable distribution of income, and their role in generating employment. However, she was sensitive to the fact that empirical evidence supporting these claims was very mixed. The real reason that developing country governments should be interested in SMEs was not because of the benefits of smallness, but because "they are there", and account for a large share of employment.

3. The poverty levels in Zambia

According to the latest statistics from the Zambia CSO, Zambia has a population of about 11 million. Of this population, about 500,000 are formally employed while the rest are either children, retirees, or are self/informally employed. A walk in the streets of Lusaka, more so in the unplanned settlements (or "compounds" as they are commonly referred to), shows a large proportion of the self-employed, notably women. These are arguably the visible urban poor. Those in rural settlements are considered to be arguably worse off[121] because of the volatile nature

[120] Kristin Hallberg, *Small and Medium Scale Enterprises: A Framework for Intervention,* Small Enterprise Unit, Private Sector Development Department, The World Bank, May 21, 1999.

[121] On the other hand it may be argued that although materially poorer, those in rural areas, in the absence of drought and animal disease, are better off in that they are spared the squalor of urban settlements which are often incubation spots for disease and societal rot.

of their economic lifelines, e.g. crop yield and livestock rearing may be susceptible to drought and disease.

While poverty levels in Zambia remain unacceptably high, there has been tremendous progress made in terms of macroeconomic stability since 2002, which has had positive effects on the microeconomic variables. While there is a lot to be done in terms of developing a culture of competition in public procurement and private business dealings, there is still a lot that has been done in terms of realigning the economy from a State-controlled economy to a market economy.

Table 1 shows the relatively commendable growth rates that have been achieved since 2000, with relatively higher growth rates registered since 2002 onwards.

Table 1: Key macro-statistics 1996–2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total GDP at current prices (ZK'billion)	3,950.2	5,140.2	6,027.9	7,477.7	10,071.9	13,132.7	16,260.4	20,479.2	25,997.4	32,456.3	38,676.5
Total GDP at constant (1994) prices (ZK'billion)	2,328.1	2,404.9	2,360.2	2,412.7	2,499.0	2,621.3	2,707.9	2,846.5	2,999.2	3,155.9	3,343.3
GDP *per capita* at current prices (kwacha)	444,059	564,127	645,869	782,201	1,028,587	1,301,621	1,562,085	1,906,038	2,344,290	2,836,723	3,278,034
GDP *per capita* at constant (1994) prices (kwacha)	261,707	263,935	252,886	252,384	255,213	259,806	260,138	264,930	270,450	275,830	283,365
GDP growth rate at constant (1994) prices	6.9	3.3	–1.9	2.2	3.6	4.9	3.3	5.1	5.4	5.2	6.2

Source: CSO, National Accounts Statistics.

With the growth rate, the poverty levels appear to have also diminished, as shown in Table 2:

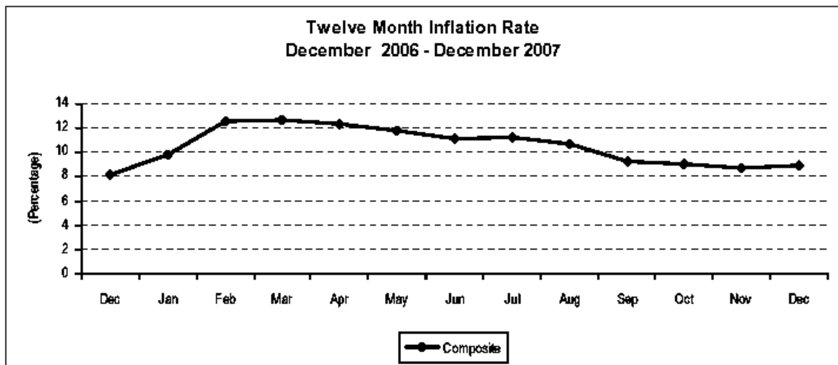
Table 2: Poverty trends 1991–2006

Total/Residence	1991	1993	1996	1998	2004	2006
Zambia	70	74	69	73	68	64
Rural	88	92	82	83	78	80
Urban	49	45	46	56	53	34

Source: CSO, *Living Conditions Monitoring Survey V* (2006).

Despite the liberalization and commercialization of the economy from 1991, the biggest challenge to Zambia's efforts to reduce poverty have been years of high inflation in the 1990s. It was not until 2002, when the "New Deal" policies[122] of the present Government were announced, that Zambia appeared to show great strides in this regard, which culminated in a single-digit figure in 2006. With reduced inflation, this has seen interest rates decrease and provided affordable finance capital to business, more so the SME segment that provides critical supply linkages to the growing mining industry.

Graph 1 shows the inflationary trend from December 2006 to December 2007.



Source: Consumer Price Index (CPI), December 2007

Graph 1: Inflation rate December 2006 to December 2007

While stabilisation of inflation has been a significant success story of the New Deal policies – and admittedly other macro-economic

[122] At his inaugural Presidential speech in January 2002, current President Levy Mwanawasa, enunciated "New Deal" policies that he promised his government would follow in order to change the economy and reduce poverty levels.

statistics show some good news – the figures would appear to still be far from the reality on the ground in so far as extreme poverty levels are concerned. A consideration of those that are poor shows that they are to be found somewhere in the

- small informal businesses sector (largely street vendors and market traders), and
- agriculture sector (largely the rural areas, where the poverty levels are about 80 per cent).

It would be in these areas that competition law should show itself active in ensuring that any interventions yield efficiencies that trickle downstream.

4. Why there is still extreme poverty in Zambia

Having identified where the majority of the poor are, it is a natural consequence to ask the question: Why do we have poverty, especially extreme poverty? Various reasons have been advanced by both Government and external development partners on the causes of extreme poverty levels in Zambia. Whatever the causes, they should be the primary mischief that competition law and policy should, directly, and/or indirectly, be engaged actively and otherwise to resolve. Various writings including those of the CSO and the PRSP (pp. 28–29) have posited hypotheses as to why there is poverty in Zambia. These have been considered as follows:

4.1. Lack of economic growth

At the time that the PRSP was being drafted and finalized (in 2002), the economic reality of Zambia was uninspiring in many ways. This was perhaps true at the time of formulation of the PRSP, when the economy was marginally growing. The trend has been different since 2002. For now, this has been sustained above 5 per cent and it is hoped that policy stability shall continue. However, much of the growth is attributed to the discovery of new mines and the increased copper prices as a result of the high Chinese demand. Bottlenecks such as

HIV/AIDS continue to be a toll on the human capital although there has been a drastic reduction.

Significant poverty reduction requires a substantial injection of resources into poverty reduction activities and that is not possible without growth. In its absence, there can be little increase in domestic resources either through savings or tax revenues. Fortunately, there has been a remarkable improvement in macroeconomic statistics from 2002, with a reducing trend in inflation and an increasing trend in GDP. For instance, Table 3 shows that international reserves have increased by almost 50 per cent between 2006 and 2007, which is exceptionally good for Zambia considering where it is coming from.

Table 3: International reserves 2006–2007

International reserves	**December 2007 (ZK billion)**	**December 2006 (ZK billion)**	End-period exchange rate Dec. 2007: US$1=ZK3,845 Dec. 2006: US$1=ZK4,407
Gross official foreign assets	**7,251**	**5,334**	
Foreign currency reserves	4,110	3,054	
SDRs holdings	38	59	
IMF reserve position	3,086	2,220	
Other foreign assets	17	1	

Source: adapted from CSO, *Zambia National Summary Data Page, External Sector 2007*[123].
SDRs - Special Drawing Rights; IMF - International Monetary Fund.

4.2. High inequality

Increased economic development inevitably leads to more wealth for the wealthy and/or more money for those who are able to exploit the opportunities. The prospects for growth as well as the subsequent impact of any growth on poverty reduction are thwarted by a

[123] Figures on http://www.zamstats.gov.zm/extern.php captured on 3 March 2008.

high level of inequality. Rural-urban, interprovincial, and inter-social strata disparities are already evident from the tables presented so far. Another crucial conclusion of empirical research has been that a historically unequal situation might perpetuate itself unless changed by government policy, such as asset redistribution.

It is possible for competition law and policy to influence or facilitate measures that would be aimed at expanding the base of entrepreneurship through modification and/or outright prohibition of anti-competitive arrangements by dominant firms and trade associations. The provisions for small business promotion in the Australian *Trade Practices Act 1974* provide a relevant model that countries such as Zambia may also opt to include in their legislations.

4.3. Debt burden

Another major factor that has reduced resources for poverty reduction is the heavy debt burden, which has exerted a significant crowding-out effect on social expenditures. Over the years up to 2003, debt service has on average accounted for 10 per cent of the GDP, while all the social sectors together have accounted for only 5 per cent. With Zambia reaching the "Highly Indebted Poor Countries" (HIPC) benchmarks set by the International Monetary Fund (IMF), debt relief has come as a major boost to economic activity as it has freed resources. Overt evidence of this has been a strengthened local currency and reduced interest rates due to less Government borrowing from the domestic financial institutions.

Considering that not more than three years ago the country had an external debt of over US$6 billion (ZK24 trillion), a reduction to US$1 billion (K4 trillion) lays good ground for using resources for development rather than for debt serving.

Table 4: External debt 2006–2007

External debt	**December 2007 (ZK billion)**	**December 2006 (ZK billion)**	End-period exchange rate Dec. 2007: US$1=ZK3,845 Dec. 2006: US$1=ZK4,407
Total debt (stock)	3,923	4,350	
Official debt (stock)	3,496	4,077	
Multilateral	2,392	2,336	
Bilateral	1,104	1,741	
Private debt, incl. parastatals (stock)	427	273	

Source: adapted from CSO, *Zambia National Summary Data Page, External Sector 2007*[124].

4.4. Excessive external dependence

The absence of growth and the huge debt burden have made external funding a necessity. External funding constituted, for instance, 89 per cent and 84 per cent, respectively, of the total spending in the water and sanitation sectors in 1995 and 1996, compared to 31 per cent in 1990. In 2001, 53 per cent of the national budget was expected to be funded from outside.

By 2007, this was reduced to about 30 per cent, which is a commendable drop within a period of five years. It is likely that the trend is going to be downwards although such dependence may easily fluctuate in higher realms where international factors adversely affect the balance of payments, e.g. oil prices.

[124] *Ibid.*

4.5. Other causes

Other causes include inappropriate prioritization; inadequate social safety nets; and HIV/AIDS, and rural-urban migration. CSO statistics show that rural-urban migration has led to congested urban areas, overburdened social amenities and a pressure on jobs that has in turn led to a burgeoning informal sector. Migrants formally of an occupation in agriculture, fisheries and animal husbandry accounted for the highest percentages in all provinces compared to other occupations. In Eastern Province they accounted for 46 per cent followed by Luapula at 39 per cent and Western Province with 36 per cent (CSO, 2003).

5. What needs to be done to address poverty in Zambia?

It is evident that most of the poor in Zambia are in the agricultural sector. Thus, policy interventions in agro-related industries would likely have the greatest impact on improving the extreme levels of poverty. It is already a known fact that agriculture is expected to be a key sector for the future development of the Zambian economy, together with mining and tourism. This perhaps is true for most of sub-Saharan Africa. Infrastructural issues normally come to mind in terms of accessing the rural with farming implements as well as the rural farmer accessing markets with his harvest. Transportation of agricultural inputs and outputs is a major constraint each year, a constraint that the unscrupulous and opportunistic trader has taken advantage of to abuse the rural farmer. The condition of rural roads is of key importance to farmers as is wider agricultural and regional development, especially in trying to bring subsistence or marginally commercial farmers into the cash economy[125]. The competition law would ordinarily come in handy to ensure that the bidding process for such critical infrastructure is not marred by anti-competitive practices such as bid rigging or collusive tendering[126].

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[125] United Nations, *Zambia Country Profile,* Johannesburg Earth Summit, p. 89, 2004.

[126] Section 9 of the *Competition and Fair Trading Act,* CAP 417 of the Laws of Zambia.

In the 2006 *Living Conditions Monitoring Survey (V)*, households were asked to indicate which developmental projects they would like provided or improved in their communities. The results show that 30 per cent of the respondents desired projects related to road infrastructure. Provision or improvement of education facilities was the second preferred project with 18 per cent of the households followed by health facilities with 13 per cent. The least desired projects were credit facilities, employment issues, police/security facilities, and sanitation at one per cent each (CSO, *The Monthly*, 2007).

Even the rural poor know that infrastructure development will be a decisive factor in their socio-economic transformation. The role of competition policy in infrastructural development is critical to its success. The bid-rigging or collusive tendering instances would be minimized in the wake of competition for public works. This has actually been a major problem in capital-intensive projects such as road and bridge construction where contractors are given a contract to do the same job, one after the other fails to complete it. The following section shall deal with how competition has been used in agro-related sectors to stimulate or sustain wealth creation.

6. Using the competition law and policy to deal with poverty

A competition law has a specific sphere of operation and objectives that may in many ways contribute to the alleviation of poverty by ensuring that failing firms are taken over by more vibrant competitors or new entrants. The competition law may also be used to break cartels that constrain freedom of trade and business expansion as is shown later in a poultry case study. Further, this law may also be used to ensure that there is no exclusive dealing that is anti-competitive and that leads to the failure of other market actors to penetrate markets and/or thrive competitively. It is in, *inter alia,* these areas that a competition authority would directly and/or indirectly contribute to wealth maintenance and wealth creation, which are key to any strategy to alleviate poverty.

The United Nations system in Zambia has recognized the role of competition law in economic development. The Zambia Country Profile notes that the *Competition and Fair Trading Act* regulates the

market to ensure fair trading practices and prevent market domination through the Competition Commission[127].

The report noted that the Ministry of Commerce, Trade and Industry has come up with initiatives to foster industrial development, including:

- promoting institutionalized consultative dialogue with the business community
- regional and multilateral agreements
- bilateral agreements
- competition policies – promote fair trading
- investment promotion
- a privatization programme
- establishing export processing zones.

The PSRP does not mention promotion of competition in any precise way. However, on its p. 62 there is an outline of *Industrial Development Programmes for Poverty Reduction*, of which the basic principles and goals were adopted from the 1994 *Industrial, Commercial and Trade Policy*[128]. In order to align manufacturing growth to poverty reduction, it is necessary to ensure a strategic focus on poverty both in the medium and long term in the manufacturing growth strategy. In this regard, the following vision was to guide Zambia's industrial development over the next 25 years[129]:

"To attain a dynamic, competitive, and environmentally sustainable industrial sector in both urban and rural areas as a means of reducing poverty through sustained economic growth and employment creation."

In order to attain this vision, the specific objectives for manufacturing development were presented as to:

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[127] United Nations, *Zambia Country Profile,* Johannesburg Earth Summit, Country Profile Series, CP2002-Zambia, p. 79, 2002.
[128] Competition Policy has been given prominence in a revised *Draft Industrial, Commercial and Trade Policy*, which is yet to be adopted. At the time of writing this report, the Ministry of Commerce, Trade and Industry had set up a committee to draft a distinct and comprehensive national competition policy.
[129] Per 2004 *Industrial, Commercial and Trade Policy*.

- Promote investments in both urban and rural areas that primarily utilize local raw materials.
- Encourage output and employment expansion in the sector by promoting growth in manufactured exports especially in areas where Zambia has comparative advantage.
- Promote growth in small- and medium-scale enterprises.
- Promote an enabling environment and even the playing field with respect to competing imports, efficient utilities in energy, transport and telecommunications, skills training, science and technology development, and a legal and regulatory framework that is conducive to the growth of manufacturing.

The 2004 *Industrial, Commercial and Trade Policy,* however, lacked programmes targeted at poverty reduction and did not give concrete indications as to how to involve the poor and the disadvantaged in manufacturing activities aimed at stimulating growth and reducing poverty. The policy also lacks strategies for encouraging new investments, establishing competitiveness in industry, and economic diversification. Efforts to establish strategic export niches also need strengthening. Cross-cutting issues of gender, the youth, HIV/AIDS, environment, and energy will form a critical pillar to attaining industrial development[130].

While competition policy has been tacitly mentioned in various policy documents in Zambia, the enactment of the *Competition and Fair Trading Act* in 1994 was a major milestone in having a comprehensive law that dealt with improving the "*efficiency of production and distribution of goods and services*"[131]. It is a general expectation that one of the key objectives of competition policy and law is to preserve and promote competition as a means to ensure the efficient allocation of resources in an economy. This preservation and promotion of competition should result in tangible (and not hypothetical) growth, equitable distribution, and lower prices and adequate supplies to consumers. For a developing economy handicapped by resource

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[130] An acknowledgment made in the *Poverty Reduction Strategy Paper*, 2002.
[131] One of the statements in the preamble to the *Competition and Fair Trading Act*, 1994.

constraints, efficient allocation of resources is absolutely essential to enable optimum utilization of limited resources[132].

Addressing the ills brought about by market power (i.e. control of abuse of dominant position) is a likely good starting point to ensure that the benefits of competition accrue to all the market actors. This would thus maintain business momentum, jobs, and wealth creation, which are cardinal to poverty alleviation.

To illustrate the contribution of competition law enforcement efforts in alleviating poverty, the following key areas are identified where interventions appear to have yielded positive results in Zambia:

- The cotton sector
- The horti- and floricultural sector
- The poultry sector
- The beef sector.

These sectors are deliberately chosen because they are agricultural based, an area where 80 per cent of the poor find their socio-economic livelihood. Therefore, efforts aimed at improving efficiencies, equitable market benefits, grass-root growth in these sectors are most likely to have the greatest impact in alleviation of poverty.

6.1. Interventions in the cotton industry

The Commission was moved to intervene in a major case in the cotton industry after an article that appeared in the *Post* of Saturday, 28 October 2006 entitled "*Katete women farmers call for review of cotton contract*". The complainants contemplated "*to fight unfair trade practices*" in the Zambian cotton industry[133]. The women[134] alleged that

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[132] World Bank & OECD, *A Framework for the Design and Implementation of Competition Law and Policy,* Washington D.C., 1999.

[133] In *Competition Assessment Framework – An operational guide for identifying barriers to competition in developing countries,* January 2008, at page 42, DFID has recognized that contract farming is not necessarily either good or bad for farmers, or for competition. The system can be mutually beneficial to the farmer and the company purchasing the output. It can be particularly useful for higher

multinational companies stole their money during the 2005/2006 cotton-marketing season by reducing the price of grade A cotton from the previous ZK1,220 per kilogram to ZK850[135].

The ginners through the Zambia Cotton Ginners Association contended that the low prices were as a result of the strong kwacha experienced in 2005. The farmers were reported to have claimed that it was unfair for the ginners to transfer the burden of the kwacha's appreciation onto the local farmers, and appealed to the Government through the Ministry of Agriculture and Cooperatives to investigate such issues and ensure that there was equity and fairness in the business. One of the strategies proposed for the following season was that outgrower agreements should be entered into between farmers and ginners and the elimination of third parties who previously appeared to gain more than the farmers.

The Zambia Competition Commission had been closely monitoring the developments and growth of the cotton industry through its interventions pertaining to mergers and acquisitions as well as other industry-related anti-competitive trade practices since 1998. The matter of cotton contracts has been an issue that has been of concern since the liberalization of the economy in 1991 and the sale of the then State-owned enterprise LINTCO to Lonrho Cotton.

After considering the market dynamics, the Commission's view was that all economic activity has to translate into economic efficiency and ultimately enhance the welfare of the citizens. It was observed that despite growing cotton under contract for some time, the socio-economic welfare of most of the contract cotton farmers did not appear to show that the benefits accrued to farmers, whose poverty levels have remained high.

Since the initiation of major agricultural reforms in the early 1990s, Zambian cotton production and processing has grown rapidly and now ranks as one of the most important sources of crop income

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value crops, and can provide the farmers with access to reasonable terms for finance, technical information and markets. However, there are sometimes situations where the terms imposed by the buyer are unnecessarily restrictive.

[134] Women are reckoned to account for 51 per cent of the population in Zambia.

[135] US$1 = ZK4,000.

among small farmers and agribusiness firms in key agricultural production regions of the country[136]. The subsequent report by the Food Security Research Project (FSRP) under the Ministry of Agriculture, Food and Fisheries revealed that cotton production in Zambia has doubled since the dismantling of the cotton parastatal monopoly LINTCO and the introduction of outgrower programmes supported by private agribusiness firms in the mid-1990s. In spite of these achievements, the cotton sector was still faced with the following key challenges:

- Sustaining and building upon previous success and remaining competitive in the face of a projected long-term decline in world cotton prices as well as shorter price cycles;

- Bringing about more transparent practices and less volatility in prices for farmers;

- Maintaining agribusiness firms' provision of supply inputs and extension of support to smallholder farmers to achieve productivity growth while addressing ginners' and other firms' problems with farmer loan repayment; and

- Financing necessary investments in agricultural research and extension systems to achieve long-term productivity growth in an environment where the public sector is not likely to provide these investments.

The Commission's findings showed that the outgrower schemes under the smallholders are a critical strategic link to the merchants/ginners. Large-scale commercial farms do not necessarily have all the land they need to meet market demand for their produce in the rainy season. Neither would it be profitable for them to have large areas of land lying fallow in seasons when the market demand is low. It has thus been acknowledged that it is more economic to meet the expansion/contraction cushion effect by utilizing the services of small- and medium-scale farmers who have the ability to change crops quickly. For this reason, it is a matter of course that the ginners invest heavily in

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[136] *Key Challenges and Options Confronting Smallholder, Agribusiness and Government Leaders in Zambia's Cotton Sector*, Food Security Research Project (FSRP) Team 2000.

the crop and do what is in their power to recover their cost. However, such recoveries do not appear to be effected in an equitable manner. The ginners ruthlessly attempt to recover all their fixed and variable costs as well as ensure a profit even where the farmers themselves are left with nothing. To attain this, the ginners engage court-certified bailiffs to salvage the little chattels that the farmers may have and/or threaten them with blacklisting them from future financing arrangements[137].

The outgrower scheme principally creates a monopsony buyer, who determines the price at the signing of the outgrower contract. In 2006, market share estimates showed a duopolistic market of which Dunavant held 53.49 per cent and Cargill Cotton held about 30 per cent, with the rest fragmented amongst five on-and-off players. The two-firm concentration ratio (CR2) was 83.49 per cent.

During the same period, the cotton farmers found their feet in the name of the Cotton Association of Zambia (CAZ), which advised all its member farmers not to collect inputs from ginners for the 2006/7 farming season before the price for the commodity was agreed upon. With the Commission knocking on its door, Dunavant was reported to have increased its 2006/7 planting price at ZK1,000/kg for grade 'A' seed cotton from the ZK850/kg offered during the 2005/06 marketing season. The company further reduced the input prices to ZK36,000 per pack from the ZK40,000 set for the previous farming season and promised to revise the ZK1,000 price if circumstances changed positively at harvesting time[138].

In the ensuing unfair pricing complaints in the agricultural sector, under the headline **"***Peasant Farmers Call for Better 2007 Crop Marketing Strategy"* the *Post* reported that the National Association for Peasant and Small-Scale Farmers of Zambia (NAPSFZ) had called on

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[137] The world prices for cotton are an important element in the pricing of the seed cotton at the local level. James Tefft in his paper entitled *Building on Successes in African Agriculture; Mali's White Revolution: Smallholder Cotton from 1960 to 2003* has noted thus **"***subsidies to cotton farmers in the United States currently depress world prices by about US$0.11 per pound. If these subsidies were removed and the price increase transmitted to Malian farmers, the typical farm would increase earnings*".

[138] Business Post , Tuesday 14 November 2006, "*Dunavant Raises 2006/2007 Pre-Planting Cotton Price*".

government to come up with a better crop marketing strategy for the 2006/7 farming season[139].

According to a report that was subsequently produced by the Commission[140], the outgrower schemes have the potential to greatly contribute to reducing poverty and contribute to the efforts being made by Zambia as a country to achieve the Millennium Development Goals (MDGs) but the current (lower) prices in these outgrower schemes undermine this potential. The MDGs represent a global partnership that has grown from the commitments and targets established at the world summits of the 1990s. Responding to the world's main development challenges and to the calls of civil society, the MDGs promote poverty reduction, education, maternal health, gender, equality, and aim at combating child mortality, AIDS and other diseases[141].

Table 5: "Dunavant pledges not to reduce prices next year"

Dunavant assured farmers of no reductions in prices next marketing season (2006/7), regardless of the performance of the local currency and world market situations.

Mr Richard Laurin, the company's chairman based in Geneva Switzerland, explained the circumstances to price changes in the previous marketing season and apologized for a sharp decline in prices after the kwacha appreciated against the US dollar. During meetings with farmers in Sinazongwe, Mobola and Monze, Mr Laurin repeatedly assured the farmers that the guaranteed pre-planting price of ZK1,000 per kilogram of seed cotton would not be reduced as was the case during the previous marketing season.

Mr. Laurin is reported to have admitted that in 2005 Dunavant had announced that they would buy a kilogram of seed cotton at ZK1,220 but after the kwacha appreciated, the price of cotton came down to ZK850. The paper reported that Mr. Laurin admitted this and said that it was his personal failure. Mr Laurin apologized to the farmers for the situation.

Source: *The Business Post, Tuesday, 12 December 2006.*

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139 Saturday Post of 18 November 2006.

140 Zambia Competition Commission, *Report on Competition & Fair Trading regarding Outgrower Cotton Farmers,* August 2007 (Case Officer – Willard Mwemba).

141 United Nations Development Programme; Millennium Development Goals. http://www.undp.org/mdg/

The Commission reviewed the imbalance of power in the negotiation of prices of cotton in outgrower schemes. Multinational entities such as Dunavant and Cargill Cotton were actually disproportionately benefiting, compared to the farmers, whose economic gains were stagnant against the huge profits that the merchants were making. Not surprisingly, the cotton association and Dunavant could well afford to offer ZK 1,120 per kilogram of grade seed cotton this marketing season[142]. The offer price of ZK1,120 included an additional ZK50 per kilogram premium for deliveries up to 14 July 2007.

In the same period, Cargill Cotton also took steps to correct its pricing system. The input prices for the 2006 planting season were reduced by 28 per cent year on year making Cargill's complete input package cheaper than that of any other ginner. This dramatic reduction in input costs was part of a conscious effort by Cargill Cotton to offset the impact of low global cotton prices on the incomes of small-scale Zambian farmers. In line with its previously stated strategy to pay a competitive seed cotton price, Cargill Cotton announced a buying price for the 2007 crop of ZK1,120/kg, an increase of 32 per cent over the previous year. Considering the reduced input cost, Cargill Cotton reported that their farmers were to enjoy the largest increase in net revenue in comparison to other cotton farmers throughout the country. This was to give the average farmer an additional net income of 75 per cent compared to the previous year[143]. It was a desirable outcome that the ginners were finally using higher promised returns to the farmers as a competitive advantage.

What began as an ordinary newspaper article and an investigation by the Commission ended up being one of the biggest poverty alleviation stories in the Zambian agricultural sector, with the cotton association calling on the farmers it had previously dissuaded to encourage them to grow cotton[144]. Cargill Cotton had become a founding member of the Zambia Cotton Outgrower Association (ZCOPA), which aimed to provide an industry-wide forum to promote

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[142] Post, Friday, 11 May 2007: "*CAZ, Dunavant sign agreement*".
[143] The Post, 13 June 2007: "*Cargill Cotton Information Bulletin*".
[144] The Post, Wednesday, 27 June 2007 "*Continue growing Cotton, CAZ appeals to farmers*".

cotton production and enforce sanctity of contract with a stated goal to eradicate the practice of side-marketing.

In its report, the Commission made recommendations that included continuous monitoring of this very dynamic industry by bringing to the attention of the relevant stakeholders that include, *inter alia*, the Cotton Association of Zambia, the Government, the Ginners Association of Zambia and the National Association for Peasant and Small-Scale Farmers of Zambia, the following advisory opinions: the ginners and the smallholders should come up with a mechanism for sharing the risks that may arise due to the appreciation of the kwacha, the fall in the world prices and other production risks involved in the cotton industry.

In addition, better access by farmers to information on market trends, including the pre-planting price for cotton. Such information could be provided by the CSO and the Ministry of Agriculture and Cooperatives, thus making it easily accessible. Efforts are also required to improve farmers' marketing skills, coupled with the cultivation of long-term relations between the farmers and the ginners. This could be achieved by holding seminars, workshops and field days whereby farmer associations (such as CAZ) and ginners associations will interact.

Furthermore, it was also recommended that the existing cotton cooperatives, such as the Cotton Development Trust, be strengthened. If the objectives of the cooperatives were well formulated, they could benefit both the farmer and the ginners. The following objectives were recommended for the cooperatives:

(i) To encourage members to be thrifty and to establish a fund from which could be given loans for agricultural purposes.
(ii) To encourage farmers to adopt modern farming methods.
(iii) To help farmer members market their produce at lucrative prices as well as helping them process their produce if necessary.
(iv) To supply members with agricultural equipment and seeds.

At the time of writing this report, all the parties had reached what appeared to be a “win-win” arrangement where principally the ginners were not to pass on their losses to the farmers, notably the smallholder “peasant” farmers. The Commission has continued to

monitor the situation through information links with the cotton association and the Zambia National Farmers Union. It is likely that with the formation of distinctive formal associations to represent their interests, the cotton farmers will have a better platform through which to express and/or channel their grievances.

6.2. Horticultural sector

At the point of merger and acquisition notification, the mandated competition authority is given an opportunity to influence the structure of markets through structural undertakings and/or influence behaviour of market players through behavioural undertakings aimed at ensuring that a particular player does not abuse its market power *vis-à-vis* other players, notably smaller players. This inherently assists in assuring that small businesses can exist in their niche markets and that they are not unduly encumbered when trying to access markets.

On 6 December 2004, Agriflora Limited (Agriflora) and Chalimbana Fresh Produce Limited (Chalimbana)[145] (herewith referred to as "the parties") submitted a joint notification to the Zambia Competition Commission for the transfer of controlling ownership of Agriflora to Chalimbana. At the time, Agriflora was highly in debt and on the verge of being declared bankrupt by the creditors. Its expatriate Chief Executive Officer even fled the country, leaving the company in a serious limbo[146].

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[145] At the time, Chalimbana was reported to be a start-up company with the major shareholder being Plantation and General Investments Plc (UK) (P&G) and Arthur Gregory Barnes of Khal Amazi Farm of Lusaka as the minority shareholder. P&G is majority owner of Khal Amazi Limited - a rose-growing farm in Lusaka. In Malawi, P&G is involved in horticultural, floricultural products, dairy farming, wheat and maize farming. Chalimbana shall engage in similar activities in Zambia.

[146] Agriflora Limited started operating in 1994. By 2001/2002 it had 22 hectares of roses and 1,000 hectares of vegetables. Agriflora had processing factories with 7000 tonnes capacity of fresh produce per year, drip irrigation systems and a refrigerated transport fleet. It had an outgrower scheme that had over 3,000 workers. There are about 25 players in the market. Agriflora had the largest market share of 80 per cent while the second was York Farm. The market share for the other competitors including York Farm was 20 per cent. 60 per cent of

Agriflora was mainly involved in the growing of fresh vegetables and flowers for the export market. In the case of *The Acquisition of the Assets of Agriflora by Chalimbana Fresh Produce Limited*[147], the Commission authorized the takeover of the assets of Agriflora by Chalimbana on the basis of assurances from Chalimbana that the takeover was envisaged to provide the continuity of the viable and lucrative business of Agriflora, with supply linkages to the small to medium scale farmers. Agriflora needed to be revitalized in order to revamp the business and assure the continuity of the outgrower scheme. Therefore, the takeover was necessary to keep the vibrant business going, with the assurance that:

"*the transaction will create 3000 jobs; contribute to Government revenue through taxes; contribute to national economic development through foreign exchange in export earnings; and put Zambia on the world map through horticultural and floricultural produce from Zambia selling on the international market*".

The takeover has contributed to a thriving flori- and horticultural export market that is somehow managing to compete with the regional market leaders, South Africa and Zimbabwe. The resuscitation of operations and repositioning of Agriflora after the takeover authorization by the Commission has seen the enterprise continue to forge linkages with small-scale farmers in the horti- and floricultural industries.

The role of Agriflora[148] in the sector is perhaps exemplified through the USAID captioned story in Table 6:

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the produce for Agriflora was vegetables while flowers accounted for 40 per cent of Agriflora's exports.

[147] Zambia Competition Commission, Staff Paper No. 211, February 2005.

[148] The Multilateral Investment Guarantee Agency (MIGA) of the World Bank issued a US$3.6 million guarantee to the Industrial Development Corporation of South Africa Limited (IDC), of South Africa, to cover its US$4 million equity investment in Zambia's Agriflora, the second largest food production company in the country, Keith Nuthall, June 2003, http://www.just-food.com/article.aspx?ID=90513.

Table 6: Irrigation technology: small-scale farmer enters international export business

On retirement from the Zambian Civil Service in 1988, Mike Phiri settled on his four-hectare smallholding just 60 kilometres from the capital, Lusaka. Since any type of pension is negligible in Zambia, Mike cultivated his land during the rainy season producing enough corn to feed his family. Occasionally, he grew vegetables for subsistence. He lived simply, well aware that given the low local maize prices, he would be losing money if he tried to grow maize or other crops for the local market. In March 2000, everything changed. Under a new loan scheme, the Zambia Agribusiness Technical Assistance Centre (ZATAC) would supply irrigation equipment for the production of baby corn, runner beans, and mangetout peas. **The vegetables would be contracted for sale to the country's largest horticultural exporter, Agriflora Ltd. The firm, near the Lusaka International Airport, had over the years exported a wide range of fresh vegetables to Europe. Interested in expanding production beyond its own farms, Agriflora saw the attractiveness of working with various smallholders in the vicinity of its pack house located just outside the airport. This would only be possible if the small producers overcame the constraint of rain-dependent agriculture and were organized by some other organization to act as a group**. At ZATAC's request, CLUSA, with their group-mobilizing techniques, began working with the small farmers.

Within three months, Mike's drip irrigation equipment was installed by ZATAC while Agriflora Ltd. installed a small refrigeration warehouse next to his house. By September 2000, nine months after his irrigation equipment was installed, Mike had delivered 1.3 tons of fresh vegetables to Agriflora and received US$1,500 payment for the produce. Over the next 12 months Mike's net income target was US$4,000. Mike remarked, "*Things have moved very fast. We are very happy with ZATAC. Both my neighbours and I have been occupying this land for over a decade. We did not know that we would one day be in the international export business. The vision of ZATAC and Agriflora in mounting this project is simply phenomenal. We have now broken clear of the vagaries of seasonal agriculture. We grow crops all year round for the European market and we receive an all year round income*".

Source*: USAID, Human Resources Development Project (HRDP) Newsletter April/May 2000 – Success Stories*
http://www.usaid.gov/regions/afr/success_stories/zambia.html

A further success story with linkages to the horticultural sector was the Commission authorization of the takeover of the assets of the previously State-owned and privatized Sunripe Products Limited, whose

primary business was food processing and canning. Following numerous bidders and a blockage by the Commission to have the assets relocated to South Africa, the Commission eventually authorized the takeover of the assets by Fresh Pikt Limited, which has since resuscitated the plant and restored linkages with the smallholder farmers. The company produces 18 different canned products which include baked beans, mixed beans, pineapple chunks, tomato puree, tomato and onion mix and whole peeled tomatoes[149]. Table 7 shows the current economic lifeline role that Fresh Pikt is playing in the economy, more so as it relates to small-scale farmers:

Table 7: Fresh Pikt out to fight poverty in rural areas

Most rural communities in Zambia are hard-working, a trait honed out of decades of subsistence existence on the land where survival has been a function of production from the land…One of the companies that are turning around this gloomy scenario, at least on the current scale is Fresh Pikt.

In an effort to encourage citrus fruit production, Fresh Pikt Limited has just signed a contract with farmers in Mwinilunga for the supply of 40 tonnes of pineapples to its Lusaka plant on a weekly basis. The development would enable more than 1,000 farmers in the area to expand both the pineapple production and earnings from their produce.

Choice Nuts Zambia Limited, a sister company to Fresh Pikt, has set up a network to access the abundant groundnuts from Eastern Province which it exports after treatment at its Lusaka plant. The company will this season export over 2,000 tonnes of raw dried groundnuts worth approximately US$2 million.

Both Fresh Pikt and Choice Nuts are companies that have shown a practical approach to a quick way of tackling poverty in the rural areas.

***Source**: Times of Zambia, Wednesday, 6 February 2008.*

[149] Times of Zambia, Monday, 3 March 2008.

6.3. Poultry sector

The poultry sector is one of the largest employers in the country and is highly fragmented downstream, with a large informal sector thereof. The industry has increased from 16 million birds in 2000 to about 26 million in 2007, with enquiries and orders for mainly processed eggs and hatching eggs coming from as far away as the Comoros Islands, the Democratic Republic of Congo, Angola, Tanzania and Uganda among other countries in the region[150].

Interventions by the Commission have assisted in creating, maintaining, and sustaining competition and employment. This has been done in several ways as explained in the following paragraphs.

During a series of meetings involving management of the then largest day-old chick supplier in Zambia, Hybrid Poultry Farm Zambia Limited (Hybrid Poultry), and the Zambia Association of Manufacturers (ZAM) with the Zambia Competition Commission in the second quarter of 1999, it was revealed that Hybrid Poultry and Galaunia Holdings Limited (Galaunia) had earlier agreed to effect a sale of a farm (Mariandale Farm) and a poultry processing factory thereon to Galaunia, subject to agreed exclusive dealing clauses and conditions (Galaunia was the largest customer for Hybrid Poultry and specialised in raising day-old chicks to table broilers). Upon this discovery, the Commission advised the parties to notify the said exclusive agreements for assessment under Section 7[151] of the *Competition and Fair Trading Act*. In January 2000 Hybrid Poultry notified the said agreements[152].

Through this agreement Hybrid Poultry was to sell to Galaunia its Mariandale Farms comprising fixtures and fittings, stock-in-trade

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[150] *Times of Zambia,* 14 November 2007, quoting Matthews Ngosa, Chairman of the Poultry Association of Zambia. See also quoted at http://www.thepoultrysite.com/poultrynews/13331/zambian-poultry-attracts-world-market.

[151] Which states that: "*Any category of agreements, decisions and concerted practices which have as their object the prevention, restriction or distortion of competition to an appreciable extent in Zambia or in any substantial part of it are declared anti-competitive trade practices and are hereby prohibited*".

[152] Zambia Competition Commission, Annual Report, 2000.

(chickens) and the goodwill of the business and the premises subject to anti-competitive terms. The Commission was concerned that Hybrid Poultry required Galaunia to only purchase day-old chicks from itself. Further, Galaunia was also required to offer Hybrid Poultry right of first refusal should it intend to resell Mariandale Farm. Galaunia was also not allowed to raise any type of poultry at the farm, apart from broiler chickens, including the provision not to go into the business of a chicken hatchery. The parties also agreed that Galaunia was to be accorded the right of first refusal in the event that Hybrid Poultry sold some of its shares. In return, Hybrid Poultry was given the first right of refusal to participate in an outgrower scheme in the event that Galaunia came up with one. These are highlighted in Table 8 below:

Table 8: Salient clauses from the sale and purchase agreement between Hybrid Poultry Farms Limited (HPF) and Galaunia Holdings Limited:
Clause 11: The consideration, selling price, Hybrid Poultry property was US$250,000 for the goodwill, chattels, chickens and premises, payable on completion.
Clause 13: That Galaunia would not raise any type of poultry on Mariandale Farm other than broiler chickens.
Clause 14: That Galaunia and any subsidiary or associate company would not enter into the business of a chicken hatchery or breeder broiler production in Zambia.
Clause 15: That Galaunia would only procure its day-old chick requirements exclusively from Hybrid Poultry.
Clause 16: That Galaunia shall purchase DOC from Hybrid Poultry at short notice.
Clause 17: That Galaunia shall have the exclusive right to collect all chicken manure from HPF chicken houses located in the Lusaka-Chisamba area at a cost of US$0.30 per 90-kg bag.
Clause 19: That Galaunia should give Hybrid Poultry the right to first refusal to purchase, within five years of completion date, should it decide to sell the business.
Clause 21: Should Galaunia develop and implement an outgrower scheme to

Source*: The Sale and Purchase Agreement between Hybrid Poultry Farms Limited and Galaunia Farms Limited.*

In another agreement pertaining to the formerly Hybrid Poultry owned Poultry Processing Company Limited that was purchased by Galaunia, it contained restrictive clauses. Principally, in the sale of the poultry factory, the parties agreed that they would keep out of each other's business, i.e. that Hybrid Poultry would not set up a poultry

processing factory and that in the event that Galaunia intended to sell the factory, Hybrid Poultry was to be accorded the right of first refusal. The poultry processing factory was viewed as a third-stage downstream operation after the Hybrid Poultry hatchery and the broiler farms under Galaunia. This was a vertically integrated and restrictive arrangement that had been a complete foreclosure of the Zambian poultry market. These are highlighted in Table 9 below:

Table 9: Restrictive clauses in the sale and purchase agreement of the poultry processing company

Clause 11: The purchaser agrees that should it within five years of the completion date wish to dispose of the business then it will give the Vendor right of first refusal to purchase the Business at cost plus the value of any improvements that the purchaser has made to the Business such value to be mutually agreed failing which to be assessed by a registered valuation surveyor mutually appointed by the head of the Valuation Surveyors Institute of Zambia. Should the Vendor not exercise its right to purchase the Business within 30 days then the Purchaser will be at liberty to dispose of the Business to any other person.

Clause 12: In the event that the Management buy-out (MBO) wishes to sell its shares to the vendor then the Purchaser shall be accorded the right of first refusal to purchase the shares from the MBO. Should the Purchaser not exercise its rights to purchase the shares within 30 days then the MBO will be at liberty to sell the shares to any other party.

Clause 13: The Vendor hereby agrees that it and its subsidiaries and associates will not at any time in the future in Zambia enter into the business of processing or selling of frozen chickens of any type except in collaboration with the Purchaser as mutually agreed in writing.

(**Source:** *The Sale and Purchase Agreement.*)

In defence of the agreements, Hybrid Poultry argued before the Commission that the terms of the agreement did not restrain competition nor did they have any adverse effect on trade or the economy in general. The condition for Galaunia to buy day-old chicks exclusively from Hybrid Poultry was arguably there in order to "protect" the chicken industry as a whole in the country. According to Hybrid Poultry, the nature of the product was such that genetically, the day-old chicks of two or more different breeds could not be put together at the same chicken run. This was purportedly for fear of an outbreak of disease.

While this was scientifically arguable, the exclusive dealing effectively excluded competition as Galaunia could not buy day-old chicks from Hybrid Poultry's only formidable competitor at the time, Tamba Chicks.

At the time, it was evident from the Commission's analysis that Hybrid Poultry was a dominant firm both in the quantitative and in the qualitative sense in the relevant product market.

6.3.1. Market shares for day-old chick suppliers

Hybrid Poultry – 60 per cent
Tamba Chicks – 30 per cent
Others – 10 per cent

6.3.2. Major buyers

Table 10 shows the major buyers of day-old chicks in 1999. The position of Galaunia was significantly higher than that of its nearest rival, who trailed at 10,000 chicks per week:

Table 10: Major buyers of day-old chicks - 1999

Company	**Chicks per week**	**%**
Galaunia (Diamondale & Mariandale)	42,000	24%
Eureka	10,000	6%
Jonken	5,000	3%
Mapepe	5,000	3%
Others (11,000 farmers)	115,500	65%
Total	**177,200**	

Source: *ZCC Assessment Report on the proposed takeover of Tamba Chicks by Hybrid Poultry Farms Limited.*

Galaunia was by far the most important customer for day-old chicks in the country. Hybrid Poultry's exclusive deal was a source of its dominance to which Galaunia was tied. These agreements led to higher prices of day-old chicks for Galaunia, and affected the operations of Tamba Chicks and effectively constrained entry both upstream and downstream.

6.3.3. Effects of the agreements

The parties seemed to have taken advantage of their dominant market positions upstream and downstream where either party was dominant. The parties were, both by motive and concerted practices, excluding competition both in the day-old chicks, table birds (broiler) and broiler chickens markets.

The signing of these exclusive supply arrangements adversely affected the operations of the other only notable day-old chicks supplier at the time, Tamba Chicks Limited. The problem went so far as to have Tamba Chicks facing liquidity problems and its owner decided to sell the company to avert actual liquidation. During the same investigations, the Commission discovered that Hybrid Poultry had used its economic power to facilitate a loan for Tamba Chicks, which facilitation compelled Tamba Chicks to sign a "Right of First Refusal" with Hybrid Poultry in the event that Tamba Chicks was put up for sale. The Commission nullified these agreements under Sections 7 and 9 of the *Competition and Fair Trading Act*. When Tamba Chicks was finally advertised for sale, the Commission blocked the bid by Hybrid Poultry and instead allowed a new entrant, Ross Breeders, who is still around and providing the relevant market checks and balances in the industry that are desirous to the Commission.

The result of the competition intervention is that the general downstream industry has grown to more than ten notable players, with almost a new entrant every year. Ross Breeders has been able to sustain and in many ways outcompete Hybrid Poultry in the day-old chicks segment. Ross Breeders is reckoned to have about 50 per cent market share now, with Hybrid Poultry trailing at about 40 per cent.

Currently, the poultry industry is the largest livestock industry in Zambia and is very competitive. The sector has seen an inflow of high investment and the market players in the industry have benefited from

rapid returns on their investments. With barriers to entry such as that instigated by Hybrid Poultry in the 1990s gone, there are reasonably low start-up capital costs especially in the broiler segment with production cycles of 6 to 7 weeks. The numbers of broiler chicks marketed have increased from 16 million birds in 2000 to about 26 million in 2007. As for the pullets, 1.7 million pullet layer chicks are marketed per annum and populations of pullet layers inlay stands at 1.25 million per annum[153]. A phenomenal growth of 30 per cent has been experienced since liberalization, and growth is envisaged to reach 50 per cent in the next two years due to increasing demand from international markets.

This segment has seen intensive investment on aggregate and has allowed for generation of income in the economy standing at Zambian Kwacha 195.7 billion (about US$ 51,578,947)[154]. Approximately 24.4 million broiler chickens are produced per annum – 15.86 million and 8.54 million in the formal and informal sectors, respectively. Of the broilers sold at wet markets, 65 per cent are dressed while 35 per cent are live chickens[155]. Large producers of chickens are promoting broiler contracts in collaboration with small-scale farmers to meet the demand for processed chickens on the market and these have helped this sector to grow at an astonishing rate with both formal and informal providers[156].

Since 1999, the market has seen a number of entrants in the day-old chicks sector. Hybrid Poultry has repositioned itself over the years following the entry of a vigorous competitor, Ross Breeders, who took over the assets of Tamba Chicks. Both entities claim to have a larger market share than the other. The figures in Table 11 are based on a survey by the Commission as well as sales figures registered by the Poultry Association of Zambia:

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[153] Poultry Association of Zambia, 2008.
[154] US$1=ZK3,800.
[155] *Ibid.*, 2007.
[156] Zambia Competition Commission, *A Study of Competition in the beef, poultry and dairy retail sector in Zambia* (financed by the International Development Research Centre (IDRC) of Canada), January 2007.

Table 11: Day-old chicks market shares - 2007

Producer	Brand name	Market share
Hybrid	Cobb/Bovans	40%
Ross Breeders	Ross	35%
Bokomo	Ross/Lonhman	20%
Panda	Hubbarb	5%
Total		100%

Source: *Figures estimated from Zambia Competition Commission Survey 2006,PAZ 2007 report as well as findings from survey*[157]**.**

As regards the processed chicken segment, the competition is as shown in Table 12:

Table 12: Market shares for processed chicken brands

Producer	Brand name	Market share
Hybrid	Verino	25%
Galaun Holdings	Crest	20%
Zambeef	Zamchick	15%
Eureka Chickens	Eureka	10%
Savannah Chickens	Savannah	5%
Zambezi Nkuku	Zambezi Nkuku	5%
Informal sector	Traditional	20%
Total		100%

Source: *Figures estimated from Zambia Competition Commission Survey 2006,PAZ 2007 report as well as findings from survey*[158]*.*

6.4. Beef sector

Cattle ranching is one of the most lucrative rural businesses and occupations in most of the countryside, notably in Southern and Western provinces. It is thus a source of livelihood for most of the rural dwellers that constitute part of the 80 per cent of the population that falls into the poverty bracket. Besides the natural hazards of animal disease outbreaks, most of the traditional cattle owners are vulnerable to commercial traders, abattoirs, and processors. The market is

[157] *Ibid.*
[158] *Ibid.*

predominantly under the control of one dominant firm, Zambeef. As observed in a recent Commission report, the Zambian beef sector has large economic potential for the country. Not only has it been a major source of employment in the formal context, but it has also been a source of income for the informal sector[159].

The socio-economic role of cattle in the traditional sector dates back to the pre-colonial days. In this sector cattle has multiple roles. Cattle ownership has always been regarded as a symbol of family wealth. It is known from Zambian history that tribes such as Tongas (Southern Province), Lozis (Western Province), Chewas (Eastern Province), Namwangas and Mambwes (Northern Province) were traditional cattle keepers. As far back as 1993, it was estimated that about 70 per cent of the Zambian cattle is found in this sector, which underlines its importance[160]. The areas where such cattle is found actually have registered high poverty levels. Table 13 shows the areas.

Table 13: Overall and extreme poverty by residence and province, Zambia, 1998

Residence	***Overall poverty***	***Extreme poverty***
Rural	83	70
Urban	56	36
Central Province	77	63
Copperbelt Province	65	47
Eastern Province	**80**	**66**
Luapula Province	81	69
Lusaka Province	52	34
Northern Province	**81**	**67**
North-western Province	76	63
Southern Province	**76**	**60**
Western Province	**89**	**78**

Source*: CSO: Living Conditions in Zambia, 1998.*

Table 13 shows that there are higher levels of poverty in the provinces where traditional cattle ranching is practiced. This is of

[159] *Ibid.*

[160] Chindo Hicks, *The role of Zambian cattle populations in socio-economic development*, Royal Veterinary and Agricultural University, Department of Animal Science and Animal Health, Bülowsvej 13, 1870 Frederiksberg C. Denmark.

concern when taking into account that the growth that entities such as Zambeef have achieved from buying cattle from the same provinces, notably in Southern Province and Western Province, where poverty levels are relatively higher[161]. Furthermore, the market shares in processed beef show the imbalance of economic power even amongst the market players, as shown in Table 14.

Table 14: Market shares in the beef sector

Beef producer	Brand name	Ownership status	Market share
Zambeef	Zambeef	Publicly owned	65%
Galaun Holdings	Luscold	Privately owned	10%
Northern Zambezi Traders	Pama	Privately owned	7%
Dar Farms	King Quality	Privately owned	3%
Best Beef Company	Best Beef	Privately owned	3%
Savannah Beef	Savannah	Privately owned	2%
Others	Traditional	Privately owned	10%
Total			100%

Source: *Figures estimated from Zambia Competition Commission Survey 2006 and from primary data collected.*

As shown in Graph 2, the prices of the various beef products have actually continued to rocket since 1993, and have made Zambeef in particular one of the most prosperous enterprises in the Zambian economy[162]. The same cannot be said of the "Others" in the chain.

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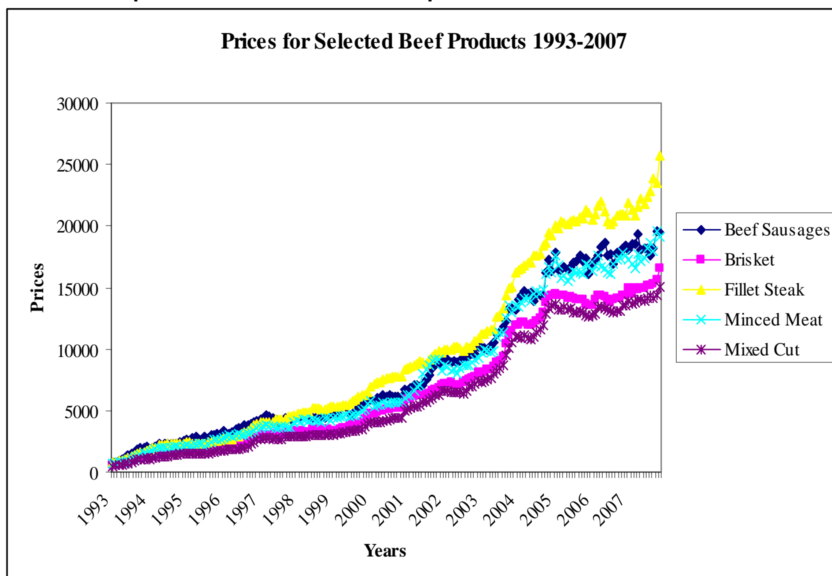
[161] Which posted a 26 per cent growth in turnover in 2006 with US$55 million, with a net profit of US$8 million (which increased by 78 per cent from 2005). For Zambian-owned companies, this is in the blue-chip category. Source: Zambeef Annual Report 2006.

[162] Zambeef Products PLC Group is a major agribusiness whose core activity is the production, processing, distribution and retailing of beef, chickens, eggs and dairy products through its own retailing network throughout Zambia and Nigeria. It has since expanded into Ghana (trading under the name "Master Meats"). The conglomerate controls key abattoirs in major cow-belts. It slaughters 60,000 cattle per annum and produces 12,000 grain-fed cattle per annum from its feedlots. It had a turnover of US$56 million (ZK223 billion) in 2006 – *2006 Annual Report*.

Graph 2: Prices of selected beef products 1993 to 2007



Source: Central Statistical Office.

Thus, the Commission has been vigilant in its consideration of matters in the sector driven by Zambeef. In the assessment of *The proposed takeover of Rumcortin Meat Processors by Zambeef Products PLC*[163], the Commission was concerned with allegations that Zambeef's strategic objective in taking over the Rumcortin abattoir, which was the only usable abattoir in the Southern and surrounding Western Province areas, was to have the abattoir certified as the only one that meets the national and/or international Sanitary and Phytosanitary (SPS) standards or other such specifications. In effect, this was feared to lead to a situation where all the other competing abattoirs in Livingstone and surrounding areas would be closed, especially during animal disease outbreaks. Such a situation would lead to entrenching Zambeef's monopoly position in the major cattle belt in the country. Similar allegations were made during cattle disease outbreaks in Mongu (Western Provincial capital) in the late 1990s and in Namwala (key cattle area in Southern Province) and surrounding areas in 2004/2005.

[163] Zambia Competition Commission, Staff Paper No. 267.

Zambeef was alleged then to have monopolized the cattle trade by insisting that all cattle slaughtered at the only abattoir in the area (which it controlled) had to be sold to them. The carcasses were then transported by Zambeef in refrigerated trucks for processing. Other commercial competitors would also be put in a difficult position to deal with a vertically integrated operator who had first access to the best cattle brought for slaughter.

It was with this background in mind that the Commission required undertakings from Zambeef to address the competition and unfair trading concerns. While it was understood that Rumcortin was not operational, the Commission was aware of both the financial, technical and vertically aligned abilities of the Zambeef conglomerate to turn the company around and make it viable. The Commission supported efforts made to resuscitate a failing firm while at the same time it was desirous to ensure that the resuscitated firm was not used to prevent, restrict or distort competition leading to the exit of other market players and/or create a barrier to entry for prospective players. The long-term effects of the latter scenario were likely to lead to market stagnation and the desired holistic investment results not being attainable.

Further, through the competition law's objective of expanding the base of entrepreneurship and ensuring that no single entity unduly dominated, through abuse or acquisition of a dominant position of market power, the Commission has advised the parties to provide undertakings essentially to guarantee third-party access to the abattoir in the event that it is the only abattoir permitted to operate. The Commission was also concerned about the livelihood of the rural poor whose primary source of wealth was cattle. Zambeef gave undertakings to the Commission as shown in Table 15.

Table 15: Undertakings given by Zambeef Products PLC to the Zambia Competition Commission

1. In the event of a major disease outbreak and upon formal written notification by the relevant authority, if Rumcortin Abattoir is declared to be the only SPS certified abattoir and all other slaughter facilities in the relevant geographic area/district are closed, Zambeef shall allow third-party access to the Rumcortin abattoir on an objective criteria and without discrimination.

2. For third-party access to the abattoir in a period of disease outbreak, Zambeef will charge an access fee set at a reasonable economic and competitive rate that takes into account the prevailing rates for similar services, which rates shall be negotiated entirely between Zambeef and the third parties.

3. Zambeef shall not insist on third-party cattle slaughtered at the abattoir to be sold to Zambeef but shall allow the cattle owners/traders to exercise their freedom of trade.

4. The first priority for slaughter and storage of carcasses in the cold room will always be for Zambeef cattle. However, Zambeef will make efforts to consider third-party slaughter and storage as provided above.

5. Zambeef shall appoint a senior management official within its ranks who shall be the "Trade Practices Compliance Officer" and who shall liaise with the Commission from time to time on matters of compliance with the undertakings and/or the *Competition and Fair Trading Act*, 1994, CAP 417 of the laws of Zambia.

Source*: Memorandum of Undertakings given by Zambeef Products PLC to the Zambia Competition Commission, February 2007.*

The Commission has thus continued to monitor the situation and ensure that Zambeef adheres to the undertakings through regular contact with the compliance officer. The undertakings afford ease of access to this key facility in the cattle-belt and principally, guarantee the freedom of trade of the village level and other small scale farmers. A good return on their cattle investment is a step in alleviating the levels and effects of poverty.

6.5. Tobacco sector

The tobacco industry is one of the most lucrative sectors in the Zambian agriculture sector. As in the cotton sector, it is dominated by multinational merchants who operate outgrower schemes. Competition-related interventions in this sector are thus necessary in order to ensure that the rural poor are not exploited in the pricing and distribution of the tobacco they grow under contract. During the latter months of 2005, the Commission was handling the merger of Dimon Incorporated (Dimon) and Standard Commercial Corporation (Stancom) into Alliance One[164]. The Commission raised concerns about the possible anti-competitive trade practices in the industry that would arise as the two merging firms were going to create a monopoly undertaking with a likely chance of abuse. Stancom was at the time the third largest independent leaf tobacco merchant in the world while Dimon was the world's second largest dealer, both of which had operations in more than 30 countries. The merger was to create the second largest tobacco merchant in the world, and the largest in Zambia, i.e. actually a monopoly.

The Commission thus demanded undertakings that would address the competition concerns that had been raised during the investigations. Alliance One contracted lawyers from America who responded and disputed the finding of the Commission that Alliance One was going to be a monopoly undertaking, since there were other players in the Zambian tobacco industry. The Commission argued in turn that under the Zambian competition legislation, a monopoly was a firm with at least 50 per cent market share and since Alliance One was going to have 55 per cent market share, this raised competition concerns.

Employing its usual analytical framework, the Commission had defined the general relevant market as the processing, storage, shipping and marketing of leaf tobacco, but the actual relevant product market as made up of flue-cured, burley and oriental tobacco.

The main competition issue of the Commission was that there appeared to be no effective countervailing power from the leaf tobacco farmers in the outgrower schemes who were under contractual arrangements with Stancom and Dimon. The merger into Alliance One

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[164] Case File ZCC/CO/383.

meant that the farmers would have no choice of contract between the two, despite the presence of other alternative merchants already existing in the market. The Commission further argued that the merger of Stancom and Dimon would definitely result in the removal of a vigorous competitor from the market. Apart from Stancom (40 per cent) and Dimon (15 per cent), the rest of the market (45 per cent) was made up of a fragment of small to medium-sized leaf tobacco dealers who were not likely to offer effective competition to the merged entity.

After being convinced of the monopoly status of Stancom in the tobacco industry in Zambia and likely competition issues affecting the outgrower farmers, the parties finally agreed to give the undertakings outlined in Table 16.

Table 16: Undertakings given by Alliance One on the occasion of the merger between Stancom and Dimon

1. Alliance One shall continue to use multiple transportation providers and shall not engage in exclusive dealing in the relevant market without seeking the express authorization of the Zambia Competition Commission.
2. Alliance One shall continue to promote and develop better tobacco farmers through the outgrower scheme and encourage local entrepreneurs.
3. After the merger approval, Alliance One shall identify a suitable senior officer who shall act as a Fair Trade Compliance Officer with the Commission on competition and fair trading matters.

Source: Undertakings given by Alliance One to the Zambia Competition Commission, 2005

This case demonstrated the use of undertakings or commitments from the industry as one of the enforcement tools available to a competition authority to ensure that the gains of market liberalization are not unduly concentrated in one entity. There would appear to have been no incidence of complaints on prices since 2005.

7. Conclusions

The role that competition law and policy plays in poverty alleviation cannot be overemphasized. While there is no claim that such a law and policy would be the “cure-all” in terms of poverty as found in countries such as Zambia, it is a major step in combating extreme poverty levels as has been evidenced in the Commission’s interventions in the cotton, poultry and other sectors.

There is a need to identify areas where poverty levels are high and to use appropriate interventions in those areas, and perhaps with more than ordinary vigilance and focus. There is a lot to be done by the Commission and perhaps said by the public in terms of the contribution of competition law and policy in their daily lives. While some results may not be tangible, others are clearly tangible.

The effective implementation of competition law and policy clearly assists in the attainment of efficiencies in the production of goods and services as has been demonstrated through the prohibition of cartels and attempted anti-competitive acquisitions in the poultry sector in Zambia. There is of course need for in-depth research that would empirically show whether or not the changes explained in the horticultural, poultry, beef and tobacco industries in Zambia are solely due to competition enforcement efforts. It is not likely that competition law enforcement is the only force behind the resuscitation of some sectors, but there is a strong correlation shown in the intervention against the cartel activities of Hybrid Poultry and the opening up of the day-old chicks market as well as the broiler segment to more entrants, which have in turn created employment and, through outgrower schemes, facilitated the continued growth of the micro and small enterprises.

This is perhaps even more so in the horticultural sector, where a firm that was almost on the verge of collapse was resuscitated through an acquisition authorized by the Commission and vertical linkages created with small-scale farmers (Fresh Pikt and Agriflora).

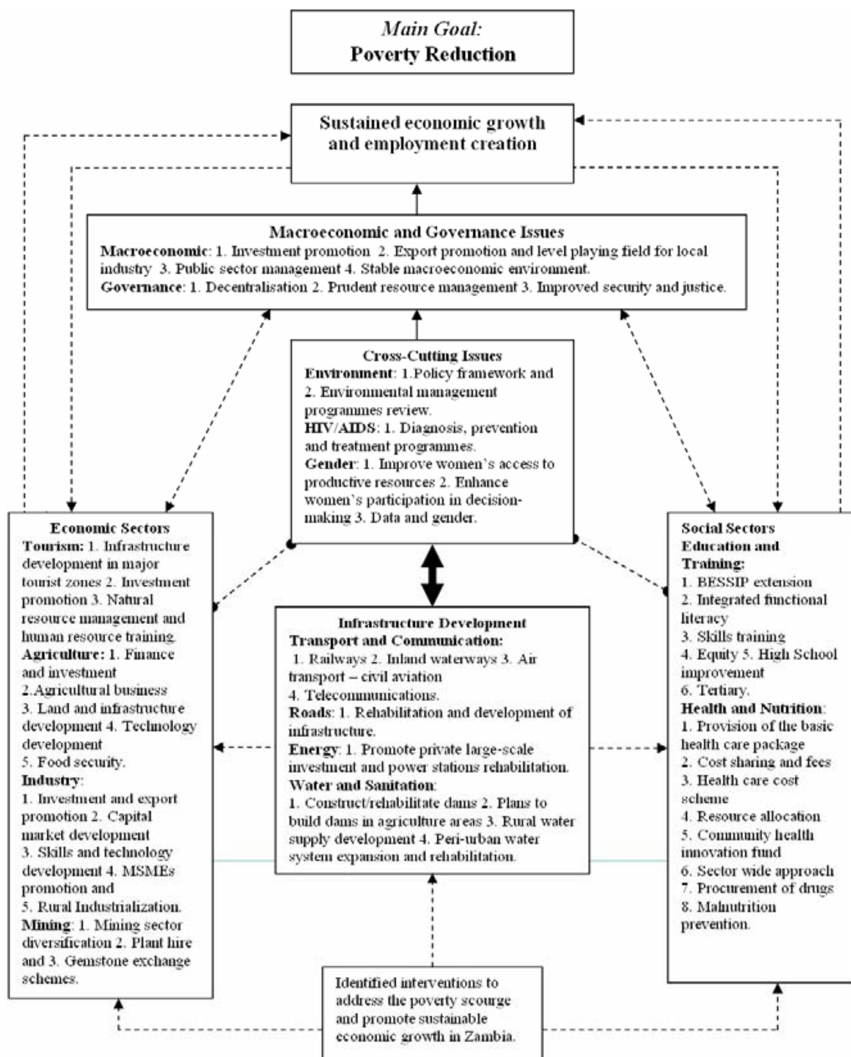
As a way forward, there would be need to have deliberate provisions in a competition legislation that support small business growth and development, as explicitly provided for in the *Trade*

Practices Act 1974 of Australia. For developing countries, the growth of the micro and small businesses into medium, larger and perhaps even into more formalized business organizations would provide a better base for industrial renaissance. Competition law and policy may be effectively used in this regard, contemporaneously with other pro-business/pro-consumer policies.

Suffice it to state that it remains a highly debatable though saleable idea in Zambia that the implementation of competition law and policy actually does contribute to poverty alleviation. To sale this idea, there would be need to raise the extremely low levels of competition law-policy culture that exist at policy formulation stage. The visibility of the competition authority and its programs and achievements must be self-evident, even to the “small” citizen striving to sell cotton or cattle in the rural areas. This is no easy task and Zambia may not be unique in this regard.

Appendix 1

SUMMARY OF THE ZAMBIAN PRSP



Antitrust, Economic Development and POVERTY: The Other Path

Eleanor M. Fox*

"*Technocrats may be inclined to ignore distributional issues, but no one else will.*"
Harvard Institute for International Development, 1991[165]

Abstract

Developed countries often insist that antitrust only exists for aggregate efficiency and consumer welfare and that any broader focus will protect small competitors and mire the economy in inefficiencies. Developing countries retort that *their* antitrust must also address issues of distribution and power.

This study argues that developing countries do and must ask a broader question than whether conduct decreases aggregate consumer or total wealth. While antitrust should not be used to protect inefficient

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* Eleanor Fox is the Walter J. Derenberg Professor of Trade Regulation at New York University School of Law. This chapter is based on *Economic Development, Poverty and Antitrust: The Other Path*, first printed in 13 Southwestern Journal of Law & Trade in the Americas 211 (2007). The chapter is dedicated to, and is in memory of, my dear friend, colleague and co-author, Lawrence A. Sullivan, a great humanist who always cared about the less fortunate people on this earth. The author thanks Dennis Davis, John Fingleton, Frederic Jenny, Wolfgang Kerber and D. Daniel Sokol for their helpful comments. She thanks the members of the symposium in honour of Lawrence Sullivan sponsored by Southwestern Law School. She thanks Gauri Chhabra and Meredith Laitner for their research assistance. Also, she is grateful to the Filomen D'Agostino and Max E. Greenberg Foundation for its generous research support.

[165] *Reforming Economic Systems In Developing Countries* 3 (Dwight H. Perkins & Michael Roemer, eds, 1991).

Davids against Goliath, it may and should be used to *empower* Davids against Goliath by opening paths of mobility and access. Indeed, enhanced mobility tends to produce efficiencies in societies in which the economic opportunity of masses of people has been suppressed. An antitrust law for developing countries that values mobility, access and efficient development of the economy, while not protecting small firms at the expense of consumers, is 'The Other Path' of this study, which articulates principles, factors and strategies that give content to the other path.

1. Introduction

This study is about competition, antitrust law, poverty and economic development. It asks: What is the foundational perspective that should inform competition law in developing countries?

Important scholarship argues that context matters in designing and applying competition law and its supporting institutions for developing countries[166]. This literature commonly begins with the model of antitrust law of industrialized countries. It then asks what changes are warranted by context such as weak institutions, lack of funding, high barriers, and weak capital markets. This study takes a next step. It advocates the need for placing a developing country's antitrust in the broader context of development economics. In doing so it argues for the relevance of developing countries' plight in the storms and bargains of world trade and competition, which often result in the marginalization of the weakest economies.

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[166] Ground-breaking work has been done by William Kovacic. For example, William Kovacic, *Capitalism, Socialism, and Competition Policy in Vietnam*, 13 Antitrust 57 (1999); *Getting Started: Creating New Competition Policy Institutions in Transition Economies*, 23 Brook. J. Int'l L. 403 (1997); *The Competition Policy Entrepreneur and Law Reform in Formerly Communist and Socialist Countries*, 11 Am. U.J. Int'l L. & Pol'y 437 (1996); *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine and Zimbabwe*, 44 DePaul L. Rev. 1197 (1995); *Competition Policy, Economic Development, and the Transition to Free Markets in the Third World: The Case of Zimbabwe*, 61 Antitrust L. J. 253 (1992); William E. Kovacic & Robert S. Thorpe, "Antitrust and the Evolution of a Market Economy in Mongolia", in *De-Monopolization and Competition Policy in Post-Communist Economies* 89 (Ben Slay, ed., 1994).

Spokespeople for developing countries often express the need for an antitrust paradigm different from that of the developed world[167]. Spokespeople for the developed world tend to argue for universal norms[168]. Moreover, they commonly describe antitrust as "*for efficiency*"[169], meaning no antitrust enforcement unless the transaction is, by some measure, inefficient.

This study takes a different starting point. It treats as the central condition a deep systemic poverty, aggravated by corruption, cronyism, selective statism and privilege, weak institutions, and often unstable democracy[170]. It asks, for such economies: what is the most congenial

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[167] See Ajit Singh, U.N. Conf. On Trade & Dev., *Competition and Competition Policy in Emerging Markets: International and Developmental Dimensions* (2002).

[168] See, e.g., Makan Delrahim, *The Long and Winding Road: Convergence in the Application of Antitrust to Intellectual Property*, Remarks at George Mason Law Review Symposium (Oct. 6, 2004), in 13 Geo. Mason L. Rev. 259 (2005) ("*consensus-based antitrust enforcement is vital to global business and consumer welfare*").

[169] By one common formulation, antitrust is only for efficiency. One common formulation of the efficiency standard is that antitrust law should proscribe only that which does a disservice to consumers and is inefficient, as judged by output limitation. Business conduct other than hard-core cartels is presumed efficient; it is argued that, apart from cartels, the law should proscribe only conduct that has an output-limiting outcome and is not a legitimate business response to consumers. There are alternative ways to regard efficiency and how to achieve it. One major alternative focuses on preserving the structure and forces of competition, positing that the process of competition is most likely to create incentives to compete and invent. Diversity and openness are thought to promote knowledge and experimentation and to function as a feedback mechanism that facilitates adaptation and dynamic change. See Wolfgang Kerber, *Competition, Experimentation, and Legal Rules and Institutional Framework* (Dec. 2, 2006) (unpublished manuscript, on file with author); see also Eleanor Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 Antitrust L. J. 371 (2002).

[170] Mark Dutz and R. Shyam Khemani wrote on the "*tyranny of predatory vested interests*": These factors (high market concentration, high barriers to entry, high ownership concentration and weak corporate governance) tend to reinforce one another and give rise to inflexible, inefficient industrial and financial market structures. They also have adverse implications not only for fostering effective competition and competitiveness, but also for governance at both the state and

foundational perspective on which to formulate antitrust law? In particular, would this cohort of countries be best served by a foundational principle that trusts liberalization and free enterprise ("first model"), or would it be served by a foundational principle that centrally takes account of the opacity, blockage and political capture of markets, and includes some measure of helping to empower people economically to help themselves ("second model")? There are, of course, other formulations. There are also formulations within the formulations[171].

There are trade-offs, whatever model is applied. I would be clear at the outset that protectionism is not a desirable option, whether in terms of protecting small firms from efficient competition or protecting domestic firms from foreign competition. The inquiry of this study is how to make the market work for the good of development, and not to suppress it. If suppression is politically inevitable, then that is an obstacle that will tend to defeat the enterprise.

The choice of models is not uncomplicated. Even if the second model (recognizing empowerment and distributional concerns) might in the abstract seem more legitimate to a developing economy than the first (emphasizing the virtues of aggregate efficiency and non-intervention as the means to produce it), the first model is a path well travelled, and reinventing a path is difficult and costly. Moreover, the first model offers some clear and relatively simple rules without risking the

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corporate levels – and for the persistence of an anti-competitive nexus mutually supporting vested interests between incumbent firms and government, with some of the earned rents used to entrench market power by buying government favouritism. Since firms tend to be large in size and few in number, they have organizational and financial advantages in influencing legislation and regulation. Mark Dutz & R. Shyam Khemani, *Competition Law & Policy: Challenges in South Asia* 11 (2007).

[171] For example, one mainstream perspective assumes that markets work well and that government interventions work badly (neo-liberal assumptions). At the other end of the continuum, analysts may acknowledge that market structures may be "*skewed in favour of entrenched elites with inequitable distributions of wealth with social stratification drawn along racial or ethnic lines*", a situation that competition law might exacerbate. Taimoon Stewart, Julian Clarke & Susan Joekes, *Competition Law in Action: Experiences from Developing Countries* iv (2007), available at http://www.idrc.ca/en/ev-111677-201-1-DO_TOPIC.html.

costs of error from too much intervention and costs of political forays inherent in a grant of excessive discretion to officials.

The study concludes by suggesting that reliance on markets is critical for economic welfare; that extreme neo-liberal principles that animate much of antitrust law in this age of "modernization"[172] are not necessary for efficiency and could run contrary to it; and that developing countries are likely to be served by exploring a path that is most sympathetic to their context.

This study is written at a time when "convergence" is repeatedly referenced as an imperative objective of antitrust in a globalized world. Convergence implies universal standards, or at least universal norms implemented in common ways. The phrase "universal standards" normally refers to the standards of the United States and Europe,[173] which have become the dominant models for the world. This study suggests that developing countries should nonetheless consider the benefits of a perspective of their own before considering the virtues – which there are – of convergence. It further suggests that substantial convergence can be achieved and will naturally occur even in the face of varying perspectives.

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[172] Both the United States and the European Union have launched commissions or projects to consider how competition law should be modernized. Moreover, in the United States, successive Supreme Court opinions have narrowed the purview of US antitrust law. See, e.g., *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 2007 WL 1835892 (US June 28, 2007); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S. Ct. 1069 (2007); *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 US 164 (2006); *Tool Works Inc. v. Independent Ink, Inc.*, 547 US 28 (2006).

[173] This is the case even while the standards of the United States and Europe are changing, as institutions in both jurisdictions embark on "modernization" projects, and as the United States Supreme Court successively narrows the scope of the law. Yet with the economic rise of China and India, one might expect the American and Euro-centric centre of gravity to shift, and to do so in ways not predictable today.

2. The choice

Approximately one hundred nations in the world have adopted antitrust laws. Perhaps a quarter of these nations are developing countries. Yet other developing countries have not adopted antitrust laws; some are considering doing so.

By one perspective, all of these nations should adopt antitrust laws[174], and all of these nations should adopt the developed world's framework: free markets and antitrust in the service of unleashing markets and pursuing aggregate efficiency. Much like the developed countries, developing economies are often riddled with cartels and other restraints that obstruct their markets and hurt their people. Many are peppered with monopolistic abuses, especially by state-owned and privileged enterprises – more than are developed countries. Globalization has lowered barriers and paved the way to the efficiency benefits from markets and, it is argued, liberalization and antitrust should work hand in hand to anchor these benefits[175].

This study argues that developing countries require a larger canvas. The canvas includes the dire economic conditions of developing countries and the treatment they receive from the world community. Developing countries often see free-market rhetoric and aggregate wealth or welfare goals as inappropriate to their context because of the

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[174] ***Compare*** A.E. Rodriguez and Mark D. Williams, *The Effectiveness of Proposed Antitrust Programs for Developing Countries*, 19 N. C.J.Int'l L. & Com. Reg. 209 (1994) (arguing that antitrust law is largely inappropriate for developing countries and that the liberal effects of the law will be overwhelmed by interest-group politics procuring protection), ***with*** Craig W. Conrath and Barry T. Freeman, *A Response to "The Effectiveness of Proposed Antitrust Programs for Developing Countries*," 19 N.C.J .Int'l L. & Com. Reg. 233 (1994) (arguing that antitrust law and advocacy will benefit consumers).

[175] Efficiency is usually seen as the measure of antitrust benefits. At this point I do not raise differences between consumer welfare and total welfare in measuring efficiency. I stress aggregate concepts – whether defined in terms of all consumers or all consumers and producers: Do the winners win more than the losers lose? And if so, should we disregard distributional consequences?

tendency of free-market policies to disproportionately advantage the already advantaged in every game played[176].

This does not imply that antitrust for developing countries would or should look dramatically different from a developed country's antitrust. There are reasons why it might look much the same, as I develop below; but there are also reasons why the perspective might differ from the neo-liberal one that currently informs many antitrust laws of developed countries – a perspective that has "*relatively little resonance for the great majority of the population that is poor*"[177].

3. The competition challenge

3.1. Introduction

Putting poverty, marginalization, cronyistic control, and dire economic conditions at the centre of the universe, we ask: First, to what extent will competition and the market help developing countries develop efficiently for the good of their people? Second, to what extent will antitrust law help? Third, if antitrust law is adopted, what form of antitrust law?

3.2. To what extent will competition and the market help?

Freeing up the market has been shown to produce great economic benefits for developing and transitional countries. The converse approach, command and control, so ill served Russia and Eastern Europe that the systems fell of their own weight[178].

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[176] See Nancy Birdsall, *Inequality Matters: Why Globalization Doesn't Lift All Boats*, Boston Rev., Mar.–Apr. 2007, at 7; Francis Fukuyama, *Keeping Up with the Chavezes*, Wall St. J., Feb. 1, 2007, at A17; Peter Sutherland, *The Doha Development Agenda: Political Challenges to the World Trading System — A Cosmopolitan Perspective*, 8 J. Int'l Econ. L. 363 (2005).

[177] Fukuyama, *supra* note 12.

[178] A third option – among others along the continuum – is a combination of competition and industrial policy. Some commentators argue that industrial

Hernando de Soto, in *The Other Path*, eloquently demonstrates the benefits of tearing down barriers to free market participation. He catalogued and studied the barriers, such as dense licensing requirements, that excluded the poorest Peruvians from Peru's market system, relegating them to their own informal economy. Alienated by the exclusion and their dismal lives, many joined the terrorist organization Shining Path. To counter the Shining Path and its destructive forces, de Soto proposed another path ("el otro sendero") that would tear down the barriers to participation in the recognized economy, give people hope and opportunities, and enable the poor to participate in markets on their own merits. Regarding matters of government regulation, *The Other Path*[179] is a blueprint for building the ladder of mobility. It envisions a society that values mobility; that opens the door to inclusion, from the

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policy in Japan and Korea put those nations on a sound footing before they fully exposed their businesses to the winds of competition. Others observe, however, that vibrant competition within the borders of both nations co-existed with government-managed external competition; and these commentators credit the countries' successes to the market and not to its suppression. See Working Group on the Interaction between Trade and Competition Policy, *Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, pp. 168–257, WT/WGTCP/W/228 (May 19, 2003), available at http://www.jmcti.org/2000round/com/doha/wg/wt_wgtcp_w_228.pdf; see also Ajit Singh, *Multilateral Competition Policy and Economic Development: A Developing Country Perspective on the European Community Proposals* (paper presented at the fifth session of the Intergovernmental Group of Experts on Competition Law and Policy, Geneva, July 2–4, 2004, available at http://www.networkideas.org/feathm/aug2003/MCP.pdf (developing countries often query whether they should follow the model of Japan and Korea).

Free markets are regarded with some scepticism by the new left in several South American countries, wherein the populace complains that it has not seen the benefits of liberalization. The economic, social and political reforms in Latin America beginning in the 1980s had not delivered their promises of economic growth and there was resentment among the people because the reforms had not reduced poverty and inequality. This produced a populist shift towards socialism, returning more power to the state and rolling back whatever achievements were made. See Jorge Castañeda, *Latin America's Left Turn*, Foreign Affairs, May–June 2006, at 28.

[179] Hernando de Soto, *The Other Path: The Invisible Revolution in the Third World* (1989).

poorest up; and it proposes to do so for the pragmatic reason of building a better society.

The counter-viewpoint – embrace of government control and indifference to the plight of the excluded – blocks the market through excessive regulation, privilege, and cronyism. The powerful insiders protect their friends at the expense of the public and often at the particular expense of the poor. This was the story of Telmex in Mexico. Owned by a close friend of each successive president, Telmex was guaranteed a monopoly price for incoming cross-border telecom connections. The monopoly price was guaranteed at the expense of poor Mexicans who migrated to the United States for work and whose telephone lifeline was to Mexico[180]. The entrenched system likewise deprived the aspiring new-entrant Mexican entrepreneurs of the right to price-compete against Telmex for incoming calls[181]. Thus, it exploited, it excluded, and it stymied opportunity.

Hence, not only does globalization tend to stack the deck against a critical mass of developing countries and those people who are least able (least educated, skilled and moneyed, and lacking infrastructure) to ride the wave of globalization's opportunities[182], but it

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[180] Not only do the poor suffer from prices that are too high, but they suffer from suppressed growth. "[*T]he rest of the country suffered from [Telmex's] favored position. In a modern age when businesses need low-priced, high-quality telecommunications to compete in a global economy, Mexican growth has borne the cost of Mr. Slim's privilege. Any genuine effort to help the poor necessarily requires more healthy competition, starting in the telecom market*." See Mary Anastasia O'Grady, *A Telecom Monopoly Cripples Mexico*, Wall St. J., Feb. 10, 2006, at A19.

[181] See Eleanor Fox, *The WTO's First Antitrust Case – Mexican Telecoms: A Sleeping Victory for Trade and Competition*, 9 J. of Int'l Econ. Law 271 (2006).

[182] See Paul Collier, The Bottom Billion: Why the Poorest Countries are Failing and What Can be Done About It (2007). See also Pascal Lamy, Dir. Gen., WTO, *Making Trade Work for Development: Time for a "Geneva Consensus",* Emil Noel Lecture, New York University School of Law (Oct. 30, 2006) (transcript available
http://www.nyulawglobal.com/events/documents/emilenoellecturefall06.pdf).
Pascal Lamy recounts the bias in the prior trade rounds against developing countries. He notes the persistence of "economic colonization" and the developing countries' "bitter" "potion" of intractable adjustment problems. Developing countries' problems of adjustment to the onrush of free trade are

also allows cronyistic governments to block upward mobility and entrench the condition of the poor.

3.3. Antitrust: can antitrust help and in what form?

3.3.1. Mobility

Just as de Soto would remove government regulatory barriers in deprived economies, a contextualized antitrust law can remove the roadblocks erected by powerful market actors, public and private. Both liberalization and antitrust can tear down the barriers facing the people who are the least well off. They can invite these often alienated individuals into the economic system, giving them hope, dignity and self-worth.

Antitrust law attacks artificial obstructions that market players create. But nations disagree about what acts constitute artificial obstructions. Are they only acts that shrink the size of the pie, decrease aggregate wealth, and are allocatively inefficient[183]? Or are they also acts that block the channels of mobility, keeping worthy actors down and moats wide[184]? If the latter, obstructions can be seen in more human terms and perhaps antitrust policy and its language can be better aligned with efficient development[185].

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particularly serious "*because [trade openings] often hit larger parts of the population and because the countries have little capacity to handle the much needed accompanying policies to assist the victims of globalization*." *Id*. at 6, 7, 10. Moreover, developing countries usually lack safety nets, and the lack of safety nets means that job loss causes severe hardship. Further, the promised benefits of market openings are harder to capture: the time and costs to market (e.g. trucking goods to a port) can overwhelm gains.

[183] It is important for an antitrust agency to identify and target anti-competitive acts that shrink the pie. I do not imply the contrary.

[184] See Eleanor Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 Antitrust L. J. 371 (2002).

[185] Protecting mobility and opportunity on the merits need not and should not imply protecting inefficient competitors from competition or handicapping efficient firms. See Eleanor Fox, *We Protect Competition, You Protect Competitors*, 26 World Competition 149 (2003); see also Dutz & Khemani, *supra*

There are good reasons why mobility factors should play a role in the antitrust laws of developing countries. The countries look to the marketplace to give firms, including smaller and younger firms, a fair chance to compete on the merits of their products and services, free from artificial and unnecessary foreclosing restraints by powerful firms. Empowerment to engage in markets free of unnecessary business restraints by firms with substantial market power is the counterpart to de Soto's vision of empowerment to engage in markets free from unnecessary and unjustified government restraints. Undue market restraints, whether public or private, retard efficient development. They also tend to harm allocative efficiency and surely do not advance it. To the extent that "efficiency" as the goal of antitrust implies disregard of distributional values, this may be a contradiction in terms in developing countries, where severe distributional inequities are depriving the marketplace of the talents and energies of the majority of the population. Aggregate efficiency, turning its back on maldistribution and severe economic inequities, is probably not the centrepiece that most developing countries are likely to choose.

3.3.2. Assessing local problems before adopting law

Law making should come from within, not without. Legislation should respond to contextual problems that need to be solved. Ideally, law is not generated by outsiders who proclaim "*we have this law and you should, too*"[186]. It is important for each country, or regional

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note 6. See Michael Boudin, *Antitrust Doctrine and the Sway of Metaphor*, 75 Geo. L. J. 395 (1986), for a discussion as to the power of metaphor.

[186] The two clauses need a link. Does the outsider claim that the law is needed to solve negative externalities visited on the outsider, as in pollution: "*Your smokestacks are polluting us*"? Does the outsider claim that its businesses pay a cost and to be fair the insider's businesses should pay the same costs? Does the outsider claim: "*If only you will make your laws like ours, our businesses will find it easier to make more money in your backyard*"? Or is the outsider altruistic; a paternalistic Good Samaritan: "*We know this is good for you; we "offer" it to you*"?

See Daniel Berkowitz, Katharina Pistor & Jean Francois Richard, *Economic Development, Legality, and the Transplant Effect*, 47 Eur. L. Rev. 165 (2003),

groupings of like countries, to take stock; to assemble the facts: who within the country is harmed by what practices? How can such harm be prevented? And at what cost?

Professors Jenny and Evenett, and the Consumers Unity & Trust Society (CUTS) under the leadership of Pradeep Mehta, have done noteworthy work to build the databases that may help to answer these questions. The data show that:

- In many developing countries, seller cartels target basic necessities of the people, including dietary staples. In Peru, poultry farms and their trade association conspired to eliminate competitors and prevent entry. In Zambia, the dominant producer of day-old chickens required the biggest buyer to stay out of the production market, and the buyer agreed to the requirement.
- Evidence of buying cartels is rampant. These include cartels that exploit small farmers and producers such as coffee producers in Kenya and Latin America, cotton, tea and tobacco growers in Malawi, milk processors in Chile, and fish processors near Lake Victoria.
- Cartels, boycotts, and non-compete agreements have been detected and prosecuted in the milling and baking, milk and sugar markets. Beer mergers in highly concentrated beer markets have threatened to exploit buyers in Namibia, Turkey, Malawi, Kenya and Tanzania.
- In Kenya, owners of minivans garnered monopolies over lucrative routes. They teamed up with criminal gangs, not only overcharging for simple and necessary van transportation but also terrorizing the travellers. Also in Kenya, the fertilizer manufacturers organized a secret bidding cartel in their tenders to the government buying authority, impoverishing the farmers who needed increasing supplies.
- In many countries, vertical agreements tie up scarce inputs and scarce channels of distribution.
- In Turkey, the two dominant telecommunication firms had sole control of the infrastructure necessary to provide national roaming capability for a GSM mobile telephone service and refused to allow access to would-be new entrants. Typically,

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for a discussion of the problems of legal transplants when the law is not adapted to the country's conditions.

dominant firms deny small firms access to essential facilities such as telecom and electricity infrastructure[187].

Press stories add to the data daily. In Mexico, half of the people live on US$4 or less a day, and many survive on tortillas and beans. From December 2006 to January 2007, the price of corn soared, and the price of the tortilla rose by 35 cents a pound. The *New York Times* reported: "*The crisis has hit hardest for the poorest Mexicans, who may spend more than a quarter of their daily salaries on tortillas*"[188]. It has displaced poor tortilla makers, who have lost up to 40 per cent of their business, since the people are compelled to buy and eat less. While the price shock arose first from extraneous causes, the giant Mexican tortilla

[187] See Frederic Jenny, *Anticompetitive Practices in Developing Countries: Lessons from Empirical Evidence* (May 23–24, 2005) (unpublished paper presented at First National Competition Seminar, Amman, Jordan) (on file with author); Frederic Jenny, *Anti-Competitive Agreements: Meaning and Examples*, Caribbean Dialogue, July–Sept. 2004, at 1 (anti-competitive practices in Trinidad and Tobago, Kenya, Lebanon, Indonesia and other smaller economies; Kovacic, *supra* note 2; Simon J. Evenett, U.K.'s Dep't for Int'l Dev., *Links between Development and Competition Law in Developing Countries* (2003), available at http://www.evenett.com/reports/dfidpaper.pdf; Ana Maria Alvarez, Simon J. Evenett & Laurence Wilse-Samson, "Anti-Competitive Practices and the Attainment of the Millennium Development Goals: Implications for Competition Law Enforcement and Inter-Agency Cooperation", in *Implementing Competition-Related Provisions in Regional Trade Agreements: Is It Possible to Obtain Development Gains*? 60 (2007). The latter chapter documents numerous other specific restraints in health, education, financial services for low-income earners, infrastructure and housing, and food. *Id.* at 65–77. See also *Pulling Up Our Socks* (Consumer Unity and Trust Society Centre for Competition, Investment & Economic Regulation, Rajasthan, India), Feb. 2003 (report based on the 7-Up Project analysing competition problems in seven developing countries – Kenya, Tanzania, Zambia, South Africa, Sri Lanka, Pakistan and India); Pradeep S. Mehta & Nitya Nanda, *Competition Policy, Growth and Poverty Reduction in Developing Countries*, http://www.competition-regulation.org.uk/conferences/southafrica04/mehta&nanda.pdf (last visited June 30, 2007). For examples of abuse of dominance violations in Latin American countries, *see* Russell W. Pittman and Maria Coppola Tineo, *Abuse of Dominance Enforcement under Latin American Competition Laws*, March 2006, available at SSRN: http://ssrn.com/abstract=888186.

[188] James C. McKinley Jr., *Cost of Corn Soars, Forcing Mexico to Set Price Limits*, N.Y. Times, Jan. 19, 2007, at A12.

makers took advantage of the situation "*hoarding supplies to drive prices up even more*", according to Mexican officials[189].

Mexico's monopolies thrive even under the free market regime of President Calderon. Jorge Castañeda, Mexico's former foreign minister, wrote: "*The monopolist control of practically every walk of Mexican life is in place*". Huge monopolies that exclude and exploit dominate the country – in oil, electricity, fixed line and mobile telephone, television, cement, banks, bread, and tortilla production[190]. The case of Mexico is not unique to the developing world. It is typical.

In sum, the people of developing countries are seriously impacted by cartels and monopolistic practices. These practices include those that raise consumer prices and input prices to their businesses, which exclude or build hurdles to their outputs, and foreclose domestic suppliers. They do so by all means: coercive practices such as boycotts, covenants not to compete, price manipulation, and predation. They shore up their power to do so by mergers. Anti-competitive practices are rife in areas of physical and business necessity, such as milk, soft drinks, beer, chicken, sugar, cotton, paper, aluminium, steel, fertilizer chemicals, telecommunications, cement and other construction materials, transportation including trucking, shipping and port access, industrial gases, banking, insurance, coal and electricity. Many of the practices are local; many of these are facilitated by the country's own government; and many others are offshore, targeting the vulnerable developing countries. Many of the harmful practices are illegal under the standards of the industrialized countries. A critical mass is not, or is unlikely to be proved illegal, under these standards.

3.3.3. A perspective

We are (let us suppose) policy makers who live and work in a developing country and we have at heart the welfare of our community. Half of our fellow citizens live in abject poverty. A third of the citizens are farmers. We have extractive natural resources. We have a slender

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[189] *Id.*

[190] Jorge Castañeda, *Mexico Needs to be Freed from Unhealthy Monopolies*, Fin. Times, Feb. 5, 2007, at 13.

manufacturing industry with potential for growth. We have cotton and lumber. Our citizens are extraordinary craftspeople. Most of our people do not have enough food to eat. State-owned monopolies dominate our infrastructure industries. The education system is poor and sometimes barely existent. Disease and corruption are rampant. A decade ago in an expanding economy we glimpsed possibilities to move up the ladder so that at least our children could have a better life. After opening our markets, the richest two per cent have better lives. A fraction of others who have had sufficient education and training now fortunately embrace opportunities opened by globalization, including opportunities from outsourcing. But the overwhelming majority of our people have seen no gains. They see a bigger wealth gap: no ladder and a wider moat[191].

What do we want?

Of course we want food, medicine, necessities at lower prices, education and training, and infrastructure. We want a better chance to fend for ourselves; to participate in the economic enterprise; to have a real opportunity to make a living. Do we need and want antitrust? And if so, what type of antitrust? We want to explore what antitrust can do for us, assuming that we have enough money and trained people to staff the office and enforce the law.

We believe that antitrust law can help – if we can obtain sufficient funding and access the necessary information to find and prosecute cases; if we can get jurisdiction over the violators, who may be offshore; if we legally and practically have sufficient enforcement power; and if reasoned agency decisions will be upheld by the courts, and within a reasonable period of time. Antitrust can deter the harmful practices catalogued above, and in doing so it can empower people to participate in the market on their merits.

Assuming that we want antitrust, what kind of antitrust do we want?

We have looked at the anti-cartel law of industrialized countries. We find it strong and attractive in principle although we worry about our ability to prove cartel agreements even when we are confident they

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[191] See Lamy, *supra* note 18. There may be gains but they are not perceptible to the majority of the poor; and the gains are unequally distributed to the wealthy or the otherwise (e.g. educationally) advantaged.

exist. Moreover, our country's economy is run by monopolists more than cartels.

For monopolization and abuse of dominance, we look at the United States' recent monopolization jurisprudence[192]. We observe that US law has a narrow scope for dominant-firm violations: It is not concerned itself with excluded or marginalized competitors. It *is* concerned that antitrust law might be overly aggressive and might chill efficient conduct by dominant firms. It is in theory concerned with consumers who are overcharged; yet it tends to strike the balance in favour of freedom for dominant firms on the theory that the incentives of dominant firms are aligned with consumer interests, and antitrust duties discourage firms from inventing and investing[193]. It does not experience at all the problem that haunts us the most: abusive conduct, by state-owned and privileged monopolies, that suppresses competition on the merits.

Moreover, government policy papers and commissions focus on whether it is too easy to prove that a firm has dominant power and whether safe harbours for monopoly-firm conduct are too few and too narrow[194], rather than mapping out the mine fields of anti-competitive conduct.

Verizon v. Trinko[195] illuminates the perspective that non-intervention against the dominant firm is the best prescription for economic welfare. Verizon was the incumbent local telephone service provider in the north-eastern United States, and it owned elements of the local telephone loop, which connected long-distance calls to the local area. When competition among local telephone service providers became technologically feasible and economical, the United States

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[192] See *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S. Ct. 1069 (2007); *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 US 398 (2004).

[193] See R. Hewitt Pate, "The Common Law Approach and Improving Standards for Analyzing Single Firm Conduct", in 2003 *International Antitrust Law & Policy: Fordham Corporate Law Institute*, Chap. 12, p. 195 (Barry Hawk, ed. 2004) (supporting the minimalist approach).

[194] See *Report and Recommendations of the Antitrust Modernization Commission* (April 2007), especially Chap. 1.C. Exclusionary Conduct.

[195] 540 US 398 (2004).

deregulated the market and invited local competition into each geographic area. Rivals entered. They needed access to the local loop, which a federal statute required the incumbent to assure. Verizon, however, wanted to keep its own customers from defecting to the new entrants. Therefore it interrupted its rivals' access to the local loop so that it – by definition – would provide better service[196]. The Supreme Court held that the conduct did not violate the antitrust laws[197].

Before the Court, plaintiffs had argued that Verizon was guilty of strategic manipulations accomplished by many "small" acts, such as disrupting local loop connections, and that in this way Verizon "*threatened [the rivals] with 'death by a thousand cuts'*"[198]. This is a metaphor sometimes used in civil rights cases to describe the thousands of everyday slights that work synergistically to keep the marginalized marginalized.

The US Supreme Court embraced the metaphor and turned it against the plaintiffs:

> *"[T]he identification of [a thousand cuts] would surely be a daunting task for a generalist antitrust court. Judicial oversight under the Sherman Act would seem destined to distort investment and lead to a new layer of interminable litigation…"*[199].

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[196] The Court assumed these alleged facts to be true because the case before the Court arose on Verizon's motion to dismiss the complaint.

[197] The Court would have preferred to leave the problem to the regulatory agency, and to the regulatory statute that prohibited the conduct, but the statute declared that antitrust law was not pre-empted. Therefore, by necessity, the Court's opinion went beyond the regulated industry context. The Court expressed a general principle of non-interference with the monopolist's freedom of action

[198] Brief for the State of New York *et al.* as Amici Curiae, in Support of Respondent at 10, *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 US 398 (2004) (No. 02-682).

[199] The Court held that a dominant firm's use of leverage to gain advantages in, but not to monopolize, the local telephone market was not an antitrust violation. "Mere" leveraging by a monopolist that will not lead to a new monopoly is not of US antitrust concern. Trinko, 540 US at 414, n. 4.

Verizon's everyday abuses were put beyond the reach of antitrust.

For developing countries, death by a thousand cuts would seem to be a reason *for* antitrust accountability, not against it. The concept describes the perpetuated condition of the powerful against the powerless.

We want a law against cartels, monopolistic practices, and abuses of dominance that prevent dominant firms from using their power and leverage to fence out powerless firms. We want a law against mergers that create or reinforce the power to exploit and exclude. Moreover, we want a strong law that tackles restrictive and market-blocking acts by state-owned enterprises – problems that are exponentially greater in developing countries than in, for example, the United States.

We would not want to use the law to undermine efficiency. We would guard against inefficient applications by limiting principles[200]. But our main problem today is not how to widen the safe harbours for exclusionary acts of monopolists; it is how to break through blocked and opaque markets to create competition and competitive opportunity.

4. Observations on the design of appropriate law

Developing countries face countless dilemmas and opportunities in formulating their substantive principles. Some are telescoped above. Here are eight:

1. Developing countries face markets that are much less dynamic and open than markets in developed countries. Moreover the markets are pockmarked by state intervention

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[200] For example, we might choose a principle that must not harm consumers through antitrust *enforcement*.

Law that protects the openness of markets and access of market players on merit does not inherently protect inefficiencies, and law that ignores the values of openness and access can protect the power of the dominant firm. See Eleanor Fox, *Monopolization, Abuse of Dominance, and the Indeterminacy of Economics: The US/EU Divide*, 2006 Utah L. Rev. 799 (2006).

and control. Whether the intervention is through state measures, state-owned enterprises, or enterprises licensed or privileged by the state, these enterprises are likely to run on principles of privilege, preference, and cronyism[201]. These factors have major implications regarding error costs. If the competition agency is relatively independent, resourced, and capable, more intervention, especially against market blocking and discriminatory action[202] by state-owned or state-privileged enterprises, might promise more gains and fewer costs than abuse-of-dominance intervention in developed economies[203].

2. Most developing countries have insufficient resources to run their competition offices. They are short of staff, and especially short of economists. This suggests that bright-line rules might be needed, whether they tip in the direction of more or less aggressive enforcement. Much developed country analysis, such as that suggested by the US Supreme Court in *California Dental Association*[204], might be too complex and of uncertain application. Focused analysis with fewer factors in play is more appropriate[205].

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[201] See Dutz & Khemani, *supra* note 6.

[202] I refer to discrimination in favour of cronies and against outsiders.

[203] See John Fingleton, “De-Monopolizing Ireland”, in *European Competition Law Annual 2003: What is Abuse of Dominant Position?* 53, 65 (Claus Dieter Ehlermann & Isabela Atanasiu eds, 2006); *see also* John Vickers, *Competition Law and Economics: A Mid-Atlantic Viewpoint*, The 10th Burrell Competition Lecture (Mar. 19, 2007) (explaining that historically monopolized economy and weak “self-righting mechanisms” may require more interventionist policies towards abuse of dominance).

[204] *Cal. Dental Ass’n v. F.T.C.*, 526 US 756 (1999) (holding that dentists’ rules against the advertisement of price discounts and quality do not inevitably lessen the output of dental services, and that the probability of output limitation must be the subject of detailed inquiry).

[205] See the dissenting opinion of Justice Breyer, relying on experience and theory to conclude that rules against advertising discounts raise prices. *Id.* at 782. See also Justice Breyer’s dissent in *Leegin Creative Leather Products, Inc., v. PSKS, Inc.*, *supra* note 8.

3. In view of insufficient resources and expertise, and faced with putative violators much bigger than their own country, the agency may be tempted to rely on presumptions in its favour, e.g. that a certain high market share presumptively proves dominant or substantial market power. Presumptions that shift a burden to the putative violator are very helpful and indeed important when the basis for inference is a good proxy and when the respondent gets a fair chance to rebut. Thus, if the market is well defined, the next good constraint is far from the market boundary, and the respondent has occupied 80 per cent or more of the market for many years (implying barriers to entry), a simple presumption and shift of the burden makes sense[206], and may enable the agency to get on with its project to prove abuse. However, a much lower share (e.g. less than 40 per cent) does not by itself tend to support an inference of substantial market power. The agency – to do its job – must examine other factors, and must listen sympathetically to the respondent's story that it has no power.

4. Apart from the observations above, each nation must make important decisions regarding the degree of antitrust intervention. It faces conundrums. For example, excessive pricing, especially after price controls are removed, may be a pressing problem, especially as to the price of necessities. But easily triggered antitrust intervention may lead to price control by another name and undermine the effort to prime markets and make them work. Low, especially below-cost, pricing might seriously threaten local firms and undermine their chance to take root. But intervention against low pricing deprives the people of one of the most important benefits of competition. Moreover, whether the low price is truly below cost might be difficult or impossible to ascertain. The nation might want to fashion a rule, such as that of the United States

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[206] This is so even if developed countries' laws require the agency to engage in an all-factors economic analysis of market power at the first stage. In fact, in most jurisdictions these facts would give rise to a presumption and cause a shift in the burden of proof or burden of production of evidence. See *Antitrust Law Developments*, vol. 1, pp. 234–36 especially at note 39 (5th ed. 2002). This problem – proof of substantial market power – is currently under discussion in the International Competition Network.

or of the European Union, to avoid intervening against low pricing.

5. A legitimate abuse-of-dominance law would be copious enough to prohibit unjustified foreclosing restraints, without the need of a plaintiff to prove output effects across the whole market. But as a corollary, law that seriously respects the right of the underdog to compete on the merits should also seriously respect the right of an alleged violator to prove: my conduct responded to consumers and served the market. Whatever the presumptive rule of violation for foreclosure, the careful agency will want to listen seriously to a pro-market, pro-competition defence.

6. While there is high value to a nation in formulating its own law, nations will also appreciate the benefits of following a blazoned path. Anchoring new law in existing jurisprudence promises greater legal certainty and other efficiencies. If one adopts “dominant” law, one need not reinvent the wheel. One can take account of international norms while enhancing the ease of foreign investment. The challenge is to understand when foreign law is appropriate law and when it is not[207].

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[207] This is a challenge that South African law explicitly embraces. See *Mondi Ltd. & Kohler Cores and Tubes v. Competition Tribunal, Competition Appeal Court*, 2003 (l) CPLR 25(CAC) (S. Afr.). Gesner Oliveira and Cinthia Konichi Paulo add the following differences and concerns that developing countries must take into account when implementing competition law: 1) the large informal sector, which does not comply with law and may lead to overestimation of market power; 2) the size of the market, which for Brazil is a medium-sized economy with many prominent multinationals; 3) the magnitude of expected efficiency gains, which often are larger for transitional than developed economies; 4) precariousness of the infrastructure; 5) higher transaction costs, which can prevent new entrants from contesting quasi-monopolies; and 6) more severe political market failure. “*In sum, developing countries have more competition problems and fewer resources.*” Gesner Oliveira & Cinthia Konichi Paulo, *The Implementation of Competition Policy in Developing Countries: The Case of Brazil* (May 2006) (prepared for the workshop, The Development Dimension of Competition Law and Policy: Economic Perspectives in Cape Town, South Africa).

7. Insufficient resources and expert staff are likely to be complicated by political pressures to refrain from doing what is right (e.g. sue to enjoin an anti-competitive joint venture that is half-owned by the government or the president's friend). Agencies in all nations face political pressures, but those faced by agencies in developing countries are likely to be exponentially more severe, and the independence and ability of the agency to resist them are likely to be low. The question here is not one of law by practical politics. The prescription is: learning how best to deflect the anti-market and harmful political demands – a subject on which agencies – mature and young – should engage[208].

8. For efficiency and growth, developing countries must always adjust to the changing dynamics of markets and competition. All principles and rules should be consistent with the imperative of flexibility and adjustment and should avoid the temptation to try to hold back the tide of change.

5. Correlatives

The perspective suggested above concerns antitrust proper – the substantive rules and principles of antitrust *law*. A number of additional considerations and conditions are necessary to make the law useful and meaningful[209].

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[208] See remarks of US FTC Commissioner William Kovacic at DOJ/FTC hearings on Technical Assistance, Feb. 6, 2008.

[209] These considerations and conditions have been well articulated by others. See, e.g., William Kovacic, *Getting Started: Creating New Competition Policy Institutions in Transition Economies*, 23 Brooklyn J. Int'l L. 403 (1997); *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine and Zimbabwe,* 44 DePaul L. Rev. 1197 (1995); Clive S. Gray, "Antitrust as a Component of Policy Reform: What Relevance for Economic Development?", in *Reforming Economic Systems in Developing Countries* 404 (Dwight H. Perkins & Michael Roemer eds, 1991); R. Shyam Khemani, *Competition Policy and Economic Development*, Policy Options, Oct. 1997, at 23, available at http://www.irpp.org/po/archive/oct97/khemani.pdf.

First, exemptions must not be overly broad. Antitrust operates only within the area carved out for it. Exemptions and immunities, including untouchable market actors who may be favoured by the state, can so shrink this area as to lose most of antitrust law's promised benefits. In that spirit, including within the coverage of antitrust law regulated industries and state enterprises that operate in a commercial capacity can be significantly advantageous to developing countries. Often the industries most important to the people are regulated and each is dominated by a state-owned monopolist. These industries include infrastructure industries such as energy, communications, and transportation. Exclusion of the market actors in these markets from antitrust is not only a recipe for cronyism and exploitation[210], but it is also a recipe for a tiny antitrust domain[211].

Second, the competition agency must be as independent as possible, free from political interference, lest the government and its politicians commandeer antitrust and confine it to a not-too-meaningful realm.

Third, institutions, ideally the competition agency should be well funded and sufficiently staffed with educated and trained personnel. The leaders and staff should not be corrupt. Appellate channels should be provided. Appellate institutions, too, should be staffed by well-qualified and non-corrupt individuals. Due process should be assured in all proceedings. The workings of the institutions should be transparent and their agents accountable. Their decisions and judgements should be published and accessible. Well-functioning institutions are more important to trade and competition than is the convergence of the laws of various nations[212].

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[210] See Fox, *supra* note 17.

[211] Likewise, antitrust should not be crowded out by protectionist measures that serve the entrenched interests. See Dennis Davis & Eleanor Fox, "Industrial Policy and Competition – Developing Countries As Victims and Users", *in 2006 International Antitrust Law & Policy: Fordham Corporate Law Institute*, Chap. 8, p. 151 (Barry Hawk, ed., 2007).

[212] See Roumeen Islam & Ariell Reshef, *Trade and Harmonization: If Your Institutions Are Good, Does it Matter If They Are Different?* (World Bank, Policy Research Working Paper No. 3907, 2006). The choice in developing countries, however, is often a grim choice. The quality of institutions cannot be expected to approach the ideal.

Fourth, advocacy is a critical tool. Commonly, the most serious restraints are government measures, often procured by vested interests. Moreover, "*corporate elites . . . [tend to] resist policy reforms…*"[213]. The competition agency can play an important role in calling attention to anti-competitive and unproductive state measures and their costs to society. It can be the nation's "*strongest public voice on promoting competition and articulating the competition perspective*"[214].

More generally, education and adequate health care are *sina qua non* for effective participation in the economic system.These are difficult requirements to fulfil. If crucial elements are missing, wise policy makers might choose not to adopt antitrust at all.

6. The developed country's duty of cooperation

Developing countries are hurt by international cartels and practices and are vulnerable to them. The violators know that developing countries have few resources to devote to antitrust (if any, after they serve other human priorities). Offshore firms direct exploitative practices at developing countries, often by acts taken and agreements made on their home shores[215].

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[213] Dutz & Khemani, *Competition Law & Policy*, *supra* note 6, at 12.

[214] *Id*. at 28. Dutz and Khemani noted: "*[E]ffective competition advocacy can help create an environment where, over time, enforcement strengthens the role of markets by reducing government interventions and concomitant regulatory burdens. Thus advocacy may not just be a complement to enforcement, but an essential first step in expediting full, effective competition. Given that competition authorities typically lack sufficient political capital and reputation in their early years, and that policy-generated obstacles to competition are often maintained by support from powerful vested interests, initial advocacy efforts should focus on public restraints whose removal is subject to less debate, or [on projects] that directly benefit entrepreneurs, exporters, and other stakeholders who can be counted on to provide strong backing and support. Special attention should be paid to initiatives that directly or indirectly benefit as broad a base as possible*". *Id*. at 28–29.

[215] *See* Frederic Jenny, "Globalization, Competition and Trade Policy: Issues and Challenges", in *Towards WTO Competition Rules* 3 (Roger Zäch, ed., 1999).

These anti-competitive practices launched from distant shores are likely to be beyond the practical reach of developing countries. To solve this problem, the European Union has proposed a helpful framework[216], which could be (or might have been) implemented in the context of the WTO, but could also be implemented as a stand-alone project.

In the spirit of the EU proposal, developed countries with mature antitrust laws can and should help developing countries, especially when the developed country's own nationals are the violators of clear and shared principles of antitrust[217]. The developed countries can and should revise their laws, extending jurisdiction so as to make hard-core export cartels illegal[218].

An environmental convention provides a model and is a testament to political possibility. This is the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal[219], which the United States has signed. Under the Basel Convention, if a signatory country prohibits the import of hazardous wastes, all other signatories must make illegal the shipment of hazardous wastes to that country. The United States and other developed countries could and should adopt this model for hard-core export cartels, which are the hazardous wastes of antitrust.

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216 Working Group on the Interaction between Trade and Competition Policy, World Trade Organization, *Communication from the European Community and Its Member States*, WT/WGTCP/W/184 (Apr. 22, 2002).

217 It has been estimated that for 19 selected products, the value of cartel-affected imports to developing countries in 1997 was US$51.1 billion, and that the price of these imports by reason of the price-fixed overcharge was elevated by at least 10 per cent. Margaret Levenstein & Valerie Y. Suslow, *Contemporary International Cartels and Developing Countries: Economic Effects and Implications for Competition Policy*, 71 Antitrust L. J. 801, 813–16 (2004).

218 See Eleanor Fox, Testimony Before the Antitrust Modernization Commission, Hearing on International Issues in Washington, D.C. (Feb. 15, 2006), available at www.AMC.gov*;* see also Special Committee on International Antitrust, ABA Antitrust Section, The Special Committee's Report 83–90 (Sept. 1, 1991).

219 Mar. 22, 1989, 1673 U.N.T.S. 125.

Failing that, the United States and other developed countries should amend their antitrust laws to provide jurisdiction for the discovery of documents and testimony from knowledgeable people regarding lawsuits against them and other nationals launched abroad. This should include *subpoena* power when the developed country's citizens are the alleged victimizers of the people of developing countries[220].

In antitrust law and enforcement, in the absence of international law, the world demands a cosmopolitan vision and a willingness by developed nations to accept responsibility for the harms they cause[221].

7. Networks

Networking is a new world order[222]. Antitrust networks exist[223]. They tend to be dominated by developed nations because developed nations' experience is deeper and longer; developed nations are likely to be heavier users of networks[224]; they have more resources – people and money – to devote to the project; and the network may provide a virtual forum to export their law. As a result, the agendas tend predominantly to reflect the interests of developed countries[225].

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220 Fox, supra note 54.

221 The evolving case law of the United States does not demonstrate this vision and it does not reflect generosity of spirit. Instead it shows a retreat and puts the United States on a track towards solipsism and Balkanization. See F. Hoffmann-La Roche Ltd. v. Empagran, 124 S. Ct. 2359 (2004) (holding that foreign buyers in worldwide conspiracy cannot invoke US antitrust laws unless they are harmed by the effect in the US); Intel Corp. Microprocessor Antitrust Litigation, 452 F. Supp. 2d 555 (D. Del. 2007) (holding that US plaintiff complaining about worldwide anti-competitive strategies of US defendant cannot invoke defendant's foreign acts as part of the mosaic).

222 Anne-Marie Slaughter, The Real New World Order, Foreign Affairs 183 (Sept.–Oct. 1997).

223 See D. Daniel Sokol, Monopolists Without Borders: The Institutional Challenge of International Antitrust in a Global Gilded Age, 4 Berkeley Bus. L. J. 41 (2007), also available as a working paper, Univ. of Wis. Legal Studies Research Paper No. 1034. See text at notes 178–94, 287–92.

224 *Id.*, text at notes 226–29.

225 For example, the International Competition Network's first project was convergence of procedures for pre-merger notification – an issue of concern to multinational corporations. Subsequent projects have stressed substantive merger standards and coordination of cartel procedures. Technical assistance

Developing nations need their own networks to explore their own interests more centrally. Regional trade groupings can serve as a platform for this objective[226]. A worldwide developing-country competition network could supplement the International Competition Network[227].

Developing nations themselves are diverse. They share certain characteristics and do not share others. The situation and characteristics of India are not the same as those of Benin[228]. Communications and cross-fertilizations through the network can begin to sort out differences as well as to crystallize commonalities.

8. Conclusion

Developing countries deserve an antitrust law that fits the facts of their markets and responds to their conditions and needs. They deserve a law so designed and so characterized that their peoples will embrace it as sympathetic and legitimate, rather than reject it as foreign.

If there is an appropriate symbol for a developing country's antitrust, it is not neo-liberalism, which may imply a widening moat. It is the rising ladder. Antitrust can be seen as the complement to Hernando de Soto's *The Other Path*.

The antitrust law of developing countries is likely to incorporate the lion's share of developed countries' antitrust principles. It is, however, likely to embody a different set of default presumptions about how well markets work, while incorporating a mandate and perspective of inclusiveness. Developing countries have a choice.

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for developing countries is, however, also on the agenda. See International Competition Network Home Page, http://www.internationalcompetitionnetwork.org (last visited June 30, 2007).

[226] See UNCTAD, 2007: Implementing Competition-Related Provisions in Regional Trade Agreements: is it possible to obtain development gains? United Nations. New York and Geneva.

[227] UNCTAD is one important forum that has specific regard for the interests of developing countries. Competition law is one of its many missions.

[228] See Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can be Done About It* (2007) (distinguishing the conditions and the plight of the poorest 20 per cent of the world).

COMPETITION POLICY AND POVERTY ALLEVIATION: THE CASE OF PAKISTAN

Joseph Wilson[229]

These "Trusts" (monopolies, in fact)
Must starve the needy;
They from the poor life's blood exact
With death not speedy,
Bread, iron, coal, [cement, sugar] and such they seize,
For who dare cow them?
And they'll keep up the price of these–
And other matters if they please,
While YOU allow them![230]

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[229] Member, Competition Commission of Pakistan. The views expressed in this study are those of the author and do not necessarily reflect the views of the Competition Commission of Pakistan or any of its individual members. The author wishes to thank Ms. Shasita Bano, Ms. Syeda Batool and Ms. Hina Sarafaraz for their research assistance.

[230] http://wakeupfromyourslumber.blogspot.com/2005/12/poverty-amidst-plenty.html

1. Introduction

The relationship between a poor man and a monopolist dates back to time immemorial[231]. However, the first law to control the conduct of a monopolist was only drawn up in 1867[232]. During the last century, mankind has made astronomical advances in every aspect of human endeavour including proliferation of competition laws in the last decade, yet over 1 billion people in this world live on less than US$1 a day, and almost half of the world's population (2.8 billion) lives on less than US$2 a day[233]. On the other hand, the three richest people in the world have more wealth than 600 million people living in the world's poorest countries[234]. Poverty or income inequality is pervasive in both developed and developing countries [235]. Recognizing poverty as a social problem, the world leaders met in Copenhagen in 1995 at the United Nations' World Summit on Social Development and for the first time committed to eradicate poverty in the world[236]. Since Copenhagen, the nations of the world reiterated their commitment again in 2000 through the Millennium Declaration to "*spare no effort to free ... fellow men, women and children from the abject and dehumanizing conditions of extreme poverty*"[237]. In 2002, the World Summit on Sustainable Development again stressed the need to alleviate poverty[238].

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[231] See http://www.henciclopedia.org.uy/autores/Laguiadelmundo/Usury.htm (The practice of usury – lending money and accumulating interest on the loan – can be traced back 4,000 years. But it has always been despised, condemned, restricted or banned by moral, ethical, legal or religious entities).

[232] Joseph Wilson, *Globalization and the Limits of National Merger Control Laws*, at p. 65 (Kluwer Law International, 2003). The first antitrust law was passed by the State of Maryland. (footnotes omitted).

[233] UN HDR, 2003.

[234] http://www.christianaid.org.uk/stoppoverty/trade/facts/index.aspx

[235] *World Summit for Social Development Programme of Action* – Chapter 2: Eradication of Poverty (Para. 19) (accessed 2 March 2008) (also available as a PDF in report A/CONF.166/9 – Report of the World Summit for Social Development): (It occurs in all countries: as mass poverty in many developing countries, pockets of poverty amid wealth in developed countries).

[236] *Id.*

[237] *United Nations Millennium Declaration*, A/RES/55/2, (18.9.2000)

[238] http://daccessdds.un.org/doc/UNDOC/GEN/N02/636/93/PDF/N0263693.pdf?OpenElement

Since then national governments, both at national and international levels, international donor agencies, non-governmental organizations and the private sector have taken initiatives to combat poverty. Any policy to eradicate poverty, argues Amartya Sen, "*must focus on creating environments in which people have the opportunities to 'lead the lives they have reason to value and to enhance the real choices they have*"[239]. Coincidentally, enhancing real choices is also a core element of "consumer welfare", which is the rationale (put simplistically) of competition policy and law[240], and of classical trade theory[241].

Competition policy forms a part of broader economic policies that are used as tools to improve and sustain the engines of growth that preserve the health of a nation; improve the welfare of the people; and reduce poverty[242]. The WTO and its 151[243] member nations agree that the goal of international trade is to increase standards of living across

[239] Mary-Ellen Boyle and Janet Boguslaw, *Business, Poverty and Corporate Citizenship: Naming the Issues and Framing Solutions*, 6/22/07 J. Corp. Citizenship 101; 2007 WLNR 13760904 quoting Amartya Sen, *Development as Freedom* at 293 (Anchor Books/Random House, New York, 1999).

[240] Robert H. Bork, *The Antitrust Paradox*, 61 (Basic Books Inc., New York, 1978); (Consumer welfare as defined by Judge Robert Bork, means all things that are good for consumers, such as low prices, innovation, and choices.)

[241] Erik Johansen, *I Say Antitrust; You Say Anticompetitive: Why Bridging the Divide Between U.S. And EU Competition Policy Makes Economic Sense*, 24 Penn St. Int'l L. Rev. 331 at 335 (2005):
(It is choice. It is access to information. It is the availability of consumption alternatives; the ability, if one is so inclined, to walk to the corner store and to choose from among 200 different types of cheese. Quoting: Raj Bhala, *International Trade Law: Theory & Practice* 1–6 (2nd ed. 2001); and *Economics Focus: Chasing the Leader*, Economist, Feb. 8, 2003, at 70.)

[242] Fox, Eleanor M., *Economic Development, Poverty, and Antitrust: The Other Path.* Southwestern Journal of Law and Trade in the Americas, Vol. 13, 101 at 108–9, 2007. (Market tools are a very important part of the panoply of tools needed to address world poverty and should be used liberally. These market tools include market-freeing measures that reduce prices. They also include antitrust priority setting that targets conspiracies that raise the price of staples, such as milk, bread, transportation and utilities, helping the poor as well as those who are better off.)

[243] With the accession of Ukraine on 16 May 2008, the membership of the WTO will reach 152.

the globe[244]. The phenomenon of globalization marked by trade liberalization and foreign direct investment, among others, can be harnessed and used efficiently only if there is sound competition policy and law in place.

Competition policy and law provide a necessary framework that supports and complements measures aimed at alleviating poverty. Competition policy, where it exists, hovers over all economic activity within a country, promotes rivalry among businesses, and keeps a check on rent-seeking and anti-competitive practices, which could stall any poverty-alleviation programmes[245].

Section 2 discusses the definition of poverty, reviews the objectives of international trade, foreign direct investment and competition policies, and their role in poverty alleviation. Section 3 overviews the competition regime in Pakistan and takes account of the Competition Commission of Pakistan's intervention in cases that have a direct bearing on the poor population of the country. It also reviews the state of competition in public utility sectors. This study concludes that a competition regime embodying modern competition law principles and having the objective of preserving competition in the market, thereby enhancing consumer welfare and allocative efficiencies, can serve as an important tool in alleviating poverty in developing countries.

2. Poverty and competition policy

2.1. Poverty defined

Various scholars and organizations have attempted to define poverty[246]. The World Summit for Social Development defines poverty

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[244] http://www.wto.org./english/thewto_e/whatis_e/inbrief_e/inbr00_e.htm; (The goal is to improve the welfare of the peoples of the member countries).

[245] William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 Chi.-Kent L. Rev. 265, 281 (2001).

[246] Boyle and Boguslaw, *supra* note 11, provide an account of definition by various scholars, e.g. Poverty occurs because of restricted/inadequate access to the opportunities and resources necessary for health, safety, and well-being (Shapiro and Wolff 2004). The conditions that characterize the impoverished status are not limited to insufficient income; also lacking are social and public

broadly to include "*lack of income and productive resources sufficient to ensure sustainable livelihoods; hunger and malnutrition; ill health; limited or lack of access to education and other basic services; increased morbidity and mortality from illness; homelessness and inadequate housing; unsafe environments; and social discrimination and exclusion*"[247]. It defines "absolute poverty" as a "*condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on* ***access to social services***"[248]. In 2001, the World Bank in its annual World Development Report included *vulnerability* and exposure to risk as well as voicelessness and powerlessness in the concept of poverty[249].

Poverty can be simply defined as *social disadvantage vis-à-vis* various necessities of life. Poverty is usually measured through a consensus based on the minimum income question, which is used to derive the "Poverty Line"[250]. In Pakistan, the official poverty line is based on consumption, *i.e.*, the caloric norm of 2,350 calories required by an adult in a day, and on minimum non-food requirements. The poverty line was set at Rs.673.54 (US$12.6) per month/per adult in 1998–99, which rose to Rs.723 (US$11.9) in 2000–01, and to Rs.878 (US$14) in 2004–05[251]. The current poverty line in Pakistan, which is around US$14 a month, is below the dollar-a-day standard, which sets the poverty line at US$30 a month.

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services and investments in education, primary health care, water, sanitation, transportation and energy. Poverty is aggravated by the lack of natural resources necessary for well-being and often by environmental degradation (Sen 1999; UN 2000).

[247] *World Summit for Social Development Programme of Action* – Chapter 2: Eradication of Poverty (Para. 19) (accessed 2 March 2008) (also available as a PDF in report A/CONF.166/9 – Report of the World Summit for Social Development); Since 1990, the World Bank's annual World Development Report (WDR) identified poverty not only in its income dimension but also in terms of low achievements in education and health status , World Bank, WDR 1990.

[248] *Id.* See also, Sen *supra* note 239.

[249] World Bank, *World Development Report*, 2001.

[250] Peter Saunders, *Defining Poverty and Identifying the Poor, Reflections on the Australian Experience*, SPRC Discussion Paper No. 84 (1998): http://www.sprc.unsw.edu.au/dp/dp084.pdf

[251] *Pakistan Poverty Reduction Paper*, available at www.finance.gov.pk. The conversion in US dollars is made using the exchange rate prevalent during the period in question.

Poverty is intensified by unemployment, labour market inequalities, an "***unequal distribution of power**, and by limits on political participation*"[252]. From the definitions above, the dimensions of poverty that competition policy can directly and indirectly address are: access to social services, unemployment, labour market inequalities, unequal distribution of power, and vulnerability. A competitive market demands multiple service providers for the provision of social services and other sectors *hitherto* in the exclusive control of the state. Competition law by ensuring fair market play encourages trade, which in turn can generate employment, and reduce labour market inequalities. Competition law also prohibits and penalizes abuse of dominant position (unequal distribution of power), and it provides a shield to vulnerable persons against artificial price hikes and other anti-competitive practices affecting prices.

Poverty may be classified into three different categories:

1. Extreme/absolute/chronic poverty: households cannot meet basic survival needs.

2. Moderate/transitory poverty: basic needs are barely met; people must often forgo education and health care. The smallest misfortune (health issue, job loss, etc.) threatens survival.

3. Relative: household income level is below a given proportion of average national income; people lack access to quality health care, education and prerequisites for upward mobility[253].

While the three categories require different types of interventions, the responses often complement one another[254]. Of the three categories, the moderate or vulnerable poor are directly affected with the enforcement or lack thereof of competition laws.

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[252] Boyle and Boguslaw, *supra* note 239, quoting Nef (1999); Mani (2004); and Page and Simmons (2000).
[253] *Id.* developing on the model by Jeffrey Sachs, (2005: 20): See also Chronic Poverty Research Centre: http://www.chronicpoverty.org/pdfs/PolicyBriefs/CPRC_PB6.pdf.
[254] *Id.*

Reporting on the causes of poverty in Pakistan, an ADB report of 2002 noted that poor governance[255] was the key underlying cause of poverty during the 1990s[256]. Poor governance had contributed to the "*declining competitiveness of the Pakistan economy in the increasingly skill-based global economy*"[257]. The report also noted that there are "*strong linkages between pro-poor growth on the one hand, and human development [and] good governance*" on the other. To promote pro-poor economic growth, it recommended "*structural reforms in key sectors through promoting deregulation, privatization, and the creation of an enabling environment for private sector foreign investments*"[258]. While the deregulation and privatization processes were started in the early 1990s in Pakistan, the enabling environment encouraging foreign investment requires a sound and well-entrenched competition regime –- which ensures free entry and exit, and a level playing field for foreign investors –- came into being only in 2007 through the promulgation of the Competition Ordinance, 2007.

2.2. Millennium Development Goals and Pakistan's initiatives to alleviate poverty

The first goal on the list of the Millennium Development Goals (MDGs) is to "*reduce by half the proportion of the world's population living on less than US$1 a day between 1990 and 2015*"[259]. Pakistan subscribes to the Millennium Declaration and has taken various initiatives to alleviate poverty, in addition to addressing other MDGs.

Pursuant to the Millennium Declaration, the government of Pakistan produced an Interim Poverty Reduction Strategy (IPRS) Paper in 2000. The IPRS aimed at improving growth, human development, governance, and reducing the vulnerability of the poor to shocks. In

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[255] Governance is defined as the manner in which power is exercised in the management of a country's social and economic resources in development. Asian Development Bank, 1995: *Governance: Sound Development Management Policy, Globalization and Poverty*.

[256] *Poverty in Pakistan: Issues, Causes and Institutional Responses*, at p. 2 (Asian Development Bank, July 2002; Publication Stock No. 070302).

[257] *Id.* at p. 3.

[258] *Id.* at p. 5.

[259] UN 2000.

December 2003, the final Poverty Reduction Strategy Paper (PRSP) was completed and published[260]. The PRSP was based on four pillars: (i) achieving high and broad-based economic growth while maintaining macroeconomic stability; (ii) *improving governance*; (iii) investing in human capital; and (iv) targeting the poor and vulnerable. To implement the Strategy, the Ministry of Finance set up a PRSP Secretariat, which is responsible for implementing and monitoring the progress made under the PRSP. The PRSP Secretariat is assisted by a research centre called the Centre for Research on Poverty Reduction and Income Distribution. Additionally, the Planning Commission of Pakistan also provides support to the Ministry of Finance in meeting the obligations under the PRSP[261].

The Strategy is part of the Poverty Reduction and Growth Facility given by the International Monetary Fund (IMF) and the World Bank to the government. The donor agencies have created a “Pakistan Poverty Reduction Support Credit (PRSC) Technical Assistance Trust Fund” under which funding for technical assistance may be granted to the newly constituted Competition Commission of Pakistan.

The vulnerable or transitory poor (pillar 4 of the PRSP) are a target of the government’s initiative to reduce poverty. The government has established two micro-credit banks and a few other institutions responsible for making direct transfers to the poor. Some of these are: Khushali Bank; The First Micro Finance Bank Ltd., SME Bank, Pakistan Poverty Alleviation Fund (PPAF), Social Safety Nets, Food Support Programme, Pakistan Centre for Philanthropy[262].

Creating access to employment is a *sine quo non* for alleviating poverty. The government of Pakistan has encouraged gender-support programmes in rural areas and in services within the urban centres. As a result, female unemployment rate has dropped from 12.8 per cent in 2004 to 9.4 per cent in 2006. The steepest decline was recorded in Balouchistan, where the unemployment figures fell from 29.2 per cent in 2004 to 7.1 per cent in 2006. Females are encouraged to seek employment in non-traditional sectors, such as police and air force, and

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[260] *Accelerating Economic Growth and Reducing Poverty: The Road Ahead*. Ministry of Finance, Government of Pakistan, December 2003.
[261] *Id.*
[262] *Id.* at p. 138.

the financial institutions are directed to offer credit to female entrepreneurs to encourage small and medium enterprises.

Since the implementation of the PRSP, Pakistan has witnessed a growth in its gross domestic product (GDP), from 1.8 per cent in 2000–01 to more than 7 per cent since 2004[263]. During 2004–05, "*agriculture, which has the strongest immediate impact on rural poverty, grew by 7.6 per cent, manufacturing by 12.5 per cent, and services by 7.9 per cent*"[264]. The fiscal deficit of the country has reduced from 8.8 per cent of the GDP in 1990–91 to 3 per cent in 2003–04, and the "*government intends to keep it around 3.5 per cent until the financial year 2008*"[265].

In 2006–07, the three-year Poverty Reduction Strategy Programme I (PRSP-I) came to an end. During this period, the pro-poor expenditure was increased from Rs.167.25 billion in 2002–03 to Rs.452.4 billion in 2005–06. National initiatives, in addition to global growth have contributed in the alleviation of poverty in Pakistan. The percentage of the population living below the poverty line – the headcount ratio – has declined from 31 per cent in 2002 to 17 per cent in 2006[266].

The PRSP II covering the period 2008 to 2010 is being finalized and is based on the following seven pillars:

i) Drivers of economic growth and macroeconomic stability;
ii) Crafting a competitive advantage;
iii) Harnessing the potential of people;
iv) Financial deepening and economic development;
v) World-class infrastructure;
vi) Effective governance and management, and
vii) Targeting the poor and vulnerable[267].

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[263] *Pakistan Economic Survey*, 2006–07 at p. 53. available at http://www.finance.gov.pk/survey/survey.htm.

[264] Akhtar Mahmood, "Linkages between Trade, Development and Poverty Reduction: The Case of Pakistan", at 135 in *Trade-Development-Poverty Linkages* Vol. I (Jaipur Printers, Jaipur); CUTS International, 2008.

[265] *Id.* at p. 136.

[266] http://www.sbp.org.pk/reports/annual/arfy07/Chp-8.pdf

[267] *Pakistan Economic Survey*, *supra* note 263, at 53.

The three additional principles added in the PRSP II are i) crafting a competitive advantage, ii) financial deepening and economic development, and iii) world-class infrastructure. Effective governance, among others, is a principle which continues to be part of PRSP I and II. An important section in the governance structure is the efficient and well-crafted competition policy and law. Under the PRSP I, the government of Pakistan designed a new competition policy and Competition Ordinance, 2007, which was promulgated on 2 October 2007. The Competition Ordinance is discussed more in detail in Section 3.

2.3. International trade, foreign direct investment, competition policy and poverty

The underlying objectives of promoting international trade, foreign direct investment (FDI) and competition policy have a common theme, that is, to "*increase world wealth*" or alleviate poverty by "*opening markets to foreign goods, services, and capital*"[268]. Examining

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[268] Kevin C. Kennedy, *Foreign Direct Investment and Competition Policy at the World Trade Organization,* 33 Geo. Wash. Int'L. Rev. 585 (2001); see also OECD, *Trade and Competition Policies: Exploring the Ways Forward* (1999); WTO Secretariat, *Synthesis Paper on the Relationship of Trade and Competition Policy to Development and Economic Growth*, WT/WGTCP/W/80 (Sept. 18, 1998); Michael J. Trebilcock, *Competition Policy and Trade Policy, Mediating the Interface*, 30 J. World Trade 71 (1996).

Prof. Kennedy has succinctly described the relationships between international trade, foreign direct investment and competition polices: *"These three policies can be mutually reinforcing when pursued with the common goal of encouraging cross-border competition. For example, a liberal trade policy has as its goal the elimination or lowering of barriers to trade in goods, opening foreign markets to goods from abroad, and bringing competition to bear on domestic producers. A liberal trade policy thus can have a significant impact on competition and on markets. To the extent trade liberalization reduces entry barriers to foreign markets, it gives domestic firms less ability to engage in anti-competitive behavior. Similarly, to the extent that domestic firms tie up channels of distribution in local markets and thereby block market access to imports, a liberal investment policy can eliminate such anti-competitive practices by permitting foreign firms to own distribution networks in the local market. In theory, then, trade, investment, and competition policies ought to work in harmony. Their shared goals and objectives suggest teaming rules against private anti-competitive behavior with rules on the elimination of government*

the link between trade and poverty, one study concludes that: "*while there is no simple one-to-one relationship between trade and poverty, the evidence seems to indicate that trade liberalization is **generally** a positive contributor to poverty alleviation — it allows people to exploit their productive potential, assists economic growth, curtails arbitrary policy interventions and helps to insulate against shocks*"[269].

Competition policy aims to promote business rivalry and allocation of resources in which consumer welfare is maximized[270]. It provides the basic framework that ensures the success of liberalization processes[271]. It is reported that countries with an effective competition regime have a "*high level of competition in local market*", which in turn has a direct effect on the "*levels and rates of growth in per capita gross domestic product*"[272]. The growth in *per capita* GDP is taken as the primary indicator of poverty reduction.

However, to ensure that effective competition regime pans out as it should, there is a need to foster a competition culture in the developing countries. *"A culture of competition in this context refers to the awareness of the business community, governmental agencies, non-governmental agencies, the media, the judiciary, and the general public, of the rules of competition law, and their overall responsibility to ensure that such rules are observed in the interest of competition and overall economic development…The lack of such a culture has plagued*

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barriers to international trade and investment". Id., at p. 585.

[269] WTO, Special Studies*, Trade, Income Disparity and Poverty*, by DanBen-David, Håkan Nordström, LAlanWinters (1999) at p. 6.

[270] *See* Harry S. Gerla, *Restoring Rivalry as a Central Concept in Antitrust Law*, 75 Neb. L. Rev. 209 (1996). Quoting *Roland Mach. Co. v. Dresser Indus.*, 749 F.2d 380, 395 (7th Cir. 1984). See also *General Leaseways, Inc. v. National Truck Rental Leasing Ass'n*, 744 F.2d 588, 596 (7th Cir. 1984) ('the allocation of resources that maximizes consumer welfare').

[271] Kovacic, supra note 245 at 273. (The massive privatization of assets without the creation of mechanisms for ensuring competition and effective shareholder governance may enable company managers during the era of planning to loot the productive core of the newly private enterprises.); see also R. S. Khemani, *Competition Policy and Promotion of Investment, Economic Growth and Poverty Alleviation in Least Developed Countries*, (World Bank 2007) at p. 8

[272] Khemani, *Id.* at p. 3.

practically all young agencies"[273]. Young agencies should make competition advocacy an integral part of their functions, so that competition culture may be developed, which will help facilitate the implementation of the competition policy and law.

A properly designed competition regime embedded in a well-nurtured competition culture, would make antitrust enforcement effective, which will prevent and arrest anti-competitive practices adversely impacting poverty in the following, among others, manner:

i) Collective price fixing – raising prices artificially thereby harming poor consumers;
ii) Restricting the supply/output of essential commodities in the market and thereby depriving the consumers of the basic necessities;
iii) Bid rigging: especially in government contracts for infrastructure projects. Bid rigging raises the cost of state projects thus misappropriating public funds, which could be used for other development and poverty reduction projects.
iv) Tied selling – forcing people to buy items they do not need, thus depriving them of their scarce funds.
v) Cartels in essential supplies, e.g. wheat, sugar, cooking oil, cement, etc.

As an illustration of one of the above anti-competitive activities adversely affecting competition and thereby development processes, a World Bank Report noted: *"Procurement irregularities have been a significant problem in Pakistan, in large part due to a weak regulatory framework that discouraged due diligence in contract awards and stifled open competition. Specific problems have included inadequate bidding documents, inadequate response time to bidders, prequalification as a means of restricting competition, price negotiations, lack of independent complaints handling process, and irregularities in inspections or measurements*"[274].

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[273] *Lessons to be Learnt from the Experiences of Young Competition Agencies*, Competition Policy
Implementation Working Group, International Competition Network, Annual Conference, Cape town, South Africa, 3–5 May 2006.
[274] The World Bank Group, Report No. 35718-PAK, at p. 26

While Pakistan established the Pakistan Procurements Regulatory Authority (PPRA) to regulate all public sector procurements, a sound antitrust enforcement is essential to curb the bid rigging and other above-mentioned anti-competitive practices, which affect consumers, more so those living close to the poverty line.

3. The competition regime in Pakistan

The *Monopolies and Restrictive Trade Practices Ordinance* of 1970[275] (MRTPO), was the principal instrument forming the competition regime in Pakistan until October 2007, when it was repealed and replaced by the *Competition Ordinance* of 2007("the Ordinance")[276].

3.1. Monopolies and Restrictive Trade Practices Ordinance, 1970

The MRTPO was drafted with the objective of preventing an undue concentration of economic power in the hands of the few. The substantive provisions of the MRTPO proscribed i) undue concentration of economic power; ii) growth of unreasonable monopoly power; and iii) unreasonably restrictive trade practices[277]. The MRTPO did not have promotion of business rivalry or efficient allocation of resources as its objective. As such, the MRTPO did not provide the necessary legal framework that could ensure that the liberalization process, which started in early 1990s, does not fail. Thus, there was a need to reform the competition policy and law with a view to effectively harness international trade, and FDI, and also to bring it in line with the globally accepted competition policy norms and practices.

3.2. The Competition Ordinance, 2007

In order to strengthen good governance in Pakistan, the Ministry

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[275] *Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance*, 1970 (Pakistan) (Published in the Gazette of Pakistan, Extraordinary, Feb. 26, 1970) [hereinafter MRTPO]. For a commentary on the MRTPO *see* Joseph Wilson, *At The Crossroads: Making Competition Law Effective in Pakistan*, 26 NW. J. Int'l L. & Bus. 565 (2006).

[276] *Competition Ordinance*, 2007 (Pakistan) (Published in the Gazette of Pakistan, Extraordinary, Oct. 2, 2007) [hereinafter "CO 2007"].

[277] Preamble and Section 3 MRTPO *supra* note 275.

of Finance, under the Poverty Reduction Strategy Paper put forward for legislation a competition Bill, which was promulgated by the President of Pakistan as the *Competition Ordinance* on October 2, 2007. The objective of the *Competition Ordinance* is "*to provide for free competition in all spheres of commercial and economic activity, to enhance economic efficiency and to protect consumers from anti-competitive behaviour*"[278]. While the term competition[279] is not defined in the Ordinance, and rightfully so[280], it means promoting business rivalry, as enhancing economic efficiency and protecting consumers are separately mentioned. The triad mentioned in the preamble holistically captures the norms and objectives of contemporary competition regimes.

The Ordinance applies to all undertakings, whether governmental or private, and to all actions or matters that have the effect of distorting competition within Pakistan. The Ordinance prohibits abuse of dominant position[281]; agreements that have the object or effect of preventing or reducing competition within the relevant market[282]; and

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[278] Preamble, CO 2007, *supra* note 276.

[279] For definitions of competition, see Webster's New World Dictionary of the American Language (College ed. 1968) (defining "competition" as "*striving for the same object, position, prize ... usually in accordance with certain fixed rules*") and Black's Law Dictionary 278–79 (7th ed. 1999) (defining "perfect competition" as "*a completely efficient market situation characterized by numerous buyers and sellers, a homogeneous product, perfect information for all parties, and complete freedom to move in and out of the market. Perfect competition rarely if ever exists, but antitrust scholars often use the theory as a standard for measuring market performance.*").

[280] Defining the term "competition" would have narrowed the scope of the Ordinance.

[281] CO 2007, *supra* note 276, Section 3.Abuse of dominant position.- (1) No person shall abuse dominant position. (2) An abuse of dominant position shall be deemed to have been brought about, maintained or continued if it consists of practices which prevent, restrict, reduce or distort competition in the relevant market. (3) . ...

[282] *Id.*, Section 4.

4. **Prohibited agreements**.-(1) No undertaking or association of undertakings shall enter into any agreement or, in the case of an association of undertakings, shall make a decision in respect of the production, supply, distribution, acquisition or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under Section 5 of this Ordinance. (2) . . . (3) Any

deceptive marketing practices[283]. The Ordinance introduced pre-merger notification, and a two-phased merger clearance regime[284]. The substantive test for merger clearance is the substantial lessening of competition by creating or strengthening a dominant position in the relevant market[285].

The Ordinance provides for the establishment of a Competition Commission of Pakistan (CCP)[286]. The CCP is comprised of five members including the Chairperson[287]. Apart from implementing the substantive provisions of the Ordinance, the functions of the Commission includes conducting studies of different sectors with a view to promoting competition, and engaging in competition advocacy for promoting a competition culture[288].

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agreement entered into in contravention of the provision sub-section (1) shall be vo*id.*

[283] *Id.*, Section 10.

10. **Deceptive marketing practices:**- (1) No undertaking shall enter into deceptive marketing practices.

(2) The deceptive marketing practices shall be deemed to have been resorted to or continued if an Undertaking resorts to-

(a) the distribution of false or misleading information that is capable of harming the business interests of another undertaking;

(b) the distribution of false or misleading information to consumers, including the distribution of information lacking a reasonable basis, related to the price, character, method or place of production, properties, suitability for use, or quality of goods;

(c) false or misleading comparison of goods in the process of advertising or packing;

(d) fraudulent use of another's trademark, firm name, or product labeling or packing.

[284] *Id.*, Section 11.

[285] *Id.*, Section 11(1).

[286] *Id.*, Section 12.

[287] *Id.*, Section 14.

[288] *Id.*, Sections 28 and 29.

29. Competition advocacy – The Commission shall promote competition through advocacy which, among other, shall include:–

(a) creating awareness and imparting training about competition issues and taking such other actions as may be necessary for the promotion of competition culture;

(b) reviewing policy frameworks for fostering competition and making suitable recommendations for amendments to this Ordinance and any other law that affect competition in Pakistan to the Federal Government and Provincial Governments;

All matters under the Ordinance are decided in the first instance by a single member of the CCP or its authorized officer. Appeal against the order of a single member, or authorized officer, may be preferred before a bench comprising of no less than two members of the Commission. The order of the appellate bench can be appealed against before the Supreme Court of Pakistan[289].

In case of contravention of any provisions of the Ordinance, the Commission may impose a penalty of up to Rs.50 million (around US$850,000) or an amount not exceeding 15 per cent of the annual turnover of the undertaking[290].

3.2.1. Antitrust enforcement

In a short span of less than four months since the CCP was constituted, the Commission has initiated *suo moto* actions, and has acted on complaints, which have direct impact on consumers.

3.2.1.1. Banks' cartel: fixing interest rates

The Pakistan Banks' Association (PBA) advertised on 5 November 2007 in the daily press that "*under the auspices of Pakistan Banks' Association, all scheduled banks introduced the Enhanced Saving Account (ESA)*" for all saving accounts with a maximum deposit of Rs.20,000[291]. Under the ESA, small account holders will get a fixed interest of 4 per cent per annum. The Competition Commission took notice of the advertisement and issued notices to PBA and 41 banks under Section 30 of the *Competition Ordinance*, 2007 requiring them to explain their position regarding jointly introducing a financial product and

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(c) holding open hearings on any matter affecting the state of competition in Pakistan or affecting the country's commercial activities and expressing publicly and opinion with respect to the issue; and
(d) posting on its website all decisions made, inquiries under review and completed, merger guidelines, educational material and the like.

[289] *Id.*, Section 41.

[290] *Id.*, Section 38.

[291] The NEWS, 5 November 2007.

fixing profit rates, which *prima facie* violates Section 4 of the Ordinance[292].

The banking sector in Pakistan is still concentrated, despite a large number of banks entering the market in the last decade[293]. The top five local banks[294] enjoy 80 per cent of the market share of the banking sector. These banks are charging high lending rates, and passing only a portion of the profits on to their depositors on whose money they make the profits. The banking spread in Pakistan is among the highest in the world, and Pakistan's banking sector has enjoyed the highest profits in the Asia-Pacific region.

On April 10, 2008, the CCP issued its order against the bank cartel requiring PBA to desist from collusive price-fixing and imposed a penalty of Rs. 30 million on it and Rs. 25 million each on seven leading banks[295]. Fixing the interest rates, apart from killing the competition, directly impacts the account-holder's potential to save, and thus enhances his/her vulnerability. Such conduct is clearly adversely affecting the efforts to alleviate poverty in the country. It is hoped that the order of the CCP will restore competition in the market for small depositors, thereby giving them a choice to opt for banks offering high interest and low lending rates.

3.2.1.2. Bahria University: the tying case

Bahria University, run by Pakistan Navy and having campuses in Karachi and Islamabad, imported 4,500 laptops in 2006 to sell to students. However, when the laptops were not sold as expected, the University administration made it mandatory for all new entrants to purchase the computers[296]. The price of the laptops in the market is

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[292] See footnote 282, for the text Section 4; *Competition Commission Warns Banks of Heavy Penalties*, http://www.dailytimes.com.pk/default.asp?page=2008%5C02%5C22%5Cstory_22-2-2008_pg5_1; http://www.thenews.com.pk/daily_detail.asp?id=97538.

[293] *Banks' profit up despite odds*, http://www.dawn.com/2008/03/04/ebr8.htm.

[294] Habib Bank, National Bank, Muslim Commercial Bank, United Bank, and the Allied Bank.

[295] http://www.cc.gov.pk/Downloads/Order_of_Banks.pdf

[296] *Bahria University Forcing Students to Buy Old Laptops*, http://www.interface.edu.pk/students/Feb-08/Bahria-College.asp

around Rs.40,000.00 (US$650.00) whereas the university is charging on a lump-sum basis Rs.56,000.00 (US$903.00) or in the case of payment by instalment it costs Rs.17,000.00 (US$275.00) per semester for four semesters (a total of US$1,100.00) or Rs.10,650/- (US$171.00) per semester for eight semesters (a total of US$1,374.00). The University intends to continue this practice while the stocks last[297].

The CCP took notice of this practice, after picking it from the press, and initiated an inquiry as the practice is violating Section 3(3)c of the Ordinance, which prohibits “tie-ins”, that is where the sale of goods or services is made conditional on the purchase of other goods or services.

The practice of tie-in was putting an unnecessary burden on the poor students by: i) forcing them to purchase a laptop even if they already have one; and ii) selling the laptops at a price that is at least 45 per cent more than the market price in the case of a lump-sum purchase and over 100 per cent more in case of purchase by instalments. This anti-competitive practice is clearly a tax on students, who wish to improve the human capital thereby reducing the incidence of poverty. In response to the CCP’s notice, the University has voluntarily agreed to stop the practice of mandatory purchase of laptops immediately. It is hoped that this will send a signal to others to abstain from engaging in activities that unduly burden the captive, often vulnerable, customers.

3.2.1.3. The colas: exclusive dealing case

Murree Brewery Company Limited (MBCL), a local producer of alcoholic and non-alcoholic beverages, complained against McDonalds, Kentucky Fried Chicken (KFC), and Pizza Hut for exclusive dealing with cola companies and selling only cola drinks at their outlets, thereby refusing to deal with it and other local beverage manufacturers.

McDonalds, KFC, and Pizza Hut together enjoy the dominant position in the foreign fast-food restaurants market. Their refusal to deal with MBCL forecloses a local competitor from the relevant market. Keeping efficiencies flowing from exclusive dealing aside, such

[297] This information is obtained by the Commission in the process of initiating the inquiry.

agreements by restricting competition indirectly restrict an undertaking's potential to grow thereby limiting potential employment opportunities, in addition to limiting choices to consumers. Competition law by prohibiting agreements restricting competition indirectly ensures that opportunities for growth and potential employment are not stifled, and thus contributes towards alleviating poverty.

3.2.2. Intervention in essential commodities sectors

The CCP has made interventions, either at its own behest or at the request of the government, in certain essential commodities markets with a view to preventing artificial price hikes and supply shortages.

3.2.2.1. Cement industry: an entrenched cartel!

Cement costs form a significant portion of a country's infrastructure development budget. A price hike in the cement sector may lead to the reallocation of funds for the purchase of cement instead of some other developmental work. In Pakistan, a sudden upsurge in cement prices by all the cement companies was (again)[298] observed in February 2007. The prices were increased from Rs.220~230 to Rs.275~360 per 50-kg bag indicating a cartel-like behaviour.

The government of Pakistan took notice of this sudden rise in prices and the Cabinet Division instructed the erstwhile Monopoly Control Authority (MCA) to initiate an enquiry. The MCA established a committee to conduct an in-depth special enquiry under the provisions of the MRTPO. The Committee took statements and viewpoints of all stakeholders including the general public by soliciting information through newspapers. The MCA was however unable to effectively investigate the cartel, as the MRTPO did not have provisions for leniency and inspection of premises.

Continuing the work undertaken by the MCA, the Competition Commission using the powers[299] to forcibly inspect premises inspected

[298] The price-fixing behaviour by cement companies first came to the surface in 1998, and keeps recurring time and again.
[299] See Sections 34, 35 and 39 of the CO 2007.

the offices of All Pakistan Cement Manufacturers Association (APCMA) in Lahore on 24 April, 2008 and recovered reasonable evidence against APCMA for its alleged role in price fixing and output restrictions. The CCP has issued notices the office bearers of APCMA, and the case is now under investigation[300].

This was the first time that the Commission has forcibly inspected the offices of an association. The forced inspection has sent a strong signal to businesses to desist from anti-competitive practices, which hitherto were considered normal business practice.

3.2.2.2. Liquefied petroleum gas: the supply shortage

Liquefied petroleum gas (LPG) is manufactured during the refining of crude oil, or extracted from oil or gas streams as they emerge from the ground. There are ten producers of LPG including five refineries and other exploration companies in Pakistan. According to an estimate, 15 million households use LPG for cooking and heating purposes, as no other source of fuel is available to them. In Azad Jumma and Kashmir (AJK) and northern areas of Pakistan the only fuel available to people is LPG. In 2000, the government deregulated the sector allowing producers to fix wholesale prices. Consequently the distributors and dealers set their prices for retail sales.

In January 2008, there was a severe shortage of LPG: against the demand of 4,000 million tons per day there was a supply of only 1,700 million tons per day. Although, demand for LPG is usually high in the winter season, it was speculated that producers agreed to create a price hike by limiting supply. It is observed that over the last 18 months the price of LPG has skyrocketed to a 300 per cent increase[301].

The CCP took notice of this astronomical price hike and requested the Oil and Gas Regulatory Authority, the sector regulator, to take cognizance of the matter. Higher prices of LPG directly affect 15 million *vulnerable* households. In addition to household consumption, a large proportion of people in the northern or mountain areas are engaged in the restaurant profession, and use LPG for cooking. The

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[300]http://www.brecorder.com/index.php?id=731810&currPageNo=1&query=&search=&term=&supDate=

[301] http://www.views.pk/lpg-price-mechanism-completely-deregulated.

non-availability of LPG directly affects their source of earning, forcing them to live on their savings, if any, and thus pushing them towards poverty.

3.3. Competition in public utilities

The government of Pakistan liberalized and opened up markets for public utilities such as telecommunication, electric power, oil and gas in the early 1990s. The liberalization and fostering of competition has been more successful in the telecommunications sector than in other industries.

3.3.1. Telecommunications sector

Pakistan started opening up the telecommunications sector in 1991 with the corporatization and then privatization of the state-owned Pakistan Telegraph and Telephone Department (PTT) into the Pakistan Telecommunication Corporation. In 1996, the sector was reorganized through the *Pakistan Telecommunications (Re-organization) Act*, which also provides for the establishment of the Pakistan Telecommunication Authority (the “Authority” or PTA)[302].

Under Sections 4(c) and 6(f) of the 1996 Act, it is the function of the Authority to promote and protect the interest of the consumers[303]. Pursuant to Section 4, *the Protection of Telecom Consumers Regulation 2006* was promulgated with the aim of making efficient use of the benefits of a competitive environment, where a consumer is free to choose among operators and their services. Regulation 4 and other provisions of the Consumer Regulation proscribe the operators from colluding, engaging in anti-competitive practices and abusing the dominant power that would undermine consumer interests, thereby discouraging investment and/or the provision of quality services.

Section 4(d) of the 1996 Act mandates the Authority to “*promote the availability of a wide range of high quality, efficient, **cost-effective***

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[302] Section 3 of the *Pakistan Telecommunication (Re-organization) Act*, 1996 (XXX of 1996) (7 March, 1996, No. F. 2(1)/96 pub.).
[303] Section 4, *Id*.

and ***competitive*** *telecommunication services throughout Pakistan*". Section 6(e) complements the duty to promote competition by requiring the Authority to ensure that "*fair competition in the telecommunication sector exists and is maintained*". In 2006, the Act was amended by giving the Federal Government powers to make rules for "*preventing, prohibiting, and remedying the effects of anti-competitive conduct by licensees*"[304]. The rules are, however, yet to be made.

In order to maintain fair competition in the telecommunications market, the Authority regularly monitors the market to ascertain players with Significant Market Power (SMP). An operator is presumed to be an SMP when it has a market share of more than 25 per cent of a particular telecommunication market[305]. Once an SMP is determined, the Authority incorporates provisions prohibiting anti-competitive practices in their licences[306].

To encourage market entry further, the Telecom De-regulation Policy of 2003 (TDC) and the Mobile Cellular Policy of 2004 were formulated to attract new entrants in the fixed and mobile telecommunications sectors, respectively. The TDC was formulated pursuant to the commitment made under the WTO agreement liberalizing trade in basic telecommunications services, known as the Fourth Protocol to the GATS[307]. The Agreement called for the opening of "*markets to competition for domestic and foreign telecommunications network operators and service providers*"[308]. The liberalization of the telecommunications industry has attracted sizeable FDI in the country.

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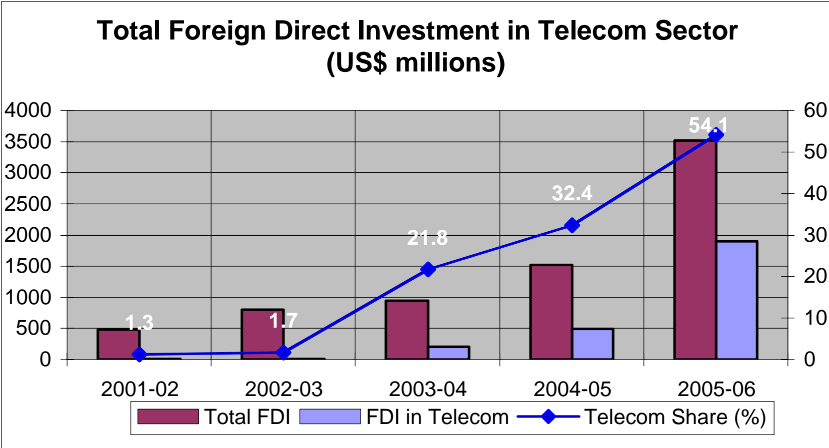
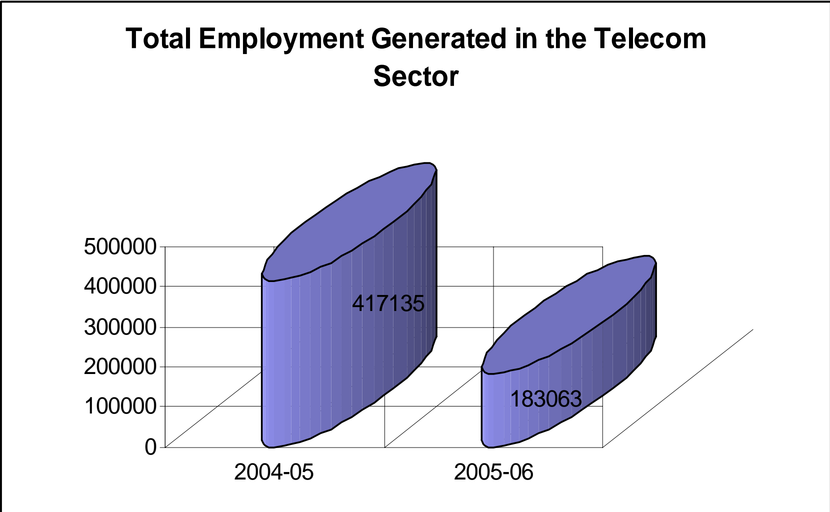
[304] Section 57(2)(ad), *Pakistan Telecommunication (Re-organization) (Amendment) Act*, 2006.
[305] Rule 17 of the Pakistan Telecommunications Rules, 2000.
[306] ¶ 5.10, Mobile Cellular Policy, 2004.
[307] Agreement on Telecommunications Services (Fourth Protocol to the General Agreement on Trade in Services), Feb. 15, 1997, 36 I.L.M. 354 (1997).
[308] *World Trade Organization Concludes Agreement on Telecommunications Market Liberalization*, Satellite Engineer: Online Magazine, Scientific Atlanta (visited Sept. 9, 1997) <http://www.satengineer.com/wto.html>.



Post deregulation (2004), the growth of FDI in the telecom sector has been phenomenal, contributing 54.11 per cent to the total FDI of US$3521 million in 2005–06. The consistent growth in investment has resulted in a better infrastructure and generated employment in the sector.



In 2005, two new mobile service providers, Telenor and Warid, launched their operations and investment by them resulted in significant job creation in the sector. In 2005–06, 183,063 jobs were created which were in addition to the 417,135 created in 2004–05. The figures indicate both direct and indirect employment generated each year. The telecom sector has contributed Rs.77.1 billion to the national exchequer in 2005–06. This figure is 15 per cent higher than that of the previous year. The contribution to the government coffers is increased by 100 per cent since the liberalization took place in 2003–04. The telecom sector is still attracting large investments and is contributing to the economy through the creation of employment thereby alleviating poverty.

In addition to attracting FDI, and creating employment, the rates (tariffs) of mobile telecommunication services in Pakistan are among the lowest in the world. All these benefits can fairly be attributed to pro-competitive legislation and its effective implementation by the regulator.

Despite the commendable growth of telecommunications in Pakistan, it should be mentioned that 70 per cent of Pakistan's total population resides in rural areas, where the total teledensity is a little less than 2 per cent[309]. Eighty million people in Pakistan have no access to telecommunication services. In Punjab, the most densely populated province, 41 per cent of villages, and in Balochistan, the least densely populated province, 94 per cent of villages, are without access to telecommunication services[310]. The rapid rise in mobile cellular penetrations, mostly concentrated in the urban areas, is widening the rural–urban divide, and the benefits are not reaching the poor masses.

However, in late 2007, the Universal Service Fund Company awarded contracts to the mobile operators for rolling out networks in remote rural areas[311]. It is hoped that with the funding from Universal Service Fund, the poor population living in rural areas will now have access to the telecommunication services and the benefits that comes with it.

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309 http://www.pakistan.gov.pk/ministries/NewsInfo.jsp?MinID=7&cPath=78&div=itandtelecom&file=031006.xml&path=ministries/moit/

310 http://english.people.com.cn/200608/01/eng20060801_288892.html

311 http://www.usf.org.pk/projects.asp

3.3.1.1. The jurisdiction of CCP over regulated sectors

The CCP has jurisdiction over competition issues in the telecommunications and other regulated sectors, in addition to the powers conferred on the sector-specific regulators.

i. Mobilink: tying case

The CCP is currently reviewing an instance of probable abuse of dominant position, in the form of tying. Mobilink, the dominant mobile service provider, is being investigated as possibly tying the purchase of a BlackBerry handset with its Internet and e-mail services. At the time, when the matter was initiated, Mobilink was the only service provider offering BlackBerry services in Pakistan. The issue was that if a BlackBerry subscriber wished to switch to another service provider for better voice telephony services he/she would then lose access to Internet and e-mail services offered by Mobilink.

ii. PTCL: abuse of dominance/deceptive marketing

In another matter affecting poor customers, the CCP has initiated a *suo moto* inquiry under abuse of dominance and deceptive marketing provisions of the Ordinance, against the Pakistan Telecommunications Corporation Limited (PTCL), the dominant fixed-line service provider, for activating, without first seeking the consent of the subscribers, the “Pakistan Package” on all accounts. Under the Pakistan Package, a fixed fee of Rs.200 is charged on all accounts for making none to up to 5,000 minutes of long-distance calls. A large section of the population, mostly the poor, does not want the Pakistan Package and has considerable difficulty in getting it deactivated by the PTCL. It is reported that 1.6 million subscribers got the Pakistan Package deactivated. While Rs.200 (US$3.2) is a negligible amount, it is equal to 22.8 per cent of the monthly livelihood of someone living on the poverty line in Pakistan.

The above two instances highlight the role that the CCP is playing in arresting and preventing anti-competitive activities in the regulated sectors.

3.3.2. Electric power sector

Pakistan is currently faced with serious electric power crises . The power crisis has been so severe during the period December 2007 to February 2008 that every 30 minutes there was a power outage in almost all parts of the country, including the capital city of Islamabad. Many areas of certain cities were often without any electricity, gas or water for an entire day in the extremely cold weather. There is a clear disparity between the demand and supply of electric power. Pakistan requires around 11,000 megawatts per day, while supply is around 8,000 megawatts per day. The power shortage is further exacerbated by power losses, which stood at 22.1 per cent in 2006–07 as against 22.8 per cent in 2005–06. The country is facing a shortfall of around 3,000 megawatts per day, which is expected to increase to 5,000 megawatts during the upcoming summer. There is a dire need for a quantum leap in electricity generation to fill the gap between demand and supply.

The power generation sector was liberalized in 1995 with the formulation of the 1995 Power Policy. The liberalization process succeeded in attracting considerable FDI and temporarily addressed Pakistan's power shortage problems. The 1995 Power Policy was a step forward in government's long-standing commitment to reform and restructure Pakistan's power sector. As part of the restructuring process, the state-owned Water and Power Development Authority (WAPDA) was vertically and horizontally unbundled. The unbundling entailed the separation of generation, transmission and distribution functions, which resulted in three state-owned generation companies (GenCos) meant for privatization at a later stage, a National Transmission and Dispatch Company (NTDC) and eight[312] distribution companies. WAPDA provides electric power to all of Pakistan, except Karachi, which is catered for by the Karachi Electric Supply Corporation (KESC). To regulate the

[312] In June 2002, the Peshawar Electric Supply Company (PESCO) was divested to create a new company, Tribal Electric Supply Company Limited (TESCO), for supply to tribal areas of PESCO. As of now there are nine DisCos.

unbundled and corporatized electric power sector, the National Electric Power Regulatory Authority (NEPRA) was established in 1997.

Pakistan has a long way to go before realizing the goal of providing "*safe, reliable, efficient and affordable electric power to the electricity consumers*"[313] throughout the country. The power sector reform and restructuring is marred by the slow privatization process. As of today, only KESC has been privatized, while efforts to privatize distribution and generation companies have not yet materialized. To meet the demand, supply of electric power is encouraged by waiving the licence requirement for generation companies, as was done in India. The monopsony of the NTDC (the sole buyer of electric power in the market) should be broken, so that the competitive process may get off the ground.

Electric power is the lifeblood for an economy and its development. The recent power crisis has affected the whole of the economy, and stalled the development processes. The poor supply of electricity has adversely affected the manufacturing industry. The increase in production costs of electricity has increased the manufacturing costs. Furthermore, electricity has not reached all parts of Pakistan. There is a considerable rural area where there is no electricity. The non-availability and/or expensive electric power have affected the whole range of poverty-alleviating activities.

The CCP under its mandate to conduct sectoral studies has commissioned a study on the electric power sector. Once the study is complete, it is hoped that the CCP will make its recommendations known to the NEPRA and the government so as to achieve the next phase of the liberalization process – thus paving the way for introducing competition in the sector.

4. Conclusion

Poverty in all its shapes, sizes and scope is prevalent all around globe. It "*is the worst form of violence*"[314] against mankind. The world's nations have recognized this evil, and have come together on various occasions

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[313] http://www.nepra.org.pk/index.htm
[314] Quote by Mohandas Karamchand Gandhi, http://thinkexist.com/quotations/poverty/

to form strategies to fight it. The Millennium Declaration's primary goal is to eradicate poverty. Pakistan designed its Poverty Reduction Strategy and is now in its third phase. There has been a considerable increase in the pro-poor expenditure, and the number of people living below the poverty line has decreased from one-third of the total population to less than one-fourth[315]. Good governance remains the primary principle guiding poverty-alleviation programmes. In order to improve governance, Pakistan reformed its competition regime by enacting a new law and establishing a new Competition Commission – a commendable step.

A carefully crafted competition regime embedded in a well-nurtured competition culture acts as a fertile soil for trade liberalization, foreign direct investment, and other economic policies which have the objective of promoting sustainable development, and enhancing the welfare of the citizenry. The vulnerable poor, who form the major portion of developing countries' population, are more susceptible to fall into poverty by price hikes and other shocks generated by anti-competitive practices. Competition law proscribes and obstructs those practices. Moreover, competition fosters economic growth, thereby creating opportunities of employment – *the essential tool* for alleviating poverty[316].

With the competition law now in place in Pakistan, and the Competition Commission becoming active by taking actions against cartels, and other anti-competitive practices, it is hoped that the new regime will lend support to the poverty alleviation programmes and activities thereby enhancing their efficacy in reducing poverty.

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[315] Pakistan Economic Survey, *supra* note 263, at p. 53.

[316] A Chinese proverb seems fitting here: give a man a fish, you feed him for a day; teach a man to fish; you feed him for a lifetime. The underlying presumption, however, is that the person knowing how to fish will actually go and fish for himself!

PART C:

Competition Issues in Commodity Markets

FROM IVORIAN COCOA BEAN TO FRENCH DARK CHOCOLATE TABLET

PRICE TRANSMISSION, VALUE SHARING AND NORTH/SOUTH COMPETITION POLICY[317]

Bruno Dorin*

1. Introduction

Faced with the downward trend in agricultural commodity prices, farmers in the North have acquired standards and organizations that define, defend and promote on markets the multiple (health, taste, territory, environment-related, etc.) qualities with which their food products may be endowed. And what if farmers in the South were to follow their example, with just as much public backing? The question is worth asking, especially by organizations such as the Centre de Coopération Internationale en Recherche Agronomique pour le Développement (CIRAD), which is already involved in characterizing various tropical products, or establishing North–South production contracts for "organic" or "fair-trade" products. But should this siphon off the majority of future development aid, notably to African agriculture? Must, or can, international bodies be convinced that this is a particularly effective way of raising agricultural incomes in the South? The answer is yet to be given, but in order to define it, it was suggested to us that we focus on a case study, the cocoa-chocolate commodity chain, analyse value formation and distribution within it, then simulate the possible benefit that

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[317] Final report translated from the original version in French.

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might be derived by African producers from respecting the standards or specifications that we were to propose.

This 7-month study[318] thus set out to analyse price transmission and value sharing throughout the cocoa-chocolate commodity chain, beginning here in the Côte d'Ivoire and ending in France. This first stage, which was novel in itself since there were no references on which to base it, was however not followed by the suggested second stage: we barely touch upon the subject of standards and quality, and even less so simulate the effect of possible changes in the matter. Yet, this was not for want of delving into the subject, but due to three major obstacles that discouraged us from spending any more time on these issues. The first was technical: it was impossible in the allotted time to obtain price differentials (or readiness to pay) depending on various qualities, a prerequisite for any serious quantitative study on the subject. Mere acquisition of series of prices for the few products manufactured along the cocoa-chocolate commodity chain was already no mean feat. The second obstacle was more to do with intuition, shared by numerous economists, to which this study might have finally devoted itself to developing and demonstrating: a proactive quality policy involves specific costs (characterization, organization, promotion, certification, control, etc.) whose importance is often considerably underestimated, and which restricts it a priori to environments that are predisposed or clearly limited in size. Lastly, and especially, the following question: what better quality for a cocoa from the Côte d'Ivoire, with which western industrialists and consumers seem to be perfectly happy at the moment, since it is by far the most imported cocoa bean in the world, to

[318] From 19 August 2002 to 18 February 2003, with funding from the Ecopol programme (CIRAD's AMIS department), and from 10 March to 9 April 2003, with funds from USDA/ARS for support to the "Global Cocoa Programme" made available to the CIRAD cocoa programme (Tree Crops Department) and to IPGRI. It should also be noted that the armed conflict that broke out in the Côte d'Ivoire on 19 September 2003 ruled out any possibility of local surveys.

produce a "generic" chocolate earmarked for mass consumption? Moreover, without this Ivorian reference, could other chocolates (and beans) be distinguished between and fetch a higher price from a minority of consumers ready to pay for "something else"?

Granted, the Côte d'Ivoire, like the other countries in the South, will be required in any event to offer a "better-quality" cocoa, since the technical, technological and organoleptic demands of importing countries are now being extended to the health, environmental and even social fields. The rules of the game are changing, even within the recipe for chocolate, when they were already having difficulty being applied by smallholders. These new rules imposed by the industrialized nations inevitably lead to higher production costs, often totally at the expense of producers in the South, since firms and consumers in the North do not pay for such a difference in quality, or only with great difficulty, or within such limited frameworks as "organic" and/or "fair" trade. In such a context, a North–South transfer appears to be warranted, and therefore deserves to be encouraged. But it will at best, and we feel, only be able to cover the additional costs incurred in respecting western quality demands; it will in no way sustainably raise the income of African cocoa farmers; at most, it will prevent their being sidelined by rivals from south-east Asia or elsewhere. Unless the issue at hand is to invent and somehow impose standards and signs of quality that enable countries in the South to capture a share of the value and modify relations between stakeholders. If such is the case, is the approach focusing on "quality" – very much a buzzword in France – the most politically adept and the most economically efficient? Moreover, would it not bring us back to the attempts at fair trade, in the hope of changing the structure of world trade by brandishing equity and solidarity as the main argument? As we feel that this perspective is bound to fail for the time being (condemned to marginal markets), we have explored a different avenue, that of competition regulations and policies, which we feel can more effectively convince and rally the support of decision makers and donors today, and

effectively bolster the incomes of small farmers such as Ivorian cocoa producers. As we shall also see later, this is without taking into account the fact that a quality policy in agriculture can be considerably limited by a competition policy: another reason to show a keen interest in the latter before designing and implementing the former.

Section 5 outlines the stakes of a new international competition policy, an option that we feel it is important to defend just as energetically as a quality assistance policy. Just before that (Section 4), we present the results that persuaded us to follow this avenue (analysis of price transmission and value sharing within the cocoa-chocolate commodity chain from 1992 to 2001), after providing a few technical, economic and political data required for the demonstration and for its clear understanding (Sections 2 and 3).

2. *Cocoa basics*

2.1. A sequence of processes

The cocoa tree (*Theobroma cacao*) and its cultivation encompass a few major particularities:

- varieties divided into three large families: *criollo*, *forastero* and *trinitario,*
- an ecological requirement: the equatorial zone,
- a favourite location: under forest shade,
- well-known diseases: black pod rot, witches' broom, swollen shoot virus, etc.,
- labour requirements for setting up and maintaining the plantation, harvesting, bean fermentation and drying,
- crop variations between years (depending on the climate) and also during the year, with the main crop usually from October to March (and the so-called "mid-crop" in the other months of the year),
- delicate storage: in a tropical climate, production cannot be stored for more than 3 months without damage,
- an economic lifespan of around 40 years (maximum productivity between 8 and 12 years).

Consequently, cocoa is traditionally sown or planted after thinning and/or felling of a tropical forest, followed by the installation of temporary shade from food crops (plantain, taro, pigeon pea, papaya, cassava, etc.) to protect young cocoa trees from direct exposure to sunlight. After 3 to 5 years' growth and upkeep (adjustment of the final shade, pruning, phytosanitary treatments, etc.), harvesting of the pods (ovoid cavity containing 30 to 40 seeds in a mucilaginous pulp) can begin. Once the pods have been opened, the seeds are cleaned, fermented and dried to give cocoa beans. The dry

beans are roasted, then ground and cleaned to give a "liquor" ("mass", "paste"), part of which is used, after pressing and alkalizing, on the one hand to make chocolate powder (for breakfast products, ice creams, etc.) from the oilcakes obtained, and on the other hand to make cocoa butter. Cocoa butter mixed with cocoa liquor during conching gives – with sugar or even milk – "couverture" chocolate. When this so-called "couverture" (dark or milk) is not manufactured by chocolate makers themselves, they rework it (tempering, moulding or coating with or without the addition of vanilla, hazelnuts, raisins, etc.) to make the many chocolate products now available on the market.

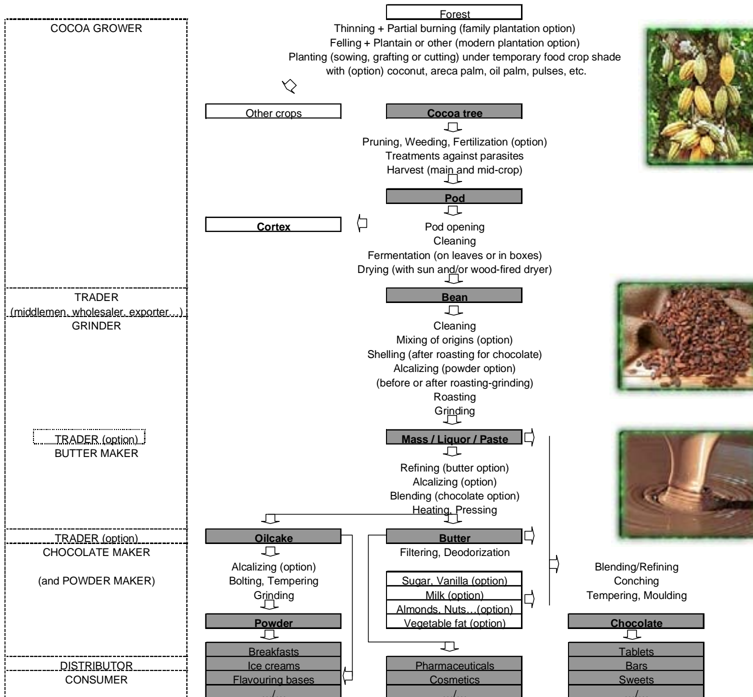
Chocolate manufacturing today is structured around three major operators (apart from those linked to trade): the cocoa grower, who produces the bean; the grinder/butter-maker (between which a greater distinction existed in the past), who processes the bean into cocoa butter, chocolate powder and, increasingly, couverture; the chocolate maker (Figure 1), who virtually no longer handles cocoa beans like before. Each of these operators uses a cocoa product, whose volume can be converted into bean equivalent (Table 1).

Table 1: Bean equivalent conversion factors

Sources: Pontillon (1997:24) for Food and Agriculture Organization FAO

	FAO	Ivorian authorities
Cocoa liquor	1.25	1.25
Cocoa powder and oilcake	1.18	1.25
Cocoa butter	1.33	1.25
Chocolate-based products	-	0.55625

Figure 1: The chocolate flow chart



2.2. Production in the South, tasting in the North

2.2.1. Supply

The cultivation of cocoa, which originated in Latin America (grown by the Mayas and sacred beverage of the Aztecs), really took off in the 1920s in the Portuguese, British and French colonies of West Africa (Sao Tome, Ghana,

Nigeria, Côte d'Ivoire, Cameroon). Today, the entire continent provides two-thirds of the world supplies (almost 2 out of 3 million tonnes), with the Côte d'Ivoire alone providing over 40 per cent of world supplies (it overtook Ghana as the world's leading producer in 1977). However, a third major production zone has been thriving in south-east Asia since 1990, with estates in Malaysia, but especially Indonesia (Figure 2). The position of this third major zone could be strengthened in the coming decades through the development of new plantations in Vietnam.

Over the last 20 years, world supply and demand[319] have virtually doubled, in a context of highly volatile prices (Figure 3). With intensified production in the 1980s, particularly in south-east Asia, there was surplus production in the commodity chain for some time (22 out of the last 30 years), but the current concern is rather the opposite[320]: farming systems exploiting new forest zones have reached their growth limit, the current plantations are tending to age rather than being renewed, diseases are developing, whilst demand remains strong in the European Union and the USA (Figure 4) and new markets, such as those in Eastern Europe and the Far East, are becoming established.

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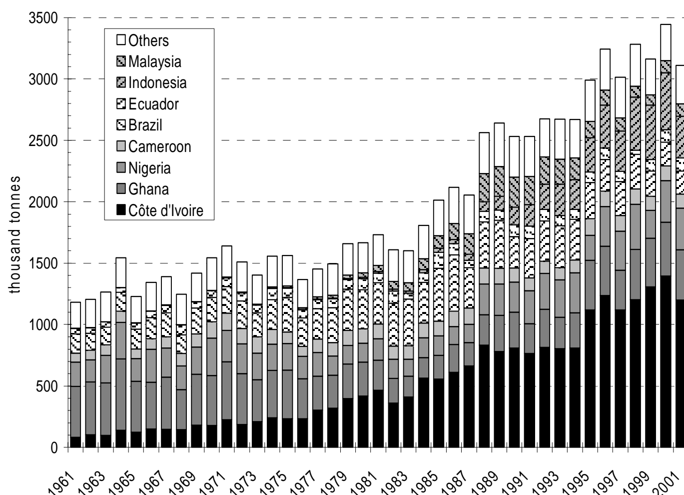
[319] Measured here as the volume of ground beans. It is also possible to use consumption statistics published by certain organizations (FAO, CAOBISCO, etc.), but they would not effectively represent cocoa consumption in its entirety (with biscuit making, dairy products, etc.). Foreign trade statistics can also be used, but the conversion coefficients that have to be used in that case are arguable; with those of the FAO, and with net import volumes for cocoa beans (I_C), liquor (I_L), butter (I_B), oilcake and powder (I_P): Consumption = $I_C + (1.25 \times I_L) + (1.33 \times I_B) + (1.18 \times I_P)$.

[320] According to ED&F Man, in 2002/03 there was apparently a production shortfall again (of 110,000 t) compared to grindings, for the third year running.

Figure 2: Bean production by country (1961–2001)
Source: data from FAO (2002).



2.2.2. Demand

Be it in bars, tablets, balls, spreads or powder, plain or flavoured and/or incorporated in other confectionery, poured or coated over enrobable fillings[321], chocolate is consumed today in very diverse forms, multiplied by a range of presentations, alongside niche products which are also on the rise (aromatic, organic or fair-trade chocolates). However, clear preferences for some of these types exist from one country to another (Table 2), even though bars seem to be increasingly the most

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[321] "Fillings" which themselves fall into various categories: "fondant" (mixture of sugar dissolved in a little water and glucose syrup, which may be coloured or flavoured with vanilla, orange or lemon), "praline" (mixture of sugar, finely ground roasted almonds or hazelnuts, to which a small quantity of cocoa and cocoa butter is added), "ganache" (mixture of melted chocolate, cream, butter and full-fat milk, flavoured or not with vanilla or alcohols).

widely appreciated. For instance, the Spanish are particularly fond of drinking chocolate, whilst the Germans and Italians are great consumers of chocolate spreads. In France, where the preference is (unlike in the USA or the UK) for products somewhat richer in cocoa than in other ingredients such as sugar, it is the tablet that reigns supreme: in 2000, chocolate tablets alone generated a turnover of 4.6 billion francs[322], almost half of which was for milk chocolate (Figure 5). Chocolate consumption is also seasonal, with major peaks at festive times such as Christmas, Saint Valentine's Day, Easter or Halloween[323]. Lastly, it is not limited to food uses, since chocolate now seems to be used for skincare (Brieu, 2002)[324]. It is true that cocoa butter is already used to make soaps and cosmetics[325], and also in traditional medicines such as remedies for burns, chills, dry lips, fevers, malaria, rheumatism, snake bites and other wounds (CNUCED, 2003). For their part, the husks and pulp obtained further upstream in the process can be used as animal feed, or for fertilizer, alcohol, or pectin production[326].

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[322] Household chocolate and sugar confectionery consumption reached 33.6 billion francs the same year, though no distinction could be made between the shares of these two sectors, which INSEE groups under the NAF code 15.8K.

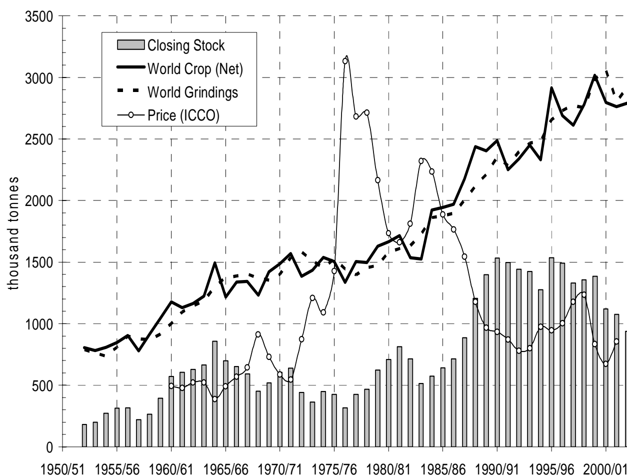
[323] The Halloween confectionery market alone apparently amounts to 2 billion dollars in the USA (35 per cent of annual sales).

[324] Some Parisian beauty parlours apparently now propose 100% chocolate treatments for the face and hands. In Hershey, Pennsylvania, a town entirely devoted to chocolate, a spa centre was opened in 2001, proposing a range of original treatments: cocoa and whipped cream baths, coating in chocolate lotion, cocoa butter massage, etc.

[325] 1% of cocoa butter production apparently went to the cosmetics industry at the end of the 1990s (www.icco.org/questions/cosmetics.htm).

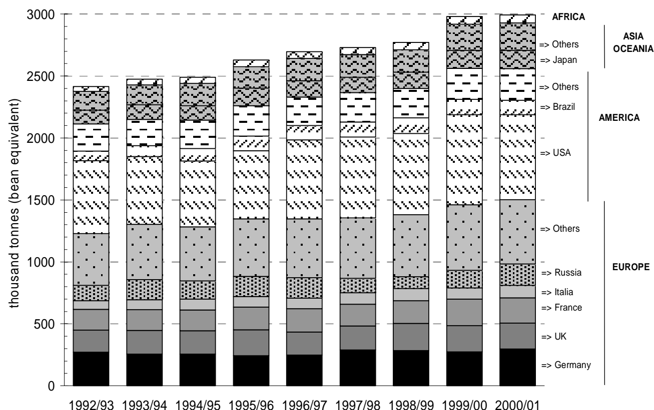
[326] See in particular www.icco.org/questions/byproducts.htm.

Figure 3: Bean supply and demand (1950–2001)
Source: data from ED&F (2002) and ICCO (2002b).



Note: 2001/02 and 2002/03: projections ED&F Man.

Figure 4: Domestic cocoa production (1992/93–2000/01)
Source: data from ED&F (2002) and ICCO (2002a).



Note: Apparent consumption = Cocoa bean grindings + Net imports, in bean equivalent,of chocolate, chocolate-based products and other cocoa-based products.

Figure 5: French production of chocolate end products (1999–2000)

Source: data from XERFI (2001).

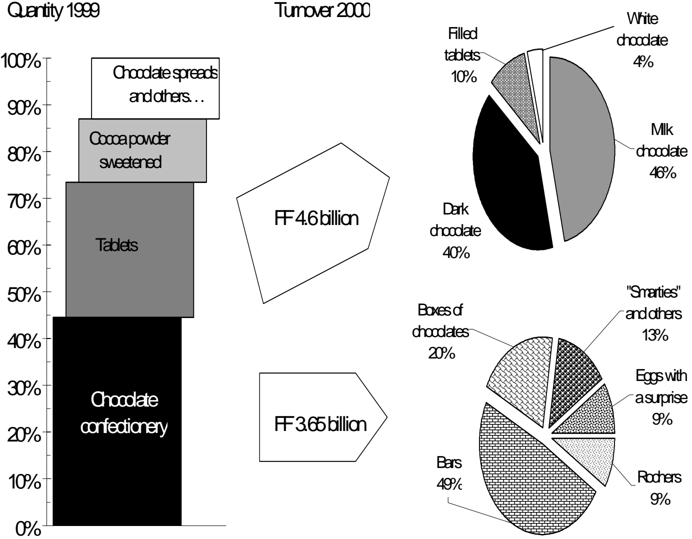


Table 2: World consumption of chocolate-based products (1998)
Source: based on Aryal (2000:78-79).

	TOTAL (kg/inhab /year	Unfilled tablets	Filled tablets and bars	Chocolate sweets and confectionery	White chocolate	Cocoa-based candies	Cocoa powder	Chocolate spreads
Switzerland	10.16	3.99	2.91					
Germany	9.81	1.50						1.15
Belgium	9.68		3.52					
Denmark	8.94	2.57		2.75				
UK	8.65	2.04	3.15					
Norway	8.58	0.44	0.42				0.39	
Ireland	8.29		1.69		8.92			
France	6.94	1.93		1.67				
Australia	6.04			1.81		1.83		
USA	5.53		2.65					
Sweden	4.95	1.58		2.43				
Netherlands	4.73							
Finland	4.02		1.42	1.58				
Spain	3.41	0.85					1.56	
Italy	3.33			0.59		0.76		0.57
Brazil	2.05					1.25		
Japan	1.92			0.68		0.51		

2.3. Small family farms and multinationals

2.3.1. Cocoa producers

At the end of the 1990s, the number of cocoa producers worldwide was estimated at 14 million, two-thirds

concentrated in Africa (10.5 million)[327], primarily in the Côte d'Ivoire (3.6 million on at least 600,000 farms)[328]. Whilst large estates can be found in countries such as Malaysia or Brazil, most producers are smallholders, since 90 per cent of world production apparently comes from farms of under 5 hectares (De Lattre-Gasquet *et al.*, 1998): on these small family farms, labour remuneration (the main cocoa production cost) is much more flexible than on estates (Hanak Freud *et al.*, 2000), as Malaysia realized too late when prices slumped at the beginning of the 1990s[329].

Cocoa growing was introduced into the Côte d'Ivoire via Ghana in the east and south-east of the country (a pioneer front where oil palm and rubber development has now taken over), then spread to the centre-west, where the largest quantity is now produced (36 per cent); the latest pioneer fronts are located in the south-west and west[330]. The two driving forces behind this development were the possibility (nowadays virtually exhausted) of opening up new plantations in forest zones after slashing and burning, along with available labour – primarily of Burkinese origin (Baoule in the west) – which was encouraged to settle through particular ownership rights[331] (now contested).

Despite the vitality of this "foreign" population, and the relatively young cocoa plantings (almost 70 per cent of them are under 30 years old), there has been virtually no

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[327] For a breakdown of this estimate by country, see http://www.icco.org/questions/smallholders.htm.

[328] Which apparently provides a livelihood for 6 million Ivorians, i.e. 40% of the population.

[329] The cocoa trees, which were also attacked by pod borers, were finally pulled up to make way for new rubber and oil-palm plantations.

[330] It is consequently on the savannah highlands in the north (where most of the country's Muslim population is settled) that most of the Ivorian sorghum and cotton are grown.

[331] According to Félix Houphouët-Boigny, Ivorian President from 1960 to 1993, "la terre appartient à celui qui la met en valeur" (land belongs to the person who develops it).

productivity gain, and the increase in Ivorian cocoa production is primarily down to the incorporation of increasing quantities of land and labour (Daviron et Losch, 1997). There are various explanations for these low Ivorian yields (around 500 kg of beans/ha/year, whereas hybrids can produce at least double or three times that figure with fertilization and irrigation): smallness of the farms (84 per cent of production comes from farms of under 5 ha), ageing producers (80 per cent are over 55 years old), limited adoption of, or training in, new techniques (for replanting, pest control, post-harvest processing, etc.), difficult access to cheap credit, volatile prices from one year to the next, neglect of the plantation when prices are too low, etc.

These cocoa farmers are represented on a national level by ANAPROCI (Association Nationale des Producteurs de Café-Cacao de Côte d'Ivoire) and FIPCC (Fédération Ivoirienne des Producteurs de Café et de Cacao), and on an international level by the CPA (the Cocoa Producers Alliance). The latter, like the ICCO (the International Cocoa Organization), may be involved in the work undertaken by a dozen scientific and technical organizations involved to varying degrees in monitoring or supporting Ivorian cocoa cultivation (CNRA, CIRAD, ANADER, etc.).

2.3.2. Cooperatives, middlemen, wholesalers

The collection and transportation of beans to processing units near export ports is an operation that is as crucial as it is tricky, since the dispersal of smallholders in remote areas (forests) is combined with poor road infrastructures (developing country) and the need to bring out production rapidly (quality deteriorates more rapidly in tropical countries).

In the Côte d'Ivoire, beans are collected and transported by cooperatives[332] (or GVC), which may export directly (COOPEX, PMEX, etc.), but particularly, and increasingly (82 per cent in 2000/01 as opposed to 68 per cent in 1998/99) by middlemen (*pisteurs* in French), who are frequently of Lebanese origin[333], working for wholesalers (*traitants* in French) often of the same origin, who provide them with vans and with cash to pay producers for their crop.

The credit needed by cocoa producers for cultivation, but also to school their children (the new term begins before the main crop) also seems to depend increasingly on these middlemen/wholesalers. The loans granted are then repaid when yields are delivered, at interest rates that are obviously higher than those practised by public services (when such services are available).

Wholesalers, who are based in the main towns of the south, are independent, or themselves funded by exporters. In 2000/01, 550 were accredited by GPEX (Groupement Professionnel des Exportateurs de Café-Cacao)[334], which cost each of them 100,000 CFA francs for that season, alongside the licence fee of 400,000 CFA francs they have to pay in each department where they operate (Jacquet, 2001).

2.3.3. Conditioning plants, exporters

Near the export ports (Abidjan or San Pedro), conditioning plants which are often export units, buy beans from wholesalers and make them conform to market standards and requirements: pre-cleaning and stone removal, re-drying

[332] Particularly dynamic in the east and centre-south zones, where their collection share was 48 per cent and 27 per cent, respectively, in 2000/01.
[333] Or Malian, or Burkinese.
[334] A dissident organization, UNOCC, was founded in 2000/01.

where necessary, etc. If quality proves to be inadequate, such purchases may be subject to discounts[335].

Beans earmarked for export are then dispatched in containers once three formalities have been completed: (1) batch checking, which was contracted out in 2000/01 to accredited private companies (SGS, Cornelder, Veritas) at a cost of 1,900 CFA francs/ton; (2) phytosanitary inspections, at a cost of around 1,000 CFA francs/ton, at the expense of the exporter; (3) payment of taxes, of which DUS (*Droit Unique de Sortie*, export duty) is the main component: 140,000 CFA francs/tonne of beans in 2000/01 (Jacquet, 2001).

At the beginning of 2000, there were around 40 accredited export companies, which could be classed into three categories (Jacquet, 2001): (1) traditional local exporters, whose market share fell from 43 per cent in 1997/98 to 10 per cent in 1999/00; (2) exporters associated with international trading houses, which, for their part, are developing their operations (48 per cent of exports in 1999/00); (3) exporters linked to international bean processing groups (42 per cent), the largest three being ADM, Barry-Callebaut and Cargill, who are integrating an increasing amount of upstream collection and conditioning units, whilst also developing local bean-grinding activities.

2.3.4. Grinders, butter makers

More than half the beans ground today worldwide are ground in the European Union and the USA (Figure 6), and by five major grinding companies: ADM (Archer Daniels Midland), Barry-Callebaut, Cargill, Hamester and Blommer[336].

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[335] Too high a number of beans per 100 g (i.e. over 100), moisture content over 8 per cent, lack of fermentation, or too many defective beans (notably mouldy).

[336] Chocolate makers such as Nestlé also grind large volumes of beans, though they are not specialized in this activity.

In the Côte d'Ivoire, the first processing factories had been set up, with Government encouragement, to process "off-standard" beans or small beans (primarily mid-crop). In a fiscal environment that remains propitious to such local processing (BNETD, 2001), these capacities (350,000 t at the end of 2002) have been strengthened with international groups[337] that have embarked upon vertical integration, buying up trading firms, and buying and installing factories in producing countries.

All in all, the Côte d'Ivoire today processes almost a quarter of its beans to export semi-finished products[338] with higher added value, as do Brazil and Malaysia. It nonetheless remains that such processing can in theory barely be extended beyond couverture chocolate, since even manufacture of the latter – if it is to be adapted to the different tastes of consumer countries – requires blends of origins, which are less risky and costly to make in the major chocolate-consuming zones.

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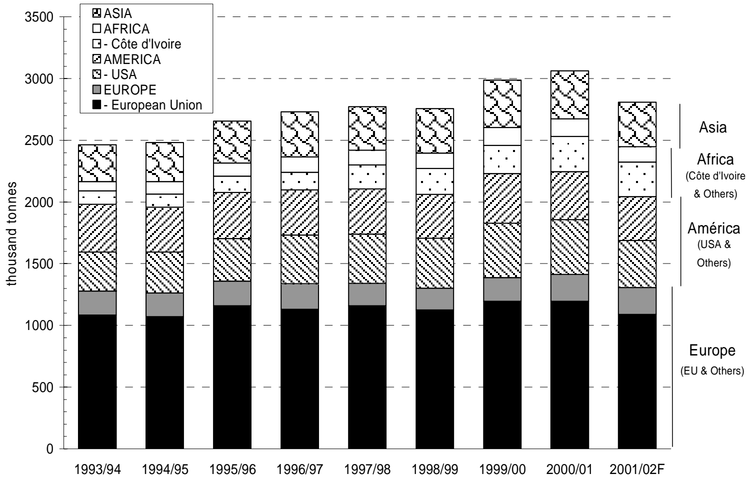
[337] Bean-processing capacities at the end of 2001, apparently employing barely more than 900 people (Jacquet, 2001): 100,000 t/year for SACO (Barry-Callebaut), 100,000 t/year for MICAO (Cargill), 75,000 t/year for UNICAO (controlled by ADM's SIFCA) and 75,000 t/year for CEMOI Côte d'Ivoire.

[338] 2000/01 exports (April to March) from the Côte d'Ivoire according to ICCO (2002): 122,924 t of mass, 56,360 t of powder and press cake, 45,018 t of butter and 3,900 t of chocolate, local production of the latter being sold more on the domestic market, since it remains difficult and costly for a bean-producing country to supply chocolate incorporating various origins to meet the various tastes of the main consumer countries.

Figure 6: Bean grinding per region (1993–2001)

Source: data from ED&F Man (2002).



Note: 2001/02: projections ED&F Man.

2.3.5. Chocolate makers, distributors

The move towards concentration and internationalization is also speeding up among chocolate makers. A distinction can be made between two markets on this level: (1) a captive market with groups such as Cadbury, Kraft Foods (Philip Morris), Mars or Nestlé*,* which above all produce chocolate for their own product range; (2) an open market on which groups such as ADM, Barry-Callebaut or Cargill sell powdered or couverture chocolate (*via* traders such as Euro Distribution Alimentaire in France, or not) to chocolate makers-confectioners, who do not produce their own chocolate, or not enough to meet their requirements (with surpluses on one or other of these markets figuring in transactions between them). Among food industrialists, there are also international companies specialized in the production of fine or "prestige" quality chocolates, the leaders being Lindt,

Peter's Chocolate Company (Nestlé group) and Valrhona (CNUCED, 2001).

With this concentration of the profession, the fabric of the French chocolate and confectionery industry[339] is now dominated by a few foreign groups owning powerful brands (

[339] 111 companies employing more than 20 people each and/or with a turnover of more than 35 million francs in 1999, i.e. 5.2 per cent of the total turnover of the agrifood industries in France, and 5.6 per cent of salaries in the branch (XERFI, 2001). Alongside these companies, there are SMEs that, unable to compete with the major brands through advertising, capitalize on the good reputation of French products representative of a certain lifestyle. It remains that the French chocolate-making industry stands out on the whole through the increasing share accorded to semi-finished products, which seem today to account for half the tonnages. Indeed, through its geographical position, France is a worthwhile production rear base for foreign groups.

Table 3). In fact, colossal advertising budgets[340] are necessary for their promotion, particularly as supermarket own brands, such as Carrefour or Auchan, are now coming to the fore (more than 15 per cent of the French market value for chocolate tablets in 2000).

With stiff competition between brands, but also the rising influence of particularly competitive substitute segments such as biscuits and sugar confectionery, chocolate industrialists are having to regularly deploy new strategies, which now follow two major trends. The first is to seek new market niches by sophisticating chocolate tablets (notably with biscuit), by offering products in bite-size versions (to adapt to "nomadism" or "snacking" trends), by umbrella marketing campaigns at certain key times of the year (Christmas, Easter, etc.: event marketing, as particularly well achieved by Ferrero). The second trend is to use distribution circuits other than the currently all-powerful hyper- and supermarkets (Figure 7), notably the "long circuit" via bars-tobacconists (34,000 in France), bakery-cake shops (32,000), petrol stations (17,000), newspaper kiosks (32,000) or vending machines (527,000), supplied by wholesalers such as Eda, SFP or Altadis Distribution, through which manufacturers such has Haribo have succeeded well (XERFI, 2001).

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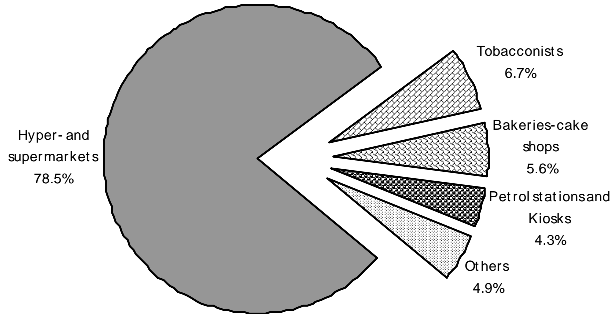
[340] In 2000 for example, Ferrero spent no less than 222 million francs on communication: a winning strategy since the Italian chocolate maker's turnover jumped by 10 per cent. Likewise, Nestlé reaped the benefits of its support for the Lion brand (37 million francs), since sales increased by 6 per cent on the chocolate snack market in 2000 (XERFI, 2001).

Table 3: Groups dominating the French chocolate and confectionery industry (2001)

Source: according to XERFI (2001).

Group	Country	Consolidated turnover 2000 (Billions of FF)	Main companies controlled in France	Main brands
Nestlé	Switzerland	343,0	Nestlé France	After Eight, Crunch, Frigor, Galak, Kit Kat, Quality Street, Lanvin, Lion, Menier, Smarties…
Kraft Foods (Philip Morris)	USA	188,9	Kraft Foods France, Kraft Foods Strasburg, Kraft Jacobs Suchard Rheims	Côte d'Or, Daim, Milka, Suchard, Toblerone…
Mars Incorporated	USA	108,9	Masterfoods	Bounty, Mars, Maltesers, Milky Way, M&M's, Snickers Twix…
Cadbury-Schweppes	UK	47,6	Cadbury France	Cadbury, Hollywood, Kiss Cool, Krema, La Pie qui Chante, Malabar, Poulain…
Ferrero	Italy	25,6	Ferrero France	Ferrero Rocher, Kinder, Mon Cheri, Nutella, Rafaello…
CSM	Netherlands	17,9	Lami Lutty France…	…
Barry Callebault	Switzerland	10,1	Barry Callebault France	…
Lindt and Sprungli	Switzerland	6,9	Lindt and Sprungli France	Caffarel, Ghirardelli, Lindt…
Cemoi	France	2,3	Cantalou, Chocolaterie Aiguebelle, Chocolaterie d'Aquitaine, Chocolaterie de L'Abbaye Suisse Normande, Chocolaterie Moulin d'Or, Chocolaterie Real, Phoscao	

Figure 7: Market shares of the chocolate distribution circuits in France (2000)
Source: data from XERFI (2001),



2.3.6. Traders

The cocoa-chocolate commodity chain is subject to multiple transactions, due to the distance between production and consumption sites, but also because of the various products and processes required to make the end product. For beans, the most important trading centres are futures (and options) markets in London (LIFFE) and New York (NYBOT) (see Section 3.4), which make cocoa one of the most traded agricultural commodities in the world. These marketplaces are the focus of a multitude of dealers, which the concentration/integration policy implemented by the major downstream operators is tending to short-circuit today (integration of trading activities, as is also the case for French sugar mills and refineries). This trend is not without influencing price formation, which also depends on public policies.

3. From stabilization to liberalization

3.1. National stabilization boards and funds

As Daviron and Losch reminded us (1997), the general frame of reference for post-war policies up to the 1970s was that of development economics, in which economic prosperity was built on a Nation-State scale. In substance, in the Côte d'Ivoire as in other countries, national or international funding agencies encouraged (1) the improvement of such a development framework in terms of infrastructures (roads, port facilities, energy, hydraulics) and legislation (based on a transfer of regulations largely established during the colonial period); (2) the creation of productive bases and improvement of market functioning; (3) the stabilization of farmers' incomes, the latter being considered as essential for productive investment and social order (Daviron et Losch, 1997:10-11).

In this context, two major systems of marketing and commodity chain supervision were adopted in west and central Africa by cocoa-producing countries: stabilization boards and funds. Marketing boards were set up in countries such as Nigeria (up to 1986) or Ghana. They were characterized by the existence of a parapublic organization with a monopoly in domestic and international marketing. When cocoa was bought from a producer, it became the property of the board, which took charge of it throughout the commodity chain, after fixing prices at the different stages for the entire crop year. For their part, stabilization funds (*caisses de stabilisation* in French) were adopted in countries such as Cameroon or the Côte d'Ivoire. Like the boards, they fixed domestic and export prices. However, physical routing of the merchandise – from producers to export ports – was ensured by private operators accredited by the fund (CNUCED, 2003).

The domestic stabilization of prices and internal securing of purchases/sales that these systems allowed, went hand in hand – as with CAISTAB in the Côte d'Ivoire – with systems of territorial equalization, quality control and export management (futures sales, regulation between exporters and conditioning units, etc.), along with operating aid and investment in the commodity chain, be it through credit (to cooperative structures in particular), the creation and maintenance of roads or tracks, or the funding of technical assistance or research organizations (SATMACI, IRCC, IDEFOR, etc.). These systems also made it possible to apply sometimes extremely large levies: the Ivorian CAISTAB supplied up to 30 per cent of the State's special investment budget up to the end of the 1970s (Daviron et Losch, 1997:14-15).

These substantial levies, along with their sometimes highly dubious use, did not argue in favour of maintaining such stabilization systems, whose inefficiency was also increasingly criticized (see Section 3.3), even without counting such unfortunate strategies as the "cocoa war" entered into by ageing President Félix Houphouët-Boigny at the end of the 1980s. Indeed, rather than raising the bidding by blocking supplies of Ivorian products to the world market, it became necessary several months later to inform producers that the price per kilo had been halved. The Ivorian stabilization system was completely dismantled by commodity chain liberalization in August 1999 (see Section 3.3). The "barème" principle persisted between those two dates; it fixed a minimum price for producers as well as reference export prices at each stage of the commodity chain. Consequently, when a cocoa sale was made, the exporter had to compensate the stabilization fund for any difference between the actual sale price and the reference price, if the former was higher than the latter (the so-called "repayment" operation). On the other hand, when world prices were lower than the reference price, CAISTAB compensated exporters by granting them a payment (known under the generic term of "support") corresponding to the difference.

3.2. International stabilization agreements

Between 1972 and 2001, there were six successive cocoa agreements. It took no less than 16 years and countless meetings to establish the first with, one year later, the International Cocoa Organization (ICCO) to manage it. That agreement was based on a quota system, combined with a buffer stock. The quota system granted quotas to each producing country, which varied in line with prices. However, it was never necessary to apply the agreement as prices remained above the fixed target range throughout its duration. Nevertheless, the contribution of 1 cent per pound helped to establish a fund of around US$80 million. The second agreement, concluded in 1975, was based on the same system, but did not work any better than the previous one, as the USA (the world's leading consumer) did not agree to take part. However, the "kitty" rose to US$ 230 million. A third agreement saw the light of day in 1980, in a very different context, as the market then had a surplus and prices were declining. The quota system was abandoned to the benefit of a buffer stock that could reach 250,000 tonnes. But this measure was barely more operational: the stock proved to be less than the surplus, funding resources were inadequate, and neither the USA nor the Côte d'Ivoire took part. Moreover, currency exchange fluctuations had not been taken into account. A fourth agreement was then reached in 1986, after two years' work under the aegis of UNCTAD. It, too, was based on a buffer stock of 250,000 tonnes, with the possibility of withdrawing 120,000 tonnes. But it remained powerless to stabilize prices above the reference level of 1,600 SDRs per ton: in January 1990, the ICCO indicator fell to 900 SDRs (Jouve et Milly, 1990:120-121).

In 1993, when the fifth agreement was concluded, the decision was taken to liquidate the buffer stock by selling 4,250 tonnes per month until it ran out, which occurred in

March 1998 (CCI, 2001:148-154). In reality, that agreement heralded the one concluded in 2001, to which the European Union and 40 cocoa-importing or -exporting countries adhered (except Indonesia): the forsaking of any ambition to intervene on the market in the short term, in favour of a sort of forum that monitored market trends, in order to ensure a balance between supply and demand in the medium and long terms. In 2001, this capitulation led to the announcement of the following objectives: (1) promote international cooperation in all sectors of the world cocoa economy; (2) provide an appropriate forum for the discussion of all issues concerning all sectors of that economy; (3) help to strengthen the national economies of member countries; and (4) contribute towards the balanced development of the world cocoa economy, notably by promoting a sustainable cocoa economy, research and application of its results, collection, analysis and dissemination of relevant statistics, and consumption of chocolate and cocoa-based products (CNUCED, 2001).

Pending the results of generalizing so-called "modern" price-risk management tools to developing countries (see Section 3.4), would not STABEX be the only way left to compensate for the harmful effects of world commodity market instability? This unique system of export stabilization (for agricultural products) was in fact proposed by the European Commission right from the first Lomé Convention in 1975. It provides African, Caribbean and Pacific (ACP) countries (now numbering 77) with substantial resources (13 per cent of the European Development Fund allotted to the ACP States over the 1995–2000 period, i.e. 1.8 billion European Currency Units (ECU)) to fund their agricultural sectors – without directly intervening on the market – when they are thrown into difficulty by a decline in their export earnings. In this way, a reference level is fixed by country, and when losses in export earnings are seen, STABEX guarantees a transfer of financial resources to the benefiting country that is equal, at most, to the difference between the effective value and the reference level.

Of course, STABEX has evolved since the first Lomé Convention. It only intervenes today in the form of donations, with the so-called "principle of reconstitution" by the ACP States being abandoned in 1990. Moreover, it was in return for the abrogation of that principle that the European Union obtained the same year the concession that the way resources were used would be subject to an agreement with each ACP Government. This framework of "mutual obligations" also involves suspensive clauses whose respect by the ACP States governs the different instalments ("tranches"). This was a major change signifying the end of direct, undifferentiated, non-negotiated transfers, which is not without causing tensions alongside those linked to the inadequate amounts available in periods of severe price depreciations. In fact, these frameworks of "mutual obligations" extended not only to supporting agricultural producers[341], but also the privatization of commodity chains and the restructuring of national compensation bodies, in other words the development of the free-market economy in ACP countries (Simon, 1999).

Be that as it may, it is clearly along those lines that the Cotonou Agreement signed in June 2000 envisaged a radical reform of commercial relations between the two regions. Indeed, it was regretted that the Lomé Conventions did not prevent the marginalization of ACP countries in world trade, or enable diversification of their exports that are still too often concentrated on a small number of agricultural products. It was also felt necessary, perhaps first and foremost, to comply with the commitments made at the World Trade Organization (WTO), since the latter does not authorize trading relations that are discriminatory and non-reciprocal, a provision that was extended to agriculture in 1994. Consequently, the European Union proposes setting in place Economic Partnership Agreements (EPA) between 2008 and 2020 with the ACP countries, which would then be grouped in regional

[341] In the Côte d'Ivoire, STABEX has thus facilitated access to the banking system for around a hundred producer organizations, or, in Cameroon, the distribution of "farmer cheques".

blocks (SOLAGRAL, 2002). In other words, it involves setting up free-trade areas, a new development paradigm that has been pushed to the fore for the last 20 years or so.

3.3. Market liberalization

The post-war self-centred growth model actually fell into crisis in the 1970s: the oil shocks forced the industrialized nations to broaden their market in order to settle the increasing bill for a raw material that they now largely depended on, and therefore open up much more to world trade and its advantages (theory of comparative advantages) than they had done in the past. This multilateral opening up led to ever more condemnation and dismantling of direct public intervention in domestic and international trade for goods and services (intervention now qualified as "trade distortion"), the outcome of which was the establishment of the WTO in 1995. Naturally, for public development aid, it was then no longer a matter of contributing to the construction of self-centred national economies, but of promoting the effective insertion of territories on the international scene, since from now on, it was on this that improved growth and living standards depended (Daviron et Losch, 1997:18-19).

The free market has reigned for many years in the cocoa sector of countries such as Brazil, Indonesia and Malaysia. However, the international move towards liberalization led countries such as Nigeria and Cameroon to completely restructure the organization of their commodity chain in the 1990s. It was in 1999 for the Côte d'Ivoire a vast privatization, flanked some time later with new coordinating bodies: a Coffee and Cocoa Regulation Authority (ARCC, 2001), a Coffee and Cocoa Bourse (BCC, 2001), an Inter-ministerial Commodities Committee (CIMP, 2001), a Regulation and Control Fund (FRC, 2002) and a Coffee-Cocoa Markets Information Programme (PRIMAC).

Nevertheless, the question of projects to secure agricultural income remained. In 2001, the Ivorian national coffee and cocoa producers association (ANAPROCI) suggested the restoration of a stabilization system based on the calculation of a Mean Forward Sale Price (PVAM – *Prix de Vente Anticipé à la Moyenn*e)[342], maybe not having completely realized that forward sales have strongly diminished since liberalization: by increasingly integrating upstream operators, the main buyers need less and less to turn to futures markets. In a document dated 23 July 2002, the Ivorian BCC proposed for its part a new trading system that is in practice similar to the one that existed before 1999, except that it does not include any programme on futures sales made after the main cocoa crop[343]. This system was to be completely in place by

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[342] "Sales are forward sales (even before the product is available). Sales are spread over 33 months. For the first 21 months, these are futures sales, and the final 12 months are given over to spot sales (depending on the state of the market when the transaction takes place). In this way, prices are smoothed for producers, whose remuneration does not vary. However, the BCC could benefit from any improvements, such as an upturn in world prices, to fund foregone earnings in the case of a price drop" (Le Jour, N°1946, 13/09/2001).

[343] The following was thus proposed (Dow Jones Newsletter, 14/08/2002): (1) a Minimum Farm-gate Price (MFP) fixed by an inter-professional committee of experts within the BCC (the 2001/02 season was thus marked by the introduction of such a price: see Section 4.2.1); (2) a Reference CIF Export Price (REP), which is the MFP incremented by collection and transport costs; (3) a Safety Reserve, fixed at the beginning of each season by various representatives of the profession, with a fixed share, and a variable share provided by exporters when the REP is higher than the MFP (or even by levying a "variable reserve tax" on production); (4) an Intervention Mechanism which could take various forms when the market price tended to fall below the REP: a) introduction of preventive insurance against the price risk, by using the futures and options markets, for example, b) adjustment of the level of fixed reserves, or of variable reserves, c) payment (via exporters) of compensation or a subsidy to cocoa farmers when the REP falls below the MFP; (5) a Guarantee Fund intended to improve access to

October 2003, but a year earlier, on 19 September 2002, a deep and bloody crisis broke out in the country[344], which it is tempting to link to the over-radical liberalization of the Ivorian economy, notably in the cocoa sector. Whilst the issue is worth investigating (Losch *et al.*, 2003), one certainty remains: this liberalization has discouraged rather than encouraged systems to secure agricultural income, apart from one, the futures and options markets, to which Ivorian small-scale cocoa producers do not yet have direct access.

3.4. Futures and options markets

When trade with Europe and the rest of the world intensified in the 16th century, veritably giving birth to international trading at a distance, purchases and sales with deferred deliveries became established and developed, along with the associated risks. In order to protect oneself from losses or damage to merchandise in transit, it gradually became possible to take out insurance, or to receive letters guaranteeing the execution of the contract. But it was not until the 20th century that it became possible to (personally) protect oneself from price fluctuations, which were considerable for agricultural products (Habert, 2002): the first formally organized cocoa exchange was created in New York in 1925 in the wake of a stock exchange boom and crash (this exchange merged in 1978 with that for coffee and sugar, then in 1998 with that for cotton, to form NYBOT), with London following in 1928 (exchange now forming part of LIFFE)[345].

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credit for small and medium-sized exporters (private or cooperatives), so that the latter can purchase larger volumes of cocoa.

[344] On 19 September 2002, armed conflict broke out in the Côte d'Ivoire, splitting the country in two, with "rebel' troops of the Ivorian Patriotic Front (MPCI) in the north, and the forces of President Laurent Gbagbo in the south.

[345] Cocoa exchanges were also created in Amsterdam and Paris, but the volume of their activities never equalled that of NYBOT and

These futures contracts and markets transfer the price risk (unexpected rise or fall between the order and delivery) from those who do not accept it ("arbitrage dealers": traders, processors, chocolate makers, cocoa producers, etc.) to those who accept it and are called "speculators". The latter in fact wager on the market in line with the elements at their disposal, hoping to gain more than they lost in "arbitrage" operations (purchases and sales on paper that might lead – in 1% of cases at the most in normal circumstances – to delivering or taking delivery of the product)[346] and "compensation" operations (payment of the difference between the market value and the transactional value), which, all in all, means that to each loss there corresponds a gain (zero sum game). Purchasing options ("calls") and sales ("puts") completed this system for cocoa at the end of the 1980s. These are conditional futures contracts enabling an operator to reserve the option to request the performance of an agreed operation, or its cancellation, subject to the immediate payment of a premium (known as the "option price").

Thus, in modern merchandise trading, there exists today a clear distinction between the futures market and the "physical market", with the first shifting ten times more volumes (on paper) than the second (great liquidity which is also the guarantee of offering a counterpart at any given time). The physical market (also called the "real" market, "cash" market or "spot" market) deals in cocoa beans or cocoa products of given grades and origins, whose quantities, delivery times, packaging, prices (usually taking the futures market for a reference) and payment conditions are mutually

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LIFFE, which were virtually comparable for this commodity in the 1980s and 1990s.

[346] The term "arbitrage" is also used to mean the settlement of disputes (e.g. about quality) outside the usual legal system. Such arbitrage is usually ensured under the aegis of cocoa trading associations. In extreme cases (refusal by one of the parties to comply), it becomes enforceable through legal channels (CCI, 2001:93–95).

negotiated between the different buyers and sellers, based on standard contracts or market rules pre-established by international cocoa trading associations (CAL, CMAA, FCC). Conversely, the futures market is a restricted market (only the least attractive cocoas for users are supplied to the exchange), on which an individual must use the services of a middleman to buy or sell commodities. This involves a standard contract that can be bought or sold at a given place (NYBOT or LIFFE), during predetermined price quotation times, on the trading floor (NYBOT) or in front of computer screens (LIFFE since the end of 2000). In the futures contract, only the price and delivery month (March, May, July, September or December) are negotiable, as all the other elements are standardized and not negotiable (quantity by 10-tonne batch, delivery to the warehouse of the port on the consumer market, quality in compliance with the classifications established by each exchange, transactions in US dollars for NYBOT and pounds sterling for LIFFE, etc.). Moreover, futures contract trading assumes the availability of sufficient financial means to honour contractual obligations (obligations first of all involving payment of a security deposit, an "initial provision" generally equivalent to 10 per cent of the contract market value). These means must be made available to a middleman ("broker" or "commission agent", who is a member of the clearing office), who takes responsibility for contract performance (reverse operation or delivery) on behalf of the operator in respect of the other party (CCI, 2001:73-85).

Jouve and Milly summed up well the advantages and disadvantages of the futures market (Jouve et Milly, 1990:115-120) namely, for the advantages: (1) cost reductions throughout the commodity chain since, by limiting their risk margin (money gained by speculators is lost by other speculators), middlemen also limit their commission; (2) more flexible and more efficient management of market flows insofar as paper and physical can be dissociated in time; (3) transparency in operations through the immediate publication of quotations; and (4) theoretically more difficult price manipulation by large operators, even if "squeezes", like the

one Antony Ward[347] was recently accused of, may still more or less severely affect the smooth functioning of the markets. However, this guarantee of efficiency and transparency entails a certain number of limits or drawbacks: (1) in the short term, the futures market can increase instability, even though it does not modify long-term price trends; (2) producers always find themselves in the role of speculators, since they can choose at any moment to sell or not to sell: they optimize their speculation but do not eliminate it all the same; (3) resorting to arbitrage is not free of charge (registration fees, brokerage, exchange taxes, etc.); and (4) the options system encourages traders and industrialists to speculate, which somewhat amplifies the role of futures markets, increasing its disadvantages. We are tempted to add a fifth point to this last list: futures markets do not locally encourage the production, differentiation and recompense of quality, since in order to function they rely on the maximum homogenization of batches (by national origin as this is difficult on a world scale, hence premiums by batches – positive or negative – depending on the producing country), which, moreover, is done more to meet a low rather than a high standard (only the least attractive cocoas are delivered to the exchange).

Lastly, Jouve and Milly concluded as follows: "*In any event, the futures market remains a relatively neutral*

[347] Antony Ward, alias "Chocfinger", 42 years old, former director of Phibro, has run the Armajaro trading company (London) for the last four years with Richard Gower. He apparently took delivery of large quantities of cocoa beans over the last two years, at a time when prices doubled (from £stg600/t to around £stg1,300/t). After his purchase in the summer of 2002 of at least 150,000 tonnes of cocoa (over 5 per cent of world production and three-quarters of the quantities supplied in July 2002 to the London futures market), he seemingly possessed 15 per cent of world stocks. Suspected of operating a "squeeze" (forcing prices to rise and selling at the high price to pocket a gain estimated in this case at US$90 million), or even of funding the conflict that broke out in the Côte d'Ivoire on 19 September 2002 to multiply his stake, he is apparently backed by the American insurer AIG, or the Commodity Arbitrage Fund AIG DKR.

instrument, reproducing market facts much like a barometer. The ideal of price stability can always be dreamt of. As that ideal is very far off, theoretical and even utopian, price instability has to be lived with, given the continual instability between supply and demand. In this context of instability, the existence of a representative futures market is undeniably a positive factor. Though it can no doubt seem paradoxical that the world cocoa price is determined by speculators on markets in which only paper circulates. Nevertheless, let us not forget that old traders' saying "physical is always right!".

The "relatively neutral" nature of the futures market in terms of supply and demand would undoubtedly deserve greater discussion[348], as would its "undeniably positive" nature faced with price instability[349]. In the meantime, and in a context now free of public interventions, let us take a look at price formation and transmission within the commodity chain, and to which "market facts" they lead.

4. Price transmission and value sharing

Price and income structuring in the cocoa-chocolate commodity chain is difficult to assess, given the myriad types of end product (tablets, bars, sweets, creams, ice creams, drinking chocolate, etc.) and its variable combination of semi-finished cocoa-based products (liquor, butter, powder), and of other incorporated raw materials (sugar, milk, vanilla, fat, hazelnuts, raisins, etc.). There is also the problem of data: (1)

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[348] We have already begun them by noting that the development of futures markets is not neutral towards the production and delivery of quality products. We could continue in another register: a "squeeze", like the one by Antony Ward – be it real or the figment of a very extravagant imagination, shows that it cannot be ruled out that such an operation may – in its extreme limits – lead to the abrupt destructuring of the economy of a country such as the Côte d'Ivoire, which is definitely not neutral towards worldwide cocoa supply and demand, in the short and long terms.

[349] See Section 4.4.3 to carry on this discussion.

downstream companies – often multinationals (ADM, Barry-Callebault, Mars, Nestlé, etc.) – conceal rather than divulge their recipes, costs and marketing prices; (2) upstream producing countries – primarily developing countries – do not usually have any sophisticated economic observatories. All this is combined with the unfortunately well-known fluctuation in cocoa prices, hence the ambiguity of working on annual means. In short, the exercise we are attempting here is as daring as it is novel, and we hope it will provoke reactions and suggestions likely to come closer to reality than here.

4.1. Hypotheses and methodology

Ours is a rough analysis in more ways than one, even though certain biases were lessened by carrying it out over several years (1992–2001). First of all, it in fact stops at a relatively unsophisticated end product (the dark chocolate bar), which, it is worth remembering, is a rare chocolate product to which a VAT rate of 5.5 per cent is applied, whereas all the others are hit with 19.6 per cent tax in France[350]. Secondly, it is restricted to a transaction area (the Côte d'Ivoire => northern Europe => France), which correspondingly reduces the scope of the analysis, even though this area is in itself not insignificant in the world

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[350] Under current French legislation, where the normal VAT rate is 19.6 per cent (20.6 per cent from 1 August 1995 to 31 March 2000), products earmarked for human consumption are subject – as authorized by the sixth European Directive on VAT – to the reduced rate which stands in France at 5.5 per cent since 1982 (at least 5 per cent according to the European Directive). However, this principle includes exceptions, for 2 per cent of food products (Biron et Boucher, 2000) which, apart from alcoholic drinks, are chocolate, confectionery, margarines and caviar. However, for chocolate, there is an exception to the exception (i.e. the possibility of applying the reduced rate): (dark) chocolate and household (dark) chocolate, if in bar or stick form (e.g. the "Napolitain" dark chocolate square is taxed at 5.5 per cent, but if it is round it is taxed at 19.6 per cent), along with household milk chocolate, if presented in the same forms.

chocolate economy. Lastly, it is based on the following hypotheses.

(1) The data and calculations given in Table 4 lead to fair estimates of the prices of the different products, given that:

- the FOB price for exported Ivorian cocoa beans is not available after 1996 (IMF, 1998), leading this price series to be ruled out, which is a pity since it would have made it possible to evaluate the FOB-to-CIF cost which is not provided by BNETD (BNETD, 2000);
- ED&F Man (2002) supplies series of mean annual prices (£stg/t) for butter ("*Top 4 Dutch*") and powder (unspecified origin), but not for liquor or couverture chocolate, which led us to opt for estimating the unit price of all these goods using the same database, i.e. by dividing a sum of annual import values within Europe, supplied by Eurostat (EUROSTAT, 2002)[351] by the sum of the corresponding volumes. For butter and powder, the difference between these evaluations (Table 4) and the prices published by ED&F Man varies considerably from one year to the next (effect of arbitrage on the futures markets?), and is substantial on average for powder[352] (which by chance does not enter much into this study).

Table 4: Values used, their source and their estimation method

Variable	Source	Estimation method
Price paid to producer (the Côte d'Ivoire)	BNETD, 2000, 2001, 2002	Weighted average according to quantities collected by zones (5) and by operators (middlemen or cooperatives)
Price, factory entrance (the Côte d'Ivoire])	BNETD, 2000, 2001, 2002	Weighted average depending on quantities collected by department (44 dealers or cooperatives

[351] More detailed data than UNCTAD's TRAINS data: HS to 8 figures rather than 6.

[352] Between +25% (1992 and 1999) and –11% (1997) for butter (average of +5% from 1992 to 2001), between +44 per cent (1995) and –3 per cent (2001) for powder (average of +18 per cent over the period in question).

Variable	Source	Estimation method
		surveyed in all in 1999/00)
Processing and export (the Côte d'Ivoire)	Calculated	Difference between CIF price and factory entrance price incremented by compulsory levies
Compulsory levies (the Côte d'Ivoire)	BNETD, 2000, 2001, 2002	Levies for the State, but also professional (13% of total in 2000/01)
CIF price of imported bean (Netherlands, Germany)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 18010000[353]. Origin: the Côte d'Ivoire. Reporting countries: Netherlands + Germany (64% of volumes imported from the Côte d'Ivoire by the EU from 1992 to 2001). Ivorian beans entering the EU are not subject to customs duties.
Price of liquor (France, Belgium, Germany)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 18031000[354]. Origin: EU. Reporting countries: France + Belgium-Luxembourg + Germany (66% of within-EU import volumes from 1992 to 2001).
Price of butter (Germany, Belgium, France)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 18040000[355]. Origin: EU. Reporting countries: Germany + Belgium-Luxembourg + France (67% of within-EU import volumes from 1992 to 2001).
Price of powder (Germany, France, Belgium)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 18050000[356]. Origin: EU. Reporting countries: Germany + France + Belgium-Luxembourg (56% of within-EU import volumes from 1992 to 2001).

[353] HS 18010000: cocoa beans, whole or broken, raw or roasted.
[354] HS 18031000: cocoa paste (excl. defatted).
[355] HS 18040000: cocoa butter, fat and oil.
[356] HS 18050000: cocoa powder, not containing added sugar or other sweetening matter.

Variable	Source	Estimation method
Price of sugar (Belgium, Germany, France)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 17019910[357]. Origin: EU. Reporting countries: Belgium-Luxembourg + Germany + France (52% of within-EU import volumes from 1992 to 2001).
Price of couverture (France, Germany, Netherlands, Belgium)	Calculated with EUROSTAT, 2002	Annual imported Values over Quantities. Product code: HS 18062010[358]. Origin: EU. Reporting countries: France + Germany + Netherlands + Belgium-Luxembourg (77% of within-EU import volumes from 1992 to 2001).
Price of chocolate bars (France)	Calculated with INSEE, 2002	Price reconstituted from: (1) the INSEE annual index (100 = 1998) of the consumption price of "chocolate tablet" (product code 011821) for the whole of France (mainland + overseas departments), (2) the retail price, without tax, of a "standard" tablet of dark chocolate in 2001
VAT (France, Europe)	CAOBISCO, 2002	5.5% (in France only on dark chocolate in bar or stick form, all other chocolate products being taxed at 19.6%)

(2) Ivorian average prices and levies expressed by cocoa season (P_c: October to September) need to be converted into calendar years (P_n: January to December) in order to be properly compared with all the other average prices expressed per calendar year (from CIF bean to chocolate tablet); this conversion can be done considering that:

- 40 per cent of cocoa volumes produced are bought from producers and delivered to conditioning factories from October

[357] HS 17019910: white sugar, containing in dry state>= 99.5 per cent sucrose (excl. flavoured or coloured).
[358] HS 18062010: chocolate and other food preparations containing cocoa, in blocks, slabs or bars weighing > 2 kg or in liquid, paste, powder, granular or other bulk form, in containers or immediate packings of a content > 2 kg, containing >= 31 per cent, by weight.

to December, hence the average price paid by each of these two operators over the calendar year can be estimated by $P_n = (0.40*P_c) + (0.60*P_{c-1})$;

- levies (taxes) are mostly deducted at the export stage, for which payments are better distributed throughout the year: $P_n = (0.30*P_c) + (0.70*P_{c-1})$.

It should be noted that this operation backs up another hypothesis we put forward, and which is fairly conventional in economics, namely virtually instantaneous price transmission, which with a time period of one year, and futures and options markets that are also well developed, is far from being totally aberrant (thus, it is considered here, for example, that an increase in bean price in 1999 can lead to an increase in the price of a tablet of chocolate the same year).

(3) The Côte d'Ivoire does not gain value through local processing of beans into liquor, butter and powder, which is not true in reality, since it now processes a quarter of its beans locally, though primarily via multinationals (see Sections 2.3.3, 2.3.4).

(4) A study of chocolate value formation/distribution[359] requires that the various prices or taxes be expressed in the same unit[360], and the ECU (now the euro) proves to be a good compromise when compared to practices[361], as well as for

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[359] The term "value" used here should be understood to mean "commercial value", along with values that are incorporated or not in that commercial value: an old and vast economic debate, for which J. Généreux provides a few elements in his bestseller (Généreux, 2001).

[360] Unfortunately, the lack of data prevents us from applying the surplus accounts method here (see in particular Dorin et al., 2001: Formation and distribution of productivity gains in Indian agriculture, Economie Rurale, 263, May–June), though it would have enabled a more complete and less limited analysis than what was actually carried out.

[361] Prior to 1999, according to the French trader Touton, French Ivorian bean purchases were mostly paid for in French francs, and probably in pounds sterling or US dollars for other European

limiting the effect of European currency exchange rates prior to 1999: when data are not expressed in this unit (particularly Ivorian data), the conversion rates provided by EUROSTAT (2002)[362] are used to convert them.

(5) Value formation/distribution can be understood in two main ways, by the commercial value of the products derived from one tonne of beans (Table 5), or by the value of the different commercial forms that make up – with taxes and other levies – the retail price of one tonne of dark chocolate bar (Table 6).

(6) One tonne of beans provides 800 kg of liquor, or 400 kg butter and 400 kg of powder (at 10–12 per cent fat content). Thereafter, bean processing results in a loss of matter throughout the process of (only) 20 per cent (hull and water), at the grinding stage (Table 5, Table 6).

(7) A dark chocolate tablet is made with couverture chocolate[363] containing 50 per cent liquor[364] and 11 per cent

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countries; since 1999, the euro has taken over for African cocoa purchases, except in cocoa-importing countries such as the UK (which have not been included in the scope of our study for that reason, among others), and exporting countries such as Ghana (which apparently receives payment increasingly in US dollars rather than in pounds sterling).

[362] For CFA franc conversion into euro, we used the ECU/French franc conversion rate, multiplied by 50 up to 1993, then by 100 from 1994 onwards (devaluation in January 1994).

[363] Which is not always the case (tablet manufactured directly with mass, without added cocoa butter, unless it is meant to be "fondant"), but this assumption makes it possible to enhance the analysis, by bringing out the value added through couverture manufacture, without affecting the final price of the chocolate in any way.

[364] Itself containing 50 per cent cocoa butter.

butter[365] (Table 6), themselves made from beans of exclusively Ivorian origin.

(8) The cocoa content of a dark chocolate tablet is 61 per cent (Table 5, Table 6), a percentage considered to most effectively represent a market where it varies, in France, from 50 to 99 per cent; the remainder (39 per cent) is solely composed of sugar (which is not always the case).

Table 5: Calculation of the value of products manufactured from one tonne of beans

Bean, farm gate (the Côte d'Ivoire):	$V'_{Farm} = P_{Farm\ gate}$
Bean, factory entrance (the Côte d'Ivoire):	$V'_{Factory} = P_{Factory\ entrance}$
Imported bean (Europe):	$V'_{Import} = P_{Import}$
Liquor (Europe):	$V'_{Liquor} = P_{Liquor} * 0.8$
Butter + Powder (Europe):	$V'_{Butter\&Powder} = (P_{Butter} * 0.4) + (P_{Powder} * 0.4)$
Couverture (Europe):	$V'_{Couverture} = (P_{Couverture} / 0.61) * 0.8$
Tablet (France):	$V'_{Tablet} = (P_{Tablet} / 0.61) * 0.8$

Table 6: Breakdown of the value of a tablet of dark chocolate

Bean production (the Côte d'Ivoire):	$V'_{Prod} = (P_{Farm\ gate} / 0.8) * 0.61$
Bean collection and export (to Europe):	$V'_{Import} = ((P_{Import} / 0.8) * 0.61) – V'_{Prod} – V'_{Collect} – V'_{FactExp} – V'T_{Levies}$
- of which coop. & middlemen (the Côte d'Ivoire):	$V'_{Collect} = ((P_{Factory} / 0.8) * 0.61) – ((P_{Farm\ gate} / 0.8) * 0.61)$
- of which factories & exporters (incl. transport):	$V'_{FactExp} = ((P_{Import} / 0.8) * 0.61) – V'_{Prod} – V'_{Collect} – V'_{Levies}$

[365] i.e. a total of 36 per cent cocoa butter, with the legislation allowing the name "couverture" for products whose cocoa dry matter content exceeds 35 per cent (ditto for dark chocolate) with more than 31 per cent butter (18 per cent for dark chocolate).

- of which levies (the Côte d'Ivoire):	$V'_{Levies} = (V_{Levies} / 0.8) * 0.61$
Liquor and butter production (Europe):	$V'_{Grinding} = ((0.11*P_{Butter}) + (0.50*P_{Liquor})) – ((P_{Import} / 0.8) * 0.61)$
Sugar (Europe)	$V'_{Sugar} = P_{Sugar} * 0.39$
Couverture production (Europe):	$V'_{Couverture} = P_{Couverture} – ((0.11*P_{Butter}) + (0.50*P_{Liquor}) – V'_{Sugar})$
Tablet manufacture and distribution (France):	$V'_{Tablet} = P_{Tablet} – P_{Couverture}$
VAT:	$V'_{VAT} = P_{Tablet} * 0.055$

(9) Cocoa percentage weight (61 per cent) corresponds to the monetary value of the cocoa in a tablet, which is ambiguous in several ways: the value of the chocolate is based more on the cocoa it contains than on the other main ingredient, namely sugar, and that value itself depends on other factors (bean selection, industrial know-how, reputation, etc.).

(10) This 61 per cent dark chocolate tablet was sold in France for €8/kg exclusive of tax in 2001 (i.e. 5 French francs per 100 g tablet)[366].

(11) The total VAT deducted throughout the commodity chain amounts to 5.5 per cent of the value exclusive of tax of the dark chocolate tablet sold in France; a hypothesis which is both low, since the VAT applied to cocoa-based products (liquor, butter, couverture) is 6 or 7 per cent in the other

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[366] Nielsen's data, for example, would probably make it possible to specify this value a little more precisely. In mid-December 2002, in a hypermarket in Montpellier, tablets at 51–52 per cent cocoa fluctuated between €6.65 (Meunier) and €8.60 (Lindt Noir) per kg inclusive of tax, and those at 72 per cent between €8.10 and €12.40, with Cemoi organic chocolate at 60 per cent cocoa costing €9.40.

countries considered (Germany, Belgium, the Netherlands) (CAOBISCO, 2002:21), and high, since no European tax is levied on imported beans.

(12) An analysis at constant prices can be carried out on Ivorian and French values, using as the deflator for the Côte d'Ivoire the harmonized consumer price index with 1996 as base year (BCEAO, 2003) and, for France, the household consumer price index with 1995 as base year (INSEE, 2003)[367]; prior to use, each of these indexes was adjusted to the 1992 base year to facilitate subsequent comparisons.

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[367] The INSEE general consumer price index (CPI) could also have been used, but on the organization's internet site at least, the CPI base 100 in 1998 was not calculated prior to that date, and the base 100 for 1990 was not calculated after December 1998.

4.2. Results and comments

4.2.1. Exported beans

BNETD reports (BNETD, 2000, 2001, 2002) and data from 1995/96 to 2001/02, expressed in current CFA francs per cocoa season (October to September) – hence effectively incorporating the price surge confirmed in June 2002 (Figure 12) – provide initial information on value formation/distribution for one kilogram of beans CIF (Figure 8), even though this CIF value was unfortunately[368] derived by BNEDT from the ICCO monthly index on the London and New York exchanges (BNETD, 2002:15).

1. In 1999/00, the year the commodity chain was liberalized, the current farm-gate bean price was virtually halved, then rose again, slightly exceeding in 2001/02 the level reached 3 years earlier (+3.5 per cent compared to 1998/99)[369] (Figure 8). After abolition of the "barème" and the indicative price paid to cocoa growers, producer income instability deteriorated by a much stronger variation in

[368] In fact, this CIF price is not specific to the Côte d'Ivoire, even less so for a delivery to Amsterdam as we subsequently considered (Section 4.2.2). This CIF value considerably affects the estimation of the share of conditioning factories and exporters, since that share is calculated by deducting from the value all the compulsory levies, along with the factory gate price. For the latter, it should also be noted that its value fluctuated in the pages of the last two BNEDT reports for the 2000/01 season: between 415 and 423 CFA francs/kg; we have opted here for 415.

[369] 504 CFA francs per kg in 1998/99, 275 in 1999/00, and 522 in 2001/02. A few days after the end of the 2001/02 season, a record (over the previous 17 years) of US$2,405/t was reached on the New York futures market on 11 October 2002. However, between 14 and 18 October 2002, the closing price for cocoa fell suddenly from US$2,338 to US$1,910/t, i.e. a drop of 18.3 per cent in 4 days.

price according to the collection circuit (middlemen or cooperatives), the harvesting zone and the month of the year. For instance, in 2000/01, the average farm-gate price for that season did not exceed 255 CFA francs/kg in the western zone (middleman price), whereas it rose to 395 in the south-western zone (cooperative price). Likewise the farm-gate price for beans was 550 CFA francs/kg in February for cooperatives (all zones combined), whereas middlemen were only offering 300 in June. According to BNETD, the coefficient of variation for prices (over 20 per cent) declined slightly during the 2001/02 season, which was marked by the introduction of a minimum price to producers per three-month period[370]. However, BNEDT concluded by highlighting the problem of price labelling and the problem of minimum price payment by buyers purchasing directly from farms.

2. Over the period in question, bean collection represented from 5 per cent (1995/96) to 11.5 per cent (1998/99 and 2000/01) of the ICCO CIF price (4 to 9 per cent of the CIF Amsterdam price – see Section 4.2.2). It is not possible to see any clear trend here as to the effects of liberalization. However, it has to be said that liberalization caused problems for cooperatives, whose collection share slumped, despite the better prices paid to producers (average differential with middlemen of +30 CFA francs/kg in 2000/01): in 1998/99, they handled 32 per cent of the volumes produced, as opposed to 24 per cent in 1999/00 and only 18 per cent in 2000/01 (though retaining 50 per cent in the eastern zone). In fact, the new law on cooperatives and payment outstanding divided their access to guaranteed bank credits by almost 25 (0.64 billion CFA francs allotted by Fonds de Garantie des Coopératives Café-Cacao (FGCCC) in 1999/00 as opposed to 15.46 the previous season). So, in the absence of bank credit, and faced with the unceasing drop

[370] 325 CFA francs per kg from October to December 2001, 475 from January to March 2002, and 600 from April to June.

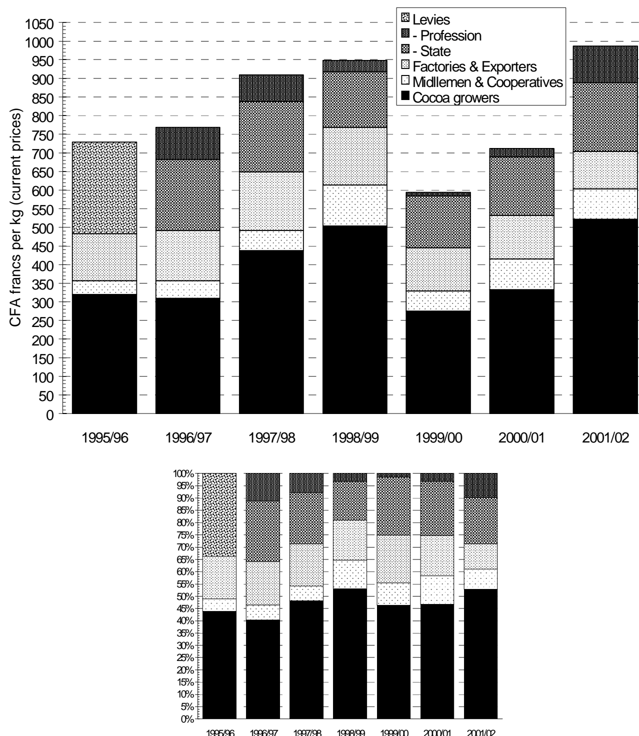
in prefunding by exporters who sought to limit their financial risks and costs, cooperatives tended only to pay producers once they themselves had been paid by the exporter (70 per cent of payments in 2000/01 as opposed to 34 per cent in 1999/00). This delay was all the more regrettable in that the operators who paid at the warehouse entrance now offered a premium (5 to 7 CFA francs in 2001) compared to the few dealers who still granted prefunding against the product (Jacquet, 2001). Fortunately, during the 2001/02 season, the gradual resumption of operations by FGCCC (0.95 billion in credits allotted), and above all the provision of revolving credits by exporters, enabled the cooperatives to increase their market share from 18 to 25 per cent, thereby returning to the 1999/00 level (BNETD, 2002:11-14).

3. Prior to liberalization, the share of compulsory levies was tending to decrease (36 per cent of the ICCO CIF price in 1996/97 as opposed to 19 per cent in 1998/99), while it has tended to increase since then (25 per cent in 1999/00 as opposed to 29 per cent in 2001/02). The main element of these levies is DUS, for which the percentage share has tended in reality to decrease since liberalization, even though it has increased in value: in August 2002, it even broke the record of 220 CFA francs/kg (Reuter), which was not really a record since, at constant prices, it remained around 20 per cent below the 200 CFA francs imposed in 1994 (IMF, 1998)[371]. On the other hand, professional levies have increased considerably (98 CFA francs/kg in 2001/02, i.e. 10 per cent of the CIF price). Most of these levies have in fact been multiplied since liberalization, to ensure services that used to come from the State. In view of their increases, we can wonder what the cheapest and most effective solution in the Ivorian context is.

[371] This export tax, levied on beans and on other types of exported cocoa-based products, was suspended from 1989 to 1993.

4. However, the share of conditioning factories ("traitants") and exporters – deduced by difference – has clearly shrunk over the last season: after fluctuating at around 17 per cent of the ICCO CIF price since 1995/96, it suddenly fell to 10 per cent in 2001/02. The same trend can be seen using the CIF Amsterdam value adjusted to calendar years (see Section 4.2.2), which confirms substantial cost savings at that level, with the major downstream operators (ADM, Cargill, Barry-Callebault, etc.) increasingly integrating the upstream operations of the commodity chain (buying out or sidelining local operators), thereby achieving major economies of scale (big-bag or bulk loading, access to international funding that is generally more advantageous than local credits, better knowledge of the international market, etc.).

Figure 8: Distribution of ICCO bean CIF value (1995/96–2001/02)



4.2.2. Couverture chocolate

Dark couverture chocolate, which is obtained by mixing conching liquor, butter and sugar, is the raw material of chocolate makers, if the latter do not make their own. It varies in composition depending on the desired end product (average adopted here: 50 per cent liquor and 11 per cent cocoa butter); for example, groups such as Cemoi-Cantalou have it manufactured in Germany and then sell it on or process it

(tempering, moulding, coating, etc.) in France[372]. With our price estimations and method (Section 4.1), the breakdown of the commercial value of one tonne of dark couverture chocolate (Figure 9) prompts the following comments.

1. Between 1992 and 2001, the prices of liquor, butter, powder and sugar varied as much as the farm-gate or CIF Amsterdam prices[373] (coefficient of variation between 12 and 14 per cent), which was not the case for couverture, for which the price was more stable (CV = 2.4 per cent): a possible benefit of the futures and options markets, at least at this stage of processing.

2. After Ivorian liberalization, the price of couverture, like that of its ingredients, fell (it fell below the level of 2,000 euro per ton), but unlike beans and liquor (and also sugar), this price did not recover in 2001; was that linked to the deferred repercussions of the price increases for the main ingredients (liquor and sugar), or to the upstream integration of grinders and to the economies of scale making it possible to offer ever cheaper cocoa butter (–32 per cent between 1998 and 2001)[374]? It is difficult to answer those questions here, particularly since the drop in butter price can also be linked to the larger profits now taken by grinders on powder. Indeed, the price of powder has clearly increased since 2000 (Figure 10): the countries of eastern Europe, where demand for chocolate-based

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[372] Such trade within Europe is therefore more of a matter of trade within firms, where the prices – which we are measuring here – are somewhat minimized in theory. However, the latter incorporate transport costs, since CIF values are involved. The same applies for our liquor, butter and powder prices, which may explain, for the last two products, why our estimations are greater on average than the ED&F Man price series (Section 4.1).

[373] More strictly, the Netherlands and Germany (see Table 4).

[374] The ED&F estimations, unlike our own, show a price rise for 2001 (
Figure 10).

products is growing, are apparently importing more and more to supply their chocolate factories.

3. In 2001, the producer's share in the value of couverture managed to rise to the record level of 25 per cent reached in 1998. However, that of dealers and exporters clearly decreased, in value and as a percentage. Indeed, many of these operators have been pushed out or taken over by grinders[375] since Ivorian liberalization (see Sections 2.3.3, 2.3.4). Such upstream integration enables grinders to strengthen their income by processing larger volumes of beans, as their gross margin per tonne of couverture fell below the level of 400 euro in 1997. In addition, if they make couverture for chocolate makers (which is the case for the largest grinders), it enables them to extract a greater unit margin upstream. In fact, prior to liberalization, the added value per tonne of couverture (price of the latter minus the cost of its ingredients: liquor, butter and sugar) steadily declined, from 36 per cent in 1992 (720 euro per ton) to 18 per cent in 1998 (381 euro per ton), whereas it has clearly been gaining ground since then (27 per cent in 2001, i.e. 532 euro per ton). It appears quite clearly in all cases that the economies of scale achieved in the Côte d'Ivoire since liberalization are not completely reflected in the price of a tonne of couverture, and that they are of greater benefit to downstream operators (grinders) than to upstream operators (Ivorian exporters).

[375] Grinders for whom the income derived from butter and powder sales has been barely estimated in this study, if at all.

Figure 9: Distribution of couverture value (1992–2001)

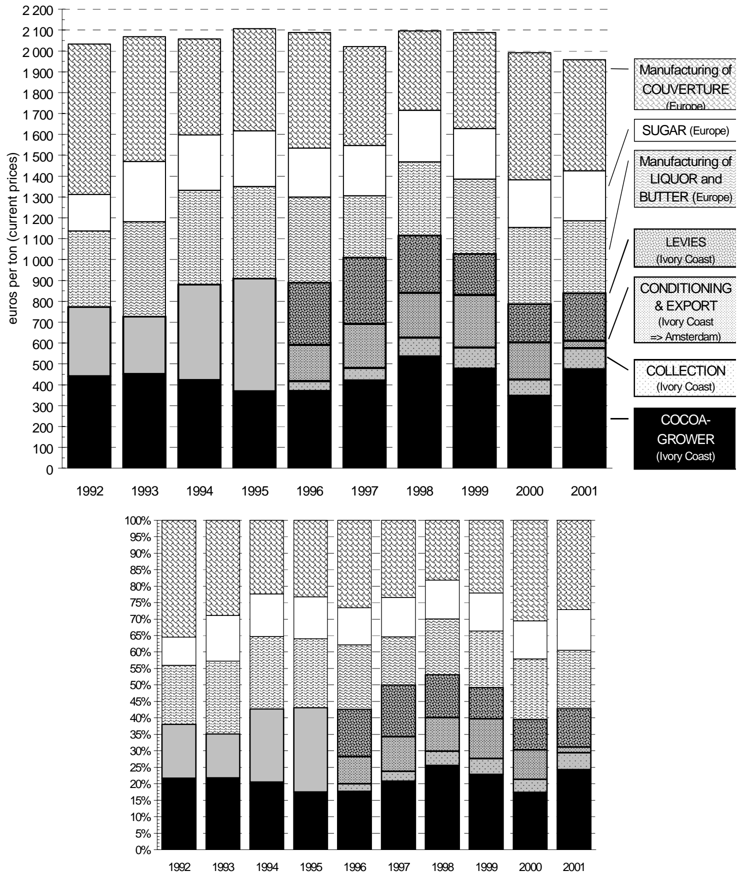
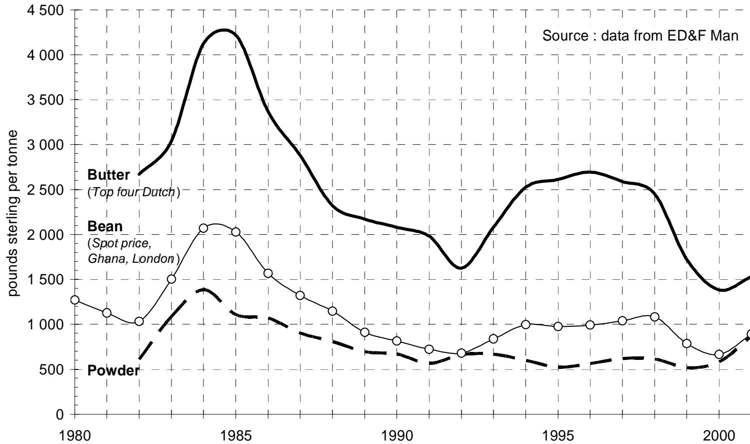


Figure 10: European current prices of beans, butter and powder (1980–2001)



4.2.3. Chocolate tablet

Integration of the previous gross margins in the value of a tablet of dark chocolate inclusive of tax (Figure 11 and Appendix 1), as approximate as the latter value might be (Section 4.1), shed fundamental light on price transmission and value sharing within the cocoa-chocolate commodity chain.

1. Whilst bean, liquor, butter and couverture prices fluctuate – often substantially – along a stationary or even depressive line, conversely, the retail price of a tablet has increased from year to year: +2.6 per cent per year on average from 1992 to 2001 in current euro, i.e. a gain of 1,550 euro per tonne in 10 years (+1 French franc per 100 g tablet). A similar trend can be seen for all French chocolate-based products. On the other side of the border,

in Germany where BDSI[376] publishes a retail price index for milk chocolate tablet, the upward trend is even greater, but only since May 1996 (Figure 12). Prior to that, the price of a German tablet of milk chocolate was tending to fall, probably due to the upheaval of restructuring in the country after reunification between West and East in 1990[377]. In terms of supply and demand, this upward consumer price trend is not surprising, at least in the most recent years. In fact, the intensification of cocoa production in the 1980s (notably in south-east Asia) had long left the commodity chain in a situation of surplus production, while that is no longer the case today: since 2000, there has been a production shortfall (tapping into stocks to meet demand) and, as that shortfall is somewhat set to increase in the coming years (cf. Section 2.2.1), prices are logically rising.

2. It can nonetheless be wondered why such an upward trend barely benefits the operators bearing most of the costs of chocolate making, from the cocoa producer to the couverture manufacturer. Since 1999 in particular, when the Ivorian cocoa sector was liberalized, European consumers have continued to pay more for their chocolate products (in France and even more in Germany, even if chocolate seems to be cheaper there[378]) while the price of

[376] Bundesverband der Deutschen Sübwarebindustrie (Bonn), association of the German confectionery industry.

[377] Adaptation of West Germany to a lower buying power in East Germany, but possibly also supplies of cheaper milk in the East. In any event, German milk imports from the rest of the European Union (EUROSTAT) occurred at virtually stable prices from 1992 to 2000: between 0.32 and 0.34 ECU/kg for code HS 040120 (milk and cream of a fat content by weight of > 1 per cent but =< 6 per cent, not concentrated nor containing added sugar or other sweetening matter) which was the most frequently imported dairy product (614,150 t in 1990) (NB: there was a somewhat downward price trend for other imported types of milk).

[378] In December 2001, a (100 g) tablet of milk chocolate of the Milka brand only cost 0.6 euro (apparently exclusive of tax).

the raw material is clearly falling (couverture and even more so imported cocoa beans) (Figure 9). Must this be blamed on the increasing costs of advertising and of product differentiation that incites the consumer society, or on the increasing profits of distributors, which we are unable to measure here[379]? On this last point, it should be noted that distributor profits are not apparently dropping, and even seem to be rising since, according to BDSI, German industrial prices (wholesale prices) for some chocolate-based products rarely exceeded in 2001 the record levels reached in 1998 or 1999, while retail price inflation continues (Figure 13).

[379] This distributor profit would currently seem to be fluctuating between 19 and 33 per cent in France, but this remains to be confirmed.

Figure 11: Distribution of chocolate tablet value (1992–2001)

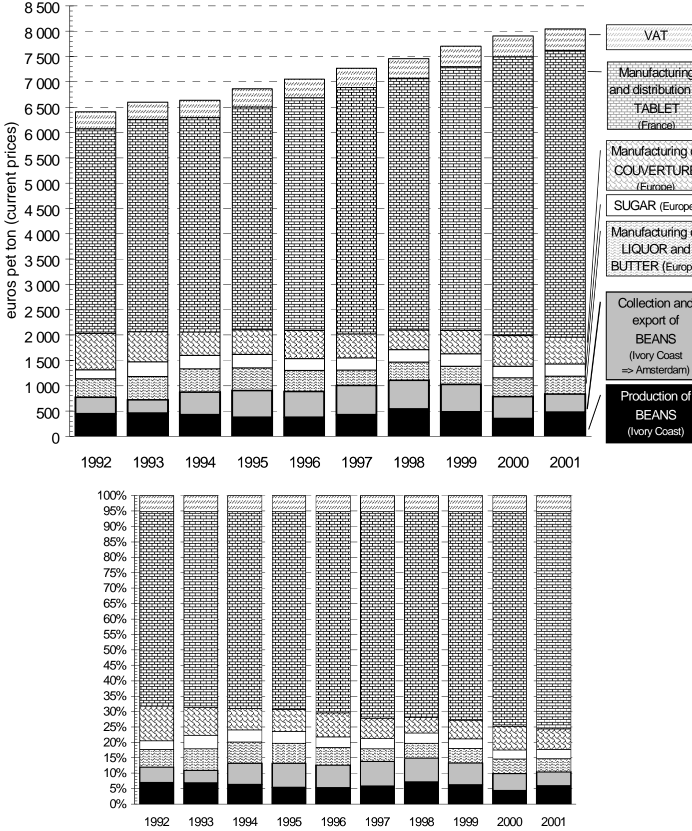


Figure 12: Current price indexes for beans and chocolate-based products (Jan. 1990–Oct. 2002)

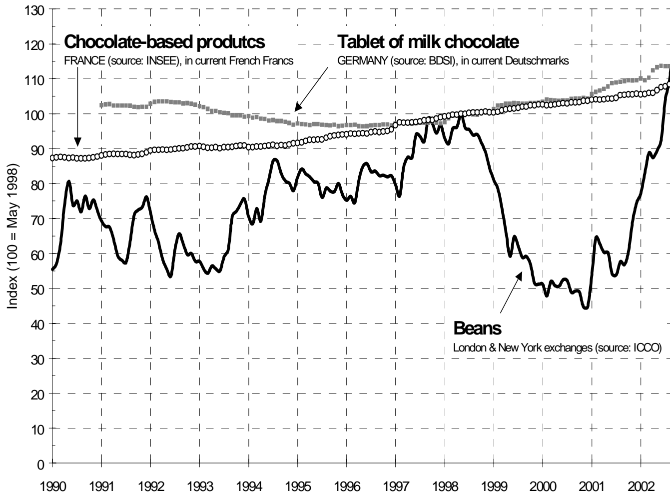
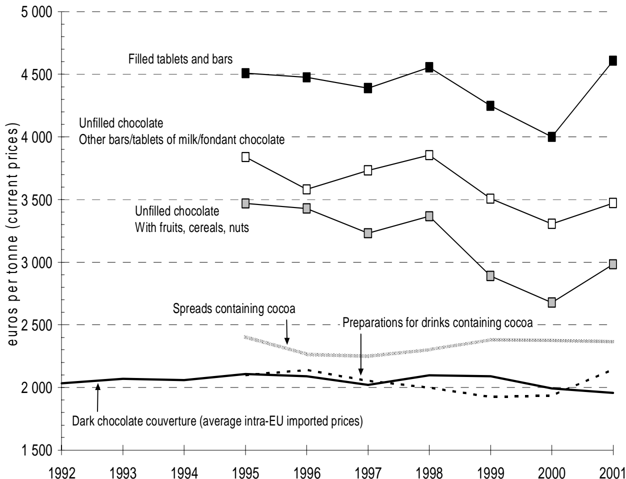


Figure 13: German industrial prices for some chocolate-based products (1995–2001)



3. The share of the tax-inclusive price of a tablet of dark chocolate going to Ivorian cocoa producers has, in any event, not increased: after descending below the 5 per cent limit in 2000 (the lowest level over the decade considered), it rose to almost 6 per cent in 2001, while it managed to drag itself up to 7 per cent just before liberalization (Figure 11). Which prompts further questions: why is cocoa cultivation, which employs and provides a livelihood for more people than in the rest of the commodity chain, unable to capture a greater share of the value of the end product, even after liberalization which was primarily supposed to be of benefit to it? Moreover, how is it possible to explain that research and public authorities still concentrate virtually all their resources on trying to improve the performance of cocoa cultivation, when the prospects for improving income in that activity (and thereby eventually its production techniques) lie more surely in downstream reforms, since it is there that virtually all the value is created and/or captured (more than 94 per cent in 2001 taking the example of a dark chocolate tablet)?

4. In 2001, the VAT levied by European countries throughout the dark chocolate tablet manufacturing chain was around 420 euro per tonne, i.e. virtually double the Ivorian levies on beans (228 euro per ton). Ivorian and European levies combined therefore amount to 647 euro per ton, i.e. 8 per cent of the price paid by consumers, and therefore more than that received by a cocoa producer (under 6 per cent, i.e. 475 euro per ton).

4.2.4. In other words

The above results can be backed up or, conversely, moderated by expressing them in other ways.

1. Might the decision to carry out the analysis in French francs, rather than euro have affected our conclusions? Apparently not, since in a comparison of value in euro (Figure 14) with that in French francs (Figure 15) for a given quantity of beans during various stages of its processing – another way of expressing the results (see Section 4.1 and Table 5) – there are very few perceptible differences, the most notable being for the tablet, right at the beginning of the period[380].

2. However, in 1992 French francs (see Section 4.1), one kilogram of chocolate tablet rose from 41.6 to 43.5 French francs exclusive of tax between 1992 and 2001, i.e. an increase of "only" 4.5 per cent in ten years (over 20 per cent in current francs or euro), whereas in 1992 CFA francs, the farm-gate price for a kilogram of beans increased by 14.3 per cent, from 200 to almost 229 CFA francs (Figure 16). However, several points should be remembered: (1) this latter price remains lower than that prevailing in 1998, just before liberalization (280 in 1992 CFA francs) and in reality compensates for the record loss suffered in 2000 (174 in 1992 CFA francs), (2) although Ivorian cocoa producers gained slightly more purchasing power in their country in 2001 compared to 1992, they did not recover the loss after the "cocoa war" in 1989/90, when their income was halved (Figure 17), and (3) if the farm-gate price is deflated by the French consumer price index rather than the Ivorian index, which is a way of measuring the gains or losses in cocoa producer purchasing power on the international market (terms of trade), a drop of 10 per cent is unfortunately seen between 1992 and 2001.

[380] In US dollars, the trend of the curve is obviously very different, due to larger annual exchange variations with the ECU (and the French franc), and especially its virtually constant increase over the study period.

3. Another way of assessing operator losses or gains over the study period is to adjust the prices of all foodstuffs in 1992 to 100, and total up to 2001 the respective price decreases or increases compared to this base, after deducting for each iteration (year) the cost of cocoa-based ingredients used in the foodstuff in question[381]. It can then be seen that since 1992, when international bean prices were particularly depressed (Figure 10), farm-gate beans accumulated a price "disadvantage" of –22 up to 2001, entailing just as many "advantages" for imported beans which totalled a gain of +181. In the same way, this price advantage for imported beans becomes a disadvantage for products made with them. However, with the price rise seen for the latter, this disadvantage is more or less well absorbed: loss of –19 in 10 years for liquor, –88 for butter and powder (combined), and –71 for couverture. At the end of the chain, the chocolate tablet accumulates an advantage of +114. The main gains therefore appear between the farm-gate bean and the imported bean, precisely where grinders have concentrated their efforts over recent years. If grinders indeed prove to have benefited most from this advantage (the strategy of capturing it for oneself is logical in any case), their downstream disadvantages (liquor, butter, powder, or even couverture manufacture) would be considerably reduced, leaving cocoa producers with the

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[381] Calculation of a sort of "advantages", by referring to the surplus account method, with the following differences: (1) the values here are not deflated by a general price index, since it is ambiguous to choose one when working with products manufactured in different countries, (2) it is assumed here that each operator produces the same quantities each year, with the same quantities of inputs (no productivity gain), and (3) the inputs here are limited to cocoa-based products, though many others ought to be included (labour, etc.). This therefore amounts here, as in the example of couverture, in deducting from the price of the latter the prices for liquor and butter, multiplied respectively by the coefficients of composition adopted in this study (0.50 for liquor and 0.11 for butter, as couverture is assumed to contain 61 per cent cocoa).

weakest bill. The line-up in decreasing order of gains through simple price variations over the decade would then be as follows: distributors and chocolate makers, then grinders, and lastly, with losses, agricultural producers: a further illustration – if any were needed here – of the ability of some distributors and industrialists in the North to impose on the South what strongly resembles a market power, a power which liberalization – all in all – merely seems to have exacerbated.

Figure 14: Value derived from one tonne of beans in current euro (1992–2001)

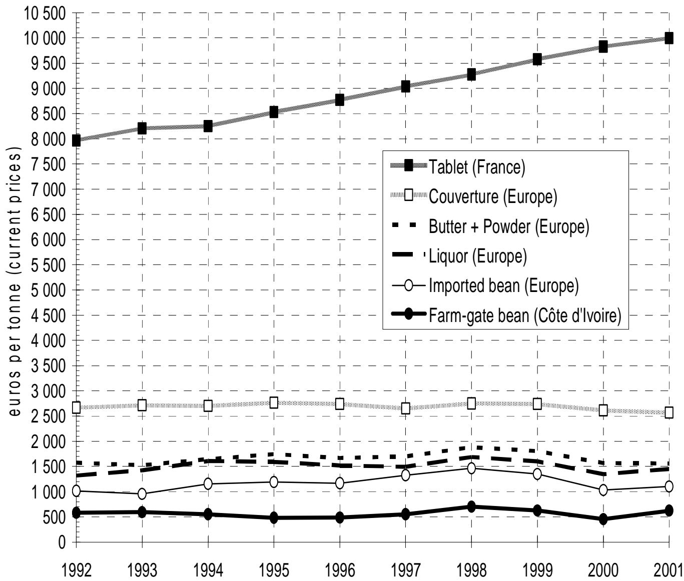


Figure 15: Value derived from one kilogram of beans in current French francs (1992–2001)

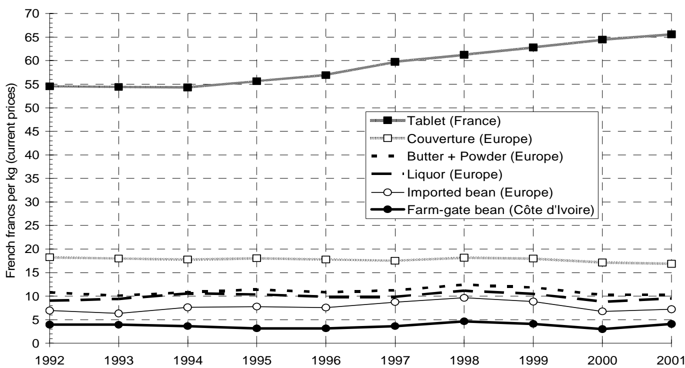


Figure 16: Kilogram of beans and chocolate at constant prices (1992–2001)

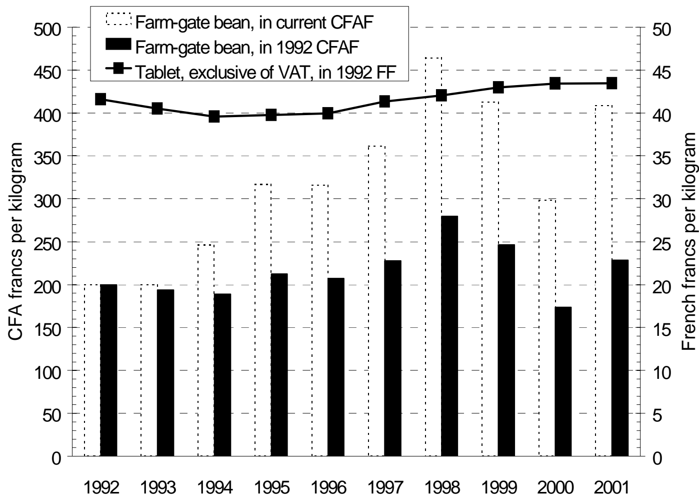
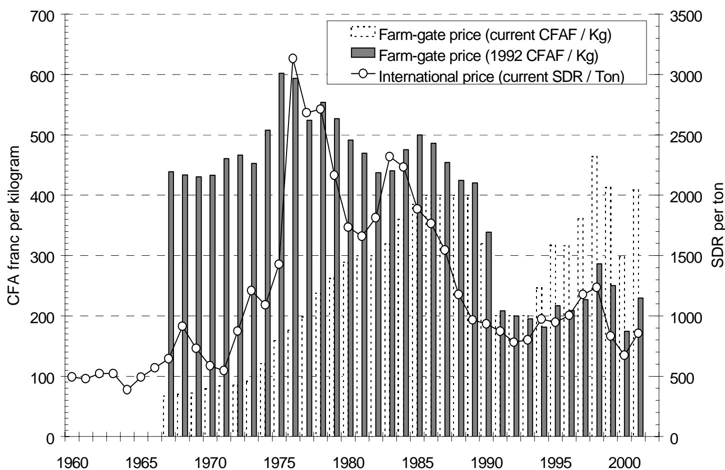


Figure 17: Kilogram of beans at current and constant prices (1967–2001)



5. Call for a less restrictive competition policy

5.1. Strengthened policies in the North

Since the mid-1990s, in both the USA and Europe (EU), the public authorities have seemed to be increasingly called upon, and themselves determined, to intervene in markets that have been marked since the 1980s by a vast liberalization movement, which has also benefited the dominance of certain firms beyond what is tolerable.

In this way, French competition policy has been subject to three new laws in five years (Galland and Raffarin in 1996, New Economic Regulations in 2001), laws followed or preceded by major reports, such as the one by the Conseil d'Analyse Economique (Rey et Tirole, 2000), and by more or less paralysing street demonstrations, such as that by fruit and vegetable producers (summer of 1999 and end of 2002) protesting against the "back margins" ("*marges arrières*" in French)[382] practised by major distributors. The Conseil de la Concurrence (1986) – an independent body of the Direction Générale de la Concurrence, de la Consommation et de la Répression des fraudes (DGCCRF) of the Ministry of Economics, Finance and Industry, a French specificity – is stepping up its investigations and sanctions (28 issued in 2000 amounting to a billion francs). The same applies for the EU Directorate General for Competition. For example, the latter imposed a record fine of 855.23 million euro on a cartel established at the end of the 1980s between 13 vitamin C

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[382] This practice consists in billing the supplier for the service that the major distributors consider they are providing by selling the product in question (and ensuring a more or less good position) on their shelves. Legally, the product is therefore not sold below its invoicing price (which would be a blatant case of dumping, which is strictly forbidden and severely punished), whereas in practice, it amounts to that, reducing the supplier's margin so much that he may finally not even cover his production costs.

producers: their European turnover fell at the time from 250 million euro in 1995 to 120 million in 1998 (Pénard, 2003), which provides an idea of the profits that can be derived today from dominating certain markets.

The Antitrust Division of the US Justice Department has also been stepping up its operations since the 1990s, apparently even more so than in Europe. Total fines are mounting up heavily (over US$2 billion between 1997 and 2001 as opposed to 27 million between 1986 and 1996), as are prison terms: up to a maximum of 36 months as opposed to 30 days previously, to which the Vice-President of ADM was effectively condemned for having supported a lysine cartel alongside Ajinomoto (Connor, 2003). The investigating powers of the FBI have also been extended (particularly to the homes of suspected managers), along with the clemency programmes which, as in Europe, allow for fine reductions – or even total exemption from punishment – for companies denouncing a cartel and providing evidence of practices that are now clearly defined as criminal[383].

This recent intensification of American and European competition policies share two other characteristics: they above all affect the agrifood sector (vitamins, lysine, citric acid, white sugar, etc.), and are primarily applied against foreign firms or managers. They also, and perhaps especially, share the same doubts about their abilities: (1) the probability of uncovering illicit collusion apparently still does not exceed 30 per cent today in the USA (10 per cent in Europe?); (2) the increase in penalties does not always prevent repeat offenders (e.g. ADM); (3) the procedures are still having great difficulty also ensuring compensation for victims (under 50 per cent are apparently compensated in the USA); (4) legal action is possible and may be won by the accused; (5) for lack of agreements or coordination, firms or managers cannot be tried

[383] It should be noted here that in the USA an individual can call in the competition authorities directly, whereas in France, this can only be done via a consumer association.

in several countries. In other words, illicit agreements or collusion between firms can still bring rich rewards, and therefore still be practised: for the lysine cartel that was dismantled, the total cost of its formation and management was estimated at under US$15.7 million , i.e. 4 to 8 per cent of its assumed profits (Connor, 2003).

5.2. A theory in practice

Both practice and theory show that a firm in a more or less established monopoly position will always tend to propose goods at a price above that of a competitive firm, the latter consequently appearing to be much better for the collective well-being (except for the so-called "natural" monopoly)[384]. This led to the voting of an antitrust law in the USA at the end of the 19th century (1890 *Sherman Act*) to denounce and fight monopolies or any agreement between firms on prices or quantities. This type of competition policy (opposition to certain mergers, dismantling of large companies, regulation in company organization, etc.) seems today to have at last taken precedence over those introduced with relative difficulty in the last century: (1) price administration by making the monopoly sell at the marginal cost (sale cost of a company in a theoretical situation of pure and perfect competition), with all the problems involved in assessing such a cost in the absence of any competition; (2) nationalization, i.e. conversion of a private monopoly into a State monopoly with civil servants less likely to incite a reduction in production costs than private shareholders; (3) total non-intervention, with the dubious argument that, all in all, market deficiencies are less serious than those introduced by State intervention.

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[384] In the case of a natural monopoly, production costs are such – continual economies of scale – that a single producer proves in the end to be more efficient than a multitude (example often quoted: rail transport).

The dismantling of cartels or other forms of collusion on prices and quantities therefore seems today to be the preferred approach taken by national authorities. The success of such an approach – in fact less contested than others – nonetheless remains restricted by some application difficulties, apart from that linked to the financial and human resources required for its effective implementation. The first of these difficulties is to delimit in advance the "relevant market" on which the behavioural analysis will be carried out, both geographically (regional, national, world scale, etc.), and in terms of products (Glais, 2003). For example, should butter and margarine be considered as two separate markets? Is it on the cola market or the vast drinks market that the case of Coca Cola should be studied? Dividing economic activity up into "industries" as proposed by Marshall (1920), and by reference to a product that is representative of a generic need, is unfortunately not particularly helpful, insofar as such "economic markets" (geographical zone and range of products within which prices are linked to each other by the arbitrage phenomenon) perfectly tolerate the exertion of a market power (with arbitrage enabling at most a reduction in that power). Yet it is precisely areas likely to be affected by a market power that competition policies do not tolerate. In order to identify these particular areas, new market concepts have developed on either side of the Atlantic.

In the USA, they have relied since 1982 (and even more so since 1992) on the hypothetical monopolist test: over a given geographical zone (a zone which should therefore be defined more or less arbitrarily), the market corresponds to the product(s) such that a (present or future) monopolist of the product(s) would probably proceed with a price increase, maybe slightly, but significantly (5 to 10 per cent) and not transitionally (at least 1 year). This econometric test clearly means possessing or gathering statistics to feed it, a major constraint aside from the fact that it can be carried out with data from a market already subjected to a power, which consequently reduces its relevance considerably. The drawbacks of this highly quantitative American method have

led the European authorities to prefer a more qualitative approach to delimit reference markets. This approach discards potential competition from the outset, since it attempts to evaluate at a given moment the possibilities (or not) of substituting a product or service, from the demand side, but sometimes also from the supply side (particularly where distribution is involved). In this framework, it delimits the relevant zone by combining various pieces of information, derived in this case from four analyses (alongside the conventional analysis of market shares) (Glais, 2003): (1) analysis of functional inter-exchangeability, by comparing the physical, technical or even taste characteristics of products; (2) analysis of reactive inter-exchangeability, to assess – after consumer surveys and/or econometric tests – to what extent variation in the price of one product might influence that of another; (3) analysis of "natural" barriers to substitution, in other words of very high investments and/or transaction costs that the activity could entail; (4) analysis of geographical delimitations, be it in terms of ingredient regulation, production quotas, public markets, the bulk-related or unstockable nature of the product, substantial price differences, special distribution methods, etc. In short, in the USA as in Europe, delimitation of the relevant markets is far from being a simple matter, and leads in all cases to stormy discussions despite the increasing sophistication of the methods intended to limit disagreements on this subject.

Moreover, the delimitation of relevant markets is only the first stage in a process intended to prevent and repress collusion between firms and/or domination abuse. Yet this objective, which is as simple as it is ambitious, is bound to raise other real difficulties. It first of all raises the question of at which stage collusion becomes reprehensible. Between the academic case of "pure tacit collusion" (acting in consort without any contact) and the severely punished "explicit collusion" (cartel), many types of behaviour can be condemned (at least suspected) up to the exchange of information, or price displaying! Although, on this last point, it has been shown that certain temporary price wars could be a

way of agreeing on a market share (as in American air transportation), competition policies do not extend to such cases. They settle for more formal, more "explicit" agreements, the problem then being to gather the evidence. But in fact that did not turn out to be difficult for the French Label Rouge (Red Label), an example that clearly illustrates what competition laws can condemn today. Despite its recognition by French and European decrees, this Label Rouge in the poultry sector was in fact challenged for the four following reasons (Raynaud et Valceschini, 2003): (1) quantity restrictions through entry regulations/barriers; (2) price agreement from abattoirs to distributors; (3) non-competition clause between abattoirs; (4) cumulative functions as far as certification is concerned. As these practices did not arise from the application of some legislation or regulation, an attempt was then made to show that they contributed to economic progress (production of better quality goods): the competition authorities conceded that, but were not convinced by the simulation intended to demonstrate at the same time that the free market could not lead to the same result. This example illustrates a given reasoning. It also strengthens a series of questions on current competition policies.

5.3. Pending questions for action

The previous sections primarily set out to show, first of all that the public authorities in Europe and the USA were concerned about the increasing power of certain firms on the markets, and secondly that they were mobilizing their competition policy to meet the problems raised by such situations, and lastly that those policies fell into a particular conceptual framework which, apart from a few application difficulties, also raised a few questions. This final section endeavours to elucidate some of those questions in order to outline the challenges of a true international competition policy.

5.3.1. What competition policy for developing countries?

The international organizations that already successfully pushed for market deregulation and liberalization 20 years ago (World Bank, IMF, OECD, etc.) clearly neglected to simultaneously promote and strengthen an international competition policy. At the turn of the twenty-first century, the fight against the abuse of economic dominance still, in fact, falls to States and their own resources, which gives rise to at least three more or less associated problems: (1) the risk of national policies turning a blind eye to their own firms: do not Americans or Europeans today condemn above all those firms or managers not of their own nationality (over 80 per cent of cases in the agrifood sector according to Connor (2003))? (2) the risk of only considering and dealing with complaints from residents: are not small farmer demonstrations against major French distributors more efficient when they take place in France rather than in some supplier country in West Africa? (3) the risk of restricting the competition policy to a few countries that possess not only the means to implement it (financial, human and statistical resources for investigating markets and groups of global dimensions), but also the power: what clout does the threat of being condemned, boycotted, or imprisoned by a small developing country hold when compared to Europe or the USA, major economic and political powers which themselves already have trouble being dissuasive enough in the matter?

This situation is corroborated by the lack of a true competition policy within the WTO (Boy, 2003): the WTO is in fact limited to promoting the free circulation of goods (the most summary way of promoting competition), and in no way to preventing and fighting abuses of position that the strengthening of free trade is very likely to amplify and encourage. Consequently, in the name of competition, it is perhaps towards the opposite that the WTO is working in the long term. Moreover, in 1994, with the signing of the

Marrakech agreements, this international governance was extended to agriculture, a sector that had until then been exempted from the General Agreement on Tariffs and Trade (GATT), due to specificities that we can appreciate today were not all assumed. Indeed, the expansion of GATT to agriculture meant, among other things: (1) resorting to scientific proof to justify the introduction of barriers or regulations in a market, which leads to major problems and disagreements when the scientific community is unable to demonstrate that certain substances such as animal growth hormones or MGOs are not harmful for human health or ecosystems; (2) taking an approach by product (and brands), and not by manufacturing process, whereas it is through the latter that "organic" or "fair-trade" products are differentiated and appreciated, as well as some other products that integrate certain qualities that are not restricted to those (phytosanitary) defined by the *Codex Alimentarius*.

The WTO does not therefore offer developing countries the means and the powers attached to the national competition policies of industrialized nations[385], whilst the Marrakech Agreements as well as structural adjustment plans require them to free the sector on which their economy still largely depends. This liberalization of the agricultural economies of the South is all the more questionable in that the commodities involved would precisely be exported to markets where collusion is structurally encouraged or facilitated. As explained by Connor (2003), and more so by Pénard (2003), certain structural factors and certain company practices are in fact propitious to collusion, either by facilitating a convergence of views, or by reducing incentives to diverge from an agreement. In both cases, there happens to be aspects

[385] To our knowledge, since the liberalization of the cocoa commodity chain in 1999 in the Côte d'Ivoire, only one measure has been taken to limit abuses of dominant position: for the 2001/02 season, ARCC fixed a tonnage ceiling for all cocoa exporters, a ceiling that was raised from 42,000 to 50,000 tonnes in mid-December 2002 (BNETD, 2002:7).

inherent to the Ivorian cocoa bean export market: (1) uniformity of goods (only one export quality), firm symmetry (an oligopsony of multinationals), concentration of supplies (three-quarters of cocoa supplies are provided by a few African countries), entry barriers (for bean grinding and especially the manufacture of highly diverse chocolate-based products), information exchanges (professions much better organized downstream than upstream); (2) regularity and transparency of transactions (via the London and New York futures markets), dispersion, regularity and growth of demand (current characteristics of the world market for chocolate-based products), multi-market contacts (multinationals trading in or manufacturing other products). The "collective dominant position" concept used by European competition authorities in the case of the Nestlé–Perrier merger shows that those authorities are well aware that certain market structures are apt to favour collusion (duopoly, dispersed demand, weak technical progress, high entry barriers). But it can be doubted that they will one day use the same concept to demonstrate that a similar market structure would affect Ivorian cocoa smallholders, firstly because the scope of application of Article 82[386] that inspires it (UE, 2002) is limited to the markets of EU Member States.

[386] Article 82: "Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in: a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; b) limiting production, markets, or technical development to the prejudice of consumers; c) applying dissimilar conditions to equivalent transactions with other trading partners, thereby placing them at a competitive disadvantage; d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts".

5.3.2. What policy against oligopsony powers?

More and more agricultural producers are currently being held by a few major firms in a pincer movement (Marette et Raynaud, 2003), with the major world seed and agrochemical suppliers upstream (AstraZeneca/Norvatis, Bayer-Aventis, Monsanto, etc.) and, downstream, the emergence of major distributors operating over vast consumer zones, such as the French Carrefour or American Wal-Mart (the world's leading company in terms of turnover for 2001 according to *Fortune* magazine). In both cases, competition policies – at least in Europe and the USA – are not failing to monitor the phenomenon, which is amplified in the distribution field by purchasing platforms set up by the major distributors to ensure collective supplies. However, this last point has not received all the attention it deserves, insofar as – more generally and in slightly overstating things – the aim of such checking of concentrations is to protect consumers from market powers, and not producers from purchasing powers. Yet, as already clearly pointed out in the report by the Conseil d'Analyse Economique (Rey et Tirole, 2000), producers also need to be protected, notably in cases where they are led to make specific investments[387] which they would ultimately be unable to amortize if distributors subsequently imposed inadequate prices on them[388] (not to mention other good reasons for specially protecting agricultural producers, notably

[387] Like setting up a cocoa plantation.

[388] To solve this problem, the solution would then consist, according to the authors, in rebalancing contracts, and stepping up sanctions in cases of violation of the commitments. This is perfectly realistic for the particular case of French fruit and vegetable producers, but barely so for the more universal case we are examining: agricultural producers far from major distributors, not only vertically (numerous processes and numerous middlemen before the end product) but also horizontally (production in developing countries of foodstuffs consumed in industrialized countries), i.e. a case in which the possibilities of contractualization, and applying sanctions are severely limited, or even ruled out.

those that are currently firing the lively debate on the multifunctionality of agriculture).

Why such pronounced concern for consumers? Probably because competition policies are based on an economic theory presenting the same bias. As indeed suggested by Alain and Chambolle (2003), traditional microeconomic analysis tends to neglect upstream oligopsony powers since it automatically models producer-distributor relations by a principal-agent relation in which the dominant role is assigned to the producer (i.e. power to impose his conditions on distributors). Likewise, since Spengler revealed the inefficiency of double marginalization in 1950, that same literature has focused on the effect of vertical contracts on efficiency and total profit of vertical structures, but virtually ignores its impact on profit sharing within those structures. Yet an imbalance in profit sharing can be harmful to long-term social well-being, by threatening the survival of certain producers and reducing the variety or quality of products available to consumers. However, as early as 1950, the negotiation model proposed by Nash (one of the fathers of the games theory after J. von Neumann and O. Morgenstern) was a first step towards endogenization in models of the balances of power, and of the negotiating powers, between firms. But it was not until 1991 that Shaffer, for example, showed – by reversing the conventional within-brand competition model – that when producers are in perfect competition with an oligopoly of distributors, profit sharing between firms favours upstream powers. Some other recent work seems to corroborate theoretically what we observe empirically in the cocoa-chocolate commodity chain. But as Allain and Chambolle (2003) concluded, whilst several questions omitted from the vertical analysis are at last starting to be explored today, the work still required remains considerable.

Once this work has made some headway, competition policies may then perhaps speak more of producers than consumers, of monopsonies and oligopsonies than monopolies and oligopolies, of a "hypothetical monopsonist

test" rather than a "hypothetical monopolist test". Like the standard economic theory (neo-classical), they may also thereby realize in future that productive efficiency does not necessarily rhyme with allocative efficiency and innovative efficiency, and that the latter two types of efficiency also have good reasons to be encouraged, in a mindset that does not, moreover, almost systematically condemn every form of agreement on prices or quantities.

5.3.3. What coordination policies?

The founding principle of European competition policy is set down in Article 81 of the Treaty establishing the Community (UE, 2002): "*The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make the conclusion of contracts subject to the acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts*". Paragraph 3 of the same article allows for exceptions from this general principle[389], but the example of

[389] "The provisions of paragraph 1 may, however, be declared inapplicable in the case of: any agreement or category of agreements between undertakings, any decision of category of decisions by associations of undertakings, and any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic

the Label Rouge shows how difficult it remains for agricultural producer organizations to benefit from mitigating circumstances, even when it involves improving the quality of a product, or highlighting and guaranteeing a collective know-how for consumers. In fact, the reinforced application of this principle has clearly led to a retreat in the French and European models of stakeholder coordination (cooperatives, protected designations of origin, labels, etc.) which, it is true, can also smack of neo-corporatism.

Yet the theoretical bases of this great principle are not as infallible as they might seem. In some clearly identified cases, it can firstly be shown, as did Gitaut-Hérault *et al.* (2003) who were particularly interested in judgments by the European Court of Justice against inter-professional committees in the wine-growing sector (cognac, natural sweet wines, etc.), that a group of producers or an inter-professional body can adopt a restrictive policy of supplies which is optimum for consumers, and which therefore does not systematically lead to a slowdown in productivity gains and innovation. In other words, such a restrictive policy can prove to be optimum from a collective viewpoint, not only in terms of quality as shown by Spence in 1975, but also in terms of quantity and market prices. This result, which is novel when compared to those of the standard monopoly theory, arises notably when there exists an inverse relation between quantity and quality, production hazards, and consumers expressing an explicit preference for quality. Lastly, according to the same authors, the more an increase in supplies leads to an objective deterioration in quality, the easier it is to justify a decentralized supply regulation policy. It would also be worth reflecting upon these points in the cocoa-chocolate commodity chain.

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progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

A second criticism of the principle, which is more fundamental but also less acceptable in the standard theory since it undermines its foundations, is based on the major question taken up today by so-called "neo-institutional" economics: are economic activities (and should they be) solely coordinated by the market or within integrated undertakings? Are there not, between these two modes of coordinating transactions (the company on one side, the market on the other), some "hybrid" forms (such as producer groups, etc.)[390] that may sometimes prove to be at least as efficient in minimizing costs (and, at the same time, countering oligopsony powers)? As Ménard (2003) points out, for the last 15 years or more (1985) there has existed a model for carrying out such an analysis, that proposed by Williamson, who attests to the existence of relatively high transaction costs (TC) (in any case not zero) depending on the uncertainty (U) surrounding a transaction, the frequency (F) of the latter, and the degree of specificity (S) of the investments (assets) it requires: TC = f(U,F,S). By only considering the last factor (specificity of assets) Ménard was led to explain that when competition authorities forbid a hybrid arrangement (

[390] There is a wide diversity of arrangements involving agreements between legally autonomous units which, on the one hand, develop transaction networks coordinated by mechanisms other than the price system and, on the other hand, pool a set of resources without automatically combining their ownership rights, notably networks of subcontractors/enterprises/franchises, collective brands, partnerships, as practised for example by major Anglo-Saxon chambers of lawyers. This diversity leads Ronald Coarse to say that the hybrid form is no doubt the dominant form of transaction organization in market economies (Ménard, 2003).

Figure 18), or impose restrictions on the parties to such an arrangement (Figure 19 – move from k_2 to k_2'), in both cases a zone is given up (between k_1 and k_2) where the hybrid form proved to be more effective than the firm or the market in reducing transaction costs. In other words, public intervention here leads to an increase in transaction costs, which, as a last resort, is passed on to consumers. It can therefore be wondered why competition policies distinguish so much[391] between all types of organization that cannot be assimilated into a single enterprise (such as producers or inter-professional groups) and those that can be (such as multinationals), particularly as they do it whilst denouncing the coordination methods actually used by both. Entry selection, internal disciplinary rules, quantitative restrictions and internal resale price controls effectively structure the organization of production just as much within multinationals. That does not mean that they and their subsidiaries are accused of "collusion", or of "*concerted practices in contradiction of Article 85 of the Treaty of Rome*". Lastly, on the pretext of encouraging competition, are not current policies under that name doing the opposite by discouraging any organizational form likely to compete with integrated enterprises? In any event, as can be seen, the boundaries between monopoly and the exploitation of synergy to reduce costs – an old economic science issue – are far from being clarified, which is not without its consequences for small agricultural enterprises, and for competition policies which are now required much more than in the past to structure their environment.

[391] In reality, competition policies are implemented with greater flexibility than transpired here. Notably, they remain subjected to the major European economic development policies (like Common Market Organizations), or to the modulations suggested relatively firmly by governments (case of the Red Label).

Figure 18: Case where the hybrid organizational form is not allowed

Source: Ménard, 2003.

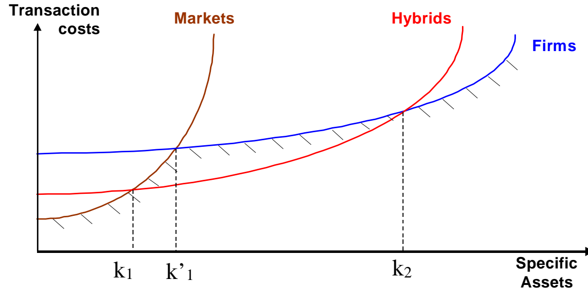
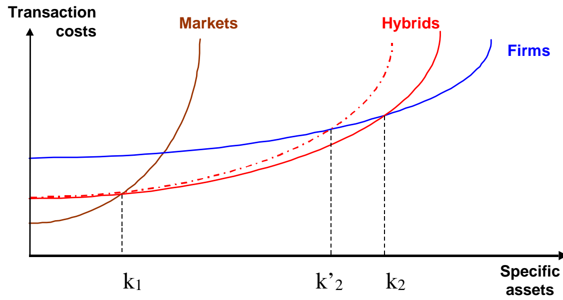


Figure 19: Case where the hybrid organizational form is rendered more expensive

Source: Ménard, 2003.



5.3.4. What price stabilization policy?

Lastly, it is not possible to speak of competition policies without touching upon the important question of agricultural price stabilization. Moreover, the report by the Conseil d'Analyse Economique (Rey et Tirole, 2000) refers to it from the first page of its introduction, since it often turns up in discussions, notably on fruits and vegetables. In the answer provided, the authors first of all emphasize that the price slump in a period of high production is inherent in the very weak price elasticity of supplies of these products; they then feel that the most appropriate solution is to develop futures markets or income-insurance, at least for products with a sufficiently liquid and established market. This proposal is disappointing in more than one way. Firstly, it hardly bursts with originality, since the World Bank, in line with lessons from welfare economics, has been promoting for some time the provision and use of such instruments in developing countries, to replace the stabilization funds, boards and other agreements often dismantled under its authority in the 1980s and 1990s (Section 3). It then turns out, as we have shown, that a commodity such as cocoa is as much marked by the existence of futures and options markets for several decades, as by the great insecurity of its producers' incomes. Of course, the champions of such tools can retort that cocoa producers do not really have direct access to those markets, and that they cannot therefore benefit from them. Agricultural producers should therefore be trained and helped to use these risk management tools. But is that truly realistic, particularly for developing countries? Or else, at what cost collectively and for each farmer? Lastly, and above all, how effective are such tools? As Daviron and Voituriez (2003) argue, their efficiency is, in reality, far from having been demonstrated by the economists, thereby placing an even greater burden of reflection and intervention on the shoulders of policies – particularly competition policies.

Daviron and Voituriez start their demonstration with several observations: (1) the post-war Keynesian or "self-centred" development model, which subjugated foreign trade to domestic stability objectives, has been succeeded by an export-driven growth model; (2) in this move towards trade liberalization, collective risk management through stabilization has given way to individual and private management through financial instruments such as futures or options contracts; (3) the crisis seen since 1998 on the cocoa, coffee, rubber, wheat, and soybean markets – which are theoretically complete since they have acquired insurance institutions and risk transfer financial markets – shows, however, that the efficiency of such instruments is arguable in the case of an extended price depression: the market price may drop below the marginal cost of the most efficient producer, whilst no private mechanism guarantees remuneration equivalent to the cost of production, unless in return for payment of a premium at too prohibitive a cost; (4) the allocation problem arising from persistent instability on the markets is combined with that of an unequal distribution of its costs, which are primarily borne by developing countries.

This leads the authors to present a typology revealing how economic science has evolved in the possible representations of instability, and to what difference in price-risk management instruments each representation leads: (1) cyclical instability around a deterministic trend (upward or downward linear trend) calls for public stabilization measures; (2) stochastic instability (of the "random walk" type), on the other hand, calls for private use of financial tools and opening up of the markets; (3) chaotic instability (non-Gaussian randomness generated by the market itself and its imperfections), however, eludes the latter measures, since they are likely to generate more instability than they resolve. Thus, depending on the type of instability, economic science can demonstrate that a risk management instrument is required or should be ruled out. This is an undeniable contribution, but which is unfortunately tainted by a major limitation, which no one has seemed to care about over recent

decades: between deterministic and stochastic trends, between randomness and chaos, agricultural price series do not reveal any marked particularities. Uncertainty and controversy remain, at least between economists since, as quite rightly emphasized by Daviron and Voituriez, political debates on the subject are prominent through their absence, whilst technically they are required and demanded.

One explanation for this paradox probably lies in the almost unanimous denunciation today of the cost of public intervention on agricultural markets over the last 30 years, which is all the more unanimous in that public stabilization favoured assurance over incentive (competition), whilst since then incentive (competition) has become the cooperation yardstick. This said, alternative risk management systems suffer from a symmetrical defect: they favour incentive over assurance. Yet, as Daviron and Voituriez concluded, since incentive is ineffective in the absence of assurance, and assurance is not cooperative in the absence of incentive, the major two types of instruments, public and financial, rather than being opposed and considered as substitutable, seem in reality to be complementary. Which, for our part, enables us to conclude with a question: when will there be an international competition policy which, in order to preserve incentive, also takes assurance into consideration, particularly for smallholders in the South, since today they bear most of the costs of market instability?

6. Concluding summary

In an African country such as the Côte d'Ivoire, cocoa cultivation employs over 700,000 farmers, provides a livelihood for 6 million people (40 per cent of the population) and counts just as much in State earnings (40 per cent of budgetary income), the balance of payments (50 per cent of exports) and national wealth creation (15 per cent GDP). On the world market, it supplies over 40 per cent of world demand

for beans. But for how many years will that continue? Indeed for some time now, cocoa cultivation has been in crisis, whereas demand for chocolate has continued to grow worldwide. Chronic price instability is now combined with increasing competition from south-east Asia, the difficulty of ensuring continued production by farming on newly cleared forest, the growing threat of diseases and resistance to pesticides, quite rough liberalization of the commodity chain in 1999, a European directive authorizing the use of cheap substitutes for cocoa butter in chocolate, an American drive to certify cocoa and chocolate "free of child slavery", dubious events on the London and New York futures markets and, lastly, on 19 September 2002, the outbreak of a civil war dividing the country in two either side of what still remains the world's largest cocoa reserve.

This crisis in African cocoa cultivation led us to examine price formation and value sharing throughout the commodity chain, from Ivorian farm-gate bean to tablet of dark chocolate sold in a French supermarket. The main lessons we learned from this exercise are as follows:

(1) In 1989/90, the "cocoa war" halved the price of a kilogram of cocoa beans paid to Ivorian producers. Since then, up to 2001, that price barely improved in constant CFA francs; the 1999 liberalization, rather than helping smallholders to regain their purchasing power, seems more to have destabilized their working environment (price, credit, etc.).

(2) The liberalization of Ivorian cocoa seems to be more advantageous to middlemen who transport harvests to export factories, all the more so since their rivals, the cooperatives, now collect fewer beans as they are unable to pay producers for their crop immediately (their access to bank credit was divided by 25 at the time of liberalization).

(3) International grinders (ADM, Barry-Calbault, Cargill…), making semi-finished products (cocoa liquor, butter and powder, or even couverture), are, for their part, increasingly incorporating upstream activities (taking over or sidelining

Ivorian exporters, dealers and middlemen) to secure their supplies and counter the shrinkage of their unit margins.

(4) On the French market, chocolate makers (Mars, Nestlé…) and/or distributors (Carrefour and others) are, on the other hand, gaining increasingly more from a tablet of chocolate: between 1992 and 2001, unlike the ingredients (bean, liquor, butter, couverture, sugar, etc.) its price rose steadily in current euro (+2.6 per cent per year on average, i.e. +1,550 euro per tonne in 10 years).

(5) Finally, in 2001, over 70 per cent of the French tax-inclusive price for a tablet of dark chocolate with 61 per cent cocoa went to chocolate makers and distributors (63 per cent in 1992), as opposed to less than 6 per cent to Ivorian producers (7 per cent in 1992), a share which is not even equal to the taxes levied throughout the commodity chain (8 per cent in 2001), in the Côte d'Ivoire and, above all, in Europe (5.5 per cent VAT).

These results, which are pioneering but obtained from data and a method that call for reactions and suggestions for improvement, lead us to believe that the world liberalization process has not only strengthened the concentration of firms downstream (confirmation of an oligopsony of multinationals engaged in fierce competition), but has also led to the exertion of a buying power upstream, particularly over farmers, since their dispersal is now total (dismantling of State regulating bodies, which in the past somehow united them, at least on a national scale). This market power (ability to impose prices) should in theory attract the attention of competition policies, since the harm it entails for the collective well-being is denounced by economic theory and in competition law. In fact, such policies are being reinforced in the USA and the European Union since the strengthening of planetary markets and trusts, notably in the agrifood sector. But, curiously, there is still no international body capable of correcting this market failure affecting Ivorian cocoa farmers, and more generally developing countries that do not have the resources to set up

their own competition policy, and more essentially to ensure that it is respected. Indeed, the WTO is limited to promoting just one very rudimentary form of competition (free circulation of goods), yet it is towards competition that it is supposed to work fully, and it is on competition that all its legitimacy is founded.

From the decline in African cocoa cultivation, we have thus been led to promote the introduction of a true competition policy within the WTO: this is a vast undertaking, which is primarily political, and which will mean discussing and overcoming the substantial limitations of the arrangements currently in place in the USA and Europe, be it a matter of oligopsony powers, types of coordination, or the thorny question of agricultural price stabilization.

APPENDIX 1: DISTRIBUTION OF DARK CHOCOLATE TABLET VALUE (1992–2001)

Current euro per ton:

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Production of Beans (the Côte d'Ivoire)	441	451	422	369	370	420	536	477	347	475
Collection and Export of beans (to Amsterdam)	333	277	459	541	520	590	579	551	441	364
- of which Collection (the Côte d'Ivoire)					*48*	*60*	*91*	*101*	*80*	*100*
- of which Wholesalers & Exporters					*173*	*213*	*215*	*251*	*177*	*36*
- of which Levies (the Côte d'Ivoire)					*298*	*317*	*273*	*198*	*184*	*228*
Manufacturing of Liquor and Butter (Europe)	364	454	452	440	409	295	353	358	367	347
Addition of Sugar (Europe)	175	288	265	268	235	241	247	242	229	241
Manufacturing of Couverture (Europe)	721	598	460	489	554	474	381	461	609	532
Moulding & Distribution of tablet (France)	4041	4188	4232	4397	4599	4870	4976	5213	5502	5665
VAT (Europe)	334	344	346	358	368	379	389	402	412	419
Total (tablet price inclusive of tax):	6408	6601	6637	6861	7055	7270	7461	7704	7907	8042

Percentages:

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Production of Beans (the Côte d'Ivoire)	6.9%	6.8%	6.4%	5.4%	5.2%	5.8%	7.2%	6.2%	4.4%	5.9%
Collection and Export of beans (to Amsterdam)	5.2%	4.2%	6.9%	7.9%	7.4%	8.1%	7.8%	7.2%	5.6%	4.5%
- of which Collection (the Côte d'Ivoire)					*0.7%*	*0.8%*	*1.2%*	*1.3%*	*1.0%*	*1.2%*
- of which Wholesalers & Exporters					*2.5%*	*2.9%*	*2.9%*	*3.3%*	*2.2%*	*0.4%*
- of which Levies (the Côte d'Ivoire)					*4.2%*	*4.4%*	*3.7%*	*2.6%*	*2.3%*	*2.8%*
Manufacturing of Liquor and Butter (Europe)	5.7%	6.9%	6.8%	6.4%	5.8%	4.1%	4.7%	4.6%	4.6%	4.3%
Addition of Sugar (Europe)	2.7%	4.4%	4.0%	3.9%	3.3%	3.3%	3.3%	3.1%	2.9%	3.0%
Manufacturing of Couverture (Europe)	11.3%	9.1%	6.9%	7.1%	7.8%	6.5%	5.1%	6.0%	7.7%	6.6%
Moulding & Distribution of tablet (France)	63.1%	63.4%	63.8%	64.1%	65.2%	67.0%	66.7%	67.7%	69.6%	70.4%
VAT (Europe)	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%
Total:	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

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PRODUCT STANDARDS, COMPETITIVENESS AND DEVELOPMENT

Kamala Dawar[392]

1. Introduction

Some of the legal issues raised by international product standards on economic development are examined. The legal framework governing both mandatory and private standards is laid out, before focusing on the impact of private product standards on economic competitiveness and consumer welfare in developing countries. The developments within the context of the informal market are further analysed. It is concluded that there is a lack of coherent regulation for certain types of mandatory and voluntary standards at the international level. This legal vacuum may not be in the interests of either developing country's export competitiveness or pro-poor development. Finally, possible policy options available to developing countries are proposed.

2. Product standards, developing countries and competitiveness

In most developing economies, local consumer expectations for product quality tend to be lower than international norms. Consequently, domestic regulations and standards are generally 'softer' than international ones and local producers develop production systems to meet these lower standards. In addition to this, it has been estimated that up 30 per cent of gross domestic product (GDP) and 70 per cent of workers in the developing world are now informal[393]. In Sub-Saharan Africa, Latin America, Central Asia and Russia it is not unusual for informality to exceed 50 per cent of GDP. Within the informal sector

[392] University of Amsterdam Law School. February 2007.

[393] Defined here as non-reported economic activities.

there is no obligation to conform to either domestic or international regulations and standards, or offer consumer protection[394].

It has been argued that one of the root causes of this type of informality is ill-designed and overly stringent product standards, which result in more harm than good[395]. In the case of Egypt, for example, the ongoing imposition of obsolete quality standards on food products, rather than minimum health regulation has resulted in more than 80 per cent of the food being produced informally by low-productivity small-scale providers. Inappropriate and expensive business legislation discouraged small entrepreneurs from becoming formal, limiting the number of new entrants to the formal market particularly in high-productivity export sectors[396]. These barriers to entry can compromise the level of competition in these markets.

Where consumers are forced through lack of choice to use the informal market for basic goods, they are denied their rights to safety, information, redress and a healthy environment. Many consumer organizations urge people not to engage in practices that fuel the informal market as this will only expose them to further suffering. Furthermore, prices on the informal market have been at least 15 per cent more than the actual price on the formal market[397].

Clearly, a lack of capacity and resources will make it more difficult for small producers to upgrade their production processes to meet the stricter international standards. This situation can result in the bulk of the lucrative export market going to the few largest local firms and multinational companies who have the capacity to adjust their production systems to meet international requirements. The smaller and medium-sized firms (SMEs) and smallholdings can get caught in a cycle of underdevelopment, whereby the lack of valuable market access without conforming to international standards serves to prevent their future development. This may also exclude them from other pro-development initiatives such as the US's *African Growth and Opportunity Act* (AGOA) and the EU's *Everything But Arms* (EBA).

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[394] Palmade (2005).
[395] *Ibid.*
[396] *Ibid.*
[397] See for example, the Consumer Council of Zimbabwe: The Cost of Living Up Again. 6th February 2007. http://www.ccz.org.zw/news/details.php?news_id=10.

Despite these difficulties, it is clear that appropriately set standards can facilitate trade by reducing transaction costs and risks and generally improve intra-firm and industry linkages. Well-defined standards and regulations can also enhance social and consumer welfare. The difficulty is that while standards may be designed to promote trade and meet important social objectives that are not automatically addressed by the private sector, the motivations for using trade measures to regulate an imported product's process and production methods (PPMs) also include competitiveness. Certain PPM requirements mask comparative advantage and are imposed for protectionist gain. This can undermine the success of any pro-poor trade and development objectives. In the context of widespread poverty, serious policy issues emerge if these measures lock small producers out of the more dynamic export markets, leaving them to supply the less lucrative local and informal markets.

Alongside these government measures, private standards are now increasingly influencing the livelihoods of exporters and small and medium-sized firms and farmers[398]. The upsurge of private-sector standards and codes of practice being passed down the supply chain to suppliers in developing countries is generally promulgated by the major retailers in developed countries and not governments[399]. Although many private product standards are not protectionist in intent and may simply aim to respond to developed country consumer or producer concerns and preferences, they are not necessarily in the interests of developing country consumers and small producers. However, these are the very sectors of the economy least able to make their interests known at the international level.

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[398] UNCTAD (2007).

[399] See for example: EUREPGAP: Harmonized standards and procedures for global certification of Good Agricultural Practices (GAP) (i) developed by a coalition of retailers; (ii) now 275 members from farm to fork; (iii) business-to-business (not communicated to consumers); (iv) independent audits and certification to measure compliance; (v) 35,000 producers certified in 62 countries; (vi) Protocol includes Integrated Crop Management (ICM), Integrated Pest Control (IPC), Quality Management System (QMS), Hazard Analysis and Critical Control Points (HACCP), worker health, safety, welfare and environmental pollution and conservation management; (vii) Horticulture: 210 Control Points (Food Safety, Environmental, Social).

World Bank research[400] indicates increased difficulties for horticultural exporters and associated smallholder outgrowers in East Africa to comply with EU regulations and private standards. For example, horticultural exports in East Africa grew at an average of 33 per cent per annum, with over 99 per cent of horticultural export products in Uganda and over 70 per cent in Kenya coming from smallholder producers. This sector represents a major source of income and livelihood to smallholder farmers. Yet the poor infrastructure and services available to smallholder farmers reduces their ability to meet the private standards especially as regards traceability, and social and environmental requirements, which is compounded by lack of effective organization and coordination among the various stakeholders.

Auditing systems also present challenges when different auditors have varied interpretations of the application of procedures. The St. Vincent submission to the World Trade Organization (WTO), for example, noted that in the Windward Islands the external auditors consider treated sleeves used in the banana industry as a pesticide and therefore require that these be stored under specific conditions. However, in the Dominican Republic sleeves are not considered to be pesticides and therefore there are no specific requirements for storage[401].

Another commonly cited example[402] of the impacts on market access due to the rise in private standards is the Kenyan green bean sector. Here production for UK markets in the 1970s–80s was dominated by small-scale farmers delivering their goods to local markets to be purchased by exporters. However, as standards rose and supermarkets dominated the market for fresh produce, these big players demanded more reliable sources than the wholesale markets were able to offer. Consequently, there was an increase in direct purchases through integrators/exporters throughout the 1990s. On the regulatory side, the 1990 UK *Foods Safety Act* developed written procedures for large retailers to follow when making their specifications, along with on-site audits. This led to new contractual standards and stability for suppliers, which in turn allowed them to make more long-term investments in production. However, those suppliers now unable to

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[400] See Wilson and Abiola (2003), Czubala et al. (2007).
[401] World Trade Organization (2007).
[402] Fulponi (2007).

meet new retailer standards could no longer supply the market and were marginalized because only those that could remain tightly integrated with large exporters through contracts remain linked to the lead retailer trade[403].

Colombian exporters of cut flowers were also adversely affected by the introduction of the Flower Label Program (FLP) which is a private, voluntary eco-labelling programme led by German industry aimed at restricting the use of toxic chemicals and pesticides for the cultivation of such flowers. Between 1992 and 1996 Colombia's flower exports increased and became Columbia's third most important agricultural export, accounting for 10 per cent of the world market. Exports to Germany declined significantly after 1996, which was widely attributed to the increase in private standards within German markets. The Colombian government's submission to the WTO contended that the FLP is based on arbitrary criteria, which are also applied in a discriminatory manner. Further, not only does the scheme impose significant compliance costs but it is *de facto* a mandatory measure since non-compliance results in 'negative pressure'.

India has also noted that compliance with the footwear industry's voluntary labelling schemes has raised the costs of compliance for Indian footwear exporters by approximately 33 per cent of the export price. These costs are not confined to the developing world, According to an Organisation for Economic Co-operation and Development (OECD) study[404], based on 55 firms in three sectors in the United States, Japan and the United Kingdom, the additional costs of complying with foreign standards can be as high as 10 per cent. The problem is that these private standards are becoming unavoidable for SMEs and smallholders, to the extent that some analysts argue that they are *de facto* mandatory for those producers who cannot afford to be locked out of these markets. For example, by participating in international standards and implementing acceptable international rules, Africa has been estimated to gain up to US$1 billion a year from higher exports of nuts, dried fruits, and other agricultural commodities. Although other studies suggest that the price premiums for goods complying with voluntary environmental requirements are not as

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[403] *Ibid.*
[404] See Andrew et al. (2003).

significant as previously thought[405]. While these may be voluntary standards set by retailers in response to developed country consumer preferences for particular conditions to be met along the production chain, the primary producer has little choice but to meet them.

In the US, private, voluntary standard-setting and product-certification activities are scrutinized under US antitrust law because it is acknowledged that when voluntary standards are set by groups of dominant firms, they may easily become industry standards that are misused against competing firms for whom such standards become a market requirement[406]. Because standard-setting and certification activities by private trade associations may also benefit competitive conditions in a marketplace, US courts have typically evaluated the pro-competitive benefits of a product standard against any anti-competitive implications under what is termed the 'rule of reason' analysis[407]. However, such a mechanism is absent at the international level despite the evidence to suggest that these standards do affect the competitiveness and ultimately the growth of developing country markets.

This study examines some of the legal issues raised by these developments. After setting out the legal framework governing mandatory standards, it focuses on the regulation of private product standards and their impact on the economic competitiveness and consumer welfare in a developing country context. It identifies how private standards are created and complied with, along with their impact on economic competitiveness and consumer welfare, in the context of the burgeoning informal market. It argues that the lack of coherent recognition of non-product-related (nPR)-PPMs at the international level applies to both mandatory and voluntary standards. This legal vacuum may not be in the interests of developing countries.

While some of the challenges involved in setting and monitoring private standards can be avoided through transparency alongside widespread stakeholder consultation and cooperation from those most

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[405] *Ibid.*

[406] Gandhi (2006).

[407] *Ibid*. See *Consolidated Metal Products, Inc. v American Petroleum Institute*, 846 F2d 284 (5th Cir. 1988) and *Allied Tube and Conduit Corp. v Indian Head, Inc.*, 484 US 814.

affected, there are other policy responses to maintain competitive environments. Finally, identified are appropriate policies for governments to respond effectively to the challenges that private standards pose at the international level, including the need to advocate the formal and transparent regulation of nPR-PPMs.

3. The GATT/WTO legal framework governing product standards

As noted above, product standards can be both mandatory (government driven) and voluntary (market driven). These standards can also be either 'product related' or 'non-product related' which refers to the PPMs used to manufacture or grow the good, that either affect (product related), or do not affect (non-product related) the nature, properties or qualities of the final product itself.

A 'product-related' PPM (PR-PPM) typically describes a process or production method that changes the characteristics and quality of the final product and that PPM is discernible in the change. These PR-PPMs are generally dealt with through product specifications and are found in industrial process requirements to ensure the quality of a product, its safety and its fitness for use. PR-PPMs typically aim to protect the end-user or the environment from either harm from the product or a substance incorporated into the product. For instance, the use of certain pesticides in cultivating a product can be traced in the final product.

Non-product-related PPMs (nPR-PPMs) describe a method of processing or production that does not affect or change the nature, properties or qualities of a product. How a product is created or harvested will not affect that final product, although it may affect the environment or society by its methods. For example, slave labour will not affect the look of an object, but it violates multiple internationally recognized and customary human and labour rights. Other examples of nPR-PPMs are related to the environment or the welfare of animals.

Mandatory product standards set by government are regulated by the following GATT (General Agreement of Tariffs and Trade)/WTO agreements.

3.1. Annex 1 and Article 2 of the TBT Agreement

In the past, the PPM debate has focused largely on the interpretation of the GATT, although both the Sanitary and Phytosanitary (SPS) Agreement and the Technical Barriers to Trade (TBT) Agreement are relevant to the PPM debate. For reasons of space, only the TBT Agreement is examined where, to date, neither PR-PPM nor nPR-PPM disputes have been handled within the WTO's Dispute Settlement Mechanism (DSM).

The principle of the TBT Agreement is to ensure that Members can apply product regulations to fulfil legitimate policy objectives – provided that these regulations are not "*more trade restrictive than is necessary*" and do not create "*unnecessary obstacles to international trade*". Thus, the overall objective is to effectively prevent product regulations being implemented for protectionist purposes. Therefore, the WTO promotes existing 'international standards' for Members to use as a safe haven while formulating their own domestic legislation. That is, any legislation made in accordance with recognized international standards is automatically presumed not to constitute an unnecessary obstacle to trade.

The TBT Agreement provides specific disciplines for two categories of domestic regulatory measures: technical regulations and standards. Annex 1 states that technical regulations are mandatory rules that regulate "*product characteristics or their related processes and production methods*". Standards are non-mandatory rules, guidelines or characteristics "*for products or related processes and production methods*". Both definitions seem to imply that only PR-PPM-based measures are covered; however, due to a lack of WTO jurisprudence, these issues have not yet been clarified.

The last sentence of both definitions states that the technical regulation or the standard "*may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method*". The first sentence in the relevant definition refers to "*related processes and production methods*", suggesting that it is to cover only PR-PPMs, the last sentence lacks such a reference and could therefore be seen to include nPR-PPMs as well. However, if the last sentence is implicitly informed by the context of the first sentence, the reverse is the case.

The non-discrimination provisions under the TBT Agreement are closer to the non-discrimination clauses of Articles I and III of the GATT and therefore an analysis of the consistency of a PPM-based measure with the TBT Agreement is likely to hinge upon a 'like product' test. However, the TBT Agreement offers no exceptions to these obligations akin to Article XX. These Article XX considerations are consumed in the balancing test provided by TBT Article 2.2.

The implications of this are that if nPR-PPM labelling is covered by the provisions of the TBT there would be an obligation under Article 2.4 to use an international standard if one exists, and, under Article 2.2, this label cannot create an unnecessary obstacle to trade. That is, developed countries would have to notify the labels to the WTO, especially in the case of non-conforming labels. From the position of developing countries, this move towards incorporating this type of private standard could overall be a positive step for developing countries.

The TBT Agreement's provisions only require Members to notify mandatory technical regulations, not product standards (Article 2.9). In cases where PPM-based measures are found to fall outside the scope of the TBT Agreement, the GATT's Article I, III or XI[408], as well as Article XX will likely apply.

3.2. Article I GATT: Most Favoured Nation (MFN) clause

Article I of the GATT provides that with respect to customs duties, taxes and internal regulations, any advantage, favour, privilege or immunity granted by a party to any product must be accorded immediately and unconditionally to the like products of all other parties. The only legally recognized exceptions to this fall under either Article XX (see below), Article XXIV provisions covering customs unions and free trade areas, and the Enabling Clause.

Products have to be 'like' for the MFN obligations to be applicable; WTO Member governments cannot apply different tariff rates on products that are found to be 'like'. The criteria used to determine

[408] This chapter does not include an analysis of GATT Article XI.

'like products' include: i) 'end use'; ii) product characteristics; iii) tariff classification; and, iv) consumer tastes and habits. If a government has implemented a standard in response to legitimate consumer preferences and has adjusted its tariff lines appropriately, a WTO panel would assess whether the criterion of consumer tastes and habits in the marketplace was a sufficient basis on which to differentiate the products according to the PPM. However, because there has not been a WTO dispute based on consumer tastes and habits in a like-product case, there is no ruling that consumer tastes is a factor that clearly applies in Article I cases or on the link between consumer tastes and PPM differentiation.

Where tariffs have been negotiated and then bound, exporting WTO Members also have some right to reasonable expectations that the tariff structures that have been the subject of previous negotiations should not be altered to undermine their market access by increasing import tariffs.

In GATT/WTO cases, importing countries maintaining a differentiated tariff scheme have owed the affected exporters compensation for their loss in trade. This applies even if a panel assessment determined that the products in the new scheme were 'not like', since the right to receive compensation by the exporting country turns upon its legitimate expectations that the negotiated scheme would not be later altered to the export Member's detriment.

3.3. Article III: National Treatment (NT) and 'like' products

Article III obligates WTO Members to grant foreign products treatment that is at least as favourable as the treatment granted to domestic 'like' products. These provisions apply to both taxation and other internal regulatory measures. This therefore potentially covers a wide variety of measures regulating nPR-PPMs.

The GATT/WTO obligations rule out domestic taxes or other regulatory measures that discriminate either between 'like products' from different WTO trading partners, or between foreign and domestic 'like products'. However, unlike the provisions governing Subsidies and Countervailing Measures (SCMs) for example, which assign 'likeness' a specific meaning, nowhere else in the GATT/WTO framework are there

specific provisions for distinguishing between traded products based on criteria that are not physically embodied in the products nPR-PPMs. This is with the exception of the use of prison labour, which is explicitly covered under the provision of Article XX(e).

If 'likeness' was interpreted so that nPR-PPMs such as environmentally or socially harmful products are seen as different from sustainable products, then the WTO's non-discrimination obligations offer considerably flexibility to Members wishing to implement measures to regulate nPR-PPMs. However, an examination of process methods does not play a role in determining the interpretation of whether or not two products or services are like, and hence the WTO's non-discrimination provisions constrain the domestic regulatory prerogative to enact environmental or social protection measures.

As noted, the exact boundaries of 'likeness' and the precise impact of the 'likeness' determination on domestic environmental and health policy making remain unclear. However, relevant GATT/WTO nPR-PPM jurisprudence to date includes the 1991 US – Tuna I (Mexico) GATT Panel report, which found that differences in nPR-PPMs are not relevant in determining 'likeness' and the 2001 EC – Asbestos case where the Appellate Body found that the determination of 'likeness' is fundamentally a determination about the "*nature and extent of a competitive relationship between and among products*".

Article III 'likeness' cases almost always reference the three Border Tax criteria for determining 'like products' from the 1970 pre-WTO report: Working Party on Border Tax Adjustments: i) the product's end uses in a given market; ii) consumers' tastes and habits, which change from country to country; and, iii) the product's properties, nature and quality. The EC – Asbestos Appellate Body clarified the proper application of the Border Tax criteria as follows. Firstly, panels must look at all evidence relevant to a 'likeness' determination, analysing each criterion separately, then weigh all relevant evidence in concluding whether products are 'like products'[409]. And secondly, even if evidence related to one of the Border Tax criteria is extremely persuasive, a panel may not end its 'like products' analysis after examining only that one specific factor but must look at all of the evidence related to the other three criteria.

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[409] EC – Asbestos Appellate Body Report, Paragraphs 101–103.

The EC – Asbestos Appellate Body determination that 'likeness' under Article III:4 "*is fundamentally a determination about the nature and extent of a competitive relationship between and among products*"[410] has been criticized by some for being too economically oriented. It is argued that it leaves little policy space for Members to distinguish between products based on non-market or non-economic considerations and is unable to consider environmental or health concerns arising from trade in certain products. However, from the perspective of developing country governments, the emphasis on competitive relationships and markets is in their favour should nPR-PPMs be included within the remit of the Agreement. The comparative advantage of most developing economy markets can be undermined by standards governing the production process.

3.3.1. The legal provisions of Article III

Domestic taxation schemes are covered by Paragraph 2 of Article III. The first sentence prohibits Members from taxing 'like' imported products 'in excess of' 'like' domestic products. The second sentence states that Members will be in violation if, under their tax regimes, "*directly competitive or substitutable*" imported and domestic products are "*not similarly taxed*".

Non-tax measures and regulations are covered by Paragraph 4 and include: "*. . . laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use*" of products. Specifically, Article III:4 requires that "*internal regulatory measures are accorded treatment no less favourable to imported products than that accorded to like products of national origin*".

The Article III jurisprudence on 'likeness' has been conducted on a case-by-case basis, involving an "*unavoidable element of individual, discretionary judgement*" as stated in the Japan – Alcoholic Beverages (1996) Appellate Body report[411], Article III:2 has two categories of comparable products because firstly it requires Members

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[410] EC – Asbestos Appellate Body Report, Paragraph 99.
[411] Japan – Alcoholic Beverages Appellate Body Report. Section H.1.a. (1996).

to ensure that 'like' imported products are not taxed at all 'in excess'[412] of 'like' domestic products and secondly, but equally importantly[413], to subject 'directly competitive or substitutable products' to similar levels of taxation. Crucially, if they are not similarly taxed, they must be assessed to see whether the different rates of taxation are applied 'so as to afford protection to domestic production'. While the scope of 'directly competitive or substitutable products' is broad, it is governed by the anti-protectionist thrust of Article III:1 by examining whether it is 'so as to afford protection'.

Although Article III:4's 'like products' term has been interpreted so as to give the overall article consistency, it is remains unclear. If products are 'like' under Article III:4, then the panels must assess whether the treatment afforded to imported products are 'less favourable' than their domestic counterparts. In EC – Asbestos the Appellate Body defined 'less favourable' treatment to apply to measures implemented "*so as to afford protection to domestic production*" (EC – Asbestos AB report, Paragraphs 97–98). Again, this is because the overall objective of Article III is to prohibit regulations that may modify the conditions of competition in that relevant market to the disadvantage of the imported product. That is, it can be seen that ensuring competition is the underlying objective of Article III.

Earlier in GATT/WTO jurisprudence, in the US – Malt Beverages the Panel employed the 'aims and effects' test as a means to ensure the general anti-protectionist objective of Article III and to prohibit internal measures that are applied so as to afford protection to domestic production when conducting 'likeness' analyses. The Panel concluded that whether the challenged measure distinguished between imported and domestic products for valid public policy purposes, or for protectionist reasons, was relevant to the question of whether the affected products were 'like products'.

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[412] Any level of taxation imposed on imported products that exceeds the level imposed on domestic 'like' products will likely be deemed inconsistent with the first sentence of Article III:2 (Japan – Alcoholic Beverages (1996) AB report, Section H.1.b.).

[413] In Japan – Alcoholic Beverages (1996), the Appellate Body clarified that the phrase 'like products' in Article III:2 must be interpreted narrowly so as to not overshadow Article III:2's second, broader category of 'directly competitive or substitutable products' Ibid.

The ‘aims and effects’ test was advocated to help balance free trade and domestic environmental and social policies. Yet it was finally deemed unworkable partly because of problems in assessing ‘intent’ and because it deviated too far from an ordinary meaning of the text of Article III. The Japan – Alcoholic Beverages (1996) Appellate Body explicitly rejected the test, holding that a party need not demonstrate any protective aim or application of the challenged tax.

The aims and effects test has not been used to assess ‘likeness’ under Article III since 1996, although clearly in the area of private standard setting it could have a role. A 2003 OECD report[414] noted that private, voluntary standard-setting and product-certification activities undertaken by private trade associations in the US have historically been the object of antitrust scrutiny under US antitrust law. It is thought that even voluntary standards when formulated collectively by some dominant firms could quickly develop into industry standards and be misused against competing firms for whom such standards become a market requirement. However, since standard-setting and certification activities by private trade associations may also benefit competitive conditions in a marketplace, US courts typically evaluate the pro-competitive benefits of a product standard against any anti-competitive implications under what is termed the ‘rule of reason’ analysis[415]. This approach could be applicable to DSM deliberations.

3.4. Article XX: the exceptions

The exceptions to Article XX include the central GATT provision that attempts to balance tensions arising between trade and other listed legitimate domestic non-trade policy goals. The most relevant sections here are:

- Article XX(b) necessary to protect human, animal, or plant life or health;
- Article XX(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction

[414] Andrew et al. (2003).
[415] See: Consolidated Metal Products, Inc. v American Petroleum Institute, 846 F2d 284 (5th Cir. 1988) and Allied Tube and Conduit Corp. v Indian Head, Inc., 484 US 814.

with restrictions on domestic production or consumption.

Only measures satisfying one or more of the subparagraphs of the exceptions are subsequently scrutinized for consistency with the chapeau of Article XX, to ensure these measures are: *"[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, ..."*.

3.4.1. Article XX(b) of the GATT

The objective of this provision is to safeguard a country's ability to adopt measures "*necessary to protect human, plant, or animal life or health*".

In EC – Asbestos, the Appellate Body dismissed a Canadian complaint against a health-based French ban on asbestos in construction materials. It upheld that health measures under Article XX(b) depended largely on the interpretation of 'necessary'. The terms 'necessity' and 'least-trade-restrictiveness' are given considerable emphasis when examining the 'reasonably available alternatives', in light of existing scientific evidence as the basis for its finding on the applicability of Paragraph (b) of Article XX.

In Korea – Beef, the Appellate Body found that for a measure to be necessary it does not need to be 'indispensable' or 'inevitable'[416]. A 'necessary' measure is situated between an 'indispensable' measure and a measure 'making a contribution to' a goal, albeit significantly closer to the pole of 'indispensable'.

The Appellate Body created a three-factor balancing test for deciding whether or not a measure is necessary when it is not *per se* indispensable: i) the contribution made by the measure to the legitimate objective; ii) the importance of the common interests or values protected; and, iii) the impact of the measure on trade[417].

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[416] Korea – Beef Appellate Body report, Paragraph 161.
[417] *Ibid.*, Paragraph 164

Elements of weighing and balancing are part of the determination of whether an alternative GATT-consistent or less inconsistent measure was reasonably available (Paragraph 166). It is important to note also that in determining whether an alternative measure was reasonably available, the Appellate Body in Korea – Beef confirmed the Panel's approach to consider factors such as the domestic costs of an alternative measure (Paragraph 173).

Appellate Body EC – Asbestos: whether a French ban on the manufacturing, sale, and import of asbestos fibres was 'necessary' to protect the health of workers and consumers, as required under Article XX(b). The Appellate Body accepted that a country may single out a product and adopt measures to address its health risks, without first exhaustively investigating the risks posed by substitutes. The Appellate Body also reaffirmed that a Member was free to choose its level of protection and found that the balancing test laid out in Korea – Beef with respect to Article XX(d), was also applicable under Article XX(b). Finally, the Appellate Body confirmed the importance of the value to be protected, noting that the preservation of human life and health was "*both vital and important in the highest degree*".

3.4.2. Article XX(g) of the GATT

Article XX(g) relates to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

The US – Reformulated Gasoline Appellate Body viewed 'measures' in Article XX as conservation measures in their entirety, and not only as provisions or elements of an overall measure found to violate the core GATT provisions (US – Reformulated Gasoline AB report, Section III.A). This introduced greater deference to environmental considerations, broadening the potential scope of application of Paragraph (g) of Article XX. The Appellate Body also interpreted the term 'exhaustible natural resources' to include living, renewable and non-renewable resources.

The treatment of biological resources in pre-WTO jurisprudence includes the adopted 1982 Panel Report US – Tuna and Tuna Products from Canada. Here both parties considered tuna stocks, including albacore tuna, to be an exhaustible natural resource in need of

conservation management[418]. In the adopted Canada – Unprocessed Herring and Salmon 1988 the Panel Report also "*agreed with the parties that salmon and herring stocks are "exhaustible natural resources"*"[419]. In US – Tuna/Dolphin I and US – Tuna/ Dolphin II: the Panels of both cases concluded that dolphins qualified as natural resources[420]. The Panel also determined that, first, clean air is a resource, second, it is natural, and third, potentially could be depleted in 1996 US – Reformulated Gasoline[421]. Finally, in US – Shrimp/Turtle I, the Appellate Body found that living resources are just as 'finite' as petroleum, iron ore and other non-living resources[422].

3.4.3. Article XX's chapeau

The chapeau of Article XX prohibits a measures' application if it constitutes either "*arbitrary or unjustifiable discrimination between countries where the same conditions prevail*" or a "*disguised restriction on international trade*".

In interpreting the chapeau's requirements during the US – Shrimp/ Turtle I dispute, the Appellate Body explicitly referred to the notion of sustainable development in trade policy, as reflected in the Uruguay Round negotiations and Members' prior practice[423]. The report noted that the opening paragraph in the WTO Agreement's preamble confirmed that WTO negotiators departed from the original GATT language and recognized that an optimal use of the world's resources should be made in accordance with the objective of sustainable development. The Appellate Body stated that preambular language "*must add colour, texture and shading to the rights and obligations of Members under the WTO Agreement, generally, and under the GATT 1994, in particular*", including under the chapeau of Article XX of the GATT[424].

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[418] US – Tuna and Tuna Products from Canada AB report, Paragraph 4.9.
[419] Canada – Unprocessed Herring and Salmon panel report, Paragraph 4.4.
[420] US – Tuna/Dolphin II panel report, Paragraph 5.13.
[421] US – Reformulated Gasoline panel report, Paragraph 6.37.
[422] US – Shrimp/Turtle I Appellate Body Report, Paragraph 128.
[423] *Ibid.*, Paragraph 152.
[424] *Ibid.*, Paragraph 155.

4. Private voluntary standards

A voluntary initiative to promote certain social or environmental objectives could take a number of forms, ranging from broad aspirational principles to strict benchmark requirements or standards. However, it is private standards[425] and monitoring systems that have been growing rapidly alongside business-to-business standards and are evident in markets such as agriculture and food, tourism, fisheries and forestry[426].

These private standards are often encouraged as a response to consumer and producer concerns regarding product quality or suitability, in addition to their potential to expand competition and trade opportunities in certain sectors in economies that are able to respond quickly to new demands and niche requirements. One recent study suggested that one of the key motivational factors behind the development of private standards schemes was establishing a firm’s reputation regarding safety and quality[427]. Developing and complying with private standards can potentially offer producers access to the global value chain, improved efficiency in operations, increased information and improved worker safety, while offering consumers greater choice, information and quality[428].

Competitiveness motivations are likely to reflect a perception that high domestic requirements put domestic industry at a competitive disadvantage in international markets. High levels of environmental or social protection in response to government policy or consumer preferences can, however, have positive effects on the competitiveness of domestic producers and countries. They can spur technological

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[425] Private voluntary standards are also sometimes known as Non-Governmental Standards.
[426] For example, the monitoring system for the foresty sector is the Forest Stewardship Council, for the apparel sector it is hasthe Fair Labour Association, for tourism includes it is the Sustainable Tourism Stewardship Council, for agriculture and food it is the Fair Trade Labelling Organization while fisheries are monitored by the Marine Stewardship Council.
[427] Fulponi (2007) *op. cit.*
[428] *Ibid.*

change, stimulate investment, improve production efficiency, and promote new industrial sectors and new market niches[429].

Nevertheless, it is also evident that private voluntary standards may have the effect of raising the compliance costs of some smaller or newer firms relative to other more established or larger firms. Such measures particularly disadvantage SME exporting firms from developing countries because they must bear the fixed and marginal costs of meeting these export standards without gaining any domestic-scale advantages. In a context of scarcity this has significant ramifications for these economic operators. This can restrict competition because it changes the competitive environment for these products by creating potentially insurmountable barriers to entry. Despite this as yet there are no international regulatory mechanisms for assessing the impact on competition from these standards.

It has been further argued that rather than being private voluntary standards, compliance with these schemes is becoming increasingly mandatory for accessing lead-retailer supply chains[430]. Products must meet the importing country's regulations in addition to the requirements of private voluntary standards schemes. However, because the necessary infrastructure and services to meet these new commercial requirements demands is unavailable, SMEs and smallholders are easily locked out of the market for supplying the leading retailer chains.

Thus, although private standards are not mandatory and it is the suppliers' choice to participate in a scheme, it is clear that where private standards become the industry norm, choice is limited. The choice of whether or not to comply with a voluntary standard becomes a choice between compliance or to exit from the market. In this way, the distinction between private voluntary standards and mandatory 'official' or 'public' requirements can blur.

The scope of PPMs covered by private standards includes both PR-PPM and nPR-PPM issues such as animal welfare, organics, traceability, environmental impact and labour standards. These private

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[429] Processes and Production Methods (PPMs): Conceptual Framework and Considerations on Use of PPP-Based Trade Measures OCDE/GD(97)137.

[430] Fulponi (2007) *op. cit*.

measures are sometimes referred to as ‘producer characteristics standards’.

4.1. Legal frameworks covering private standards

While mandatory government standards are subject to the constraints of the MFN and NT non-discrimination provisions, it is not clear that these disciplines extend to private voluntary standards, even when these standards are capable of discriminating against exporters and therefore changing the level of competition in these markets. Some private standards schemes may fall within the scope of the TBT Agreement. Annex 1 sets out the legal definitions for standards, conformity assessment procedures and non-governmental bodies. Article 4 requires that Members take reasonable measures to ensure that non-governmental bodies accept and comply with Annex 3 of the TBT Agreement (the Code of Good Practice for the Preparation, Adoption and Application of Standards), which includes notification obligations relating to the Code’s acceptance and work programmes. Articles 5 and 8 of the TBT Agreement relate to conformity assessment obligations. The TBT Agreement also obligates Members to take "*reasonable measures to ensure compliance*" by Non-Governmental Organization (NGO) bodies with the Code of Good Practice by non-governmental bodies.

However, in the Tuna – Dolphin case the Panel found that the provisions of a voluntary, federally promulgated, US eco-labelling scheme did not violate Article I:1 of the GATT Agreement (MFN Clause) because the *Dolphin Protection Consumer Information Act* (DPCIA) eco-labelling scheme could not be said to constitute a market restriction because it does not prevent a manufacturer from selling its product in a marketplace without complying with the environmental requirement. This implies that only ‘government-conferred’ advantages are subject to the MFN requirements, and for a measure to restrict access to a market, it must leave an exporter with no choice but to comply with it.

Nevertheless, from the perspective of developing country producers even voluntary PPMs can impose additional costs upon exporting manufacturers effectively preventing them from selling their products in certain markets and consequently altering the competitive environment of those markets. Developing countries have a different set

of issues related to standards and competitiveness. First, some environmental and social standards in their export markets are not always well publicized, or well understood or may not allow enough time for producers to conform to these new production methods, especially where there are many small-scale producers. Second, the standards may be set at excessively high levels or require complex testing and monitoring to ensure compliance.

Competitiveness issues underlie many of the challenges that African commodities exporters face, for example, when appropriate policies raise the price of the final good. Here a small price hike can cause purchasers to switch exporter. Commodities purchasers will not typically pay a premium for environmentally or socially high standards, despite the environmental and social issues that surround their PPMs. In the Tuna – Dolphin case, it was found that it was necessary for a measure not only to restrict market access but also that any advantage gained by one exporter over another exporter must be conferred by the government implementing the measure and not by consumer preference. Disputes between private entities, NGOs and non-state organizations are beyond the mandate of the GATT Agreement. So too are analyses of instances of market restrictions caused by private cartels creating voluntary standards or *de facto* advantages conferred by governments.

Thus, there are certain barriers to establishing that a private standard violates the MFN clause, not least because private actors have no direct role in the WTO. Not only must a private party be represented by a government but there is also an absence of a state entity to launch dispute settlement proceedings against. The scope of state attribution in the WTO regime is at present interpreted narrowly. In the Japan Films case, the WTO Panel acknowledged no ‘bright line rules’ that allowed it to rule out an action as being non-governmental, just because it was taken by a private party. In the Korea Beef Case, Korean retailers responded to a government law introducing a dual retail system by voluntarily renouncing the sale of imported beef because of commercial considerations. Although the voluntary actions of the retailers could not be attributed to the State, the WTO Appellate Body held Korea responsible for violation under Article III:4 (NT) because domestic law gave a sufficient incentive for its retailers to act in a manner inconsistent with the WTO.

In order to identify the criteria by which states should be held accountable for the use and misuse of private voluntary standards, the SPS and the TBT Agreements offer some different approaches. Article 13 of the SPS Agreement explicitly states that Members "*shall not take measures which have the effect of directly or indirectly, requiring or encouraging…such non-governmental entities…to act in a manner inconsistent with the provisions of this Agreement*". The TBT Agreement affixes gradual levels of state responsibility relating to the extent of control that a state can exercise over a non-governmental body.

However, WTO jurisprudence displays the DSM's reluctance to hold a state responsible for the trade-restricting activities of private parties within its territories, even if such activities were directly or indirectly supported by a governmental measure[431]. Although the Japan Films report found no 'bright line rules' to exempt private party actions from WTO scrutiny and the Panel acknowledged that a government's measures could assist such cartels by limiting exports, it did not incorporate a 'due diligence' requirement into Article XI:1 to ensure that a state's laws did not enable private parties to restrict trade.

The success of a contested private standard clearly depends on how widely state attribution is interpreted. If the interpretation is broad there is a case for challenging private standards under Article III:4. It is difficult to show that a private standard violates Article III:4 because the measure must be shown to constitute a law, regulation or requirement that affects internal sale, discriminates between like products and does not afford like treatment to imported products. Nevertheless, it can be argued that the scope of a 'regulation or requirement' does not *prima facie* exclude private actions under Article III:4. A private action can be interpreted as a 'requirement' under Article III:4 if "*there is a nexus between that action and the action of a government such that the government must be held responsible for that action*". This nexus can be established by private standards supported by government policy, such as the Nordic Swan Program, but these are not common.

If the primary objective of Article III is to protect the expectations to particular behaviour not actual trade outcomes then the factor at stake in judging whether a measure accords less favourable treatment

[431] Argentina — Measures affecting the export of bovine hides and the import of finished leather (DS155/R). 19 December 2000.

to an imported product should be determined by whether both imported and domestic products are afforded an effective equality of competitive conditions. In the case of developing country SMEs, it could be argued that as long as the NGO standards result in discriminatory competitive conditions which deny them effective equality, they could violate Article III:4.

4.1.2. TBT Agreement provisions regulating the use of private standards

As noted above, the objective of the TBT Agreement is to ensure that mandatory technical regulations and voluntary standards do not constitute unnecessary barriers to trade. Voluntary standards have to comply with the TBT Agreement's Code of Good Practice, which provides guidelines for the setting and implementing of these standards. Technical regulations can be both governmental and non-governmental measures. According to Article 3 Members take 'reasonable measures' available to them to regulate technical regulations that are formulated by local government bodies or non-governmental bodies.

The benchmark for a private measure to be considered a technical regulation is high. It must require mandatory compliance and is generally thought that it cannot be based on an nPR-PPM. This implies that the vast majority of private standards are not regulated by the WTO. There is considerable opposition among developing countries to the inclusion of nPR-PPMs within the WTO on the grounds that it is non-negotiated mission creep and unfairly discriminates against their economic interests. Resistance to technical regulations based on nPR-PPMs derives from concerns about exporting domestic preferences and values that are seen by some as, at best, inconsiderate of differing endowments or preferences, and at worst ripe for protectionist abuse[432].

However, the exclusion of nPR-PPMs from the WTO due to concerns over the protectionist abuse may not be the best policy option for smallholders and producers. If nPR-PPM-standards are covered by the provisions of the GATT and the TBT Agreement, the result would be a more coherent, transparent and procedurally accountable rules-based framework for setting these standards, be they mandatory or voluntary. At present, the 'default' suite of GATT disciplines to which government

[432] See for example, Bhagwati and Srinivasan (1996).

measures are subject when the TBT or SPS Agreements do not apply, and generally no regulation when the measures are private and voluntary, is clearly not in developing countries' interests.

5. The Informal Market

"*The first and second economies in our country are separated from each other by a structural fault. … Accordingly, what we now have is the reality … of a mainly informal, marginalized, unskilled economy, populated by the unemployed and those unemployable in the formal sector. The second economy is caught in a 'poverty trap'. It is therefore unable to generate the internal savings that would enable it to achieve the high rates of investment it needs.*"[433].

The informal economy in this description is positioned as structurally disconnected from the mainstream of the economy. This dualist perspective[434] sees the informal economy as operating in a distinctly separate and less advantaged position relative to the formal economy[435]. Chen (2007) argues that this conceptualization tacitly acknowledges the failure of past trickle-down economic growth policies. By splitting the economy, the government can argue that its economic policies have been successful for the formal economy and export sector; whereas, if there is an interconnected and even interdependent relationship between the formal and informal economy, then government policy for the latter is either absent or ineffective. Indeed, Chen disputes the dualist school, finding few examples of informal operators that are not linked in some way into the formal economy; informal enterprises rarely, except perhaps some survival activities,

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[433] President Mbeki. ANC Today, Volume 4, No. 47, 26 November-2 December 2004.

[434] See Sethuraman (1976), Tokman (1978).

[435] The Structuralist school sees the informal and formal economies as intrinsically linked. To increase competitiveness, capitalist firms in the formal economy are seen to reduce their input costs, including labour costs, by promoting informal production and employment relationships with subordinated economic units and workers. See Portes (1989). The legalists' school focuses on the relationship between informal enterprises and the formal regulatory environment, not formal firms, while acknowledging that vested capitalist interests collude with governments to set favourable rules for trade. See de Soto (1989).

operate in total isolation from formal firms. Most source raw materials from and/or supply finished goods to formal firms either directly or through intermediate – also often informal – firms.

If the formal and informal markets are integrally linked, focusing pro-poor policy on the interdependencies and causes of the linkages should be more effective in promoting development than ignoring them[436]. This is particularly the case when 93 per cent of new jobs in Africa are created in the informal economy[437]. At present, the formal regulatory environment comprising government policies, laws, regulations, and standards is biased towards formal registered firms to the disadvantage of both informal enterprises and informal workers, which are the majority in most developing countries. The benefits of the formal economy include not only enforceable commercial contracts, ownership rights, tax breaks and incentives to conform to standards and increase their competitiveness, but also statutory social and consumer protection. When informal enterprises obtain licenses, register accounts and pay taxes, the costs are high before they start to meet the required international standards to begin exporting their goods to the lucrative developed country markets.

It is of little surprise that the core debate on the informal economy is whether to 'formalize' it. If a small enterprise in a developing country calculates that the only way to compete with cheaper imported 'like products' is by evading sales tax and hiding its workers from the social security authorities, then the likelihood is that the enterprise will remain largely in the informal sector. This may deprive the firm of a bank loan to expand the business and increase its competitiveness by conforming to export standards because it requires an external audit. The bureaucracy of both formalization and standard conformity and authentication is expensive, and small enterprises will conform only if they calculate that it will be worth it to gain access to lucrative foreign markets. In such a situation, pro-poor government policy may find it

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[436] For example, if an enterprise is required to have six official permits, for example, but only has five, should it be considered informal even when the sixth derives from a moribund regulation that most entrepreneurs ignore? It has been seen that formality and informality are the opposite poles of a continuum with many intermediate and mixed cases. See Chen (2007) op. cit.
[437] Chen (2007) *op. cit.*

more effective to focus on creating incentives for voluntary formalization rather than on enforcement activities.

The creation of effective incentives for formalization is clearly important for consumer protection. Product informality escapes all social, health and safety regulations, in addition to offering any effective consumer protection.

6. Conclusions

The regulation of both mandatory and private standards is not yet comprehensive regarding nPR-PPMs. While developing countries have traditionally rejected the incorporation of these standards within a binding framework, this may not be the most effective way of ensuring that these non-tariff barriers are set according to legally rational and recognized guidelines. There is a body of research to suggest that compliance with private voluntary standards and schemes is becoming increasingly mandatory for developing country producers wishing to access the main retailer supply chains. While export traders are the key link between the purchasers and the producers[438], SMEs have an increased risk of being excluded from lucrative international markets because of the constraints of complying with these private standards. In developed countries, government policy is seen to complement producer and export industries by ensuring the provision of the infrastructure and services necessary to maintain competitiveness at both macro- and micro-levels. In the context of economic development, governments face more challenges in providing such an 'enabling' environment.

Developing country domestic policy solutions could start by identifying the extent to which subsidies or public support programmes are needed to offset the cost disadvantage that stems from international technical regulations. This would involve assessing initial set-up and variable production costs regarding both standards and technical regulations. Appropriate policy solutions could include the targeted upgrading of infrastructure along with the requisite training and capacity

[438] These intermediaries are generally responsible for transmitting demand specifications to all producers and frequently also for organizing, financing and overseeing production and certifications of small-scale producers.

building at a grass-roots level. It is the SMEs and smallholders that are most detrimentally affected by these regulations; therefore, their input in setting standards is vital to ensure that the competitiveness of their export markets is not discriminated against.

The domestic policy options to harness the informal market and enhance social and environmental protection include simplifying and reducing relevant regulations and standards, alongside arbitrary economic intervention and governance. To date, progress at addressing such issues relating to the informal market has been largely ineffective. The poorest countries tend to be those that suffer most from an inappropriate and burdensome regulatory environment – although clearly they have a very low capacity for both policy making and enforcement. In order to create a 'smarter' domestic regulatory environment, it would be useful to identify critical and neglected industry-specific policy issues. This should uncover policy priorities and allow for limited enforcement capacity to be targeted more efficiently.

At the multilateral level, there is more scope for identifying and assessing the damages to the exporting country's trade benefits if the importing country's regulations do not conform to WTO obligations. Developing country governments have been making more use of the WTO dispute settlement mechanism and they could now increase their examination of non-tariff barriers, including private product standards, particularly those that can severely undermine the competitive trade advantages that developing country exporters may have within the multilateral trading system.

GATT and WTO Panel and Appellate Body findings tend to be tough if they have been able to establish that there has been an unnecessary restriction of trade or distortion of the market. Most developing countries have not tended to make requests for consultations or mount legal challenges to the formulation or application of private voluntary standards. Rather, developing countries have traditionally been united in their opposition to the inclusion of nPR-PPM criteria within the WTO because they perceive that even to acknowledge this form of trade-restrictive standards will begin a new era where 'non-trade related' standards, such as labour and human rights are included within the remit of the WTO, destabilizing the competitive advantages of many developing countries. At present, the limitations of the TBT Agreement also make such an nPR-PPM challenge difficult. Not only is

the political environment for including these criteria inhospitable, but the provisions are ambiguous and risk assessment mechanisms inadequate.

Challenging the legal basis of an nPR-PPM standard is not necessarily strategically short-sighted. The WTO Shrimp – Turtles dispute was based on a contested nPR-PPM scheme and the Appellate Body in that case found that ultimately the measure only violated the WTO because it was both arbitrary and discriminatory. This did not set a legal precedent by authorizing the inclusion of nPR-PPM criteria within the remit of the GATT/WTO Agreements; rather the Appellate Body subjected the measure to an evaluation of its legality with the GATT Agreement. Yet the Appellate Body did show sensitivity in a dispute relating to the use of private product standards. It could be argued that it is likely to judge the measure on the basis of its restriction rather than on the criteria that were used in setting it.

The TBT Agreement is generally also thought to exclude any product standard or regulation that is based on the nPR-PPM criteria of most developing countries. While this may prevent these criteria being used to discriminate between currently 'like' products, it also results in a situation where private nPR-PPM product requirements are completely unregulated within the WTO. The primary objective of the TBT Agreement is to discipline the arbitrary use of technical barriers to trade and is generally thought to be the most appropriate framework for challenging a private standard. If terms including 'non-governmental bodies', 'standardizing bodies', 'Standards' and 'Technical Regulations' are interpreted to exempt private standards from being regulated it would undermine the primary objectives of the Agreement.

Given that the WTO DSM has been accused of enlarging the remit of the WTO beyond what was originally intended by the negotiating parties during its settlement of disputes, it is advisable that the clarification of such issues of interpretation should be addressed by the WTO membership itself and not left to rule making by judicial interpretation during a potentially politically explosive dispute. The most appropriate policy option identified here is to further utilize the TBT Agreement's 'review' mechanism, which was set up to provide the WTO Members an opportunity to "*review the operation and implementation of this Agreement*" at the Triennial Review of the TBT Committee with a view to "*recommending an adjustment of the rights and obligations of*

this Agreement…to ensure mutual economic advantage and balance of rights and obligations"[439].

Developing country WTO Members could see the TBT Agreement's unique review mechanism as a potentially effective opportunity to clarify these matters of interpretation, as well as for tabling amendments to the text of the TBT Agreement itself. In the past[440], the review has acknowledged that some standards were being formulated by bodies that are not commonly recognized as standardizing bodies; however, there were no policy proposals beyond calling upon WTO Members to encourage private standard setters to utilize the use of the TBT Agreement's Code of Good Practice. This work could be used to draft a proposal sympathetic to developing country WTO Members.

Elsewhere in the WTO, the Committee for Trade and Environment has also long been aware of the ambiguous role that the WTO has at present in facilitating the use of voluntary private initiatives[441]. Developing country WTO Members could also use this as an opportunity to actively support proposals such as those demanding a notification procedure for voluntary eco-labels and mechanisms for insuring that private standards that restrict markets are not used for protectionist purposes, in addition to proposing to increase the WTO's international policy coherence surrounding this work.

Private international product standards are playing a greater role in determining the competitive environment in markets than previously. At a very minimum, governments in both developed and developing countries should work to ensure that the membership and decision-making processes of these private standard bodies are subject to a transparent, participatory and non-discriminatory framework that can incorporate some aspect of competition policy.

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[439] See Article 15 of the TBT Agreement. Note: there is no equivalent provision within the SPS Agreement.

[440] The Triennial Review reports: G/TBT/5; GTBT/9 & G/TBT/13.

[441] See for example, The Report to the 5th Session of the WTO Ministerial Meeting at Cancun (WT/CTE/8, 11th July, 2003) under Paragraph 32(iii) on Labelling.

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PART D:

Lessons from Competition Policy and Law Enforcement

IS THERE POTENTIAL FOR COMPETITION POLICY IN THE ECOWAS?

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Abstract

The main objective of this study is to discuss competition law and policy in regional integration with the aim of identifying whether or not effective competition law can be furthered within the Economic Community of West African States (ECOWAS) integration plan. The study argues that the ECOWAS region should establish an independent competition law capable of addressing public and private anti-competitive practices that can detrimentally affect the trade between the member countries. Further, it argues that the ECOWAS requires a regional body to promote the regional law. The study identifies a number of different options for a regional competition law, ranging from a highly centralized to a highly decentralized system of regional action. The study concludes that the policy option with the most potential is the 'middle road', which allows for regional complaints and investigations but still relies primarily on the enforcement mechanisms of the Member States.

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Executive summary

- Preferential trade liberalization should facilitate increased competition in the regional market but national or regional competition policies may also be necessary to provide recourse for injurious firm behaviour emerging after the removal of governmental barriers.

- There is a stronger argument for an independent regional law and a centralized authority in the case of export restraint behaviours that affect trade between the members. The problem of dumping can be resolved by effective national laws. Intergovernmental approaches involving cooperation may be satisfactory except in the case where exporting members refuse to pass and implement national laws that can address those practices.

- Two major elements are at play in the design of competition policy in regional integration:

    1. Whether or not the region will create an independent law, together with the mechanisms by which this law would be made effective within the members' domestic legal orders.
    2. Whether the region should establish a separate authority that would be able to treat individual cases, either alone or in conjunction with the Member State authorities and courts.

- Where the objectives of an integration agreement involve a customs union or common market formation, it would be somewhat logical to favour a more centralized approach.

For the Economic Community of West African States (ECOWAS), a tension exists where the objectives of integration are set at high levels (customs union/common market) but the institutional powers are set 'low' to function by primarily intergovernmental cooperation. It is therefore questionable whether the present institutional design can give meaningful effect to the integration objectives of the

treaty. Institutional changes to the ECOWAS structure are necessary if the integration objectives of the treaty are to be met. There is no simple resolution to this other than to locate a middle ground of accommodation and compromise between the ECOWAS objectives and the institutional design in the treaty.

This study therefore recommends:

- Setting firm benchmarks for the establishment of an independent regional law and, following that, to raise the implementation aspects for an 'organic' system of enforcement within the Member State legal orders. This is based at the outset upon the superiority of the regional law (for which the ECOWAS Treaty does provide), and then to institute certain guarantees that might render a system of private rights effective.

- An independent regional authority should also be established that has certain granted powers. Here several alternatives are discussed but what is ultimately recommended is to establish a regional authority with the power to:

    - receive individual complaints
    - independently investigate complaints
    - refer cases to the national authorities and courts for action
    - apply for an alternative case-hearing mechanism if national authorities are unable to act.

- The study recommends establishing an independent regional competition law with general application throughout the region and superiority over inconsistent national laws and acts. Conflicts of jurisdiction between regional and national law are not a major barrier to the creation of a regional law. The delimitation for the jurisdiction of a regional law should ultimately reside with the highest regional court. A Council Regulation can prescribe the minimum thresholds and other exemptions that would also describe the jurisdictional application of a regional law.

- A core proposal is therefore that either the treaty provisions or

an ECOWAS Council Regulation provide for an express declaration of direct effect. For competition law, this would mean that the treaty practices listed as subject to the prohibitions could be raised by a private party in a national court in a lawsuit against other private parties or against the state and its agencies. This would allow a national authority or court ruling that an anti-competitive practice is inconsistent with the treaty and that all agreements formed to give effect to such practices are void and non-enforceable within that national legal system. The Council has this power incumbent in its authority to establish Community acts in the form of regulations.

- This recommended system of regional competition law enforcement relies, at least in part, on individual claims and cases, and includes:
  - the use of direct effect before the national courts and authorities for ECOWAS competition
  - a procedure for preliminary opinions to promote consistent interpretations and uniformity
  - a final private right of appeal from the highest national court (or final national court of jurisdiction) to the regional court
  - the West African Economic and Monetary Union (WAEMU) system should function as a single entity within the larger customs union structure.

1. Introduction: the elements of a competition law

This study refers to competition law as the set of rules and remedies that governments can adopt to prohibit and challenge practices by private enterprises and public authorities that restrict or distort the contestability of a territorial market[444]. There is no single harmonized expression of a competition law and not all competition law is formalized into statutory schemes[445]. A number of common-law-style legal systems recognize and redress a range of unfair and anti-competitive trading practices. Many of these overlap with competition law and policy considerations.

Where competition law is provided by statutory/legislative expression, all or nearly all of these provisions recognize that certain types of cartels (collusion among firms) that injuriously fix prices, restrict output or allocate portions of the market are unlawful (void) or are made actionable. This category is also known as 'hard-core cartels' and these are generally understood to be without any possibility of legality or redemption[446]. Cartels constitute the most common '*per se*' prohibition within a competition law, where the law itself does not recognize any pro-competitive effects to these arrangements that might outweigh the injury to competition.

Other agreements among firms may also 'on balance' be injurious to competition in the market but are not injurious '*per se*'. These may be subjected to an assessment by a rule of reason, which is a balancing determination made by an agency or by a court, or both. Most distribution arrangements (vertical restraints) fall within this group. Authorities deal with determinations on 'competition effects' by adopting exemption rules that recognize the pro-competitive nature of certain arrangements when they meet certain qualifications. For laws following the European Community (EC) approach, this is normally a test of

444 On the theory of contestable markets and the function of competition laws, see, for example, Whish, R. (1993), Competition Law, 3rd Edition, Butterworths, pp. 13–16.

445 There are of course 'models' for competition laws. See UNCTAD Model Law on Competition, TD/RBP/CONF.5/7, at http://www.unctad.org/en/docs/tdrbpconf5d7.en.pdf.

446 See OECD (1998), Recommendation of the Council Concerning Effective Action Against Hard Core Cartels C(98)35/Final, adopted 25 March, 1998.

stated positive and negative conditions[447]. Both the West African Economic and Monetary Union (WAEMU)[448] and the draft Nigerian competition law include positive and negative conditions for establishing exemptions from the application of a prohibition on certain types of agreements[449].

A second common element of a competition law provides for treatment of dominant positions or more commonly, abuses of dominance. These are practices engaged in by a single or collective enterprise, within or outside of the territory, with sufficient market power upon the territory to restrict the contestability of the market by other suppliers. These practices are also normally assessed by a balancing test where certain pro-competitive effects of a dominant position may also be taken into account. Some developing countries apply market share criteria to initially capture a dominant position within the purview of its law, and then proceed to analyse it in regard to the abuse.

A number (but not all) of regional systems also seek to address public practices that distort competition in the market by the application of state aid or subsidies. Some require pre-notification regimes with thresholds whereby members are obliged to notify a central authority to further determine the legality of the proposed subsidy[450]. It is also possible, as in the UEMOA arrangement, to have a stated prohibition on subsidies that are conditioned on exports or that require domestic local content. The World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures also considers that subsidies directly targeting trade are actionable by countervailing duties or by the suspension of bound concessions.

1.1. Unilateral and preferential trade liberalization

From a competition policy perspective, multilateral or unilateral trade liberalization may be most desirable when the tariff cuts made to all other countries admit the broadest range of competitors to the local market from the widest array of sources. This would tend to minimize the risk of firms making new collusions to set cartel prices, or in the case

447 As contained in Article 81 of the EC Treaty.

448 Union Economique et Monétaire Ouest Africaine (UEMOA) in French.

449 As based on the authors' field survey reports conducted in the spring and summer of 2006.

450 The EC state aids regime, for example.

of a dominant firm, the risk of a single dominant foreign firm abusing the market. This is not to say that inefficient domestic firms should survive this new competition, but that the resulting firms in the market should trade more competitively. Competition law plays a role in guaranteeing that new entrants to the market play by the rules of fair competition and in respect to the existing domestic firms as purchasers and consumers.

In a regional trade agreement (RTA), the tariff cuts are not made on a unilateral or multilateral basis and the possibility of a larger number of foreign producers contesting the market may also be reduced. This of course depends on the structure of the regional market and the profiles of the producing firms. In a case where two highly protected countries form a preferential bilateral tariff cut (to each other only), whether the resulting market is more or less competitive (contestable) would seem to require more information on the positions of the firms and the markets in the region. Preferential trade liberalization should not be viewed as automatically giving rise to a more contestable market overall. An assessment is needed, *inter alia,* of the number of firms operating in the regional market and whether they can combine effectively to set prices or restrict output or segment the market. This would also include identifying whether there is a single dominant firm from one of the territories that may be capable of extending that position across the regional market[451].

Thus, the basic argument for regional competition provisions in a free-trade area or customs union arrangement is, therefore, that while most of the traditional economic literature on welfare gains in regional trade liberalization presumes that markets commence and end with perfect competition, in the real world this is not necessarily the case. For a customs union, the core rationale for a regional competition law extends to incorporate the detrimental impact of anti-competitive practices on the trade liberalization commitments made by the members to achieve free trade. This further emphasizes the elimination of trade measures (and their future potential to be used) within a formed single customs territory. Since a customs union has the capacity to provide for

451 Generally, Nicolaides, P. (1997), “The Role of Competition Policy in Economic Integration and the Role of Regional Blocs in Internationalizing Competition Policy”, in O. Hosle and A. Saether, (eds), Free Trade Agreements and Customs Unions, European Commission and EIPA, Brussels, pp. 37–39. “But it is also possible that preferential trade liberalization may stimulate cartelization even if an industry of at least one partner country does not have an oligopolistic structure at the moment of liberalization.”, at p. 39.

the free internal movement for goods of origin, as well as duty-admitted third-country goods, the focus is more on eliminating the underlying trade distortions caused by anti-competitive practices.

1.1.1. Prices too high

If prices on export trade from one market to another are 'too high' due to export cartel activity or a cross-border abuse of dominant position, this affects the trade between the regional members. The tariff cut made by the importing country is allocated not to the import country consumers, but to the export country producers. The import country can take lawful action against these foreign practices – if it has a functioning domestic competition law. Usually, however, investigative information gathering and enforcement against foreign actors are very difficult for domestic agencies when the evidence lies outside the enforcing territory. The more centralized the investigative and enforcement mechanism, the more likely it is to capture these practices for a remedy. The most 'decentralized' approach to this problem relies wholly on national laws and agencies, and cooperation between them, in order to pass information and other investigatory assistance. A more centralized arrangement containing a separate regional law for competition, as well as an independent agency, would bypass national authorities altogether and independently assert any violation of a regional competition law.

1.1.2. Prices too low

'Too low' prices upon export trade, as in the case of dumped goods, can also be the result of anti-competitive exclusionary practices in the export country. If these firms can successfully dump (price below normal value), then they may be operating in a 'closed' market whereby those dumped goods cannot be re-imported to challenge the local prices. If there are no trade barriers in place, this 'closure' may be operated by a private set of exclusionary practices, perhaps in the form of vertical restraints in the distribution system from the producer to the ultimate consumer. In such a case, the 'trade solution' of 'parallel imports' cannot be made effective, and this is then a competition law problem that affects trade between the Member States. This problem can be addressed in the producing territory by the affected foreign firms

if there is a competition law that can be invoked against anti-competitive vertical restraints and which also guarantees a non-discriminatory right of action on behalf of all complainants[452].

This remedy is also available in a decentralized scheme relying only upon national laws that have a provision to address anti-competitive exclusionary practices. However, there is an obvious tension when there is no competition law in the producing market if the other regional members do have competition laws. The overall result is potentially highly damaging for both the free-trade regimes and economic integration. Firms from those countries without laws can effectively dump goods on the other regional members without being challenged, other than by the use of a trade remedy. Yet firms from regional members with functional competition law can always be challenged if they are dumping from behind exclusionary vertical restraints. The conflicts caused by the lack of reciprocity in competition law remedies may result in some members utilizing destabilizing trade measures (such as anti-dumping duties or safeguards), irrespective of the tariff-cutting schedule and commitments in the RTA.

Most softer integration systems (non-supranational free-trade areas) make some reference to the contribution competition policy can make in achieving the objectives of the free-trade commitments. National competition laws can contribute to reducing trade frictions even when most agreements at this lower level do not seek expressly to formulate a competition law remedy for dumping, nor do these arrangements even seek to eliminate any or all internal trade measures in the form of contingent measures, anti-dumping or safeguards. Most stronger or 'higher-level' arrangements (customs unions) make some attempt to address intra-regional dumping and attempt some link to competition law regimes, such as the European Economic Community (EEC) Treaty.

There is a stronger argument for an independent regional law with a separate regional enforcement authority that can operate without relying upon national laws at all, where a customs union has members

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[452] The EEC Rome Treaty, Article 91 treated dumping practices whereby protective measures were permitted during the transition period until the EC competition policy was in effect. Member States were also not permitted to impose trade restrictions on the re-importation of goods.

with strong export potential but these exporter members refuse to enact competition law. Nevertheless, it is possible that cooperation between national authorities can be sufficient to support a customs union plan. If the stronger export members are all willing to operate with a functional national competition law, the more decentralized and intergovernmental approach to ensuring that trade measures do not undermine the proper functioning of the customs union is workable, although some institutional overview by some overarching authority might also be necessary to keep this lower level of cooperation functioning for the benefit of the union.

1.2. Regional approaches, centralized, decentralized and 'mixed'

It has become almost the universal practice for both free-trade areas and custom union plans to declare that certain anti-competitive practices are incompatible with the proper functioning of the agreement or contrary to its free-trade objectives. These treaty expressions obviously range from 'very soft' to 'very hard' law. It is doubtful whether the softer expressions enunciate any regional principle at all that can generate actual legal effects. An example of such a 'soft' provision would recognize that certain anti-competitive practices will undermine the objectives of the RTA members to the treaty, and that the members should make (best) efforts to address anti-competitive practices. As it stands, this is an aspirational expression; while it may or may not have political effects on the behaviour of the members and their laws, it does not have legal effects. Other customs unions and common market plans contain far stronger expressions that establish an independent regional law and then institutional regional power to enforce it. For those modelled on the original EEC customs union plan, this is nearly a 'boilerplate' approach.

A 'mixed' harmonization model can be identified in some of the newer free-trade area plans (north–south in particular). Here the trend is to substitute the role of an independent regional law, with more provisions on the criteria and performance of the domestic laws. In some cases this explicitly requires the establishment of national competition laws that can treat cross-border anti-competitive practices according to certain substantive and institutional performance standards.

This study now surveys the range of possibilities available with reference to these categories.

1.2.1. A regional law and a centralized authority

Where a regional treaty states a legal expression for anti-competitive practices that affect trade between the members or distort competition within the region, this establishes an independent law and a distinct regional jurisdictional scope. This law may overlap with domestic competition law (both laws may be applicable in a given case), but has its own sphere where it is limited only to treating practices that affect the trade between members or injure a portion of the territory beyond the boundaries of a single Member State.

This regional law should be directly applicable in the laws of the Member States and have a position of superiority to the member's inconsistent legal acts or administrative and court judgements. Such a law may or may not be 'directly effective' in allowing individual firms or citizens to invoke the regional law in the domestic courts of the member countries. Where an institutional mechanism is also provided at a regional level to conduct investigations, enforce actions and assess and levy penalties, then these two features together would describe a fully centralized regional system.

Among developing country (customs union) regional arrangements, the Common Market for Eastern and Southern Africa (COMESA) and the WAEMU Treaties appear to provide the basis for centralized systems. Their approaches are modelled somewhat on the EEC Rome Treaty. The Andean Pact also has strong centralizing elements for both regional law and authority. The more centralized approaches tend to appear in customs union/common market plans, although this may be an historical accident caused by modelling on the EEC provisions.

1.2.2. A regional law and a partially centralized authority

In this model, the independent regional law is established with the elements of direct applicability and superiority, and a central authority is also created. However, that authority either does not have the full range of powers or is not able to exercise those powers with full independence. For example, it may have the power to receive complaints and initiate independent investigations, but then be required in the first instance to rely upon the Member State authorities and their national courts for processing case actions leading to enforcement and remedies. The Caribbean Community (CARICOM) arrangement as it has evolved appears to follow a similar approach. This has a clear regional law expressed by treaty provisions dealing with cross-border anti-competitive practices. It provides for a regional authority, but this authority operates together with Member State authorities. In the case where a Member State cannot take action or disagrees with the regional authority, a resolution is made after referral to a higher body.

1.2.3. A regional law but no central authority – intergovernmental cooperation

Here the independent regional law is expressed by treaty or protocol, but the application of the law is left entirely to the Member States. Cases can be brought by their authorities, as they also receive complaints dealing with regional law violations. The national courts may also receive private complaints for violations of regional law. The regional level may have an expression of common principles laying out the minimum requirements for the domestic laws and procedures, and may also prescribe some conditions for encouraging cooperation between the Member States. There may also be an intergovernmental committee formed to assist the cooperation and attempt to allocate investigations and cases among the members. The Mercado Común del Sur (MERCOSUR) competition protocol is a possible example of this approach where Member State authorities act together on an intergovernmental basis. This approach requires the existence of Member State authorities operating under domestic competition laws that have been passed and implemented.

1.2.4. No regional law but criteria for national law and/or a duty to cooperate

Several free-trade areas describe the practices that are detrimental to the functioning of the RTA and then call upon Member States to implement effective national laws to address these practices as they affect trade between the members. This approach does not establish a separate regional law at the level of treaty commitments. An example of such an approach is found in the Canada–Costa Rica Free Trade Agreement, whereby the substantive practices to be covered by a satisfactory domestic law are detailed, including procedural matters around transparency and due process (the right to be heard, the right to appeal) and national treatment requirements. No cooperation mechanism is expressly established, although the potential to engage in cooperation among authorities is suggested. A sort of political review mechanism (by a free-trade council or association) may be provided to occasionally examine the overall functioning of the agreement and its provisions. There are some examples of explicit timelines to have national laws that can operate to treat certain practices. The EC–South Africa agreement provides that the national law shall be made operational within three years of entry into force of the agreement. It further provides a sort of safeguard or recourse mechanism in the event that the national law cannot be implemented.

Another African example of this approach is found in the Southern African Customs Union (SACU) Treaty, although with far less detail then those above. Here the two-sentence Article 40 states that the members shall have competition policies (a treaty obligation) and that they shall cooperate in the enforcement of competition laws and regulations. While this provision does not establish an independent regional law, it does allow for some additional development by protocol or otherwise to outline the characteristics of Member State cooperation. And while it does not allow for the establishment of a regional authority, it does not exclude the possibility of Secretariat assistance to facilitate cooperation.

2. Minimum requirements: establishing a regional law

2.1. Independent regional law and jurisdictional scope

For a customs union, it is noteworthy that the Economic Community of West African States (ECOWAS) Treaty does not contain any expression whatsoever regarding anti-competitive practices that either affect trade between the members or distort competition in the regional market[453]. The treaty is silent on competition. A core recommendation here is that a treaty (protocol) expression should be established that includes a distinct substantive law for dealing with anti-competitive practices as they affect trade between the Member States. This law should have the capacity to operate within its own jurisdictional scope of application.

2.1.1. Affecting trade and/or affecting regional territory standards

This regional law can be expressed either by reference to practices "*affecting trade between the members*" and/or "*affecting all or a substantial portion of the region*". There is a difference between the two. This study recommends that an 'affecting trade standard' is essential to set a jurisdiction for applicable regional law, and that the desirability of the second standard depends upon the longer-term objectives of the ECOWAS. If the Community eventually intends to have a centralized apparatus to review mergers or take action against foreign practices that affect the region overall (or a substantial portion of it), then the second standard would be desirable since it expresses a single territory treatment. In this scenario both standards should be stated. If the ECOWAS commences implementing common economic and monetary policies, then this is also a stronger argument for stating a 'territory-wide' jurisdictional standard in addition to one 'affecting trade'.

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[453] The Economic Community of West African States (ECOWAS) Treaty was signed by the 15 Member States on 24 July 1993 and is available at http://www.sec.ecowas.int/index.html. It was circulated to other WTO members by communication to the Committee on Trade and Development on 6 July 2005 as WT/COMTD/54, 26 September 2005.

This broader scope of jurisdiction is already seen in the WAEMU arrangements where the region is treated as a whole (as a single territory), just as this would be expressed in a single national law where practices affecting competition ‘in the territory’ are commonly treated[454]. The EC Treaty applies the more traditional ‘affecting trade’ expression although this has also been explicitly expanded to an ‘affecting territory’ dimension for the purposes of merger control. The EC external agreements uniformly apply the ‘affecting trade’ standard. An expression treating practices affecting the ‘territory as a whole’ is not a prerequisite for a regional competition policy. A standard based upon ‘affecting trade between the members’ is a prerequisite for a regional legal expression that sets a field of play for a regional law and legal action against any anti-competitive practices affecting trade.

In order to have effects in the Community legal order, the expression of jurisdictional power has to be made at the level of treaty obligation. For the ECOWAS, this would be accomplished by a protocol that added treaty articles within a section dealing with and entitled ‘competition policy’. It is believed here that the independence and jurisdictional basis for a regional competition law cannot be promulgated by a Community regulation, directive or decision. These legal acts would be used to implement substantive standards and institutional features, but the legal basis of the law itself should be generated at the treaty-making level. For the ECOWAS, this suggests a protocol that provides amendments to the existing treaty delineating the addition of competition law articles to the treaty.

2.1.2. Zones of jurisdiction – Member States and Community

It is clear that the jurisdictional lines between regional and state territory have to be clear and well prescribed. However, in a number of regional and federal systems this jurisdictional line has also evolved

[454] 1994 Agreement for the West African Economic and Monetary Union, signed by eight Member States, and as revised in 2003 (UMOA and UEMOA). The 1994 Agreement was circulated to WTO members via the Committee on Trade and Development as WT/COMTD/23, 23 February 2000. The 2003 revised treaty is dated 29 January 2003 and is provided on the WAEMU web site (French) available at http://www.uemoa.int/index.htm.

over time as a result of the cases and interpretations made by the authorities and the courts. There are always cases where an ‘affecting trade’ and an ‘affecting the national territory’ standard both apply. And there are a number of jurisdictions (regional and domestic) where remedies taken in one system do not preclude action and remedies being taken in the other. The United States is one example where there is often a concurrent action taken by an individual state (affecting competition in the territory of the state) while the federal power is also being applied according to either an ‘affecting trade between the states’ standard or with respect to the larger US territory.

The original EEC construction provided for a first enforcement regulation, 17/62, and attempted to define several types of cases that could not be considered as ‘affecting trade’ between the members, for example where the subject firms were all based within a single Member State and the practices did not relate directly to imports or exports. Over time that expression did not serve so well for court interpretations dealing with the rise of the ‘internal market’ concept. In legal practice, the court has tended to grant quite a broader scope for ‘affecting trade’. While this has assisted the development and application of regional law, it has not tended to stimulate the Member States in applying their own national laws. Over time this situation has also evolved as the Member States have more actively pursued actions also contemplated by the Community, but in regard to their own unique legal effects upon the Member State territories.

There are inevitable overlaps between the two levels of competition law. Rather than attempt to prescribe a precise line between them, it is more important to recognize that concurrent jurisdiction is not necessarily a problem to be avoided. What is recommended is for both a final arbiter of the Community’s regional scope of application in the event of clear conflicts of application, and a cooperation mechanism that can help allocate cases between regional and national levels. The initial management of conflict can be addressed by a Commission or regional authority in respect of any particular case (if so empowered), but there must also be an ultimate arbiter to rule in the event of conflicts between laws. This function is traditionally held by the superior court, in the case of the ECOWAS – the Community Court of Justice – either on the basis of preliminary opinions, appeals, or cases of original jurisdiction. This standard, as with any standard, calls upon the court to interpret the

scope of a regional zone of jurisdictional action for regional competition law application.

This is not so much a delimitation between state and region, since the Community Court does not have the jurisdiction to instruct the state law as to its proper scope of application. This is an issue that is for the national court to determine. The only matter of issue before the Community Court is the proper definition of the zone of authority for the regional law. If this results in overlap and concurrent exercise of power, then no matter.

Identifying the zone of authority of a regional legal expression can also be prescribed by a Council Regulation that sets out the powers and activities undertaken according to the regional treaty law (protocol). This regulation can set *de minimis* levels of turnover (below which trade between the states is not deemed to be affected) and it can also establish the exemptions from regional law for small and medium-sized enterprises (by which their agreements are deemed to not appreciably affect trade between the Member States).

2.2. Prescribed anti-competitive practices: stated prohibitions applying to private and public practices

Practices that are recognized by members as injurious to trade between the states must be enunciated at the level of treaty law (protocol); however, a regional law is chosen to be made enforceable within the Community. As a basic point of departure and recommendation, the private practices listed both in Nigeria's proposed law and the existing WAEMU law also reflect current EC Treaty practice and the EC external relations (trade agreements) practice. These are the obvious candidates for a regional statement of prohibited and actionable practices. The argument being made here is to set the listing of practices as close as possible to the existing WAEMU and the draft Nigerian laws. Since any competition provision likely to emerge in an EC–ECOWAS Economic Partnership Agreement will also contain a listing for cartels, abuse of dominant position, and possibly a rule of reason for pro-competitive vertical restraints, the use of these

expressions for the anti-competitive practices to be treated should be a 'given'[455].

There can be an issue over whether the standard details that the practices are 'prohibited' or 'incompatible' or 'actionable'. The recommendation here is that a prohibition against injurious practices be clearly stated, as in the EC Treaty formulation. This establishes a stronger basis for the superiority of Community law and the obligation for the national courts and authorities to apply it. Agreements that fall within the prohibition should be stated as being 'void' and without legal effect in the Community either in the treaty or the supplementing regulation. The 'agreements' and 'practices' covered within the listing should be broad enough to cover any and all agreements or practices that detrimentally (or appreciably) affect trade between the states. Any further delineation to excuse practices should be undertaken according to negotiated exemptions for a Council Regulation. A common exemption made for this purpose is a labour agreement. It is not common practice for a regulation to exempt industry association agreements and it is not a common treaty expression to see any particular reference to association agreements being 'less actionable' in principle than any other restrictive agreement. The better principle is for the treaty to cast a clearly stated but 'wide net' as to the practices to be treated.

The listed practices and prohibitions should be applied without distinction, at the treaty level, to both private and public practices. Public practices present a myriad of complexities that have to be resolved as an ongoing activity of the Community and its Member States. However, in principle, they should be fully captured by the primary treaty expression when they fall within the legal standard of affecting the trade between the members. Otherwise, there is no legal basis to raise and assess public practices *via* a Community apparatus, and even cooperative approaches to dealing with public practices will not likely move forward. For these areas, there is a risk of distorting the field of play where one type of practice or agreement is singled out for some better treatment (as in the form of an immunity) at the treaty level. The

[455] Nigeria summary drawn from HB 70, as published in the Nigeria Official Gazette, Vol. 92, Vol. 42, 10 June 2005. An English summation of the WAEMU competition law can be found at, OECD, Global Forum on Competition, Submission by WAEMU, 13 February 2004, CCNM/GF/COMP/WD(2004)31.

treaty should not distort the field between private or public practices and nor should it distort it between cartels and associations.

2.3. Community measure of damages

The regulation giving effect to a regional law should enunciate the legal effect of agreements that violate the treaty provisions. This regulation should make it clear that such agreements are not enforceable within the national courts, i.e. that they are 'void' in respect of the listed practices. In addition to this, the regulation should include criteria for assessing injuries and calling for fines and penalties for anti-competitive practices. These penalties should be set in such a manner that they provide guidance to a national court in forming orders. The measure of damages established should ensure that wrongdoers are penalized for past practices in a manner that would not reward them or where they are able to 'break even' for the rents they have secured from the practices.

2.4. Rule-of-reason considerations

2.4.1. Vertical restraints

There are detailed theoretical arguments that can be made over the advisability of stating any prohibition for vertical restrictions and exclusionary practices, and various tests can be raised that apply to dominance and the nature of its abuse. The two more comprehensive laws in place (WAEMU and the legislation as proposed for Nigeria) currently apply the 'negative and positive' criteria approach for rule-of-reason assessments for pro-competitive vertical restraints. And for the treaty expression, it is recommended that this is the better approach. The practices themselves are covered by the prohibition, but then can be validated by consideration of the rule of reason. This follows the 'wider net' for regional law. The 'formula' for the negative and positive criteria to revalidate contractual restrictions has permitted decision makers and the courts to develop a respectable body of law regarding vertical restraints, which is available for reference in the ECOWAS context. This approach also sets a clear legal basis for a regulation to come forward over time to enunciate block and group exemptions meeting the criteria of these listed tests.

2.4.2. Dominance and abuse

Issues on dominance in the market and abuse are also constantly debated among developed and developing authorities. The most developed jurisdictions recognize that even highly concentrated monopoly firms may not be engaging in abuse if complex markets for technology innovations can render a determination of abuse redundant even before it is finalized. Developing countries can examine the earlier approaches applied to abuse of dominance by those same developed country authorities and courts. These allowed for market share expressions and particular practices that in combination with high concentrations indicated an initial finding of abuse. To attempt any more in a developing country arrangement, where the national courts will also be playing a role, may overextend the capacity of a regional competition law at the outset. A regulation can enunciate the criteria and can be amended over time to reflect the status of the evolution within the Community and its capacity to assess efficiencies generated by dominant firms. The developmental and resource dimension is clearly a consideration in this field and it does not seem appropriate here to prejudge the evolution of law in this context.

2.5. Governmental practices

Two areas that require further consideration are state aids and public practices, including government enterprise schemes and governmental grants of special and exclusive rights. Unfortunately, they are beyond the scope of this study and there is no shorthand prescription to deal with the considerations for any of these subjects. The issues that would have to be taken into account in the relationship between a regional law and domestic industrial policies include enterprise activities (special and exclusive rights) and state aids.

2.5.1. Enterprise activities – special and exclusive rights

Governmental grants of monopolies and the variety of joint enterprise schemes between government and private firms should be captured by the general treaty expression. That is, injurious public practices affecting trade between the Member States are as actionable

as purely private practices. Any other treatment at the treaty level will distort the types of measures and practices being undertaken in the Community where private arrangements can be shifted to governmental and quasi-governmental arrangements. By clearly providing application of Community law at the treaty level from the outset to all practices and agreements, the legal basis is clarified for later regulations to reflect the considerations of the members regarding exemptions and exceptions. These can be developed in a process of transparent inventory (disclosure) and classification of what activities the Member States are engaged in that may actually detrimentally affect trade within the region. This is essentially a negotiating terrain that also touches directly upon economic development activities. However, it should be engaged within the context of Community law application at the outset. Public and private practices should be equally addressed without distinction in the law of the treaty.

2.5.2. State aids

For state aids, a WAEMU legal prohibition provides an initial, sensible expression so that a member's subsidy falls within the prohibition when granted upon (made conditional upon) exportation to other members, or made conditional upon the purchase of local content. Both of these types of subsidies are so trade distorting that they clearly also fall within the actionable provisions prohibitions in the original General Agreement on Tariffs and Trade (GATT). The members should proscribe these practices as prohibitive in the treaty.

An additional complementary approach is also suggested by reference to the WTO Subsidies Agreement. While this only applies to trade in goods, there is no reason why it cannot be incorporated at the regional level for its standards, and also extended to apply to services as well. By a Council Regulation, the ECOWAS can 'reference' its Community law to the WTO Agreement on Subsidies and can state the WTO articles that are being adopted for the purposes of Community law. This provides a definitional set of terms for what constitutes actionable subsidies and provides the elements for tests dealing with specificity and injury. The WTO regime is closely modelled on EC state aid practice and has been found to be workable in the panel and appellate body cases that have come through since the WTO agreement entered into force. Where the members understand that

there is a need for greater flexibility for exempting subsidies (in relation to regional development, poverty alleviation, environmental concerns, etc.), than is currently provided for in the WTO agreement , then the Council Regulation can define the terms of agreement between the members as to the types of subsidies that should be made non-actionable or adjust the burden of proof in such cases as they wish.

The EC state aids system provides for value thresholds and an obligation of notification of subsidies to a central authority. That authority has the power to make a decision, which can be appealed to the Community Court i.e. the European Court of Justice (ECJ). Since the EC Member States are also members of the WTO, their notifications to the EC Commission are also compiled and notified to the WTO. EC Member States have had little difficulty in managing the two applicable regimes. ECOWAS members are also members of the WTO and have the same notification obligations. Developing countries are no longer exempt from the Subsidies Agreement, although differential provisions still remain for least-developed countries (LDCs).

A Council Regulation for state aids should therefore be established that can incorporate the primary elements of the WTO system (by reference), apply it to services as well as goods, and establish a Community notification and decision-making instrument. Provisions should also be made for LDCs and for non-actionable subsidies.

2.6. Merger control

There is a good argument for regional merger control and for a system of pre-notification and clearance as the region develops a territorial identity and attracts investment from firms doing business ‘in the market’. While many criticisms are made of developing countries operating pre-notification systems, the value of pre-notification is also noted for developing country and regional authorities that receive (without having to investigate) ‘free’ information on proposed concentrations and the markets upon which they operate. Developed country practitioners are critical of the proliferation of notification systems. But for developing countries, there is a potential windfall in market information generated by notices. Moreover, since developing country (or regional) authorities are actually responsible for the quality of competition upon their territories, notification systems allow them to

respond to new concentrations that affect their legitimate legal domains in the same manner as such systems operate to inform developed country authorities.

Where a pre-notification and clearance system operates in line with accepted international principles (as enunciated by members of the International Competition Network (ICN) for example), there can also be an extended benefit for regional and international firms that can exercise a single notice system for the region when their arrangements affect more than one Member State. Similarly, a regional system allows the smaller states to have access to a set of remedies for mergers substantially restricting competition in their national markets without the necessity of establishing a domestic control apparatus. A final positive effect for regional merger control is that it allows the region itself to defend its territorial interests in the external competition policy arena.

To provide for the possibility of regional merger control over time, the jurisdictional standard in the treaty should refer to agreements 'affecting the territory' or a substantial portion of it, as discussed in the section above. The administrative load on a pre-clearance system is high and a decision to adopt merger control strongly suggests the necessity of a centralized authority at the Community level capable of working in very short time frames. However, it is also conceivable that some elements of regional merger control can be facilitated by an intergovernmental group of existing national authorities (or advisory group) in cooperation with the Commission. Although there are confidentiality issues presented by these approaches, in principle it is also possible for a single member that already has a notification and clearance system to share the non-confidential components of a concentration with the other members, and then either cooperate on the review of a concentration to the extent that it affects the other members, or possibly to vet the merger in respect of the other territories. This is a high form of intergovernmental cooperation and requires structured intergovernmental or agency arrangements. An intergovernmental group of existing authorities can also be established to consider and recommend a more detailed approach to regional merger control for the Community that can form the basis for a regulation at a later time[456].

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[456] For a similar proposal as applied to MERCOSUR, see Mathis, J. (1998), *Issues in Regional Merger Control*, Journal of World Competition, 21/3, pp. 29–44.

Although a regional merger control approach may not be viewed as a first priority within a regional competition law, the groundwork should be laid by cooperative action of the Member States that is both substantive for dealing with current mergers that affect the region, and that works prospectively with a view to recommendations for a regional system of merger control.

3. Minimum requirements – Application of community law

3.1. Introduction – a system of private rights enforcement

This section examines the application of ECOWAS law within the legal regimes of the Member States, with an emphasis on application of the law by private rights of action and recourse. While this discussion is closely related to that of a regional institutional mechanism, such as establishing an ECOWAS authority or advisory grouping, the focus of this section is on the application of the regional law as it relates to the Member States.

The 1993 ECOWAS Treaty and the revisions undertaken by decision and protocol in 2006 together clearly establish the superiority of ECOWAS Community law. This indicates that the treaty provisions and the regulations drawn up by the Council according to the ECOWAS Treaty are already 'generally applicable' within each of the Member State legal regimes, and are therefore binding upon the agencies and the national courts of the members. Thus, where a national court or authority is presented with a question of Community law, Community law should be applied. Where an authority or court is presented with a possible conflict between national and Community law, it should resolve that conflict in light of the superiority of Community law[457].

These points of general application and superiority of regional law appear clear from the ECOWAS Treaty as it stands. However, these

[457] ECOWAS Treaty as cited above. Binding effects on Member States are set out in Article 9 for Authority Decisions, Article 12 for Council Regulations, and Article 15 for Court judgments.

two aspects also raise questions on the application of a regional competition law:

1) Who can invoke the law within the national systems?
2) Before which national authorities can the law be invoked?
3) How can a uniform application of regional law be guaranteed by the Member State courts and authorities?
4) What ultimate rights should be accorded at regional level to redress improper applications or non–applications of Community law?
5) What is the position of UEMOA competition law in the ECOWAS legal order for these purposes?

This discussion focuses on the application of law without reference to a regional authority except where the absence of a regional authority has a bearing on the issue or the recommendation.

3.2. The argument for direct effect of regional competition law before national courts and authorities: who can invoke the law?

Superiority and general application are not the same as granting an individual direct effect in the legal order of the Member States. Because the existing treaty indicates the superiority of Community acts, it is clear that national courts are obliged to apply the law. However, this is not the same thing as granting a party the right to invoke the Community law as expressed within the treaty articles before the national court or authority. The legal basis to invoke the law directly within a national court stems from the nature of the treaty rights and obligations and their implications for affecting and conferring individual rights, but there is no expression in the ECOWAS Treaty stating that its regional laws shall have direct effect.

The EC Treaty does not provide for direct effect of its regional competition law either. This development occurred (early on for competition law provisions) by the action of the European Court of Justice interpreting the treaty provisions as they were raised in actual

disputes, and then ruling that the competition provisions conferred direct rights for individual action. The ECOWAS Community Court has this incumbent (inherent) power to interpret the treaty and reach the same result. Arguably, so do the national courts, which also have a duty to apply Community law and could rule on an issue of direct effect if and when presented in a case.

However, the ECOWAS structure has two differences that may delay a court interpretation granting direct effect for regional competition law. Since access to the ECOWAS Court is limited to actions brought by states, such an interpretive issue may be avoided by the states in their decision to press a case. Similarly, since the ECOWAS Commission cannot bring an action to the court, this avenue for raising direct effect also may not be utilized. Nevertheless, the issue is still likely to arise in private contractual enforcement actions in the Member States. The example would be where a respondent in a private contract action defends against the enforceability of the contract terms by asserting its illegality under ECOWAS regional law. At this point a national court will refer to the superior ECOWAS regional law, and will have to decide whether or not a respondent has an individual right to invoke the treaty provisions or the terms of a Council Regulation. While the rights to seek a preliminary opinion from the ECOWAS Court are also not settled by the treaty or the Council/Court Regulation either, there is the possibility of inconsistent rulings on this point from different national courts. The possible absence of a regional authority that can receive private complaints and can rule on cases pushes the argument more strongly in favour of a clear declaration of direct effect in the national systems.

3.3. Before which state authorities can the law be invoked?

As noted above, the issue of direct effect can arise in a private contract dispute before a national court. It can also arise in an agency enforcement action under national law where the respondent pleaded an inconsistency with Community law, or sought to make a counterclaim against the moving complainant as based solely on Community law. There are states that have no competition laws, and the states themselves choose the means by which to implement their national laws – either by using an agency model exclusively or by installing a regulation that is to be mainly applied by the national courts.

The various combinations possible suggest that the level of direct effect that is to be granted to individuals within the region should be done without regard to the existence of national competition laws, or the means by which they are implemented by the national systems. This would mean that where a state has not passed a national law whatsoever, a private party could still assert (and defend) a claim based on an ECOWAS regional law in the courts of that state. Similarly, where a state has chosen to have an exclusive agency model (all competition complaints must be made solely to the authority), one can still not discount the possibility of defences being raised in private national court actions that seek to invoke Community law. That is, direct effect should be granted in respect of all courts and authorities within the Member States and not be limited solely to competition authorities alone or to those states that have competition authorities.

3.4. Can a uniform application of regional law among the Member States be guaranteed?

If the Community law is generally applicable – which it is – and the national courts have an obligation to apply it (irrespective of who can invoke it), then the national courts will also be required to interpret the Community law. The uniformity of this application, which is the ability to apply it consistently from one court to another and from one Member State to another, is an absolute priority for the legitimate grounding of a regional legal system. Without uniformity of application of the regional law, the system cannot be made functional and it cannot be relied upon to distribute rights and obligations according to the treaty provisions.

There are several means by which uniformity can be promoted, and all are relevant for any regional system that has established a regional court. A first one is to allow a right of appeal to the regional court from a national court ruling, normally from the highest national court. A second is to provide the right of a national court to request and receive a preliminary opinion from the regional court on matters of interpretation and application of the regional law. A third is to allow certain actions to have original jurisdiction before the regional court. A final area is more ‘guidance oriented’ where a regional agency or body issues papers and notices expressing its understanding for points of interpretation of the regional law.

The ECOWAS Treaty does not provide for a right of access to the regional court for any party other than a Member State acting individually or collectively by the Authority. If this limitation cannot be revisited in the context of developing regional competition law, then the emphasis has to be placed on a preliminary opinion procedure. The ECOWAS Council already has this right secured by the treaty (for the purpose of 'advisory opinion'), and what is proposed here is that this should be extended to the national courts for any case where a treaty article or a Council legal act is raised in a national proceeding. For the purposes of judicial efficiency, this power to request preliminary opinions should not be limited to the highest national court but the lower courts should also be able to obtain the regional court's interpretation and then insert that opinion into the domestic legal proceeding. A preliminary opinion procedure within the ECOWAS is therefore a minimum requirement to ensure the uniform application of regional law.

3.5. What ultimate rights should be accorded to redress incorrect application or non-application of Community law?

The ECOWAS Treaty confers a right of action before the regional court to the Member States or to the Authority[458]. It also may appear that a state can bring an action on behalf of a private party before the regional court. There is no other regional institutional entity that can bring an action before the ECOWAS Court against a state or a private individual[459]. This final question opens the door to a discussion on a regional enforcement mechanism and the balance between institutional power and private rights that may be set under a regional competition law. It can be argued that where there is no regional authority that can form a claim against a Member State to enforce compliance with Community law, that the final acts of securing legal remedies should be strengthened at the level of appeal from the highest national court. Where there is an independent enforcement mechanism established at the Community level, then an alternative and final remedy to challenge a state would be available.

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[458] ECOWAS Treaty as cited above, Article 76, Settlement of Disputes.
[459] The Council is given the right by the ECOWAS Treaty to request advisory opinions from the court. Article 10(3)(h).

This existing structure strongly suggests that the substantive treaty rights being created by the ECOWAS are essentially only being granted to the Member States and not to the firms that are seeking to trade in the ECOWAS regional market, nor to the ECOWAS institutions that have some limited mandate to make effective the treaty rules and the Council Regulations[460]. While this approach preserves the maximum amount of sovereignty for the members in the execution of the ECOWAS regional plan, it does not bode well for the ability of ECOWAS law to obtain a sufficient degree of independence from national law or to develop a system of recourse for continuing violations of the regional law.

The situation appears to be even less conducive to the interests of foreign firms who do business within the ECOWAS, since those firms would have to convince a Member State to bring the action on its behalf before the regional court. In addition to the possibility that this might be discriminatory in any external agreement (the EC and an Economic Partnership Agreement (EPA), or even under WTO rules for national treatment), it is also a serious defect in the structure of the treaty and the institutional powers of its high court. The value of this limitation on actions is questionable, if the preservation of Member State sovereignty is balanced against the functioning of the market rules for the customs union and the political downside of having these disputes forced to be generated at such a high political level. The evidence suggests that there is little likelihood of resetting the ECOWAS Court authority to hear original claims or appeals by any party other than a state in respect of a potential ECOWAS competition law. Other possibilities must be considered for a competition regime because the limitation of actions before the ECOWAS Court will cause problems both internally for the Member States and externally for the trading partners as the customs union becomes more complete. Thus, a right of final appeal for issues dealing solely with ECOWAS law should be granted from the national

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[460] The powers of the ECOWAS Commission (formerly entitled the Executive Secretary) are provided in Article 19 of the ECOWAS Treaty. Subsection 3(a) states that the Commission has the duty of 'execution of decisions taken by the Authority and application of the regulations of the Council'. We do not read this provision as granting the Commission the power to make a claim against a Member State in the regional court. The Council itself (the higher legislative authority) is only granted power to request an advisory opinion from the court. We do not offer an opinion on whether a regulation that did convey such a power to the Commission would be in violation of the Treaty provisions.

court of final jurisdiction to the Community Court. This should be provided by a treaty provision or by a decision of the authority of the Heads of State.

3.6. The position of WAEMU competition law in the ECOWAS legal order

Within the ECOWAS arrangement, the WAEMU is also a regional grouping. From a territorial perspective, the WAEMU is a distinct customs territory within the larger (forming) customs territory of the ECOWAS. For competition law, the WAEMU has all the characteristics of a single national territory, with its own high court providing for the superior application of its regional law in respect of its own members and as applicable across the entire WAEMU regional territory. This structure appears to be so identical to the position of a single Member State (with full state territorial powers) within a regional grouping, that for all practical purposes the WAEMU should be treated as a single state (customs territory) entity in respect of a created ECOWAS regional law. Just as ECOWAS law would be superior and binding on the individual Member States, so would it also be applied to the customs territory of the WAEMU. ECOWAS law already has superiority over the individual Member State laws within the region and must be applied by the courts and agencies of the states. This same general applicability and superiority of ECOWAS regional law would apply to the WAEMU territory just as it applies to the state territories of the WAEMU members. Any other interpretation of the ECOWAS Treaty would nullify its provisions stating that ECOWAS law has a binding effect on the Member States.

4. Regional bodies and institutional control

4.1. The argument for regional authority

A diffuse system of treaty law application by individuals before national courts and authorities can underpin an operational and functional regional legal order, just as private rights of action operate to ensure the legal security of law and remedies in many domestic legal systems. In competition law, this area of private action is probably most

effective in addressing exclusionary practices and abuses of supply chain dominance where complainants can more easily identify the contractual practice that is affecting their commerce and bring that practice before a court or authority for a legal assessment and action. A system of private rights can also capture many of the minor actions that otherwise fall below the 'radar screen' of competition authority attention. This is positive for building and reinforcing a set of market rules and principles that contribute to economic development where smaller players and markets create local economic and commercial growth. Many developing (and developed) countries have long provided for such types of private actions at the lowest possible court levels where claims for the 'refusal to supply' or 'unfair contract terms' overlap the subject areas of competition law.

In different subject areas and within larger regional or international markets, private rights of action are also understood to be insufficient to provide a reasonable prospect of implementing and enforcing competition law. Private actors find it difficult to obtain information on anti-competitive practices generally, but on cross-border cartel activity in particular. Cartels do not operate in public for obvious reasons and the information needed to bring them to the surface for remedial action requires investigatory power, expertise and resources. It is a rare case where a cartel is disclosed by the investigatory efforts of a private individual or firm. The vast majority of these cases are the result of agency investigations, and increasingly those with the power to operate amnesty and whistle blower programmes.

A similar gap occurs in anti-competitive practices which, while affecting the downstream purchasing firms, are also able to be passed along to the ultimate consumer who is ultimately the injured party. Where cartels or abusive practices can be relayed to the largest national and regional consumer markets, the losses to the consumer are high and yet the capacity of individual injured consumers to identify the practices and develop complaints before national courts is low.

4.2. Competition authorities and core powers

A brief examination of the types of powers granted to independent competition authorities provides some insight into the implications of considering an independent regional authority. The

enumerated powers listed below are drawn from the original enforcement regulation of the EEC, Regulation 17/62. According to the regulation and operation of Community law, all powers enumerated are made subject to review on appeal by the European Court of Justice.

- Investigations:

- to issue written requests for information to be received from the Member States, private firms and associations
- to assess penalties in the event of non-compliance with the Commission's request for information
- to initiate independent investigations within the Member States upon notice to the member. The right to obtain the cooperation of the member's own domestic search and warrant system is specified. This includes the power to enter business premises according to national law and to examine books and records, and to request explanations on the spot
- to assess penalties for providing misleading or false information to the investigators

- Decision making and adjudication:

- to conduct hearings and compel testimony according to due process rights to submit and to be heard
- to issue a decision that a practice infringes the treaty and to order that the practice be brought to an end
- to determine that a practice does not fall within the treaty prescriptions and the power to issue exemptions on a case-by-case basis

- Remedies:

- to determine and assess fines for infringements of the treaty according to the governing regulation,

There are important differences between a regional competition regime and a regional trade regime where practices being addressed in competition have a strong private nature (as addressing private firms and private behaviour), and where the interaction between a regional enforcement system and private economic actors is brought directly into

play. Another difference shown between a competition and a trade regime is that the realm of investigatory power is enlarged in the competition field. For governmental trade measures that may violate the commitments of the treaty, there is not the same need to build evidence of the practices involved or for the need to compel documents or testimony in order to disclose the practice and prove a case.

4.3. Policy proposals

4.3.1. For a fully functional and independent competition commission

The establishment of an independent institutional power considers the balance to be set between a regional authority and the Member States as they are represented in the regional legislative domain of the Council. This is fundamentally a question of balance between executive enforcement power and legislative oversight power. As such, while the questions addressed are 'legal' to the extent that they deal with institutional design, they are also obviously political in determining the degree of independence of a regional executive enforcement authority and the degree of residual sovereignty to be held by the Member States controlling the pace of regional integration. What is 'best' for integration and what is 'possible' for integration present mixed questions of law and politics.

The case for a fully functional and independent regional competition authority to deal with the functions that are enumerated above is based in a large part on the nature of competition law enforcement itself. This presents unique issues in cross-border cases that cannot be easily resolved by sole reference to national authority power and private actions. Recognizing that the existing ECOWAS Treaty structure cannot accommodate this degree of independence, the functions of a competition commission should be based outside the existing commission structure, in a separate commission or authority. This is similar to many national competition authorities where the mix of functions for investigation, decision making and adjudication renders them somewhat different from many other executive branch activities. In this sense, a competition commission is more of a complete or 'closed'

system touching upon elements that also include rule making (legislative) as well as judicial (adjudication) aspects.

While the lower ECOWAS institutions do not have any direct access to the regional court, the review or appeal of the authority's decisions should be located in the apparatus of the Council. This power should be exercised by majority voting or by a reverse consensus procedure. The Council does have the power to seek advisory opinions from the court in its operations and this power can also be used in dealing with the review of an independent commission's activities on particular cases. If the review power is to be held by the Council, then the voting aspect of this regional system is critical. If the Member States insist on retaining individual veto power over the decisions and proposed actions of a regional authority, then a functional regional authority cannot emerge with any sufficient independence to perform the tasks necessary to give effect to a regional competition law. An authority should not be established if a single member veto is retained.

4.3.2. For an advisory panel with power to refer actions

At the other end of the spectrum, the already intergovernmental character of the ECOWAS structure allows for the creation of an 'advisory panel' of individual experts or representatives of the national authorities to receive complaints by referral from the existing Commission. The panel would then refer matters to the Member State competition authorities for legal action. The minimum performance characteristics of national laws would be set out by the ECOWAS (probably by Council Regulation) and there would be minimum requirements imposed for convergence regarding the practices to be treated by the laws and the definitions for exemptions.

In this approach, the power to receive complaints and to refer to national authorities would be (more or less) the extent of the regional authority power with respect to the prosecution of individual cases. A failure of a member to address an action referred to it by the authority could be the subject of an advisory panel's follow-up report to the Council and the Council would have the power to address the Member State or to make an additional report that serves as information to the Heads of State. The advisory panel could have some power of coordination with the national authorities and there could also be some

recognized potential to assist in the allocation of particular cases or to facilitate cooperation (information sharing) instruments as these may be developed.

Additionally, the remaining functions of the advisory panel would be more similar to a system of peer review. This would include the ability to survey the functioning of the Member State laws in a manner that would isolate the points where the law was not being implemented or applied, or was not adequately applying or addressing Community law violations, or where the law was not being accorded on the basis of national treatment (in respect to the rights of foreign complainants or granting more favourable treatment of domestic firms).

4.3.3. Small economies and LDCs

The approach suggested above relies upon national law and authority to render case action effective. The contentious issue here is whether or not LDCs and the smallest economies should be required to have any competition law at national level. The resource drain for implementing national laws is demanding and some countries' resources are possibly better spent either in dealing with localized unfair trading practices or in promoting higher levels of consumer protection. Furthermore, the current emphasis is on regulatory policies that have a more direct relationship to meeting the demands of poverty alleviation and the other millennium goals. Any system that requires a Member State to have a national law should be examined in this context, since the recommendation to have a law is establishing a national regulatory priority, and obviously at the expense of some other priority.

While these smaller LDCs are also clearly affected by domestic and external anti-competitive practices, their best opportunity for recourse lies in a regional authority that can take care of their interests, especially those anti-competitive practices originating in the other Member States or internationally. Similarly, where their own firms may be engaging in exclusionary practices to the detriment of other regional member firms, a regional authority can also deal with those issues according to the treaty law without the need for an LDC to create a separate national law. Also, as a practical matter, in the smallest of markets where consumption and production levels are low, it may well be the case that most of the exclusionary practices engaged in within

these LDCs would fall below the regional turnover thresholds for application of Community law or fall within the exemptions for small and medium-sized enterprises.

4.3.4. Large economies and non-implementation

The smallest territories can be significantly hurt in an intergovernmental referral apparatus if the largest territory markets do not create functional laws that allow the regional law to be applied in their jurisdictions. Here the referral apparatus has to have a stronger mechanism to ensure either that the establishment of national competition laws takes hold in the first place, or, in the event that it does not, that cases can proceed anyway. It is not clear at all that a soft law 'name-and-shame' approach is going to be successful in the ECOWAS for these purposes. This approach has been used in various forms for aspects dealing with the trade liberalization regime of the ECOWAS, and the record of implementation with an intergovernmental Council apparatus is not very good. For matters involving trade, where the treaty also calls for Council or Heads of State actions to 'address Member States', as in the case of dumped goods for example, one wonders if any state has ever been addressed by the intergovernmental bodies in a manner that has stimulated compliance or a change of behaviour in favour of meeting the treaty objectives.

If intergovernmental recourse has not stimulated compliance with the core free-trade and compensation commitments, which have been in place since the 1970s, then what countervailing consideration would argue that this same approach should work for a competition law regime – a regulatory area for which many African, Caribbean and Pacific (ACP) foreign ministers are also on active record as opposing for inclusion in the EC–EPA Cotonou construction? Even between only the larger members, the intergovernmental route also has some significant pitfalls. In the absence of a central authority, whatever promise has been generated for a 'customs union' construction can be undermined where differences emerge between the implementation pace of national laws, or worse, by decisions taken by national authorities that others see to be reflecting industrial and trade policy interests rather than competition policy interests.

Here the MERCOSUR example is unfortunately but necessarily raised. This intergovernmental ministerial approach to regional competition law has not been implemented, due to the failure of individual members to pass national laws, and the absence of effective regional competition remedies has contributed to a degrading of the free-trade schedules for this common market. This example is too close in point to the ECOWAS situation, and far more so than the other ACP arrangements that are operating with higher degrees of institutional treaty independence such as the COMESA or possibly the CARICOM.

4.3.5. Proposal for alternative case mechanism

The primary consideration is that while a referral concept has solid value and can form the core of a regional approach, there has to be an alternative to a national case referral in the event that the referral cannot be effectively made or acted upon. This is a minimum requirement for achieving an implemented regional strategy for competition law, and without it the risk of non-implementation of regional law is too high.

The argument here is to grant the advisory panel a clear right to petition the Council in the event that a case referral cannot be responded to either because of non-implementation, or because of a substantive or procedural defect in the national legal provisions. This is similar to the criteria applied by the EU–Euro-Med and EU–South Africa free-trade area arrangements for instituting recourse on a request for action that cannot be fulfilled. In the ECOWAS, the Council, by a majority vote, would then decide whether or not the advisory panel, with the support of the Commission, can either bring the case directly before the ECOWAS regional court, or alternatively, be taken up by the Council itself for a majority decision on the merits of the case[461]. The Council would, of course, have at its disposal the power to request an advisory opinion from the court on the legal interpretation of ECOWAS law.

This alternative to national referral is a minimum loss of prospective sovereignty of the Member States given the objectives of

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[461] EU–South Africa Trade, Development and Cooperation Agreement, http://europa.eu.int/eur-lex/en/archive/1999/l_31119991204en.html. Article 37, ‘Appropriate Measures’.

the ECOWAS Treaty, and in view of the benefits that flow to all members if the implementation system was made effective. If this recourse procedure is included in the scheme, the likelihood of successful implementation of national laws should be increased and it is possible that the alternative procedure need not be utilized or only be called upon in rare cases.

4.3.6. Other requirements for national referral – investigatory powers and preliminary hearing

Even in a system where referral by an advisory panel is being made functional, there are two other points of weakness that should be addressed. First, the advisory panel is not being given a clear basis to engage in investigations of the complaints referred to it by the Commission. Second, the advisory panel does not appear to be empowered to commence investigations in the absence of a complaint being referred. Both are important aspects and discussed briefly in turn.

Whether or not a regional body should exercise all the investigatory powers enumerated above for a centralized authority is not determined here, but clearly the power to collect or compel information from authorities and private firms is a priority. It is clear that without the power to investigate, a regional advisory panel cannot make intelligent referrals in the first place. The panel needs to be able to determine if a referral should or should not be made, and investigatory powers to inquire and receive information are needed to facilitate this.

One possibility is that the advisory panel could establish a 'preliminary hearing' procedure prior to referral that would allow parties to submit information and be heard. The standard for making such a referral would be based upon a 'probable cause' standard, i.e. that there is a probable cause to believe that an infringement has occurred and that the infringement can be addressed by a referral to a particular Member State enforcement system. Investigatory power is also necessary if the advisory panel seeks to fulfil its function of reporting to the Council those cases that are not adequately treated by the national authorities. Otherwise, it is not clear how the panel can compare the outcomes of cases actually handled by the national authorities with the expectations that an infringement could be determined and corrected.

The call for regional investigatory power also relates to developing the capacity to address international practices that are beyond the visible purview of domestic firms in the ECOWAS region. It would allow the regional mechanism to survey international cartel enforcement actions being taken abroad and consider the possibilities of information collection within the ECOWAS. An authority with this power can also derive the basis to extend its investigatory powers abroad, including the potential to develop international cooperation arrangements with other developing regional authorities (within the African Union or the ACP group for example) and with other developed country authorities. The international dimension also supports the argument that the investigatory powers of an advisory panel should not be limited to dealing only with actual received complaints. There is no reason why an advisory panel should not be able to follow its own leads and determine its own basis for referrals. Rather, limiting the panel to investigate only received complaints would seem to inhibit the potential for the ECOWAS to deal with international anti-competitive practices – an area where no single Member State is likely to have sufficient power to successfully play.

An advisory panel should therefore be established with the power to receive complaints dealing with ECOWAS law and to refer action to the Member State authorities. Where a relevant national law is not implemented or cannot address the referred practice, that advisory panel should have the power to refer the matter to the Council for a decision (by majority voting) as to how the case will be heard and decided. The panel should be given reasonable investigatory powers that can be exercised in its referral determination, and the panel should be permitted to exercise its investigatory powers without the receipt of an individual complaint. A further recommendation is that the panel should be constituted to have the power of conducting a preliminary hearing on the question of infringement and referral, and that parties to the proceedings are guaranteed a right to be heard and to submit information. If the panel does not have the right to compel the provision of information and appearances at a preliminary hearing, then it should have the right to rule that a probable cause is found as a matter of default on the basis of a failure to provide requested information or to appear.

4.4. Other considerations, notification systems and cooperation instruments

4.4.1. Notifications

This study has not raised the question of whether or not a regional authority should have the power to declare exemptions in respect of individual agreements, or as to classes of agreements. Nor has it, in tandem, raised the question of whether private parties should be able to notify their private agreements for which, while falling within the treaty prohibitions, they would also be seeking to have an exemption applied based upon the balancing criteria of pro-competitive effects. The value of notification systems, either mandatory or voluntary, is that information flows to the regional body and the authority can learn the nature of the distribution markets that affect cross-border trade and can gradually determine the patterns that can form the basis for handling cases and developing regional block exemptions.

4.4.2. Cooperation instruments

This study has started from the position of assessing the prospects for decentralized administration of a regional law by the use of Member State authorities acting in cooperation. There is a role for cooperation between authorities in any regional system whether or not there is a centralized authority in position and whether or not a system is operating in tandem with private rights of enforcement. There are obvious benefits to cooperation where existing authorities can establish working relationships and render each other's enforcement efforts more viable. Cooperation can occur both in respect of Community law but also in the application of national territorial laws.

The common mechanism for enforcement includes:

- coordination, by agencies on common fact patterns with effects upon both jurisdictions
- investigatory assistance, upon a request by one agency to another seeking information on possible practices that may be occurring in the requested country that have effects on the

requesting country

- positive comity, a request by one agency for another to assess and take action on a possible anti-competitive practice that is occurring in the requesting" country's territory[462].

The record of cooperation instruments in existing RTAs that have included these provisions is not positive. Surveys by the Organisation for Economic Co-operation and Development (OECD) and the Centre for Economic Policy Research suggest that little cooperation actually occurs according to the RTA provisions. There are some cases where countries are actively requesting and notifying, but not consistently, and not in a manner that appears to be generating consistent responses from the regional partners. These are tentative characterizations because it is difficult to confirm how much informal cooperation may be actually going on beneath the cover of these cooperation provisions. Many of the agreements utilizing cooperation instruments are fairly new, as are the authorities working with them.

ECOWAS competition law cannot be given effect by the sole use of a cooperation approach. Nevertheless, there are clear benefits to using cooperation as a supportive set of instruments to facilitate enforcement of the domestic competition laws of the members. Irrespective of the regional body ultimately proposed for the ECOWAS, this body should also be given some coordination capacity to promote intergovernmental cooperation to facilitate the application of the national laws. This could be accomplished by the named regional body itself, or as an alternative, a separate intergovernmental body composed of representatives of the national competition authorities.

5. Conclusions

This study has aimed to identify a feasible middle path – between pure intergovernmentalism and absolute supranationality – that can resolve the deficiencies of the ECOWAS Treaty structure with its

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[462] These instruments as drawn from OECD (1995), Recommendation and Guiding Principles for Anti-competitive Practices Affecting International Trade, C(95)130/Final, Revised Recommendation, 27 & 28 July, 1995. These techniques are commonly recited in bilateral cooperation agreements and in RTAs.

rather ambitious integration objectives, and in light of a regional competition law. An independent law at the regional level can and should be established at the treaty level. Furthermore, this law should have a general applicability and be binding upon the authorities and the courts of the Member States. These elements are the fundamental building blocks of regional integration that can act simultaneously as a point of balance between state sovereignty and regional authority. It is clear that these elements also underlie a system of diffuse individual rights of action that relies upon a regional authority to address infringements of regional law.

A system of private rights can be built upon this structure if direct effect is made clear and if the national courts have the ability to obtain regional court preliminary opinions. In addition to this, an ultimate arbiter for appeal should be considered as a reasonable extension of standing before the ECOWAS regional court. If these elements are accomplished, then the ECOWAS can say legitimately that it has installed an effective system of private action for regional law. A pure system of private rights enforcement would not be adequate to give effect to regional law; some level of regional authority action is necessary for the regional law to operate. The differences in approaches have been discussed above, but all regional proposals build upon the same building blocks of independent law, general application and superiority. This is even more so in the case of the referral system.

It is tempting to seek to avoid the pitfalls of a referral system that relies upon Member State implementation of national authorities. The alternative of a completely independent commission with full powers is simple, effective and attractive. However, the lack of institutional tolerance for full independent executive powers cannot be ignored when this describes what the Member States may be willing to actually tolerate. Thus, this study argues for regional action that adopts a referral model but is modified to avoid the intergovernmental pitfalls that can render such a system inoperative. These include an alternative case-handling approach if a referral cannot be effectively made, and a clear investigatory power granted to the advisory panel as it attempts to determine referrals and monitor the merits of a case.

The competition law issue in ACP regional integration arrangements is not a home-grown phenomenon. There are external factors raising the competition agenda. This is particularly noticeable in

the ECOWAS setting where the treaty does not even accord competition policy the status of a regional activity. In contemplating the likely requirements that will emerge in the negotiation framework for the EPA agreements, it is perhaps helpful to identify the interests of foreign firms in the establishment of regional competition law for the ECOWAS. From the perspective of the EC, any foreign firm trading or doing business in the Community has the individual right to complain and seek redress for a violation of regional competition law. From a narrow and more mercantilist perspective, the reciprocity that can be expected from an ECOWAS arrangement is for a legal structure capable of responding to similar complaints when raised by an EC firm. In other words: "*How will OUR firms address private and public exclusionary practices that threaten to undermine the market access commitments that have been bargained for in the EPA tariff schedules?*".

A completely intergovernmental system of enforcement cannot make this EPA exchange on a reciprocal basis. Consequently, the modifications proposed here are for a referral system and the institution of private rights of action. Obviously the beneficiaries are not only foreign firms. Consumers are the main beneficiaries and welfare gains may also be generated by contestable markets. The argument put forward in this study may not necessarily lead to the best or most efficient institutional outcomes. However, the proposals aim to create an outcome that can effectively implement a regional law for competition policy in the ECOWAS. While ECOWAS Member States may not welcome encroachments on national sovereignty, it is hoped that these proposals are considered on the merits of how they meet these wider objectives.

BENEFITS OF INTRODUCING AND APPLYING COMPETITION POLICY IN EMERGING ECONOMIES

CASE STUDY – ROMANIA

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Abstract

Romania is quite a special case as it has until recently been considered to be both a developing country and an economy in transition. Romania's experience in building its competition regime may therefore be useful for both developing countries and for economies in transition, bearing in mind the important policy implications for economic development of establishing an appropriate competition framework that relies on a solid legal base and a suitable institutional structure.

Experience suggests that, in the process of transition to a more open economy, the existence and application of competition law can usefully support other policy initiatives. Trade policy, industrial policy, privatization, deregulation, regional policy and social policy all need to be conducted in a manner compatible with the market mechanism for an economy to function as efficiently as possible. These policies need to be conducted in a complementary manner and it is important that a mechanism exists for incorporating the "competition dimension" within government decisions on such policies.

The purpose of this essay is twofold. First, it provides an assessment of the effectiveness of the implementation of competition policy in Romania. Second, it shows the important role competition policy plays in the liberalization of certain sensitive sectors of the

economy. It concludes that law enforcement, competition advocacy and institutional effectiveness represent essential components and, therefore, key priorities for effective implementation of competition policy.

The available evidence suggests the importance of competition policy in the context of transition towards a market economy and emphasizes the necessity of developing an operational competition system in developing countries.

1. Do we really need competition policy?

Widespread privatization and competition policy have been a real challenge for Romania in its process of transition to a market economy. Further, trade liberalization has been an important driver of pro-competitive reforms in Romania, which brought about an unprecedented abundance of goods and showed at the same time a benchmark of competitiveness, making domestic companies that had been working without exposure to competition recognize the limitations of their competitiveness.

The introduction of the regulatory framework enabling "freedom of ownership, investment and enterprise" created great opportunities for domestic and foreign undertakings alike. The increase in the number of businesses in general and in new investments together have led to substantially improving competitiveness and, in this sense, the legal, economic, and economic policy environment supporting the implementation of the freedom of ownership, investment and enterprise has been a definitely pro-competitive reform and a driving force in transforming the Romanian economy.

As with other Central-East European countries associated to the EU, Romania took important steps with a view to achieving full harmonization of its legislation with the *acquis communautaire*, to enforce its capacity building and to observe the commitments undertaken through the Association Agreement concluded with the European Union.

The Association Council had to adopt the necessary rules for the implementation of competition provisions within three years of the

entry into force of the Agreement. Accordingly, the Romanian Competition Law was adopted even earlier, in 1996, and entered into force in 1997.

The application of the competition *acquis* prior to the closure of the negotiations was not only an EU requirement for Romania and other Central-East European accession countries but also a necessity in order to help companies to adapt well before the date of accession in order to be able to withstand the competitive pressures of the internal market. No transition period was granted to Romania since failure to properly apply competition *acquis* could have jeopardized the proper functioning of the internal market.

1.1. Building a competition regime in Romania

Against this background, an institution competent to strictly enforce the competition rules had to be established. The institution started its activity on 6 September 1996 with the elaboration of the regulations required to ensure the enforcement of Competition Law. The competition authority was defined as an autonomous administrative body whose activity had two main objectives:

- a preventive one, aimed at monitoring markets and supervising the actors operating therein; and
- a corrective one, aimed at re-establishing and consolidating the development of a normal competition environment.

However, the creation of a competition authority is only the starting point for building, on its own activity, its credibility. The provisions related to the revision of the Romanian Constitution acknowledge that **"***Romania is a market economy, founded on free initiative and competition***",** private ownership being guaranteed and unchallengeable. It is true that stipulating the role of competition within the fundamental law of a State is not a compulsory condition in order to apply the rules of the competition authority, but it highlights commitment by the political establishment. It confirms that the competition principles are at the root of economic policies in Romania.

But the mere creation of a competition authority has not been enough to provide substance to national legislation or to make it fully

operational. Since its entry into force in 1997, competition legislation has required adjustments in order to adapt the national economy to the requirements of accession to the European Union.

In December 2003, the Competition Council established by law remained the sole Romanian Competition Authority, as an independent and autonomous body, provided with institutional structures at local level, consisting of representatives in Bucharest and in 41 counties of Romania.

The law was revised extensively, eliminating unnecessary notifications of exempted agreements, increasing the turnover thresholds for merger notification, enforcing the publication of decisions, increasing the sanctions for companies refusing to cooperate with the Council, allowing for sanctions to be adopted with the same decision that identified a violation of the competition rules. The Competition Council was also entrusted with the application of the Leniency Policy with regard to cartel cases. Furthermore, the discriminating regime for the autonomous régies and State-owned undertakings, as compared to other undertakings, was eliminated through the amendments brought into law in November 2004. Last but not the least, the necessity of a Court authorization for dawn raids was abolished.

This not only contributed to the fulfilment of the accession criteria on competition, but most of all, it determined the sustainability of the Romanian economy. The new responsibilities and powers provided by the legislative framework considerably strengthened the Competition Council's role of overseeing and protecting the correct functioning of the market economy. As a result, the Romanian Competition Law now covers the principles of EC antitrust rules as regards restrictive agreements, abuse of dominant position and economic concentrations.

While the adoption of the legislative framework on antitrust and State aid was, to a great extent, a technical process that did not face major obstacles, the most important and challenging task for Romania was the foundation of a well-functioning competition authority. Thus, besides providing the competition authority with adequate legislative tools, a substantial strengthening of its administrative and operational capacity was required.

It was crucial to make the competition authority totally independent. The main characteristics of such an independence were: the competition authority had to have the appropriate legal instruments to act against companies and public institutions that breached the competition rules; the authority's decision-making body had to be approved so as to ensure that no political pressure was exercised over its actions; and the staff of the authority had to be highly qualified and sufficiently motivated.

Another challenge for the Romanian Competition Council (RCC), as a young institution emanating from the economic reform process, was to create adequate and effective relations with other public authorities and to establish a real and constructive inter-institutional dialogue. It is for this reason that competition advocacy has played a crucial role in the enforcement process in Romania. Central and local public institutions had to be, at least in broad terms, familiarized with the main principles of the competition law so as to avoid implementation of measures that could be harmful for competition. The business community had to be made aware not only of the risks they face in breaking the competition rules, but also of the possibility to address the competition authority or, to some extent, the court if another economic operator breached competition rules and caused them harm. The courts had to be aware of the competition legislation as undertakings, harmed by other undertakings, can bring the latter before the court to recover the damages under civil law.

Through its continuous advocacy activities, the Competition Council has clarified the rules of the game for Romanian society and ensured the necessary climate for setting up the mechanisms of a functional market economy.

A review of the operations of the Competition Council over the last decade shows that, without a fully functional competition authority, market rules are significantly distorted. It shows also that, without such an institutional mechanism, competition policy-based corrective measures cannot be introduced, thus jeopardizing the long-term benefits of competition policy both for private business and for the general economic growth of Romania.

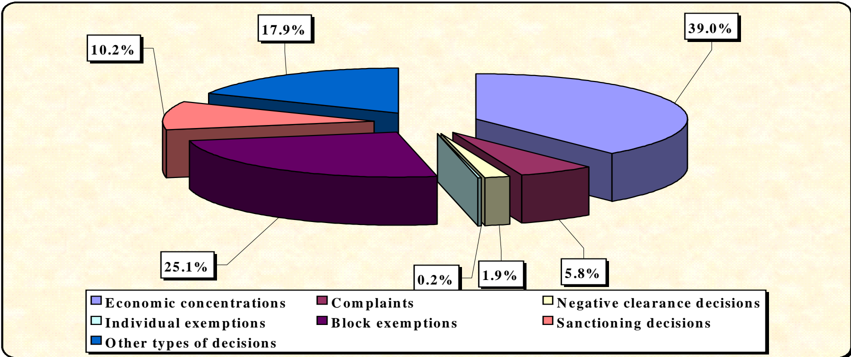
Since the very beginning of its activity, the RCC has made full use of its legal powers, including the power to carry out dawn raids, and

has concentrated its resources on the most serious distortions of competition. Thus, 3,302 decisions were issued from 1997 to 2007, of which 42.2 per cent represented merger decisions (Table 1, Graph 1).

Table 1: The increasing trend in the number of decisions issued by the Competition Council in 1997–2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Total
Total number of decisions reached	44	138	520	559	510	423	482	248	161	154	63	3,302
Economic concentrations	6	45	140	200	169	157	247	165	115	106	45	1,395
Complaints	10	15	11	32	23	48	26	18	11	8	4	206
Negative clearance	5	6	9	9	5	6	16	5	4	0	4	69
Individual exemptions	0	1	0	0	1	0	0	2	0	1	1	6
Block exemptions	4	19	312	256	163	119	22	2	0	0	0	897
Sanctioning decisions[463]	4	9	13	16	64	42	114	50	25	25	3	365
Other types of decisions	15	48	40	60	147	81	126	52	26	37	9	641

Graph 1: Structure of decisions issued by the Competition Council from 1997 to 2007



[463] These refer to sanctions for both substantive and procedural infringements.

In the work of the Romanian competition authority, the gradual transformation and re-concentration of the partially privatized market structure became apparent in 1998. This was partly attributable to global effects, as some of the mergers reflected the results of concentrations abroad on the Romanian market, while others were essentially Romanian phenomena, irrespective of the owner being Romanian or foreign. This was reflected in the notable merger wave in Romania between 2000 and 2006. This wave covered a major part of the economy, for instance, the energy sector, public services, metallurgy, the chemical industry, food and beverages, telecommunications, the banking sector and trade. All types of concentration were present at this stage, with horizontal concentration dominating, but there were also some vertical and conglomerate-type concentrations.

Fines imposed by the Competition Council for infringements of Competition Law in the 1997–2007 period amounted to 271.5 million RON, i.e. around 78 million Euro (see Table 2). This figure confirms that a systematic and conscious fining policy was drawn up and put into practice by the Competition Council over its ten years of existence. The increased total of fines recorded in 2005 can be partially attributed to the fact that more hard-core cartels were discovered in that year. From 2006, the decrease in the number of anti-competitive practices confirmed a better understanding by the business community that competition was the engine of its affairs.

Table 2: Evolution in the amount of fines imposed by the Competition Council in 1997–2007*

	Amount of fines (RON)	Amount of fines (Euro)
1997	76,900	95,045
1998–2001	1,354,400	678,702
2002	42,394,180	13,563,859
2003	3,684,680	981,120
2004	8,590,420	2,119,411
2005	159,753,750	44,088,998
2006	55,235,000	15,671,726
2007	457,061	1369,55
Total	271,546,391	77,335,816

*The estimation of the value of fines in Euro is based on the average annual exchange rate RON/Euro supplied by the National Bank of Romania.

To sum up, the stages followed by Romania in order to improve its competition regime were:

- a legislative framework on antitrust and State aid was adopted and subsequently modified to adopt the EU rules;
- an independent competition authority was established and equipped with highly qualified staff and appropriate technical equipment;
- a credible enforcement record of the EU rules on competition has been ensured with the support of other stakeholders, such as public authorities, judiciary and the business environment.

1.2. Case law

Competition Law applies to anti-competitive practices by private commercial operators and State-owned enterprises, including commercial companies where the State is a major shareholder. The

main substantive elements of the law are provided by Art. 5[464] – anti-competitive agreements – and Art. 6[465] – abuse of dominant position.

Romanian Competition Law provides in a distinct chapter the control of economic concentrations, following the model of the European Council Regulation (EEC) No. 4056/1983, having as its objective the prohibition of any economic concentration that creates or strengthens a dominant position that would significantly impede effective competition.

The merger control rules contained in the Competition Law are detailed and expanded through its secondary legislation, in regulations and guidelines.

The economic concentrations[466] – transfer of the ownership or the use of assets, rights and obligations of an undertaking through

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[464] Art. 5 of the Romanian competition law no. 21/1996, which is similar to Art. 81 of the EC Treaty, prohibits any express or tacit agreements between undertakings or associations of undertakings, any concerted practices or decisions by the associations, which have as an object or as an effect the restriction, prevention or distortion of competition in the Romanian market or in a part of it. The most serious infringements are the cartels, allocation of market power and other practices that prevent the proper functioning of the market. The Competition Council may grant, by decision, exemption for individual cases of agreements, association decisions or concerted practices, and establish (by regulations/guidelines) exemptions for certain categories of agreements, association decisions or concerted practices.

[465] Art.6 of the Romanian Competition Law, which is similar to Art.82 of the EC Treaty, prohibits certain unilateral conduct that jeopardizes competition. According to this article, any abuse of a dominant position held by one or more undertakings in the Romanian market or in a substantial part of it, by resorting to anti-competitive deeds, which have as an object or may have as an effect the distortion of commerce or the prejudice of consumers, is prohibited.

[466] A concentration is subject to the Competition Council's control and it must be notified if the aggregated worldwide turnover of the parties to the concentration exceeds EUR 10 million and the turnover in Romania of at least two of the participating undertakings exceeds EUR 4 million. The economic concentrations may be authorized if, when analysing them pursuant to the criteria provided for in the Competition Law, they are compatible with a normal competition environment, and if the involved undertakings prove that they fulfil cumulatively certain conditions such as increase of the economic efficiency and of the competitiveness of exports, and benefits for consumer through reduced real prices.

merger or through a direct or indirect acquisition of control over one or more undertakings – are prohibited to the extent that they create or consolidate a dominant position and lead to or are likely to lead to a significant restriction, prevention or distortion of competition in the Romanian market or in a part of it.

1.2.1. Ministry of Internal Affairs/RASP/Tuingdor/Mitsubishi, Decision no. 127 [1998]

Keywords: *Driving license photos, horizontal agreement, vertical agreement, abuse of dominance, Article 9(1)*[467]

Facts: This case came to the attention of the Romanian Competition Council following a large number of complaints alleging infringements of the competition law in the market for driving license photos.

The investigation undertaken showed that a contract for driving license photos had been signed between the Ministry of Internal Affairs, and the Regie for the Administration of the State Protocol (RASP), on the one hand, and Tuingdor SRL (Tuingdor) and Mitsubishi Electric Europe GmbH (Mitsubishi), on the other. According to this contract, Tuingdor, the exclusive distributor of Mitsubishi in Romania, had been granted exclusive rights to establish a network of photographers in the entire national territory, using exclusively Mitsubishi equipment. The Ministry of Internal Affairs refused photos where Mitsubishi supplies were not used. Moreover, the contract set a maximum price for the photos. It has to be mentioned that the computerized system issuing the driving licenses had been introduced by a contract signed between RASP and the Ministry of Internal Affairs, and, in the contract between the Ministry of Internal Affairs and Canadian Banknotes Overseas Ltd,

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[467] Art. 9(1) Any actions by the central or local public administrative body that have as an object or may have as an effect the restriction, prevention or distortion of competition are prohibited, especially when:
a) making decisions that limit the freedom of trade or the undertakings' autonomy which are being exercised under the law;
b) setting discriminatory business conditions for undertakings.

none of those contracts referred to the photos required for the newly introduced driving licenses.

Tuingdor established a network of photographers, initially in Bucharest and in the county capitals, which extended to around 150 photographers. The contracts between Tuingdor and each of the photographers provided for exclusive usage of Mitsubishi equipment, supplies and seals distributed by Tuingdor. The photographers also took it upon themselves to sign a service and maintenance contract with Tuingdor, for both the warranty and post-warranty periods. In cases where photographers used Mitsubishi equipment not acquired from Tuingdor, only post-warranty services were provided, on condition that the photographer acquired an initial technical evaluation and a minimum quantity of supplies.

In order to ensure the origin of the photos, Tuingdor introduced a “Mitsubishi seal” applied on the photos. Such a seal was unnecessary in terms of photos issued for drivers' licences. Its only use was to certify that it had been issued by an authorized photographer. It is worth mentioning that the price of the seal had to be paid by the final consumer.

Definition of relevant market:

The relevant product market was defined as the market for driving license photos, as there was no substitute between this type of photo and any other type of photo. The geographic dimension of the market was defined at the national level. Moreover, the anti-competitive behaviour of the parties involved affected the market for video printing equipment and supplies.

Harm on competition:

The Competition Council found that Tuingdor, Mitsubishi and RASP infringed the provisions of Article 5(1) of the Competition Law by concluding and implementing an anti-competitive agreement, having as its purpose to eliminate competition from other photographers; oblige photographers to acquire only a certain type of equipment and supplies; limit the access of other distributors to the market, as well as to limit parallel imports.

The Competition Council also found that Tuingdor infringed Article 6 of the Competition Law by abusing its dominant position in the

relevant market, by indirectly setting retail prices, especially through the price of the "Mitsubishi seal"; tying sales, forcing photographers to acquire service and maintenance, beside equipment and supplies; exploiting the dependency of its clients, as it had the right to unilaterally extend or denounce the contract when photographers did not hold similar contractual rights.

The Competition Council decided that the Ministry of Internal Affairs had infringed Art. 9 of the Competition Law, as it unnecessarily limited trade freedom and introduced discriminatory rules related to the activity of undertakings by awarding exclusivities with regard to the photo equipment and supplies used for driving license photos.

Enforcement measures:

Tuingdor, Mitsubishi and RASP were sanctioned with fines. The Competition Council decided also that Tuingdor had to give the State budget the profits it obtained as a result of anti-competitive behaviour. The decision of the Competition Council annulled both the contract regarding the photos for the driving licenses and the contracts between Tuingdor and the photographers.

Appeal proceedings:

The involved parties appealed the decision. The Bucharest Court of Appeal, as the first instance court, ruled by entirely rejecting the Competition Council's decision. In its judgment, the Bucharest Court of Appeal stressed that the decision was issued before the infringement of the provisions of competition law had been adopted and signed by the entire Plenum of the competition authority, as the law stipulated. Also, the ruling stated that Tuingdor and Mitsubishi did not infringe Article 5 since there was no anti-competitive agreement because, at the time when the contract was concluded, the competition law was not in force.

The Competition Council appealed the Bucharest Court of Appeal's ruling before the High Court of Cassation and Justice. The Supreme Court ruled that the ruling given by the first instance court was illegal and unsubstantiated and that the Competition Council's decision was legal. Thus, the court stated that the decision was legally adopted by the Plenum, one of the members being replaced during his absence by the Vice-President of the competition authority who was legally appointed. Moreover, the court concluded that the parties implemented an anti-competitive agreement, having as its purpose to eliminate

competition from other photographers and to oblige photographers to acquire only a certain type of equipment and supplies.

Harm on consumers:

This is a case where the award of exclusive rights by a State authority to a single company affected not only the companies operating on the downstream level but also the consumers through tying sales and higher prices than those that would have been established in conditions of competition. Also, despite the presence of the corruption issue in this case and the non-responsibility of the Romanian Competition Council to produce such evidence, it strove, however, for the opening of the respective markets to competition for the benefit of consumers.

1.2.2. Romanian Shareholders Registry (RSR), Decision no. 247 [1999]

Keywords: *abuse of dominant position, refusal to deal, unequal terms for equivalent services to trade partners*

Facts: This case reflects the attempt of a dominant company to hinder the entry of other companies to the market. Several well-conceived behavioural measures that were imposed on the incumbent, apart from the sanctions, played an important role in the re-establishment of a normal competitive environment in the relevant market.

The case came under the competition authority's scrutiny as a result of the complaint filed by seven independent stock registers against the RSR. The complaint related to the RSR's refusal to transfer the registers of shareholders from the client companies.

The RSR was set up in 1996 as a stock company, with the financial and logistical support of USAID, and took over, unconditionally and without charge, shareholder lists held by the National Agency for Privatization in a computerized register. This register included about 5,700 companies. During 1997–1998, the Romanian National Securities Commission authorized another ten private independent register companies to operate in this market.

At that time, according to the specific legal framework[468], the RSR was bound to transfer to other independent private register companies the shareholder lists, within a five-day period from the day of registering the company's request. The transfer should have been executed unconditionally, except in the case when the issuer company is bound to pay to the register company the charge for the services provided by it. If contractual relations were binding the issuer company and the register company, the transfer had to be executed unconditionally and without the imposition of a charge for that service.

Definition of the relevant market:

In this case, the competition authority defined the relevant market as the market of registering services on RASDAQ[469]. This service did not have substitutes at that time. Beneficiaries of this service were companies listed on RASDAQ which had the legal obligation to keep a shareholder's register, as well as the proof of shares issued and traded in this market.

Harm on competition:

From the analysis carried out on this market, the Council found that in 1997, the RSR held a dominant position, determined by its market share, i.e. 100 per cent, and in the following year, the RSR held a market share of 96.4 per cent. The RSR owed its high market share to the circumstances of its establishment mentioned above.

The investigation established that, once the other private independent register companies entered the market, client companies could either continue to use the services provided by the RSR, or transfer their shareholder list to another private Register Company. However, only 236 of 585 companies that had requested the transfer effectively accomplished it. The explanation for this lies in the RSR's discriminatory behaviour. Thus, while for several companies that had not concluded a contract with the RSR, the transfer was executed unconditionally, in other cases client companies were compelled to

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[468] The regulation of this market is accomplished by the Romanian National Securities Commission (RNSC).

[469] RASDAQ (The National Securities Market was officially launched in October 1996, in order to address the need for a transparent, institutional and technical trading environment dedicated to companies that had become public following the Mass Privatization Programme).

conclude a contract in order to have their shareholder lists transferred. Moreover, the RSR ceased charging for the services performed for the companies that consented to enter into a contract. If client companies did not follow through with their intention to transfer, the RSR wrote off their debts.

Thus, the Competition Council found that the RSR abused its dominant position by imposing unfair contractual terms in contracts concluded with beneficiaries. The abuse consisted also in the refusal to deal, namely by refusing to transfer shareholder lists to the independent private register. The RSR's action of imposing conditions on the transfer's execution with the payment for services allegedly performed prior to the conclusion of the contract resulted in either the foregoing of the transfer and entering into an agreement with the RSR, or the transfer's execution, but at a higher cost and in a longer period of time. The Competition Council also found that the RSR applied a discriminatory treatment to the issuer companies.

In that sense, the following anti-competitive practices were identified: charging different tariffs for similar services; coercing the issuer company to conclude a contract, while other companies, under the same circumstances, had their transfer unconditionally executed; requiring payments for services performed outside any contractual relations.

Enforcement measures and remedies:

In its decision, the Competition Council's Plenum sanctioned the RSR for the infringement of Art. 6 lit. a) and c) of the Competition Law.

In order to re-establish a normal competitive environment in the affected market, the Competition Council's Plenum compelled the RSR to allow transfers in strict observance of the RNSC regulations, without imposing additional conditions. The Competition Council also forbade the RSR to grant additional facilities, other than those laid down in the contract, when the issuer companies expressed the intention to transfer their lists to another register company, so as to prevent or to limit the client's transfer to other register companies.

1.2.3. National Agency of Mineral Resources/National Company of Mineral Waters/APEMIN, Decision no. 575 [2000]

Keywords: *horizontal agreement, vertical agreement, Article 9(1), mineral water.*

Facts: The case came to the attention of the RCC upon receiving, almost simultaneously, a request from the Ministry of Industry and Commerce (MIC) and a complaint from the National Company of Mineral Waters (NCMW). Both the MIC and the NCMW requested the intervention of the Romanian competition authorities[470] in solving a contractual litigation between the NCMW and 19 companies bottling mineral water regarding a price increase proposal made by the NCMW for the extracted mineral water.

On the one hand, the 19 companies, members of APEMIN, i.e. an employers' association composed only of companies operating in the mineral water bottling field, that refused to accept the price increase proposal, decided to empower the chairman of the association to negotiate a different price level. On the other hand, the NCMW, which holds a quasi-monopoly for the activity of extracting mineral water, claimed that in the last 3 years, i.e. in 1997–1999, the price had not suffered any modification and that its proposal for a price increase was based on its increased expenses.

The analysis of the product market evolution after 1990 emphasizes certain characteristics:

- Until 1990, companies that traded mineral water were subordinated to a central administrative body, according to the existing system at that time. These companies were responsible for the extraction, bottling and trading process for mineral water.
- In 1990, the extraction activity was separated from the bottling and trading activities. The extraction activity was entrusted to an autonomous regie (RAMIN) and the bottling State-owned enterprises were reorganized into trade companies under the

[470] The competition legislation in force at the time of the infringement provided for two competition authorities, namely the Competition Council as the autonomous investigation and decision-making authority and the Competition Office, the governmental body entrusted only with investigative powers.

privatization process but maintained their object of activity.

- Through this separation, a new market was created, having as its objective the trade of the extracted mineral water between RAMIN and the bottling companies.
- The reform evolution, mirrored also in the legislation, triggered the privatization of RAMIN and its subsequent conversion into a trade company (the NCMW) in December 1997.
- State interests in the mineral resources field are represented by the National Agency of Mineral Resources (NAMR).
- Mineral water resources are considered State public property and the extraction activity can only be licensed or given into administration by the NAMR to companies extracting mineral water.

Definition of relevant market:

- The market regulation and organization at the time of investigation show that the NCMW held a quasi-monopoly for the activity of extracting mineral water.
- As a raw material, mineral water cannot be substituted by the bottling companies with any other product.

As a result, the Competition Council found that the relevant product market is the extracted mineral water market, traded as raw material between the NCMW and the bottling companies.

With regard to *the geographic market*, both the supply and the demand are located near each mineral water source, with only one existing supplier and one buyer. The mineral water extracted from a specific source can only be used by a single bottling company. It can therefore be argued that each mineral water source can be defined as a separate geographic market. However, the Competition Council found that all those alleged local markets have common features, such as the same selling company, similar exploitation technology, and similar products. Based on those facts the Competition Council defined the geographic market at the national level.

The analysis of the NCMW's monopolist behaviour showed that:

- The NCMW reached an administrative monopolistic position, not a real one based on its own forces. Furthermore, it did not benefit from economic and financial strength so as to exercise market power.

- The customers rely on the NCMW, but in turn, the NCMW relies on the mineral water buyers, since the contracts concluded with the bottling companies have a long validity term (20–25 years, according to the duration of the concession obtained by the NCMW from the National Agency for Mineral Resources), and the mineral water cannot be stocked. If the contractual relations were broken, the NCMW would not have an immediate alternative for selling the water to a different customer, the investments located close to the mineral water source being mandatory and quite substantial.

As can be observed, the elements of this analysis did not highlight a potential abuse of the dominant position of the NCMW.

Harm on competition:

a) A written agreement represented by a “Negotiation Note” concluded between RAMIN and APEMIN was found during the investigation and considered illegal; first, this agreement, dated August 1997, was signed on behalf of APEMIN, only by some of its members who held the largest market shares. Second, all contractual transactions concluded between RAMIN and the bottling companies, members and non-members of the association, provided for the same price fixing of the mineral water.

b) The agreement lasted until the spring of 1999, when the NCMW, RAMIN’s successor came up with a proposal for a price increase and decided to start price negotiations with each bottling company. Accordingly, some of the APEMIN members decided, within a series of general extraordinary assemblies, not to accept the increase in price proposed by the NCMW. Moreover, they empowered the APEMIN chairman to negotiate a different price for mineral water on behalf of APEMIN members and if the NCMW did not accept, to proceed in boycotting the NCMW by ceasing payments.

Even if the minutes of the general assemblies had been signed with no objection by the representatives of APEMIN’s members, subsequently, some of them consented to sign additional documents modifying the price to the level suggested by the NCMW, and others paid the increased price.

c) The NAMR permitted the concession of the mineral water sources exclusively to a single company, the NCMW, without organizing a public tender. This was contrary to the letter and spirit of the law that stipulated that the concession should be granted to the winner of a public tender. This led to the perpetuation of the existing monopoly in the market of mineral water as a raw material, for a period of time difficult to assess, given that the NCMW's water sources represented approximately 96 per cent of the exploited sources.

d) Since 1998, the NAMR granted the concession of other sources by tender, the winners being both the NCMW and other trading companies. The concession price, i.e. the royalty cashed by the State through the NAMR, was calculated as a percentage of the value of tradable mineral water.

Therefore, the NCMW had been advantaged as it had to pay a royalty calculated on the basis of the price of the mineral water sold as a raw material while the few bottling companies that were licensed eventually to extract the mineral water had to pay a royalty calculated on the basis of the sale price of the bottled mineral water bearing in mind that any new company entering the field leased the spring for bottling the mineral water and selling it for consumption.

Enforcement measures:

The Competition Council decided that both the vertical and horizontal agreements infringed the provisions of Article 5(1) of the Competition Law, ordered the cessation of the anti-competitive practices and sanctioned with fines the NCMW and the 19 bottling undertakings that were members of APEMIN.

The Competition Council also decided that the NAMR infringed the provisions of Article 9(1) of the Competition Law by directly allowing the concession of mineral water sources to the NCMW (with no tender being held) and establishing discriminatory conditions for the undertakings involved in the concession of sources on aspects concerning the payment of royalties.

The impact on consumers:

The concerted action of the members of APEMIN led to the creation of a monopsony. If we look at this case from the economic theory perspective, we can see that the monopsony power cancelled to a large extent the monopoly power and this in fact prevented the

increase in the price of extracted mineral water, which would have eventually triggered higher prices for consumers. Moreover, the enforcement measures taken against the decision of the state authorities at that time to award the mineral water concession to a single company, the NCMW and not, for example, to each bottling company, and to establish discriminatory conditions for the undertakings involved in the concession of sources on aspects related to the payment of royalties, had also a positive indirect impact on consumers. The concessionaire companies, other than the NCMW, were acting in the market of trading the mineral water for direct consumption, in competition with NCMW clients and they were required to pay a royalty approximately 30 times higher than the NCMW. Accordingly, this higher royalty converted itself into a price increase of bottled mineral water that put the burden on consumers.

1.2.4. LAFARGE /HOLCIM /CARPATCEMENT, Decision no. 94 [2005]

Keywords: *oligopoly, collusive agreement, cement market*

Facts: In March 2001, the Competition Council opened an *ex officio* investigation into the cement market. One of the main triggering events behind this action was a significant and simultaneous increase in cement prices in the specific market operated by the local cement producers. The investigated parties were: Lafarge (member of the French Group LAFARGE), Holcim (member of the Swiss Group HOLCIM) and Carpatcement (member of the German Group HEIDELBERGCEMENT).

The three cement companies operated in the Romanian cement market, each of them controlling three homogeneously spread cement plants. This indicated an oligopolistic market structure, favourable to anti-competitive practices. The only competition the three cement producers faced was represented by imports, which accounted for 2 per cent of the market.

Harm on competition:
All three undertakings were accused of infringing Art. 5(1)(a) of the Competition Law. The evidence showed that the activities of the three undertakings (in the period analysed, 2000 – 1st quarter 2004), had as scope (respectively as “object”) and had as a result (“effect”) the

restriction, prevention and/or distortion of competition in the Romanian cement market.

In addition to the written evidence on the illegal agreement[471], evidence on the market irrefutably showed the real effects of these activities:

- All Romanian cement producers behaved in the same way by setting prices during the analysed period. This refers to the price lists whereby they offered reference prices to be discounted by the companies in order to obtain and maintain equal market shares.
- The market shares were kept constant and symmetrical, despite differences between production costs.
- During the analysed period, cement prices constantly increased, even if the real production costs were decreasing, due to investments to modernize the plants.
- When the investigation was opened, there was another player on the relevant market, Romcif Fieni, which was controlled by a Romanian company. After the investigation began, Romcif Fieni reduced its prices and maintained this downward trend until October 2001 when it stabilized the prices, which remained constantly lower than those of its competitors. This "asymmetry" was changed at the end of 2002 when Romcif Fieni was acquired by Carpatcement. Carpatcement then raised prices for the cement produced at Fieni by 30 per cent, adjusting them to the price margin of its competitors.
- During that period, the three companies were members of the Professional Cement Association – CIROM. Although the professional associations are generally legal and play a positive role, this is not the case when they are used for anti-competitive purposes. CIROM published a quarterly bulletin comprising sensitive and detailed information, including individual statistical data regarding each cement plant. The "CEMENT Committee" in the Cement Professional Association had as members only the three cement producers.

[471] A holographic copy of a note from Holcim's country manager in that period. This note proves the existence of a common strategy, a collusive agreement between all cement producers, with a view to coordinate the market shares by price-fixing practices.

Enforcement measures:
In May 2005, the Competition Council decided to impose fines of over 27 million euro on the three cement producers, considering that all three undertakings were members of a price-fixing cartel in the Romanian market.

The Competition Council also decided to annul the CEMENT Committee in order to stop the possibility of concluding collusive agreements. The decision required each producer to provide a monthly submission of cement prices for the prior month, for a period of 2 years.

The investigation also found that HOLCIM infringed the provisions of the Law for the non-fulfilment of the obligations and the conditions imposed through the conditional authorization Decision no. 221/08.05.2000 issued by the Competition Council. Holcim was sanctioned with a fine of 1 per cent of the total turnover achieved in the previous financial year.

Harm on consumers:
It is worth noting that companies that are members of the groups that operate in the Romanian cement market behaved in an anti-competitive manner in other countries. For instance, in 1994, the European Commission levied fines of 248 million euro on six companies and the cement manufacturers' association. The parties involved used the European Association of Cement (Cembureau) as a vehicle for market allocation and exchange of information on prices. In judicial appeals finally decided in January 2004, the fine was reduced by 140 million euro, and the fine on the trade association was quashed. These six included Lafarge and Holcim. Lafarge was fined 187 million euro by the EC in 2003 for participating in another cartel, the third largest fine ever levied for being a regular offender. In Germany, the competition authority sanctioned a cartel in the cement market, in which companies of the Lafarge and Heidelbergcement Groups were involved. The Italian Competition Authority applied fines to the same companies for anti-competitive behaviour in the concrete market, including price fixing and illegal exchange of information. The list is endless and only goes to prove that the reiteration of this kind of behaviour is possible and even occurred in the Romanian market. Cement enterprises are the most favoured of competition authorities around the world because they almost always collude as a cartel and fix prices, thus adversely affecting consumers and other businesses.

Apart from the sanctions applied, the impact of the RCC's intervention in such an important market for the development of the Romanian economy had immediate and positive effects: the price fell by 6 per cent, even if the construction materials sector had an upward trend.

1.2.5. National Company for Freight Railway Transport "CFR Marfa" Decision no. 119 [2006]

***Keywords**: abuse of dominant position, refusal to deal, unequal terms for equivalent services to trade partners, railway freight transportation*

Facts: This is a case where private companies as competitors of a spin-off owned by the State were disadvantaged in the market by having to pay much higher charges than the companies that had split from the former National Company of Romanian Railroads. The settlement of the competition issues that arose in this case was made through sustained advocacy measures of the Romanian competition authority that triggered the amendment of the anti-competitive provisions of the legal framework in force.

Through a complaint lodged by the Association of Romanian Private Freight Railway Transport (ARPFRT) Companies against the National Company for Freight Railway Transport ("CFR Marfa"-SA[472]), ARPFRT accused CFR Marfa of anti-competitive practices. In fact, ARPFRT claimed that CFR Marfa took advantage of its dominant position in the market of ancillary services to freight railway transport. It adopted several decisions whereby it imposed on the private-owned freight railway operators, organized in ARPFRT, different tariffs from those charged to the State-owned operators. CFR Marfa refused to deal any further with private operators on the grounds that they were its competitors.

Definition of relevant market:

In this case, the analysed product market included services of exploitation, maintenance, and repairs of locomotives, specific services for locomotive personnel (access of locomotive personnel to bedrooms

[472] CFR Marfa is a spin-off owned by the State, set up after the reorganization of the former National Company of Romanian Railroads, operating freight railway transport.

in the locomotive depots), and all the other activities required for the proper functioning of railway freight transportation.

The relevant geographic market was defined as regional given the location of regional units owned by CFR Marfa where it performed these services.

Entry barriers:
Access to the relevant market was regulated, in the sense that it required a license to be obtained from the Romanian Railway Authority. In addition, the locomotive shedding required a depot; the same requirement was applied for the provision of the locomotive personnel's access to bedrooms, as for the personnel accommodation in other types of space that would have contravened the specific legal framework.

The Competition Council's investigation revealed that, initially, the current depots were in the possession of the two State-owned railway operators, namely CFR Marfa and CFR Calatori (passengers transport). For that reason, the market had the structure of a duopoly and the clients had the possibility to opt for the services provided by one of two operators. It should be mentioned that CFR Calatori was charging much lower tariffs than CFR Marfa. Subsequently, the Ministry of Transport issued an order whereby the depots were passed either under CFR Marfa's ownership, or under CFR Calatori possession, and the market was shaped as a monopoly, since there was only one depot in the end-of-line stations, except for Bucharest and Ploiesti, where each of the two companies held a depot.

Harm on competition:
Examining the behaviour of the two undertakings acting in the same product market, CFR Marfa and CFR Calatori, the Competition Council found that the tariffs charged by CFR Calatori were the same for all its beneficiaries, while CFR Marfa was charging differentiated tariffs laid down in an internal regulation, based on the beneficiary's ownership (State-owned or private railway operators). Following CFR Marfa's refusal to conclude contracts with private operators, the concerned services continued to be provided by CFR Calatori in areas where it possessed depots and sheds.

The non-discriminatory tariffs charged by CFR Calatori were considered by the Competition Council to be a benchmark in the relevant market. In

comparison with this benchmark, the tariffs charged by CFR Marfa for private operators were, until the contracts expired, from 5 to 20 times higher.

Enforcement measures and remedies:
Based on all the evidence, the Competition Council's Plenum decided that CFR Marfa infringed the provisions of Art. 6 lit. a) and c) of the Competition Law, abusing its dominant position in the relevant market and resorting to anti-competitive behaviour consisting of:

- application of unequal conditions for similar services to private operators, namely the application of distinctive charges as compared to the same services provided to former SNCFR companies;

- refusal to deal with certain business partners, namely privately owned railway freight operators.

The Competition Council's Plenum decided to recommend that the Ministry of Transport modify the order whereby the existing depots were divided between State-owned railway operators and private operators, demanding the Ministry to guarantee equal conditions for all undertakings, irrespective of their nature.

1.2.6. OMV/Petrom SA, Decision no. 299 [2004]

Keywords: *corrective measures, commitments, acquisition, petrol market.*

Facts: On 23 July 2004, the Ministry of Commerce, as seller, and the Austrian undertaking OMV Aktiengesellschaft (OMV), the owner of OMV Group, as buyer, concluded a privatization contract regarding the acquisition by OMV of a majority participation in SNP PETROM SA and of sole control of this undertaking. This operation was notified to the Competition Council.

OMV is the parent company of an international group of undertakings acting mainly in the area of exploring, producing, processing and distributing petrol products. In addition, at the international level, OMV has joint control with Rompetrol Holding SA Switzerland over Rompetrol

Group N.V. Holland, the parent company of the Rompetrol group of companies, operating in the Romanian petrol market. Petrom is a diversified undertaking that operates in Romania and also in international markets in exploring, developing, producing and selling oil and natural gas; processing and distributing refined petrol products; developing, producing and selling various chemical products and chemical composts.

Since the acquirer OMV has joint control over Rompetrol Group N.V. Holland, a real overlap existed between the activities of Petrom that were presented above, and the activities of OMV and Rompetrol in Romania, only regarding the following activities: oil refining and processing, distributing and selling petrol products, selling lubricants, producing and selling petrochemical products.

Harm on competition:
Analysing these four activities and the associated markets, the Council found that the concentration OMV/Petrom restricted competition only in two of these markets, as a result of the important market shares held by the parties involved: the oil refining and processing market (Petrom and Rompetrol) and the market for the distribution and sale of petrol products (OMV, Petrom and Rompetrol).

Commitments:
In order to avoid restricted competition in these two affected markets, OMV submitted to the Romanian Competition Council proposals of commitments. Thus, OMV committed itself to relinquish joint control in Rompetrol Group N.V. Holland, by selling its minority participation. Also, until the sale of its shares, OMV was not to participate in decisions regarding the daily activities of Rompetrol Group N.V. Holland, which might have an impact on the competitive behaviour of this undertaking.

The RCC's review of the commitments envisaged the prevention of a possible consolidation of a dominant position in the affected markets. The divestiture of minority shareholdings was therefore considered an adequate and sufficient commitment in order to clear the transaction and make it compatible with a normal competitive environment in the Romanian market for the distribution and sale of petrol products. Consequently, the Romanian Competition Council issued a non-objection Decision with corrective measures.

1.2.7. Azomures/Chimpex, Decision 113 [2005]

Keywords: *acquisition, corrective measures, chemical fertilizers*

Facts: The parties involved in the economic concentration were:
– the acquirer, Azomures, holding a dominant position in the Romanian chemical fertilizers market, according to its volume of production and sales;
– the target company, SC Chimpex SA, the Romanian traditional port operator for chemical fertilizers, which also held a dominant position in the market of port operating services for chemical fertilizers and, furthermore, for a certain type of solid chemical fertilizers (bulk urea).

Due to its storage spaces, Chimpex had a quasi-monopoly position, being the only port operator specialized in that type of operation.

Definition of relevant market:
The relevant market has been defined as the market of Romanian port operating services. According to the activities performed by the parties involved, the economic concentration would lead to a vertical integration in the Romanian market. Since both parties involved held dominant positions in their markets, the affected market was defined as the Romanian market of port operating services for solid chemical fertilizers.

Harm on competition:
The only competitor of Chimpex was SC Socep SA, which rented an installation from SC Transocep Terminal SA. Azomures had joint control at Transocep, together with other shareholders. These facts gave Azomures the possibility to get involved in the activity of Socep, in the segment of port operations for chemical fertilizers. After acquiring a majority of the stock in Chimpex, Azomures would have been able, to a considerable degree, to behave independently towards its customers and competitors, a fact that might have led to a significant restriction, prevention or distortion of competition in the relevant market.

Analysis of the compatibility of this acquisition with a normal competitive environment:
The compatibility of the proposed merger with a normal competitive environment was regarded and assessed in two directions:

- the transaction's implications for the Romanian fertilizers market due to the vertical integration stemming from the merger;
- the transaction's effects on the relevant market affected by the proposed merger, i.e. the stevedoring operations of the solid fertilizers Romanian market.

On the basis of a survey, it was found that the other stevedoring operators either did not display any interest in performing in the future fertilizer stevedoring services, or they were interested in re-orienting their activity to this market, in case of an increased demand and a developed infrastructure. Due attention was paid to the assessment of entry barriers to the relevant market.

It was found that the entry to the relevant market depended both on the obtaining of a license of an administrative nature and the observance of certain compulsory norms. So, the total entry costs were considered as medium in terms of financial investment.

Following the cumulative assessment of the compatibility of the proposed transaction with a normal competitive environment, it was concluded that even if the merger had contributed to the enhancement of the target company's economic efficiency, the positive effects of the merger could not outweigh the negative effects of a restrained competition that could allow the authorization of the merger.

Commitments:
In order to avoid the prohibition of the proposed acquisition, Azomures submitted commitment proposals to the Romanian Competition Council, in order to make the operation compatible with a normal competitive environment. Thus, Azomures took upon itself to relinquish the joint control in SC Transocep Terminal SA, by selling the 20 per cent participation held in this undertaking.

The acquirer's commitment in the form of a structural remedy made the operation compatible with a normal competitive environment, giving sufficient grounds for the approval of the economic concentration.

2. Role of competition policy and law in the regulatory reform

A large and growing number of economies are undertaking major reforms in the area of economic regulation aimed at achieving better regulatory outcomes in the public interest. Although there are significant differences across countries and industries, major regulatory reforms have generally envisaged the privatization of former State-owned companies; rethinking universal service obligations; liberalizing restrictions on entry, prices and business practices; and taking measures to ensure that consumers are properly informed and protected.

Restoring the governance of competition and free prices in highly regulated sectors and protecting consumers against abusive prices represents a difficult task, requiring a very broad range of expertise and experience. In this context, competition authorities all over the world have an important role to play. They have a vital role in ensuring that the regulatory structures put in place are not anti-competitive or do not create competitive distortions.

The Romanian competition law applies to all sectors of the economy, even when these are subject to specific regulation. This means that the Competition Council is empowered to open investigations and to make pronouncements with regard to anti-competitive practices and economic concentrations in all sectors of the economy, even in the regulated ones.

The legal regulations applying to all these activities of general interest call for the Competition Council's specific intervention in these markets. This intervention has a *sanctioning character (ex-post)* and takes place when the regulatory authorities do not have the power to ensure that the competition rules are observed, or fail in their *preventive intervention (ex-ante)* or act in contradiction to the competition rules.

Over the last ten years, the Romanian Competition Authority has been at the forefront in advocating extensive liberalization of the domestic economy and has provided substantive input and support to the design and sound implementation of competition-oriented privatization and regulatory reforms in a large number of sensitive economic sectors and public policy areas such as telecommunications,

electricity, gas, transport, construction, the steel industry, postal services, public procurements and commercial distribution.

In Sections 2.1 and 2.2, focus will be on an analysis of two essential sectors, i.e. electricity and telecommunications, respectively, where preserving fair competition is considered of the utmost importance for the development of Romania's economy. For each of these sectors, an analysis will be made of the structure of the markets and of the general competition issues Romania faced in liberalizing these two sectors. Where possible, this analysis will be upheld by sectoral case studies handled by the Romanian Competition Council in order to explore the actual or potential benefits of competition for consumers, in particular, and for the development of a competitive market environment, in general.

2.1. Competition issues in the electricity sector

The strategic role the electricity sector plays in any economy (developed or otherwise) as well as in ensuring the welfare of consumers/citizens is unanimously accepted. The complex reform of the energy sector undertaken at the European Union level has also been pursued by Romania, particularly during its EU accession process. The heart of the liberalization process in the electricity sector in Romania consisted of privatizing State-owned energy companies, thus creating conditions for efficient competition and related reduction in the energy price for consumers and in ensuring that consumers can freely select their suppliers, the price and the quality of the product or service.

The electricity sector, as in other network industries, combines natural monopoly activities (the transmission and distribution systems) with potentially pro-competitive activities (the generation and supply systems). In 1998, in order to attain the objective of creating and ensuring the functioning of competitive electricity markets, Romania began the process of restructuring its electricity sector. An independent regulatory body, the National Authority for the Regulation of Energy (ANRE), was established and the regulatory reform has advanced significantly.

Following the example of some other European countries and the EU Electricity Market Directives of 1996 and 2003 and the more

recent Green Paper[473], the Romanian process of restructuring its electricity sector moved through successive stages that envisaged the vertical unbundling of generation, transmission and distribution systems and the horizontal unbundling of some generation companies holding a dominant position in the market. Even if it did not generate competition, the vertical unbundling of production from transmission and distribution was an important step in reforming the Romanian electricity sector that provided for administrative transparency and non-discriminating access to the network.

Thus, from 1998 to 2000, the vertically integrated State-owned company CONEL was split into five separate State-owned enterprises: Nuclearelectrica, for nuclear generation; Hidroelectrica, for hydroelectric generation; Termoelectrica, for thermal power generation; Transeletrica, for transmission; and Electrica, for distribution. Since then, the distribution function carried out by Electrica has been further divided into eight regional divisions: Muntenia Sud, Muntenia Nord, Transilvania Sud, Transilvania Nord, Oltenia, Moldova, Banat and Dobrogea.

The Italian company ENEL further signed selling–buying contracts with Electrica SA, subsequently acquiring control over three distribution companies, namely Electrica Muntenia Sud, Electrica Banat and Electrica Dobrogea. A similar sell-off strategy was approved for Electrica Oltenia and Electrica Moldova. Thus, five of eight electricity distribution companies have been privatized in Romania so far. The other three continue to be in State ownership, but there are plans to privatize them as well.

In accordance with current legal provisions, the privatization process falls under the legislation of competition protection. Most of the individual privatization acts are economic concentrations, as defined by law, and they should be notified to and approved by the Competition Council. The rationale is that privatization could create anti-competitive effects through the restructuring of the markets while also potentially enhancing efficiency. In order to establish their compatibility with the Romanian competitive environment, all the above-mentioned operations were notified and subsequently approved by the Competition Council.

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[473] European Commission Green Paper. *A European Strategy for Sustainable, Competitive and Secure Energy*, EC (2006).

The privatization that took place in the distribution system has also played an important role in the restructuring of the Romanian electricity sector. It upheld the financial development of the distribution system, covering investment needs and promoted profit-oriented normal market behaviour and the improvement of a competitive environment.

Furthermore, the process of creating independent generation companies has just started to deliver significant efficiency gains, which in the longer run can be passed on to the consumers. These gains refer mainly to the decentralization of the less productive thermo generators with a view to adapting the production capacities to local consumption requirements. Thus grouping the most viable generators (the hydro plants, the energy complexes and possibly, the nuclear producer, Nuclearelectrica) together with other less efficient thermo generators would create companies with similar average costs and market shares that could successfully compete against each other. A relevant example of horizontal unbundling is Termoelectrica. Together, the most important entities that were spun off Termoelectrica account for about 25 per cent of electricity production in Romania.

The restructuring process of the electricity sector has been accompanied by the opening up of the market to competition through the gradual increase of the competitive market. From the year 2000 to June 2005, the opening rate increased from 10 per cent to 40 per cent. Since July 2005, all industrial consumers have been able to switch their supplier, even if it was anticipated that this would only happen by 1 January 2007. Romania’s market opening is 100 per cent for industrial consumers as of 1 January 2007 and 100 per cent for residential consumers as of July 2007.

The structure of the Romanian electricity market is promising although the effects of competition have been limited, especially in the generating sector. In 2007, in this market there were 22 producers out of 67 licensed operators, 7 system services suppliers, 48 electricity suppliers in the gross market, 95 electricity suppliers in the retail market, 1 transport operator, 1 system operator, 8 distribution operators, 8 million residential consumers and 600,000 industrial consumers, able to choose their suppliers.

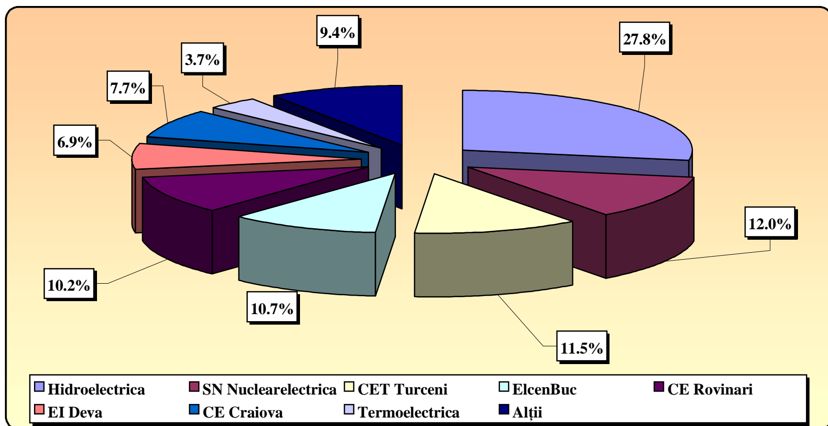
Regarding generation, the market structure offers a starting point from which to judge the possible competitiveness level of the electricity market. According to the economic theory, the following market concentration indicator may be defined:

HHI, Herfindahl-Hirschman Index = sum of square market shares of participants (%):

The indicator values signify:
1) HHI < 1,000 = competitive market;
2) 1,000 < HHI < 1,800 = moderately concentrated market;
3) HHI > 1,800 = highly concentrated market.

Since 2003, the annual values of the HHI based on both installed capacity and production have been moderate, with values of less than 1,800. More recently, i.e. in the first 11 months of 2007, the HHI recorded a value of 1,405 in the electricity wholesale market, thus reflecting a moderate concentration level of the market power held by the main economic operators (Chart 2).

Chart 2: Market structure from generation perspective in the first 11 months of 2007



Source: ANRE.

On the other hand, privatization of the generation sector has not advanced and remains almost entirely State owned. The most attractive generators, such as the hydro-generation power plants and the energy complexes that could have been of interest for private investors are still withheld from privatization, as they are considered of strategic importance. On the contrary, the thermoelectric power plants that were listed for sale several times did not attract investor interest due to their age, outdated technology and a significant need for investment. Nonetheless, it is planned that privatization will start in the short or medium term with the first major power plant most likely to be the Turceni and Rovinari lignite-fired thermal power complex, following the reorganization of the State-owned generation player Termoelectrica.

Competition in the electric energy market faces many constraints especially in the transition to its full liberalization. This is attributable mainly to the particularities of the sector as well as to other factors impacting on its functioning. For instance, it is more difficult to define the relevant market to assess the competition in the electric energy market than in other recently liberalized markets. Why? Because in the case of the electric energy market, we are dealing with a combination of different markets and different types of contracts.

According to the current legal framework, the Romanian electricity market includes a regulated market and a competitive market and the energy transactions can be performed through wholesale and retail sales.

The regulated market of electricity and ancillary services works on the basis of commercial contracts concluded between the market players based on regulated prices. The quantities contracted through wholesale transactions concluded between electricity producers and suppliers are established by ANRE.

The regulated electricity acquisition contracts can be reviewed, at the request of the supplier, as a result of the migration of the eligible consumers and the decrease in the prognoses errors as the date to deliver the electricity to consumers approaches. When the total quantity of electricity decreases, the suppliers should ask the producers to reduce the contracted quantities in the decreasing order of the prices regulated by the contracts.

However, when eligible consumers are migrating, it is less likely for suppliers to relinquish high price quantities or to contract additional low price quantities. In such circumstances, the additional costs or incomes incurred by the suppliers caused by the adjustment of the electricity quantities in the acquisition contracts are considered *ex-post*, the next calculation of the regulated tariffs for captive consumers.

It appears that the **mechanism to review the regulated contracts as a result of eligible consumer migration** may harm household consumers and **may lead to a distortion of competition in the market**.

The electricity competitive market is functioning on the basis of bilateral contracts negotiated between suppliers and producers, bilateral contracts negotiated by electricity suppliers with eligible consumers, import and export electricity contracts, auction transactions on the spot market and transactions of specific services.

The liberalization of the electricity market and the consumer's option to choose between the centralized and the competitive system of electricity delivery led to a 3.9 per cent increase in the beneficiary's consumption absorbed by the competitive market whereas the consumption absorbed by the regulated system dropped by 0.7 per cent, in November 2007, compared to that in the same month of the previous year. The number of consumers supplied by the competitive system increased by around 35 per cent in the same period (Table 3).

Table 3: Evolution in electricity consumption and in the number of consumers supplied by the competitive system from November 2006 to November 2007

Indicator	November 2006	November 2007	%
Consumption within the regulated system (TWh)	1,854	1,841	99.3
Consumption within the competitive system (TWh)	1.901	1,976	103.9
Number of consumers supplied by the competitive system (no.)	1,969	2,662	35.2

Source: ANRE.

In the EU-25 Member States, a comparative analysis of electricity prices charged to industrial and household consumers reveals that those charged to industrial consumers are lower than those charged to household consumers. In Romania, the situation is the opposite.

Since May 2007, the Romanian authority responsible for energy regulation is ANRE, following the restructuring process that merged the former National Regulatory Authority in the Electricity Field (ANRE) and the former National Regulatory Authority in the Natural Gas Field (ANRGN). The third-party access is regulated by provisions issued by ANRE.

As an overall picture, the current structure of the electricity sector in Romania reveals that all major producers are State owned (100 per cent), five of eight distribution companies have a combined ownership (51 per cent private, 49 per cent State owned), the transport operator is State owned and the largest supplying companies are private.

As shown previously, concentration in the sector is moderate and the chances to create a competitive power sector in Romania are genuine. The property regime, the inheritance of past regulation which

sought to use electricity prices as a tool for social protection, together with the political interference in the management of State-owned companies, have been the main obstacles to competition.

It is well known that the success of privatization is mainly dependent upon prior restructuring, which is needed to provide a legal background, transparency, and appropriate market conditions for investors to enter the market. In Romania, the energy sector has seen substantial change in recent years, as many of the old State-owned monopolies have been restructured and privatized. The most common method of privatization in the energy sector has been for a strategic investor to be found. However, in the future, capital markets are expected to play a greater role through the sale of shares on European stock exchanges.

Privatization of the energy system in Romania was designed not only to encourage foreign direct investment but also to allow market liberalization and increasing competition. An important step forward was made on 1 July 2007, when the entire EU market was liberalized, with household consumers now being able to choose their suppliers of electricity and natural gas. In principle, this should lead to cheaper energy but in practice reductions in energy prices may not take place immediately as major investments are needed in the sector, and will subsequently be passed on to consumers. In practice, the regulation of electricity and natural gas prices will continue and adequate measures of protection for household consumers are permanently sought in Romania. Low-income households, such as pensioners, will continue to benefit from subsidies to ensure that energy consumption costs do not exceed 15–20 per cent of their total income, according to ANRE.

A real challenge now for Romania consists in ensuring that energy providers are accountable to their customers, with clearly defined delivery targets and penalties for failure to meet them. Another challenge is that its energy sector needs significant investment to bring its technology up to date, since many installations are 35–40 years old. According to an estimate by the Ministry of Economy and Finance, the costs will be approximately EUR 30 billion between now and 2020, Some EU funding is available for the Romanian energy sector for 2008–2013, but this is relatively low (around EUR 600 million) and for selected sectors only, with a strong emphasis on improvement of

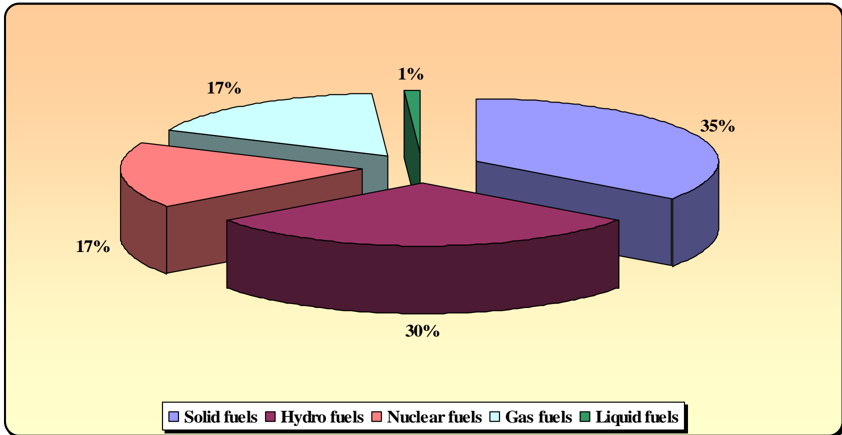
environmental standards. Still, the government is expecting that the financial gap will be filled by the private sector.

Nevertheless, these investment needs also present an opportunity for the Romanian energy sector as the latest technology will be brought in, which will make it more competitive. The electricity industry requires considerable modernization to bring the sector up to European standards.

It is true that, as a result of reform measures in Romania, the structure of available electricity output has improved in terms of primary energy sources (the share of the thermal electric capacities decreased whereas the share of the hydro-electric capacities increased), as has the beneficiary's ownership (the share of the State-owned capacities decreased in favour of the private-owned ones). In addition, the number of operators authorized to operate in the competitive segments of the markets increased significantly.

However, in comparison with other countries, which use a diversification of supply sources, with a mixture of hydro, renewable, thermo and nuclear power, most electrical energy in Romania is still supplied from coal-fired power stations. However, the following chart shows that solid fuels (35 per cent) are followed by hydro resources (20 per cent) while liquid fuel lags behind with a share of only 1 per cent (Chart 3).

Chart 3: Structure of the energy provided in terms of types of resources, November 2007



Source: ANRE.

As an emerging market and a new EU Member State, Romania offers many opportunities to investors in this field. While much still needs to be done, the country has made significant progress in environmental standards in recent years in order to comply with EU requirements. Improvements have also been made to the quality of the energy infrastructure and to the level of service provided to consumers. In addition, Romania has seen substantial economic growth and very high levels of foreign direct investment in most sectors. Potential investors are likely to view the country as an attractive place to do business.

2.2. Competition issues in the telecommunication sector

The liberalization process in the essential sectors of a transition economy forces domestic monopolies to face international competition. A perfect illustration of competition benefits for consumers, in particular, and for the economy, in general, lies in the liberalization of the telecommunication sector.

Following its liberalization in January 2003, the face of the Romanian telecom market completely changed. At the beginning of that year, Romtelecom lost its monopoly over fixed telephony. Initially, other

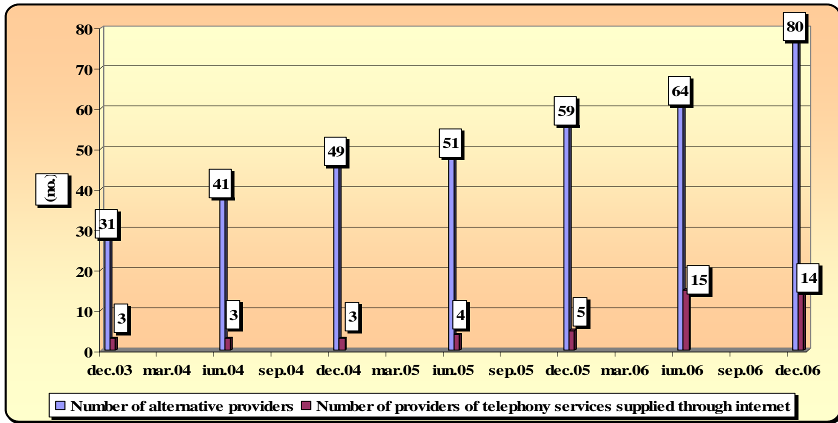
fixed telephony operators were reluctant to enter the market, which required important infrastructure investment. However, towards the end of 2005, the market share of the former monopolistic provider started to decrease considerably, while other operators were gaining significant slices of the telecom “pie”.

The new entrants made considerable investments in innovative technologies so as to reduce the cost of infrastructure development. This reduced the dominant operator’s market share and forced it to reinvent itself. The former monopolistic operator thus needed to react to the powerful wave of competition by investing significantly in its own infrastructure. The end result was a reduction in the costs for the maintenance and operation of infrastructure and higher quality connections to its clients. In the increased competition from the new entrants, the incumbent had to significantly reduce its prices. It even started to provide free calls within its network, which was inconceivable when there was no competition.

From 2002, the sector was given a totally new legislative and regulatory framework in line with the latest EU standards. During recent years the Romanian National Agency of Telecommunication Regulations (ANRC) delivered a competition-oriented set of secondary legislation, which offered investors easy access to the market, fair rules, based strictly on economic grounds, and protection from potential abuses of those attempting to take unfair advantage of their position.

Nowadays clients are expecting much more from their telephone line: broadband Internet, interactive and multimedia content and new services. From 2003 to 2006, there was a constant rate of increase in the number of fixed telephony providers. Thus, in only 4 years the number of alternative providers increased by over 1.6 times whereas the providers of telephony services using Internet connections recorded an average annual rate of increase of over 6.7 per cent for the period 2003–2006 (Chart 4).

Chart 4: Evolution of the number of alternative providers and of providers of telephony services supplied through the Internet



Source: ANRCTI, 2007.

Therefore, Romtelecom was forced once again to move into new "territories" and transform itself into a multi-services and multi-technologies provider. It is a process that has already started to produce results, with 30,000 people opting for the new digital television Dolce every month and a tenfold increase in the number of broadband Internet users.

There are currently 65 alternative fixed telecommunication suppliers other than Romtelecom that collectively account for 15 per cent of the market. The most intense competition by far is for international telecommunication services where, in 2006, 63 companies were active.

Romania is entering a second phase of the deregulation process, whereby all the benefits of liberalization are gradually becoming visible. The market has reached the stage where the core of telecom services – basic fixed telephone services – is being targeted by a multitude of market players.

As a result, tariffs are in some cases significantly lower than those of Romtelecom, the former monopolist incumbent. This is a clear indicator that the market players are willing to invest in the possibilities the sector is offering in the medium and long term.

The highest expectation in the next few years is the emergence of full competition on all fixed telephony segments. Beside the national operator, there are currently few operators who could provide fixed telephony based on their cable network.

Chart 5: The fixed telephony market in Romania – evolution of market shares

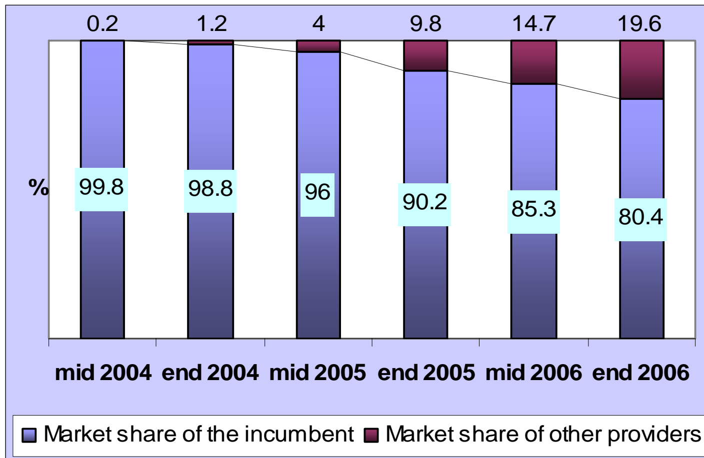


Chart 5 illustrates that competition leads to managing business in an efficient manner, with good results for both the consumers and the economy. The quality of connections of the former monopolist Romtelecom improved due to infrastructure developments generated by competitive pressures. Further, its related services were improved due to competition and good quality services provided by other companies.

2.2.1. Mobile telephony

Together with fixed telephony, mobile telephony has an important and more expanding role. Nowadays, alongside the GSM mobile communications, the latest advanced technologies – CDMA (used by Telemobil), EDGE (used by Orange) and UMTS – are being utilized in Romania. In April 2005 3G services were launched in Romania by Vodafone and in June 2006 by Orange. In January 2007,

two more 3G licenses were granted for the providers S.C. Telemobil S.A. and S.C. RCS&RDS S.A.

Because consumers have had the chance to choose between fixed and mobile telephony, the total number of users increased significantly, from 7 million (2003) to 19.5 million (2007). The penetration rate practically tripled, as shown in Table 4.

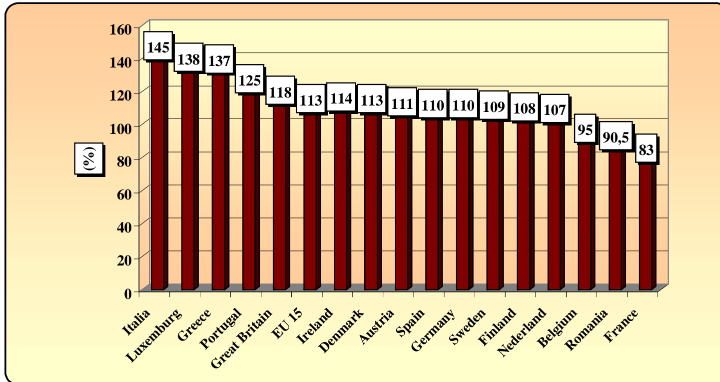
Table 4: Evolution of the total number of users of mobile telephony and of its penetration rate during 2003–2007

Indicator	31.12.03	30.06.04	31.12.04	30.06.05	31.12.05	30.06.06	31.12.06	30.06.07
Total number of users (million)	7.0	8.4	10.2	11.4	13.4	14.9	17.4	19.5
Penetration rate per 100 inhabitants (%)	32.5	38.6	47.1	52.5	61.8	68.8	80.7	90.5

Source: ANRCTI.

Compared to the other EU-15 Member States, the average penetration rate of the mobile telephony services in Romania was 90.5 per cent in 2007. It is shown in Chart 6 that Romania's position as regards the penetration rate of mobile telephony services is under the Community average by 22.5 percentage points.

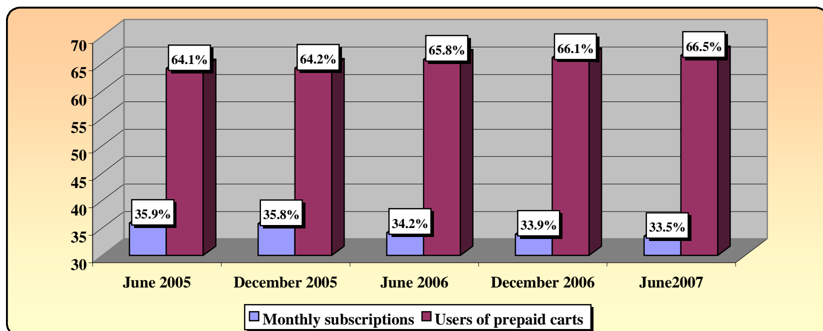
Chart 6: Romania's position compared to EU-15 Member States as regards the penetration rate of mobile telephony services



Source: ANRCTI.

The consumer's option for different means of payment for the mobile telephony services is regarded as another positive effect of the mobile telephony. Almost 70 per cent of about 2 million new "users" recorded on 30 June 2007 compared to 31 December 2006 preferred the supply of mobile services by means of prepaid cards instead of monthly subscriptions. Compared to 2006, the number of users of monthly subscriptions decreased by 2.4 percentage points, whereas the number of users of prepaid cards increased by the same percentage (Chart 7).

Chart 7: The evolution of users of prepaid cards



Source: ANRCTI.

The rising trend in users of prepaid cards may also be regarded as an increased freedom of consumers who use mobile telephony services, as well as a reaction to the various costs involved in subscriptions.

With regard to the application of competition rules in the fixed telephony markets, two cases where Romtelecom was involved are relevant.

2.2.2. ROMTELECOM/ GOCR, Decision no. 168 [2002]

Keywords*: association of two companies, non-compete clause, agreement, telecommunication*

Facts: This is a case that illustrates the behaviour of Romtelecom at the time when it had exclusive rights over the national fixed telephony market. Moreover, it shows that whenever the behaviour of the companies acting on a regulated market has the characteristics of an anti-competitive practice prohibited by the competition law, the Romanian Competition Council can intervene and impose the sanctions provided for by the Competition law.

In 1999, SNT Romtelecom SA (Romtelecom) filed a complaint to the Competition Council about the non-compete clause provided by the statute of SC Global One Communications Romania SA (hereinafter GOCR), of which Romtelecom was a shareholder. Romtelecom alleged that it was prevented from carrying out activities or capital investments in the package data transmission market (where GOCR was active), and invoked the provisions of Art. 54[474] of the Competition Law.

Gocr was established as a stock company in 1993. Subsequently, following a series of transactions, from January 1996 to April 2001, GOCR equity was held by SC Global One Communications Holding BV (50.5 per cent) and Romtelecom (48.98 per cent).

Romtelecom was the national telecommunication incumbent, which benefited at that time from exclusivity for national fixed telephony. It held sole ownership of all Romanian telecommunication infrastructures that it leased to the companies acting on the data transmission market. Global One Communications Holding BV (GOCH) was a joint venture of France Telecom, Deutsche Telekom and Sprint. It was established as a vehicle company that allowed those companies to enter the European data transmission market, services with added value and Internet. Subsequently, Deutsche Telekom and Sprint left the business, and France Telecom became the sole shareholder.

Harm on competition:

Analysing the GOCR statute, the Competition Council found that the contracting parties (Romtelecom and GOCH) were not allowed to compete with GOCR if they held shares and for a period of five years from the termination of their activity as shareholders.

Furthermore, the investigation revealed that Romtelecom did not exert any determinant influence on GOCR, which was controlled only by GOCH. Consequently, the establishment of GOCR did not constitute an economic concentration and the non-competing clause could not follow the legal regime of an ancillary restraint. Against this background, the non-compete clause had to be treated as an agreement that affected competition on the data transmission market,

[474] According to Art. 54, any contractual clauses referring to an anti-competitive practice banned by Art. 5 are null and void.

preventing the two parent companies of GOCR from entering the market independently.

The Competition Council also examined the compatibility of the association between GOCH and Romtelecom with the national competition legal framework. For that purpose, the relevant market was determined as being the data transmission (using commuting packages) market[475].

The competition authority examined the degree to which the two parent companies competed with each other. More precisely, the investigation analysed the ability of the parties to individually provide services already performed by GOCR.

The investigation revealed that GOCR parent companies undertook substantial activities in the related markets (namely on mobile and fixed telephony). In the communications sector, these markets account for a significant place in comparison with the market of GOCR. In addition, Romtelecom and GOCH, by means of their parent companies, were already performing substantial activities in similar fields, and had the financial and technical capacity to enter the relevant market on their behalf. In conclusion, GOCH (and consequently France Telecom) and Romtelecom were potential competitors, having the financial and technical capacity to enter the relevant market on their own.

The decision made by Romtelecom and GOCH to cooperate harmed competition, falling thus under the scope of the Art. 5 para. (1). According to the legal principle *accesorium sequitur principale*, the agreement on non-competing concluded between GOCH and Romtelecom falls under the scope of Art. 5 para. (1).

The analysis of the relevant market's structure made clear that, in 1999, only two firms were active on this market: GOCR and LOGIC TELECOM, GOCR being the market leader with a market share of 78 per cent. In 2000, GOCR managed to conserve its leading position in

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[475] Commuting packages represents a way to improve the network capacity and consist in splitting data sequences in «packages», commuting the packages towards the intended destination and then reassembling them in order to get the original data sequences.

the data transmission market. Under the circumstances of an oligopoly market, with substantial investments and being strictly specialized, the association of two companies, together with the analysed non-compete clause, clearly constituted an artificial entry barrier; this barrier prevented the two potential competitors from entering the market, seriously limiting competition.

Likewise, while reviewing this partnership during the investigation in April 2001, the General Extraordinary Assembly of GOCR Shareholders decided Romtelecom's withdrawal from this company, along with the annulment of the non-compete clause in the GOCR statute.

Enforcement measures:

In its Decision, the Competition Council's Plenum sanctioned Romtelecom and Global One Communications Romania for having breached the provisions of Art. 5(1) of Competition Law, by concluding an association agreement in setting up a new company, Global One Communications Romania SA, and for the stipulation of a non-compete clause in the company's statute.

Appeal proceedings:

The decision was appealed before the Bucharest Court of Appeal ("Court"), which dismissed the complaint and maintained the decision as legal and well founded. The Bucharest Court of Appeal decision was further appealed before the High Court of Cassation and Justice. In their appeal the parties (Romtelecom and Global One Communications Romania) requested the annulment of the decision claiming that the competition authority's decision did not respect their rights of defence. The parties also claimed that the decision infringed upon the principle of non-retroactivity of the competition law because the agreement and the establishment of the new company took place long before the competition law was enforced, and thus the alleged infringement of Article 5(1) of Competition Law no. 21/1996 exceeded the limitation period. The Supreme Court upheld that the limitation period of the infringement was not exceeded because it was a continuous infringement, which ended only with the competition authority's investigation. The High Court of Cassation and Justice upheld the Bucharest Court of Appeal decision.

Another interesting case where Romtelecom was again involved was brought to the attention of the RCC in 2004, after the liberalization of the fixed-telephony market. This case shows that e*x-ante* regulations must be applied together with legislation in the field of competition in a complementary manner, in order to promote effective competition in the market.

2.2.3. AIETES TELECOM vs. ROMTELECOM, 2004

The involved parties in this case were Aietes Telecom, as complainant, and Romtelecom, as defendant. The alleged infringement of Competition Law consisted in a possible abuse of a dominant position committed by the incumbent fixed-line operator (former monopolist), i.e. Romtelecom, against an alternative operator, i.e. Aietes Telecom, by refusing to grant interconnection in certain pertinent and feasible terms (both technical and economic). It was interesting that the complaint was also sent to the ANRC, thus creating a positive conflict of competences regarding the interconnection conditions provided by the incumbent in the market of access to the fixed public telephone network for call origination, termination and transit.

Since the facts of the case revealed technical problems and infringements of both telecommunication legislation and the ANRC's decision, the RCC requested the ANRC's viewpoint in this respect. After consultation between these two authorities, the RCC suspended its procedure until the ANRC issued a decision.

In its decision, the ANRC obliged Romtelecom to negotiate and conclude an interconnection agreement (using the R2 signalling system requested by Aietes Telecom) at the ANRC's tariffs settled through its previous decision. Under these circumstances, the reasons for the complaint disappeared and the RCC closed the case after the withdrawal of the complaint by Aietes Telecom.

It appears evident in this case that a clear procedure of cooperation between a national competition authority and a sector regulator needs to be in place when companies commit certain deeds or acts that may constitute, simultaneously, both a breach of competition legislation and a breach of the electronic communications legislation. In the above case, it was considered more appropriate that the sectoral

regulator intervene. However, this does not mean that we can overlook the fact that there are particular circumstances that trigger the application of competition law even if access and interconnection come under the ambit of sector-specific regulation.

Another conclusion we can draw from this case is that the paramount role of cooperation between a national competition authority and a sector regulator is to avoid the adoption of contradictory measures and the imposition of disproportionate sanctions or obligations.

Cooperation between a national competition authority and a sector regulator should be based on a procedure that stipulates clear rules for handling different circumstances, such as:

- where one of the parties finds that it does not have the competence provided by law to investigate or settle a certain dispute, but it considers that the dispute may fall under the other party's competence – it shall send the other party the relevant information, notifying the interested persons;

- where one of the parties finds it has the competence, but it considers that the respective case could also involve the competence of the other party – it shall inform the other party, in order to identify a potential positive conflict of competence;

- the party receiving the information shall make its stand on the case;

- if, during the parties' correspondence or meetings, it is revealed that one of the parties is not competent to investigate or to solve the case, that the measures or sanctions it may impose would not be effective or that the other party's actions would be sufficient, this party shall decline its competence, or suspend the exercise of its attributions;

- if both parties decide to continue the investigations, they shall consult each other in order to ensure consistency of the decisions and proportionality of the sanctions and obligations imposed;

- one party may investigate acts or deeds that have been authorized or imposed by the other party, requiring the other party to take a stand regarding that matter, and it shall consider the respective answer in the process of making a decision;

- the parties shall provide each other with the information they have, in order to exercise their legal attributions;

- the request for information shall be made in writing or, under exceptional circumstances, orally, establishing deadlines for providing the information;

- the information provided shall be used only for the purposes indicated in the request (one party shall require the written consent of the other party if it intends to use the information for other purposes);

- in order to establish effective communication, contact persons shall be designated to ensure operative collaboration between the parties.

3. Conclusions

The role of competition policy in the efficiency and productivity of the economy has not always been as relatively undisputed as it is today. There was a time when many commentators doubted which of the two competing economic orders in the world, a market economy or a centrally planned economy, would eventually lead to better results. Competition policy has slowly but surely became a growing element of the economic governance in Europe and worldwide.

Today, competition policy is part of an investment climate aimed at improving economic growth. As Joseph Stiglitz has observed: "*Strong competition policy is not just a luxury to be enjoyed by rich countries but a real necessity for those striving to create democratic market economies*".

The last ten years have seen a continuous evolution in competition law in Romania and an enforcement policy that is now widely accepted as a key policy to promote the competitiveness of the

Romanian economy. This could also serve as a model for countries with an economy in transition or still at the developmental stage.

The adoption of the relevant legislation is relatively easy as there are enough international pieces of legislation already validated by practice that can be adapted to the individual state needs.

Enforcement of competition law is however much more difficult. Public officers in transition economies or developing economies are usually not familiar with or are even hostile to privatization and free market mechanisms. If State employees, privatization authorities and competition authorities are not genuinely favourable to market mechanisms, any subsequent effort to train staff or encourage them to enforce the law is pointless. As a result, enforcement may be aggressive or passive and discretionary, with inconsistent outcomes and effects on the market.

Decision makers have an important role in building a fully functional and credible institution. Therefore, there is a need for coherent internal policies to interpret the law and the regulations, so that there is consistency in their application. Otherwise, the competition authorities could be influenced by different lobby groups (political, business, consumers, etc.) and practically "disappear", thus endangering the long-term viability of the institution.

Competition policy should be a constant part of the policy mix. The existence of such a policy would considerably ease the competition review of the privatization process and confer credibility on the competition authorities. The control of the privatization process should be fair and transparent enough to attract the interest of real investors. In an economy in transition, most of the anti-competitive practices involve the State represented at different levels (ministries, local administrations, and other institutions). It sometimes plays a double role, that of regulator establishing the rules of the game and another one as market player. This anomalous situation can be rectified only by strengthening the role of the competition authority as an independent autonomous body capable of implementing an effective competition policy, on the one hand, and by scaling down the role of the State as a market player in the economy, on the other hand.

International experience has shown that anti-competitive practices tend to be less prevalent in economies where the effective use of national competition law and policy acts as a deterrent. If correctly implemented, competition policy can protect producers and consumers from anti-competitive practices that increase costs and prices and reduce production. At the same time it can promote transparency and enhance the attractiveness of an economy to foreign investment, and also reinforce and maximize the benefits of such investment.

An important part of competition policy is its advocacy function, which helps to impart a culture of competition in the manner in which firms interact in the economy and can in itself foster increased adherence to competition principles and encourage self-discipline amongst firms, thus reducing production and enforcement costs. Finally, political will is extremely important for the success of competition and regulation regimes in developing countries.

High-quality capacity building programmes, such as those developed by UNCTAD in the area of competition law and policy, are most useful. They should continue to assist developing countries in particular in their efforts to construct and develop an efficient and competitive economy.

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COMPETITION LAW AND ENFORCEMENT: THE AUSTRALIAN EXPERIENCE

Deborah Healey*

1. Introduction

Competition law in Australia is well developed and has provided significant benefits to the economy and consumers. The Australian competition law, the *Trade Practices Act* 1974 (TPA), has changed significantly over time. This discussion below is divided into two parts and will focus on two particularly important factors in the effectiveness of Australian competition law: the breadth of competition policy and the law, and the robust enforcement of the TPA by the Australian Competition and Consumer Commission (ACCC), the agency that has responsibility for enforcement.

There was a general recognition in the early 1990s that the country needed a competition policy that took a broad approach to the issues of competition law. This led to the implementation of a National Competition Policy in the mid-1990s which resulted in major benefits to the economy, which are shared by all. Section 2 below outlines the scope of the TPA and its significant limitations prior to the 1995 amendments. The amendment process and the current application of the TPA are described, using case studies to illustrate the application to areas previously immune from prosecution, including government bodies. It also describes the broader reforms of National Competition Policy and their quantifiable benefits for the economy and consumers.

The profile of the TPA and the development of a significant culture of compliance in Australia have been aided by the robust approach to enforcement taken by the ACCC. Section 3 of the discussion outlines the ACCC's broad powers to investigate contraventions of the TPA, which have been particularly important to enforcement. Case studies show the way in which the enforcement can achieve outcomes that benefit a large number of consumers. These two areas provide some interesting lessons for other jurisdictions.

2. The breadth of Australian competition law and policy

Australia has had some form of competition law since 1906, although the area did not become particularly important until the enactment of the TPA in 1974.[476] Prior to 1974 the law was more limited, the enforcement mechanisms underdeveloped and sanctions provided little incentive to comply with the law. In summary, the laws were not particularly effective.[477]

The 1974 TPA was the first really serious competition law in Australia and was modelled on provisions contained in both the US and EU statutes operative at that time. There were, however, a number of important areas of business to which it did not apply.

A range of government and non-incorporated bodies were not subject to the TPA because of Constitutional limitations. Australia is a Federation made up of States and Territories. The Australian Parliament has specific powers to make laws under the Australian Constitution, and the States exercise residual power. The Australian Parliament's powers under the Constitution to make laws with respect to corporations[478] and trade or commerce provide the Constitutional basis for the TPA.[479]

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References to legislative provisions are to the *Trade Practices Act* 1974 unless otherwise stated.

[476] The Australian Industries Preservation Act 1906 was declared to be unconstitutional under a now-discredited view of Constitutional interpretation. The 1965 *Trade Practices Act* was also declared to be unconstitutional and was replaced by the 1971 *Trade Practices Act*, which had a more limited application and was constitutionally uncontentious. It was superseded by the 1974 TPA, which is the current law.

[477] Under the 1971 TPA, in order to avoid prosecution, a company could simply register an agreement and in 1974 there were some 14,000 registered agreements. See Productivity Commission, *Review of National Competition Policy Reforms, Productivity Commission Inquiry Report,* No 33, 28 February 2005 (the "Productivity Commission Report").

[478] Specifically trading, financial and foreign corporations: Constitution of Australia, section 51(xx); TPA, Section 4(1).

[479] Trade or commerce power: Constitution, Section 51(i); TPA, Section 6(2). There are some other Constitutional provisions of more limited relevance but those mentioned provide the major platform for the law.

Bodies that are not trading, financial or foreign corporations, or are not engaged in Constitutional trade or commerce, are not within Constitutional power. This means that the Australian Parliament itself lacks power to legislate with respect to other bodies, and they cannot be prosecuted under the TPA.

Another gap in coverage arose because State and Territory governments could enact laws within their own jurisdictions expressly exempting particular conduct and certain bodies from the operation of the TPA, possibly for anti-competitive or protectionist purposes, without the need to justify the action.[480] Prior to the reforms the Australian States and Territories often made laws and regulations favouring their own industries and undertakings and the Commonwealth could not control this.

Finally, there was a common law doctrine called the “shield of the Crown” which gave government bodies forming part of the executive arm of government immunity from the TPA, and substantially limited the way in which laws were applied to bodies that formed part of the Crown (or government). To clarify this issue, the Crown is the “government”. This means in Australia that the Crown exists at Commonwealth, State and Territory levels because each has its own government. In each of these jurisdictions the government acts through its departments and officers, and the reference to the “Crown in right of the State” or the “Crown in right of the Commonwealth” refers to the Ministries that discharge executive functions in those jurisdictions. They are not generally separate legal entities.

Under Australian laws of statutory interpretation, if there was no mention of the Crown, there was a presumption that it was not caught by the law. The TPA itself originally did not mention the Crown in right of the Commonwealth, State or Territory. In 1977 the Commonwealth Parliament recognized that it was inappropriate for Government bodies carrying on business to have immunity from the TPA, and a section was added which made the TPA applicable to Commonwealth Crown bodies where they were carrying on business.[481]

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[480]Under the TPA itself the Australian Parliament could also enact laws exempting particular conduct and certain bodies from the operation of the TPA without giving reasons.
[481] Section 2A.

Under the Constitution, however, there is no power for the Australian Parliament to make laws that bind the States, so State bodies were not caught by the TPA even where they were carrying on business.

2.1. Major review of competition policy

A major review of Australian competition policy took place in 1992 with the agreement of the Commonwealth, and all States and Territories.[482]

The reasons for the review are well summarized in the words of the Productivity Commission:

"During the 1970s and 1980s, output growth slowed, inflation and unemployment rose, and productivity growth was consistently low by international standards…high trade barriers and various regulatory and institutional restrictions on competition in the domestic market led to significant inefficiencies across the economy. They also created a business culture that focussed on securing government preferment rather than on achieving a competitive edge through cost control, innovation and responsiveness to customer needs…from the early 1980s, Australian governments embarked on a programme of extensive economic reform. As the reform programme gathered pace, it became apparent that aspects of Australia's wider competition policy framework were impeding performance across the economy and constraining the scope to create national markets for infrastructure and other services."[483].

The outcome of the review, the Hilmer Report, emphasized that competition policy embraces a range of laws, not just the TPA itself. It concluded that an effective competition policy for Australia should address six concerns:

1. Anti-competitive conduct of firms;

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[482] Report by the Independent Committee of Inquiry into National Competition Policy, 1993, AGPS, Canberra (the "Hilmer Report").

[483] Productivity Commission Report at p. xiv.

2. Unjustified regulatory restrictions on competition;
3. Inappropriate structures of public monopolies;
4. Denial of access to certain facilities that are essential for effective competition;
5. Monopoly pricing; and
6. Competitive neutrality when Government businesses compete with private firms[484].

It recommended a large number of significant reforms, which were ultimately agreed to and adopted by the Australian Government and the Governments of each of the States.[485] These reforms, which became known as "National Competition Policy", included amendments to the TPA. They also included review by governments of all laws restricting competition, structural reform of public monopolies to facilitate competition, third-party access to significant infrastructure facilities, some price oversight and introduction of competitive neutrality.

2.2. Application outside Constitutional coverage: all persons in business

The Hilmer Report stated that the competition law should apply to all entities carrying on business and that any exemptions or immunity should be of limited nature and implemented only after a transparent process. It found a number of categories of conduct that were exempt from the application of the TPA, including conduct by bodies outside Constitutional limitations, and those that were entitled to the "shield of the Crown" (or Crown immunity).[486] In particular the Hilmer Report

[484] Hilmer Report at p. 7.
[485] See Competition Principles Agreement; Conduct Code Agreement; Agreement to Implement National Competition Policy and Related Reforms. A National Competition Council was established as part of these reforms to provide advice about competition policy matters and make various recommendations in relation to the statutory access regime contained in Part IIIA of the TPA. See Productivity Commission Report.
[486] There were also a number of other bodies such as statutory marketing bodies and the professions. Other groups could be exempted by the laws of the

recommended that Government Business Enterprises (GBEs) should not enjoy any advantages when competing against their private-sector counterparts and that the TPA should apply to State and Territory GBEs in the same way that it already applied to Commonwealth GBEs.

Ultimately, the competition laws were changed so that the TPA prohibitions now cover both of these groups.

Because of the limitations of the Constitution, agreement was reached that various laws would be enacted or amended. The States enacted laws to mirror Part IV of the TPA, Restrictive Trade Practices, which mean that bodies that are not Constitutional corporations or are not carrying on Constitutional trade or commerce are caught under the Competition Codes of the States.[487] A new Part XIA was inserted into the TPA creating this Competition Code. Application legislation in each State and Territory makes the Competition Code part of the law of that jurisdiction. While the Competition Code repeats the substantive provisions of Part IV, it applies to "persons" rather than to corporations to address the issue of the limitations on the Commonwealth Parliament's power to legislate in this area.

This means that unincorporated persons or bodies such as partnerships, individuals not covered by Constitutional trade or commerce, professionals such as doctors and lawyers, and cooperatives are now caught by the TPA or a Competition Code of a State if they are carrying on business.

2.3. Ability to exempt by law or regulations curtailed

States and Territories in a non- transparent way. Other conduct could be given administrative approval after a more transparent process. So, for example, those engaged in professional activities such as doctors or lawyers were not generally caught by the TPA prior to these amendments due to constitutional limitations they were not incorporated and did not engage in interstate or overseas trade or commerce, i.e. Constitutional trade or commerce.

[487] They also agreed to maintain the mirror legislation in a uniform way going forward in the interests of creating one main competition statute for the whole of the country.

The ability of the Commonwealth, the State and Territory Parliaments to exempt particular bodies or specific conduct was significantly curtailed by the introduction of transparency and a more rigorous process of evaluation.[488]

The possibility of States and Territories exempting particular organizations by legislation is now limited by a process set out in the Competition Principles Agreement. There are also requirements for review of any new legislation to prevent the enactment of laws that hinder competition without examination under a transparent process setting out the anti-competitive effect of conduct and justifying it on public benefit grounds.[489]

2.4. Application to government bodies

Sections 2B and 2C were inserted into the TPA making the Crown in each the State and Territory liable for breaches of Part IV of the TPA. Section 2B provides that the TPA applies to bind the Crown in right of the States and Territories "*so far as the Crown carries on a business, either directly or indirectly or by an authority of the State or Territory*". The Crown is not, however, liable to penalty, but an *authority* of a State or Territory may be liable to penalty.[490]

2.5. How do you determine the status of a government body?

The issue of the extent to which government bodies are or should be subject to competition laws is an issue of complexity in many jurisdictions.

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[488] See Hilmer Report at p. 108, and Sections 172(2); 51(1)(b),(c),(d);51(1C), 51AAA. As part of the process, the States and Territories must notify the ACCC of the legislation, which must have a sunset period of two years.

[489] Authorization, which is an administrative sanction, may also be granted by the ACCC for most Part IV conduct on the basis of individual application if it can be justified on public benefit grounds see Section 88ff. This process is outside the scope of this study.

[490] An "authority" of a State or Territory is a body corporate established for a purpose of the State or Territory, or such an incorporated company in which a State or Territory has a controlling interest.

In Australia, for the purpose of determining whether a government body is subject to the TPA it is necessary first to determine whether it represents the Crown or not, and then secondly to see whether or not it is carrying on business.

There is a whole range of government bodies of different characters in Australia. Some continue to exist as Government departments carrying out government functions. Some carry out regulatory functions. Some have been corporatized and others have not. Some are corporatized but wholly owned by government. Some are partially government owned. There are various categories of legislation governing their status and operation depending upon the nature of their functions, the way they are managed and the degree of autonomy that they have over day-to-day matters.

2.6. Does it represent the Crown?

In order to determine whether or not a body is part of the Crown (executive) (and hence whether or not it is entitled to Crown immunity), the courts have traditionally relied upon two tests: the incorporation test and the control test.

The incorporation test asks whether or not the body has been incorporated and the way in which this has been done. The fact that the Government has decided to create a separate body to perform a particular activity is an indication that it is not meant to be the Crown. To determine whether an incorporated body is the Crown it is necessary to look to the legislation establishing it to ascertain the intention of the legislators. If the legislation setting up the body is silent on the issue of whether or not it is part of the Crown, it is likely that it is not. The courts generally require clear wording indicating that a body forms part of the Crown for this to be the case. If a body is set up under the general *Corporations Act*, for example, it is unlikely that the body represents the Crown.[491]

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[491] See, for example, *NT Power Generation Pty Ltd v Power and Water Authority & Anor* [2004] HCA 48 (“NT Power case”) where the subsidiary of PAWA was incorporated under the Corporations Act, not the statute setting it up.

A test called the control test applies and a government body is entitled to the Crown immunity if a Minister of the Crown exercises control over it, in the sense of control and direction of activities. Control for the purposes of the test refers to the right to control, not necessarily the actual exercise of control. The test was summarized in the NT Power case, discussed further below, where the High Court stated:

"*...in every case where the question arises it is necessary to examine the nature and degree of control that the Crown exercises over the corporation. If the corporation is subject to the same control as a governmental department it is likely to be the alter ego of the Crown. If the corporation is largely free of ministerial control then it is unlikely to be the Crown's alter ego.*"[492]

In that case the High Court found that the mere giving of guarantees by the government was not sufficient to suggest that Gasgo should have immunity from the TPA on the basis of its connection with the Crown or PAWA, which had Crown immunity.

Where the boards of Government-owned corporations or GBEs are subject to Ministerial directions it is likely that they are entitled to Crown immunity. This may not be a total immunity. It may be that they are entitled to Crown immunity in respect of some activities and not in respect of others. This will be the case should their relevant legislation allow for the grant of Ministerial directions in respect of only some conduct. This is an issue that has sometimes proved difficult to determine without significant consideration and it thus an area of risk for these bodies.

If a Government body is not part of the Crown, then the TPA applies to it in the same way that it would to any other body. The relevant questions are then whether or not it is a corporation and if it is, is it a trading, financial or foreign corporation, or the holding company of one of them, such that the TPA applies? If it is not within one of those categories of corporation, then is it a "person" acting in trade or commerce in which case the TPA applies, or if not, is it a person to which one of the State Competition Codes would apply?

[492] NT Power case at para. 126.

2.7. Is the Government body carrying on business?

Once a government body is characterized as the "Crown" the next question is to consider whether or not it was carrying on business when it engaged in the conduct, to see whether or not the TPA is capable of applying to the conduct.

"Carrying on business" for the purposes of the TPA does not require a profit motive.[493] The nature of the activities undertaken, and whether or not they are in the nature of government activities, or are activities that usually would be undertaken by business, are important considerations in analysing whether or not a body is carrying on a business. The High Court emphasized in the NT Power case that the TPA should be given a broad application rather than a narrow one, based on it purposes and the intention of the Competition Policy amendments. The nature of the statute setting up the government body concerned is an important consideration in this issue. If activities are carried on in a regular manner with repetition and system they are more likely to involve carrying on a business.[494] Carrying on procurement for the use of the government body is unlikely to be carrying on a business.[495]

Section 2C of the TPA lists a number of activities that do not constitute carrying on business and some of these are:

- Collecting taxes and levies;
- Licence fees;
- Granting or revoking licences;
- Transactions involving only Crown organizations;
- The compulsory acquisition of primary products by a government body under laws in certain circumstances.

This idea of carrying on business has been the subject of many decisions in Australia. The following activities have been held not to be

[493] Section 4(1).
[494] See *J.S. McMillan Pty Ltd v Commonwealth* (1997) 77 FCR 337 ("McMillan case").
[495] McMillan case, *op. cit.*; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1.

carrying on business for the purposes of Section 2C and the similar State provisions:

- Inviting tenders to sell off part of an existing business;[496]
- Running immigration detention centres for profit;[497]
- Managing a national park;[498]
- Running the Trade Practices Commission (the predecessor of the ACCC);[499]
- Operating a public hospital providing services to public patients through a contractor;[500]

2.8. Other issues related to the Crown: derivative Crown immunity

"Derivative Crown immunity" is the name given to a further exemption that might be given to parties who are engaged in conduct involving the Crown. Where conduct in breach of the TPA occurs between two or more parties, and one of the parties is entitled to Crown immunity (or the shield of the Crown), the other party may also be entitled to immunity on the basis that to make orders against that party would have the effect of indirectly applying the TPA to the Crown.[501] This approach was applied in a number of cases and in effect allowed a party dealing with Government to escape liability for breaches of the TPA in certain circumstances.

2.8.1. Case examples

Three fairly recent interesting cases have considered different aspects of the way in which the TPA applies to government bodies in Australia.

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[496] McMillan case, *op. cit*.
[497] *Corrections Corporation of Australian Ltd v Commonwealth of Australia* (2000) 104 FCR 448.
[498] *Easts Van Villages v Minister Administering the National Parks and Wildlife Act* [2001] ATPR (Digest) 46-211.
[499] *Thomson Publications Pty Ltd v TPC* (1979) 40 FLR 257.
[500] *ACCC v Australian Medical Association (WA) Inc*. [2003] FCA 686.
[501] *Bradken Consolidated Limited v Broken Hill Pty Co Limited* (1979) 145 CLR 107.

The first case considers what happens when a government body not previously exposed to competition and traditionally performing a public service is faced with a competitive threat; when a government body entitled to Crown immunity is “carrying on business”; the extent to which the TPA applies to the refusal of such a body to enter a new business area or to assist others to do so and whether a subsidiary is entitled to Crown immunity.

In *NT Power Generation Pty Ltd v Power and Water Authority*,[502] PAWA was a government body set up under a special law and subject to directions of the Minister. It generated electricity and purchased electricity from others; it transported electricity from generation sites to distribution points and then distributed the electricity to customers.

NT Power Generation Pty Ltd (NT Power) had a licence to generate electricity issued by PAWA. It wished to sell the power it generated to customers but could not do so without access to the existing electricity transmission and distribution infrastructure, which was owned by PAWA. It sought access to this infrastructure and PAWA refused it access.

It was accepted by the parties that PAWA was entitled to the Crown immunity because it was set up under special legislation and was subject to Ministerial direction, but the issue before the High Court was whether it was carrying on business in refusing the use. The fact was that it had never allowed anyone to have access before – because of industry restructuring this now became possible. PAWA was in the process of setting up an access regime for its infrastructure under the Access provisions contained in Part IIIA of the TPA, but this had not yet been finalized when the request was made by NT Power. PAWA refused to give the access because it wished access seekers to be dealt with under that Part IIIA regime once finalized. It argued that it was not carrying on business in making its refusal, which meant that the TPA did not apply.

The High Court found that PAWA was carrying on business and using the infrastructure as a significant part of its business. This was despite the fact that PAWA had never before allowed anyone to use the

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[502] [2004] HCA 48.

infrastructure. PAWA had an express duty under its legislation to act in a commercial manner, and itself described its transmission and distribution facilities as "business products" in its own documentation. The High Court said that the actual refusal was conduct that advanced PAWA's business and that it had taken the decision not to supply NT Power because of the negative impact that this would have in the short term on its business of selling electricity. The fact that PAWA had not supplied the access before was not relevant to the point. Ultimately the High Court found that PAWA had breached Section 46, Misuse of Market Power, in refusing to allow NT Power to use the infrastructure.[503]

There was a second government body involved in the dealings with NT Power. PAWA had a subsidiary, Gasgo, and the High Court also looked at whether Gasgo was entitled to derivative Crown immunity. NT Power required gas from suppliers for its generator and sought an undertaking from Gasgo that it would not insist on its existing contractual pre-emptive rights, which might have left NT Power without supply. Gasgo refused to give this assurance to NT Power. NT Power said that this refusal was in breach of Section 46, Misuse of Market Power, of the TPA and Gasgo said in its defence that it was entitled to Crown immunity or derivative Crown immunity. It argued that the Northern Territory Government would suffer financial prejudice if derivative Crown immunity was not extended to Gasgo. This was because Gasgo and PAWA would need to seek additional supplies of gas in a competitive market where those supplies might be constrained by the available reserves if the guarantee requested by NT Power was given.

The High Court found that Gasgo was not entitled to Crown immunity nor was it entitled to derivative Crown immunity. The finding on derivative Crown immunity was on the basis that financial prejudice was not enough to justify the immunity. The High Court said that in order to benefit from derivative Crown immunity it is necessary for a body seeking the immunity to demonstrate that the application of the TPA to the party would adversely affect a more tangible right such as a legal prerogative, or a statutory, proprietary, contractual or other legal or equitable right or interest belonging to the Government.[504]

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[503] The High Court overruled the decisions of the Federal Court and the Full Federal Court on appeal.
[504] Relying on earlier High Court authority.

The issue of derivative Crown immunity was also considered in *ACCC v Australian Medical Association (WA) Inc*. [505] where the court reviewed the issue of Crown immunity in a complex situation that arose after the Hilmer amendments. There were two aspects to the case but only one will be referred to here. The State Government entered into contractual arrangements with Mayne Nickless Limited (MNL) under which MNL would provide medical services free of charge to public patients on behalf of the State and thereby the Minister would discharge his statutory obligations to the community. The ACCC alleged that the Australian Medical Association (WA) (AMA(WA)) and MNL made an understanding containing a price-fixing provision, namely that MNL would contract doctors to provide services to public patients at rates prescribed by the State fee for service rates controlled under a relevant state agreement.

The Federal Court found that there had been no price fixing.[506] However, even if there had been, the Court stated that MNL would have been entitled to derivative Crown immunity. The State of WA was not carrying on a business in operating a public hospital. The TPA thus did not apply to the State. MNL was entitled to derivative Crown immunity on the basis that the Crown had been heavily involved in the negotiation of all of the arrangements and that the interests of the Crown would have been prejudiced if the TPA had been applied to the contractual arrangements.

A different view on derivative Crown immunity that did impose some limits on the scope of the immunity was reached in another case involving the health system in 2007. There the High Court considered derivative Crown immunity in the context of the supply of pharmaceutical products to the State-run hospital system. This is an interesting case because in this context there is no consideration of the market power of the State-purchasing authorities – ordinarily one would assume that they had significant power but this was not an issue in the case. *ACCC v Baxter Healthcare Pty Ltd*[507] involved a situation where Baxter Healthcare Pty Ltd (Baxter) had bundled one sterile fluid product that it supplied almost exclusively in Australia with other sterile fluid products that it competed with others to supply. The contract price for

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[505] [2003] FCA 636.
[506] (2003) 199 ALR 423.
[507] [2007] HCA 38.

the bundled products was much cheaper than the prices for the individual products under the contract tenders submitted by Baxter. The products were supplied to the State-purchasing authorities for public hospitals in a number of States.

The lower courts found that this bundling conduct in some respects breached Section 46, Misuse of Market Power, and Section 47, Exclusive Dealing of the TPA. However, they found that Crown immunity applied to the State-purchasing authorities because they were not carrying on business in providing public health services to public patients. The lower courts found that derivative Crown immunity also applied to protect Baxter from the application of the TPA.[508]

The High Court disagreed with the application of the derivative Crown immunity in these circumstances. The relevant contracts were entered into after a period of negotiations following a formal request for tender by the State purchasing authorities and each of these requests allowed bundled offers.

In finding that Baxter was not protected by derivative Crown immunity, the High Court reiterated that the purpose of the TPA set out in Section 2 was to enhance the welfare of Australians through the promotion of competition and fair trading.[509] The High Court noted that the case relied upon in the lower courts to support derivative Crown immunity, *Bradken Consolidated Ltd v Broken Hill Proprietary Company Ltd* ("Bradken")[510] had been decided prior to the Hilmer amendments. This meant that at the time of the Bradken decision, the State Crown was not bound by the TPA at all. Amendments in 1995 meant that the Crown in right of the State was now caught by the TPA in so far as it carried on business.[511] Later decisions of the High Court in relation to Crown immunity had formulated a more flexible approach than that applied in Bradken.[512] Importantly, the High Court noted that Baxter was a trading corporation and stated:

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[508] In doing so they felt compelled to following existing authority on the point.
[509] TPA Section 2.
[510] (1979) 145 CLR 107.
[511] By the addition of Section 2B, discussed earlier.
[512] *Bropho v Western Australia* (1990) 171 CLR 1.

"A conclusion that, in carrying on dealings with a government in the course of its own business, it enjoyed a general immunity not available to the government when the government was carrying on business itself would be remarkable. Such a conclusion would be impossible to reconcile with the object of the Act as now declared in s2. Further such a conclusion would go far beyond what is necessary to protect the legal rights of governments, or to prevent a divesting of proprietary, contractual and other legal rights and interests."

2.9. Other National Competition Policy reforms

Processes were put in place as part of National Competition Policy to review all Commonwealth, State and Territory laws to isolate examples of provisions having an anti-competitive outcome and delete those that could not clearly be justified on public benefit grounds. This process of review of legislation was supervised by the National Competition Council (NCC) and was completed under a timetable approved by the NCC. States and Territories received payments for compliance with this timetable.

In 2005 the Productivity Commission reviewed the impact of National Competition Policy and related reforms on the Australian economy and the Australian community.[513] As part of the reform process A$834m were paid to the States and Territories between 1998 and 2003 for compliance with agreed processes. The Productivity Commission Report concluded that National Competition Policy had delivered substantial benefits greatly outweighing its costs, contributing to the productivity surge that has underpinned 13 years of continuous economic growth and associated strong growth in household incomes. The annual benefits to the Australian economy were estimated at 2.5 per cent of GDP, or A$20bn annually. Reforms had directly reduced the prices of goods and services such as electricity, gas, milk, freight rail rates, port charges and telecommunications.[514] Many households would have benefited from lower prices for other goods and services made possible by cheaper infrastructure inputs for businesses, as well as from the longer-term stimulus to employment and wages provided.[515] They

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[513] The Productivity Commission Report also looked at the issue of ongoing competition policy reform.
[514] Productivity Commission Report at p. xix.
[515] Productivity Commission Report at p. xx.

had stimulated business innovation, customer responsiveness and choice.[516] In summary, the Productivity Commission stated:

"In contrast with the 1970s and 1980s, Australia's recent productivity growth has also been strong by international standards. That rapid overall growth has been sustained despite a decade of economic stagnation in Australia's largest export market (Japan) and the financial crisis which struck that country and other key Asian trading partners in 1997.

While many factors can influence productive growth, a number of analytical studies indicate that microeconomic reforms – including NCP – have been a major contributor to Australia's productivity surge in the 1990s and to the economy's increased resilience in the face of economic disturbances. The reforms have achieved this by increasing the pressures on both private and government businesses to be more productive, through increased competition, while simultaneously enhancing their capacity to respond through more flexible work arrangements, the removal of unnecessary red tape and the like. Other suggested causes of the productivity surge, such as recovery from recession or unsustainable increases in work intensity, have not withstood analytical scrutiny."[517]

The mix of National Competition Policy reforms has had a very significant impact on the community and particularly consumers in Australia. The dismantling of many traditional regulatory barriers to trade and commerce, the restructuring of government bodies and monopoly suppliers, the broader application of the TPA and significant industry reform have all contributed to these benefits.

To quote the ACCC on National Competition Policy:

"… whether you are a doctor or a lawyer, whether you own shares in a power company, own a bottle shop, work on a wheat farm, ever catch taxis, have gas heating in your home, purchase CDs, have sugar in your tea, have milk on your cereal , take public transport, own a

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[516] Priorities for reforms going forward included strengthening the national electricity market, building on the national water initiative, developing integrated national strategies on efficient and integrated freight transport services, and an overarching review of the health system.

[517] Productivity Commission Report at p. xvii.

mobile phone, post letters , you are benefiting from competition policy reforms."[518]

3. Enforcement of the TPA by the ACCC

Part IV of the TPA, Restrictive Trade Practices, contains prohibitions similar in many respects to those of other jurisdictions.[519] It contains provisions dealing with the usual forms of anti-competitive conduct, plus more onerous provisions in relation to aspects of the telecommunications market, and an access regime in relation to essential facilities.[520] It also deals in depth with various areas of consumer protection and product liability, which will not be discussed here.[521]

The ACCC has extensive powers to investigate and enforce the TPA and has done so in areas related to both restrictive trade practices and consumer protection.[522] The successful high profile prosecutions that it has taken over the years undoubtedly have raised the consciousness of both business and consumers, and have acted as a significant deterrent to businesses contemplating conduct that might breach the TPA.

In enforcing the TPA the ACCC has stated that its priorities are promoting vigorous, lawful competition and informed markets. When deciding whether or not to pursue court action the ACCC looks at whether the matter involves:

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[518] Willet, E., Commissioner, Australian Competition and Consumer Commission, *The ACCC's role in promoting competition and protecting Australian consumers,* speech to Australian Bankers Association at Banking Regulation Forum, 24 August 2007, at p. 1.

[519] The Constitutional issues relating to its application have been discussed above.

[520] Part IIIA.

[521] See Part V, Consumer Protection, Part VA, Product Liability.

[522] There have been far more consumer protection cases taken under the TPA than cases involving restrictive trade practices. In 2005–2006, for example, 87 per cent of total enforcement outcomes related to breaches of Part V. See Samuel, G., Chairman, Australian Competition and Consumer Commission, *The foundations of good consumer protection policy: strong law, vigorous enforcement and the educated consumer,* Speech to National Consumer Congress, 15 March 2007 at p. 1.

- conduct that is in blatant disregard of the law;
- conduct that is by a person, business or industry with a history of previous contraventions of competition law, including overseas contraventions;
- conduct that causes significant detriment to consumers and/or business, and/or a significant number of complaints or has disproportionate effect on disadvantaged groups;
- conduct that is of major public interest or concern; or
- a situation that has the potential for action to have a worthwhile educative or deterrent effect and achieve a likely outcome that would justify the use of the resources.[523]

A wide range of remedies is available to the ACCC in enforcing the competition provisions of the TPA.[524]

The ACCC may take a matter to the Federal Court and seek civil pecuniary penalties. These penalties are currently set at the greater of A$10 million, three times the value of the benefit from anti-competitive conduct, or 10 per cent of the turnover of the body corporate and all its related bodies corporate during the period of 12 months ending at the end of the month during which the act or omission occurred.[525] Individuals involved in conduct are liable for pecuniary penalties for up to A$500,000. Penalties are levied in respect of "*each act or omission*",[526] so that the cumulative total of penalties may theoretically be much higher than the levels set for an individual breach.[527] There is currently a well-advanced proposal to introduce criminal penalties for serious cartel conduct.[528]

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[523] See Samuel, G., *op. cit*. These views have been expressed by the ACCC on many occasions over the years.

[524] Private remedies are also available to parties under the TPA.

[525] Section 76(1), 76(1A), 76(1B). The Crown is immune from pecuniary penalties: Section 2B (2).

[526] These are not criminal provisions. Contraventions must be proven on the balance of probabilities and have been characterized as "quasi-criminal" due to the size of the potential pecuniary penalties. Draft legislation is currently being circulated for discussion to introduce criminal liability for "hard-core cartels".

[527] Factors relevant to penalty setting are set out in Section 76(1) and additional factors have been set down in cases such as *TPC v CSR Ltd* (1991) ATPR 41-076 at p. 52,152–3.

[528] Both sides of Parliament have committed to the proposal and draft legislation has been circulated for comment.

The ACCC may seek injunctions restraining future similar conduct,[529] and other orders.[530] It has the ability to reach binding agreements called enforceable undertakings, which settle court proceedings.[531] In this context, or where respondents admit liability, penalties may be negotiated and an agreed figure on penalty is sometime presented to the court.

The ACCC may seek orders that individuals be disqualified from managing corporations for a specified period.[532]

3.1. Powers of the ACCC to investigate and question

The ACCC may investigate complaints lodged by consumers or traders or initiate its own inquiries. In its investigations it has wide administrative powers to gather information, which are contained in Section 155 of the TPA, which it routinely uses.[533]

Where the ACCC has reason to believe that a person is capable of furnishing information, producing documents or giving evidence in relation to a contravention, it may issue a notice requiring a person to furnish information, produce evidence or appear before the ACCC to give evidence.[534] This can be done before or after proceedings are commenced.[535] There are two preconditions to the issue of such a notice: a matter that may constitute a contravention, and a reasonable belief that the person named in the notice is capable of assisting the inquiries. The addressee must know what the possible contravention is. The privilege against self-incrimination is abrogated in relation to these

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[529] Section 80.
[530] Section 87.
[531] Section 87B.
[532] Parties may also take proceedings in relation to breach of Part IV of the TPA, and have access to relief such as injunctions, other orders and damages under Section 82 for loss or damage flowing from a contravention.
[533] ACCC, Annual Report 2005–2006 at p. 43.
[534] Section 155.
[535] *ACCC v Abbco Iceworks* (1994) 52 FCR 96.

notices.[536] It is, however, permissible to refuse to provide information and documents that are subject to legal professional privilege.[537]

Where the ACCC conducts an oral examination it is unclear whether or not the rules of natural justice apply as the TPA is silent on the issue.

The ACCC may also formally interview persons suspected of contravening the TPA before commencing proceedings to gain admissions that it might use in the proceedings. In this situation a person may decline to answer questions.

There has been controversy about whether a person is entitled to be represented by a lawyer while being examined by the ACCC. The TPA is silent on the issue. As a matter of practice the ACCC usually allows representation to a limited extent but requires both the lawyer and client to keep the content of the discussions confidential.

A more extensive power to enter facilities and seize documents was introduced in 2006. Documents may be seized voluntarily where there are reasonable grounds for believing that there is evidential material on the premises. If consent is not forthcoming, the inspector must obtain a search warrant from a magistrate after providing sufficient information about the grounds for the warrant.[538] Once a search warrant has been obtained an inspector may enter, search, make copies of material specified in the warrant, operate electronic equipment and take equipment into the premises to carry out its search. Seizure of documents is most likely to occur where the ACCC fears destruction of potentially valuable evidence.

If a person fails to comply with an ACCC notice under the TPA they are guilty of an offence.[539]

In 2005–2006 the ACCC issued 347 notices under Section 155 to compulsorily acquire information, 124 notices to provide information in writing (Section 155(1)(a)), 135 notices to provide documents (Section 155(1)(b)), 88 notices to appear in person (Section 155(1)(c)) and no authorities to enter premises and inspect documents (Section

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[536] Section 155(5).

[537] *Daniels Corp International Pty Ltd v ACCC* (2002) 213 CLR 543.

[538] Section 154D, 154E.

[539] Sections 155(5).

155(2)).[540] These statistics underscore the utility of the provisions for information gathering, which add significantly to the enforcement law arsenal of the ACCC.

Documents obtained under these provisions are not admissible in criminal proceedings other than for non-compliance under the TPA.[541]

3.2. Enforcement in relation to conduct affecting consumers

The ACCC has been successful in prosecuting conduct of various types under Part IV of the TPA. Case studies set out below illustrate a number of enforcement actions that have resulted in substantial fines and concrete benefits for consumers.

3.2.1. Cartel conduct

Cartel conduct is routinely listed as the ACCC's top priority in enforcement. Cartel conduct is prohibited under Section 45 of the TPA, which prohibits the making or giving effect to a contract, arrangement or understanding that has the purpose, effect or likely effect of substantially lessening competition. Additional provisions prohibit price fixing outright, i.e. without consideration of its effect or likely effect on competition[542] and "exclusionary provisions", which catch arrangements to share markets and in the nature of primary boycotts.[543]

The ACCC has prosecuted a number of high-profile companies for cartel conduct such as price fixing, market sharing and collusive tendering.

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[540] ACCC, Annual Report 2005–2006 at p. 43.

[541] See, for example, *ACCC v Neville* [2007] FCA 1583, where a real estate agent was fined A$2160 and given 200 hours of community service for giving false evidence in breach of Section 155(5). See also Samuel, G, Chairman ACCC, *The enforcement priorities of the ACCC,* Competition Law Conference, Canberra, 12 November 2005.

[542] Section 45A.

[543] Section 4D.

Industries as diverse as major construction,[544] the express freight industry,[545] the pre-mixed concrete industry,[546] the vitamin industry[547] and the power distribution transformer industry[548] have been the subject of major litigation, sometimes on more than one occasion. Most of the behaviour in these cases had been going on for significant periods of time. Importantly, each of the areas mentioned above has the capacity to significantly impact on consumers. The express freight industry case, for example, added costs to many deliveries of goods paid for by retailers. Consumers bore the brunt of increased costs when the costs were passed on in the retail purchase price. In the power distribution transformer case, the costs were ultimately passed on to consumers when they paid for their electricity.

3.2.1.1. Case studies

A recent high profile cartel case pursued by the ACCC was the Visy case.[549]

It involved two Australian companies, Visy and Amcor, which together during the relevant period held 90 per cent of the corrugated fibreboard packaging market in Australia. The two companies engaged in price fixing between 2000 and 2004 in breach of Section 45 of the TPA. Amcor received conditional immunity from the ACCC. The price fix was revealed to lawyers acting for Amcor during unrelated legal proceedings and Amcor approached the ACCC and received conditional immunity under the ACCC Immunity Policy.

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[544] *ACCC v CC (NSW) Pty Ltd* (1999) 92 FCR 375 (collusive tendering and market sharing by industry participants); A$200,000 penalty for CC (under lower maximum penalties).

[545] *TPC v TNT Australia Pty Ltd* (1995) ATPR 41-375 (price fixing in freight forwarding); A$4.1m against TNT (under old limits); A$6m against Mayne Nickless.

[546] *ACCC v Pioneer Concrete Pty Ltd* (1996) ATPR 41-740 (price fixing); agreed penalties of A$6.6m for each corporate respondent and A$50,000 for each individual respondent.

[547] *ACCC v Roche Vitamins Australia Pty Ltd* (2001) ATPR 41-809 (price fixing re vitamins) fines of almost A$23m in total.

[548] *ACCC v ABB Transmission and Distribution Ltd* (2001) ATPR 41-815.

[549] *ACCC v Visy Industries Holdings Pty Limited* (No.3) [2007] FCA 161 2 November 2007 (Heerey J.).

The behaviour included an overarching agreement to fix prices and maintain market shares (including compensation where customers were lost to the other), understandings to increase prices from time to time and annually, and related understandings on price with customers. The arrangements were agreed at almost 50 meetings, and the overarching agreement was reinforced by the CEOs of the two companies, one of whom was Mr Pratt, at a lunch meeting.

Ultimately Visy and three of its senior officers admitted the contraventions. The Federal Court found that there were 69 contraventions of the TPA. It imposed a penalty of A$36 million on Visy for 37 contraventions of the TPA but did not impose an individual penalty on Mr Pratt, who was knowingly concerned in the conduct, because he owned the company. Mr Debney was involved in 14 contraventions and was given a penalty of A$1.5 million;[550] Mr Carroll was knowingly concerned in 49 contraventions and was given a penalty of A$500,000.

Of particular interest in relation to consumers was the following statement of the Federal Court (Heerey J.):

"Every day every man, woman and child in Australia would use or consume something that at some stage has been transported in a cardboard box. The cartel in this case therefore had the potential for the widest possible effect…

The cartel went on for almost five years. Had it not been accidentally exposed, it would probably still be flourishing. It was run from the highest level in Visy, a very substantial company. It was carefully and deliberately concealed. It was operated by men who were fully aware of its seriously unlawful nature."[551]

In the context of levying the highest cartel penalty ever in Australia, His Honour made a number of statements that reflected his views on the conduct of the participants. His Honour described the corporate compliance culture of Visy as "non-existent" and stated:

"…*The Visy Trade Practices Compliance Manual might have been written in Sanscrit for all the notice anybody took of it*".

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[550] This was a very high penalty for an individual under the TPA, imposed because of his seniority and level of involvement.

[551] At para. 312, 315.

He also described a statement made by Mr Pratt on behalf of the company in relation to the decision to admit liability in the matter as being "…*hardly consistent with a frank admission of wrongdoing*"[552], and noted that the cartel in effect operated for Mr Pratt's "*personal benefit via his ownership" of Visy*".[553]

The size of the penalties in this case, and the publicity given to it in the media given the high profile of the company and its owner, illustrate the importance of such cases for protection of consumers and also as a deterrent to others contemplating similar arrangements. A class action has also been launched on behalf of persons suffering loss because of the conduct, who are reportedly claiming A$700 million from Visy and Amcor on the basis of additional packaging costs paid.[554] Other parties affected by the conduct have reportedly launched additional, individual actions. Visy and Amcor supplied many of Australia's leading food companies such as Nestlé, Coca Cola Amatil and Goodman Fielder.

3.2.2. Exclusionary conduct

Arrangements that constitute "exclusionary provisions" are prohibited by the TPA *per se* or absolutely – without consideration of their effect on competition in a market. This conduct involves a situation where competitors agree not to supply or acquire from particular persons or classes of persons[555]. Market sharing or similar conduct often falls within this provision.

3.2.2.1. Case study

In 2006 penalties totalling A$4,750,000 were imposed on Liquorland (Australia) Pty Ltd when it admitted breach of the TPA. Penalties were subsequently imposed on Woolworths for similar

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[552] At para. 324.
[553] At para. 326.
[554] Washington, S. and Wood L., *Visy customers claim $700 m damages,* Sydney Morning Herald, 10 October 2007. The immunity granted to Amcor by the ACCC will not protect it from third-party actions for damages.
[555] Section 4D.

conduct. The two were Australia's retailers and substantial retailers of liquor.[556] The conduct arose out of similar arrangements made by Liquorland and Woolworths individually with applicants for liquor licences in local areas. Under the state legislation, existing retailers of alcohol in an area could object to the grant of additional licences by the NSW Liquor Administration Board on various grounds. Liquorland and Woolworths had existing retail outlets in the areas under consideration. In each case Liquorland and Woolworths had lodged objections to the granting of the licences to small applicants. Small applicants up against the resources of very large retailers did not really have the resources to deal with the objections. In each case there would have been a contested hearing for the licences but Liquorland and Woolworths agreed to withdraw objections to the applications on condition that the applicants accept restrictions on their liquor licences. The agreements were evidenced in various Deeds signed between Liquorland and Woolworths and the various parties. The types of restrictions contained in the agreements were:

- Liquor license applicants were prevented from selling packaged takeaway liquor from their premises;
- Liquor licence applicants were restricted and prevented from opening a dedicated bottle shop or establishing a separate drive-through bottle shop;
- Liquor license applicants were restricted and prevented from advertising or conducting promotions for the sale of packaged takeaway liquor over the counter to consumers;
- Liquor license applicants were prevented from expanding the size of their licensed premises; and
- The amount of liquor that liquor license applicants could keep on their premises to meet consumer demand was limited.[557]

Woolworths did not admit the conduct and was ultimately found to have contravened the TPA. The Federal Court found that the agreements between Woolworths and the small retailers contained unlawful exclusionary provisions, and they also had the purpose of substantially lessening competition. The Federal Court imposed penalties totalling A$7 million.[558]

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[556] *ACCC v Liquorland (Australia) Pty Ltd* (2006) ATPR 42-123.
[557] ACCC Press Release 22 December 2006.
[558] ACCC Press Release, December 2006, outlining judgment of Allsopp J.

In levying this penalty, the Federal Court (Allsopp J.) made the following comments:

"Lying at the heart of the Act is the competitive process. A subjective purpose of a substantial commercial entity of substantially affecting competition is of the utmost seriousness. This is especially so when experienced senior officers undertook such conduct deliberately to ensure that licences did not become any form of competitive platform or threat. Whilst no particular effect was proved, I should approach the matter on the basis that the conduct was seen as relevantly important to protect Woolworths' interest by ensuring the absence of a competitive platform. It was of relevant commercial significance to Woolworths and should be viewed in that light".

The conduct of the two retailers was clearly relevant to the potential for competition between liquor suppliers for the consumer dollar at a local level. For this reason, the case was a significant outcome for consumers, in that it eliminated conduct that limited the ability of smaller liquor outlets to sell to consumers.

3.2.3. Misuse of market power

Section 46 of the TPA prohibits a corporation with a substantial degree of market power from taking advantage of that power for anti-competitive purposes such as deterring competitive conduct or preventing market entry.

The enforcement of this provision has been problematical and it was amended in 2006 to assist small business. Further amendments are currently planned. Unresolved issues exist about the level of protection that the provision should provide for small businesses, the role of the concept of recoupment in cases involving allegations of predatory pricing, and the approach to be taken to the measurement of the threshold level of market power.

3.2.3.1. Case studies

The Safeway case[559] involved a consideration of issues including misuse of market power in the context of that company's acquisition of bread for sale in its stores. Safeway adopted a "deletion policy" under which it imposed a term of trade on three bakers who supplied bread to it. Under this term, if they sold bread to competitors of Safeway at a price less than their price to Safeway they must offer Safeway the same price.[560] If they refused to do so, Safeway would not display any of their bread products in its store and would stop purchasing further supplies. This was found to fall within the misuse of market power provision by the Federal Court. Safeway had a substantial degree of market power in the market, and both the trial judge and a majority of the Full Federal Court found that it had taken advantage of that power in four instances where it removed all or most of the baker's products from one of its supermarkets. The conduct was directed at the supply of discount bread to a competitor, and a firm without market power would have been commercially compelled to stock the full range of products in order to satisfy consumer demand. Safeway had also introduced "fighting brands" of different bakers to achieve its outcome. The majority (Heerey and Sackville J.J.) characterized the conduct as:

"…the use of the leverage it had in the market to inflict pain on the plant baker concerned and thereby dissuade it from continuing to supply discounted bread to Safeway's' local competitor"[561]

Penalties totalling A$8 million were imposed on Safeway in respect of this conduct.[562]

3.2.4. Exclusive dealing

Section 47 of the TPA prohibits various vertical arrangements that have the purpose, effect or likely effect of substantially lessening competition. Both the making of the arrangements with specified

[559] *ACCC v Australian Safeway Stores* (2001) FCR 1; (2003) FCR 339.
[560] Commonly called a "most favoured customer" provision.
[561] *Op. cit.* at para. 329.
[562] (2006) ATPR 42-094 (Keifel J.).

conditions, and the refusal to deal without acceptance of those conditions, are prohibited. Third line forcing conduct is prohibited *per se* or absolutely.

The conditions concern such things as customer and territorial arrangements, tying contracts and requirements contracts.

3.2.4.1. Case study

The Universal Music case involved the issue of anti-competitive conduct in the supply of CDs to retailers. On 30 July 1998, amendments to the *Copyright Act* 1968 (Cth) removed the previous prohibition on the importation of sound recordings without the consent of Australian copyright owners or licensees. The effect of the amendments was that Australian wholesalers and retailers of CDs and other sound recordings could acquire stock from other countries; provided the manufacture of that stock did not infringe copyright law in the source country and had been carried out with the consent of the copyright owner. This meant that Australian retailers were no longer obligated to acquire their stock from Australian sources. Australian distributors Universal Music Australia Pty Ltd ('Universal')[563] and Warner Music Australia Pty Ltd ('Warner'), ceased to supply certain retailers who imported CDs from overseas. They also made it known they might not supply other retailers who imported. The ACCC brought proceedings claiming breaches of Sections 45, 46 and 47 of the TPA. Hill J., at first instance, found that both distributors had contravened Sections 46 and 47, and that certain executives had been knowingly involved in the conduct.[564] He also found certain of their executives had been knowingly involved in those contraventions. Between the decision at first instance and the appeal the Boral case was handed down. This overruled the original decision on Section 46. The recording companies appealed on the Section 47 issue.

The relevant market was confirmed as the Australian wholesale market for recorded music, and 70 per cent of this music originated overseas. Specifically, Universal wrote to retailers stating that it reserved the right to review the terms and conditions of trade with

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[563] The actual Universal conduct was engaged in by PolyGram, which subsequently became part of the Universal group.
[564] [2001] FCA 1800.

retailers who parallel imported its recordings. Threats were made to discontinue certain discounts. Other threats were made to cease supply where parallel importing took place. Warner engaged in similar conduct. The conduct was said to constitute an offer to supply goods and services to retailers on condition that they agreed not to acquire goods of a particular kind or description, namely imports consisting of non-infringing copies, directly or indirectly, from a competitor.

The conduct was found to infringe Section 47 and the Full Federal Court confirmed this. The conduct did not have the effect of substantially lessening competition because many retailers purchased non-infringing copies by direct importation or purchasing stock imported by others. This may have been because the conduct was "nipped in the bud" by the intervention of the ACCC, or because many retailers were not intimidated by the threats. It was not possible on the evidence for the Full Court to find that the conduct had the likely effect of substantially lessening competition. The conduct did, however, have the purpose of substantially lessening competition. The record companies said that their purpose was to prevent freeriding, but the trial judge found that it was motivated by an intention to bring about the result that persons would not import recordings into Australia. The Full Court agreed that this brought the conduct within Section 47.

3.2.5. Resale price maintenance

Resale price maintenance, or fixing the price at which goods are to be resupplied, is prohibited in wide-ranging provisions of the TPA.[565] The ACCC has been particularly successful in prosecuting cases under this provision. Of recent note are two cases involving consumer products. The highest ever penalties for resale price maintenance were imposed in 2007 against companies involved with the sale of Jurlique cosmetics for conduct occurring between 1991 and 2003. There was a long-standing policy against discounting, and the conduct in question included attempting to induce retailers not to sell at prices less than those specified by Jurlique, supplying on condition that there would not be discounting, and withholding supply on account of discounting. Ultimately the parties admitted the conduct. The Federal Court ordered penalties totalling A$3.4 million against four companies and their

[565] Sections 48, 96–105.

founder, Dr Jurgen Klein. Dr Klein was ordered to pay a penalty of A$200,000 personally as well as A$20,000 in costs. The penalties were large because the conduct went on for a long time and involved the most senior executives of the company.[566] In another recent decision penalties totalling A$1.36 million were imposed on Navman Australia Pty Ltd, a company supplying car, marine and personal navigational equipment, and its employees.[567] The company sought to ensure that there was no discounting in its products and in some cases cut off supply where discounting took place. In levying the penalty the judge commented that the conduct was not merely deliberate but was systematic and pursued in an aggressive and high-handed manner by senior managers of the company. In commenting on the outcome, the Chairman of the ACCC noted that consumers like to shop around to get the best deal on GPS and other electronic equipment, encouraging competition and enabling consumers to buy at lower prices.[568]

3.2.6. Mergers

Mergers and acquisitions in Australia are prohibited if they have the purpose, effect or likely effect of substantially lessening competition in a market.[569] Enforcement action by the ACCC in this area is extremely rare. It engages on a regular basis in reviewing acquisition activity in an administrative context. There is no requirement for mandatory filing of pre-merger notifications in Australia. Where parties are of the view that conduct risks breaching the TPA there are a number of options available to them.

A party may approach the ACCC informally to seek its views and seek reassurance that it would not be likely to take the matter to court.[570] This informal process is used extensively but there is no review

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[566] *ACCC v Jurlique International Pty Ltd & Ors*. [2007] FCA 79 (8 February 2007).
[567] *ACCC v Navman Australia Pty Ltd* [2007] FCA 2016 (21 December 2007).
[568] See Australian Competition and Consumer Commission, Press Release *Navman penalised $1.2 million for resale price maintenance,* 21 December 2007.
[569] Section 50.
[570] See ACCC, Merger Review Process Guidelines, July 2006. As to the approach of the ACCC to examining such proposals, see ACCC, Merger Guidelines, July 2006.

and the outcome does not protect the parties to the merger from action by third parties.

A new formal merger review process, administered by the ACCC and reviewable by the Tribunal was introduced in 2007. Its aim is to provide additional certainty to applicants while maintaining a relatively short time approach to the issue.[571] This process is not reviewable.

Alternatively parties may apply to the Australian Competition Tribunal for an authorization, which is an administrative sanction available for a variety of conducts under the TPA based in this context on a test which provides that the authorization must not be granted unless the Tribunal is satisfied in all the circumstances that it would result in such a benefit to the public that it should be allowed to occur.[572] The authorization route was previously used only rarely.[573]

The ACCC has not taken court proceedings in relation to a proposed acquisition for a number of years, although this is open to it and it has the power to seek divestiture of assets for conduct in breach of the TPA.

It is, however, extremely active in the area of informal clearance. In 2005–2006, for example, the ACCC examined 272 mergers, acquisitions and asset sales for compliance with the TPA. Two hundred and sixty-one were not opposed (including 26 withdrawn before final decision). Two were initially opposed and subsequently resolved with acceptance of court-enforceable undertakings. Six were resolved during the review process with court-enforceable undertakings. One hundred and forty-one matters were considered on a confidential basis and, of these, three were opposed or had concerns confidentially expressed.[574]

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[571] See Part VII Division 3.

[572] Section 95AZH. This process was previously undertaken by the ACCC. Delays arising from the process, including the ability to appeal to the Tribunal, made the process unworkable and it was amended in 2006 to its current form. There are no decided cases as yet.

[573] But see Qantas Airways Limited [2004] ATPR 42-027; 42-065; Re Qantas Airways Limited [2005] ATPR 42-065 where the original rejection of authorization by the ACCC was overturned by the Tribunal on review. This was before matters went straight to the Tribunal, and also involved other areas of the TPA.

[574] See ACCC Annual Report 2005–2006.

3.2.7. Conclusions

It can be seen from the Case Studies that the ACCC takes particular note of the potential impact of conduct on consumers when making decisions on enforcement priorities. All of the cases mentioned have a significant consumer impact. The tangible effect of the curtailment of offending conduct in all cases was increased competition and ultimately reduced costs for consumers. The broad powers given to the ACCC to investigate and enforce the provisions of the TPA significantly assist and are essential to the effective prosecution of competition law cases under the TPA.

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AN OVERVIEW OF THE ANTI-MONOPOLY PRACTICE IN THE PEOPLE'S REPUBLIC OF CHINA

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1. Introduction

This study seeks to explore the anti-monopoly practice in China from 1993 to 2007. In 1993 the first competition law, the *Law Against Unfair Competition* ("LUC"),[575] was enacted which embodies a few provisions concerning anti-monopoly issues and laid down the initial foundation for the antitrust practice in China. Thereafter, the Chinese government issued several other anti-monopoly provisions in different laws, regulations or even directives to supplement the LUC. Such an incremental approach led to a fragmented legal framework against restrictive behaviour in the Chinese market. The *status quo* is expected to be altered when the new *Anti-monopoly Law* (AML) takes effect on 1 August this year. The law was passed by the People's Congress on 30 August 2007, after a long legislative history of about twenty years.

The basic pillars such as prohibition of restrictive agreements, abuse of market dominance and merger review, which are common in all antitrust regimes, have been gradually established from 1993 to 2007 in China. It began with the condemnation of abusive conduct of public enterprises and undertakings with monopoly positions, provided for in the LUC. The law empowers the State Administration for Industry and Commerce (SAIC), along with its local offices, to safeguard competition in the Chinese market. The supervision over restrictive agreements, in particular price cartels, was stipulated in the *Price Law*[576] passed by the People's Congress five years later. Not the SAIC but the National Development and Reform Commission (NDRC) was authorized in this respect since the NDRC and the local price bureaus have been responsible for pricing activities in the long administrative tradition. However, in practice, the SAIC seemed to be actively involved as well.

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[575] It was promulgated on 2.9.1993 and took effect on 1.12.1993.

[576] It was promulgated on 29.12.1997 and took effect on 1.5.1998.

The competition review on mergers and acquisitions (M&A) was attached with no great importance until the issue of takeovers of domestic enterprises by foreign investors, in particular its impact on Chinese industries, raised notable concerns of policy makers. In 2003, the first merger review was provided for in the *Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (Interim Provisions),[577] which put only M&A involving foreign enterprises under control. A third authority – the Ministry of Commerce (MOFCOM) – was entrusted, together with the SAIC, to carry out competition assessment.

Therefore, not only was the legal framework for antitrust issues fragmented but also the competence for implementation was granted to different administrative bodies. In the following, the enforcement practices by respective bodies will be addressed. Part 2 explores the crackdown of price cartels as the most pernicious form of anti-competitive behaviour. After reviewing the cases dealt with by the SAIC in sanctioning abusive conduct of public enterprises and undertakings with legal monopoly status (Part 3), the focus will be turned to merger control by the MOFCOM and the SAIC (Part 4). In Part V, abuse of administrative power impeding competition, a special feature of the Chinese anti-monopoly practice, will be addressed. A brief comment on the transition from the past anti-monopoly practice to the implementation of the AML will be given at the end of the analysis.

2. Restrictive agreements

The prohibition of restrictive agreements by the Chinese authorities has been limited to the hard-core cartels, in particular price cartels and rig bids. Cases concerning production restriction and market allocation were little condemned. Due to the lack of legal basis, other restrictive agreements such as collaboration in production, joint marketing schemes and resale price maintenance, which may also raise competition concern, were not even investigated.

For the crackdown of price cartels, two major administrative agencies are involved: one is the NDRC together with local price bureaus, and the other is the SAIC with its local offices. The NDRC and local price bureaus became sluggish ever since they failed in the first

[577] It was enacted on 2.1.2003 and took effect on 12.4.2003.

cartel case in 2001. It lasted until July 2007 when the draft of the AML was discussed in the People's Congress. The SAIC and its local offices seem to be more active, according to the cases and the statistics disclosed to the public.[578] However, their competence is controversial, which thus leads to an inconsistency in the practice of different local SAIC offices. As far as rig bids are concerned, there was a structural change conceived in 2000 as the *Chinese Tender Law* was promulgated. This greatly reduced the power of the SAIC.

2.1. A growing awareness of the NDRC and local price bureaus

By virtue of the *Price Law*, the NDRC and local price bureaus are the government authorities that are authorized to investigate abuse in pricing activities including cartels. Most of the cases are handled by local price bureaus and only important ones with a significant effect on the whole Chinese market are to be dealt with by the NDRC. Compared to other kinds of unlawful pricing practices condemned by the authorities, cartel prohibition is rare in practice.

The first notable case is the price collusion among sellers of gold jewellery in Shanghai in 2001. After the abolition of the price control over pure gold jewellery by the state, gold jewellery sellers in Shanghai started to reduce their sales prices. Facing such a "price war", the Shanghai Industrial Association for Diamond and Jade and the Shanghai Gold & Jewellery Trade Association, upon the request of several members, called for a meeting with the participation of 13 undertakings, amounting to 80 per cent of the total market share in Shanghai. As a result of the conference, the participants agreed on a minimum price for pure gold jewellery. This action was made public in a joint statement released by the participants claiming that an

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[578] From 1999 to June 2005, there were 14 price cartels investigated by the local SAIC offices, whereas there were only two cases investigated by local price bureaus of the NDRC at the same period of time. For details of cases and statistics regarding the SAIC, see SAIC/CASS[国家工商行政管理总局公平交易局/中国社会科学院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 216.

unreasonable price war among them would only destroy their own existence. The Price Bureau of Shanghai initiated an investigation over the issue and concluded that the concerned practice constituted a price collusion infringing Article 14 of the *Price Law*.[579]

The participants contested the decision by arguing that the price coordination was aimed at curbing the destructive price war among them since a ruinous pricing under cost would only destroy the market order, consequently to the detriment of consumers. Moreover, there were no formal agreements concluded. No coercive measures had been taken by associations to enforce the minimum price agreed. It was absolutely up to the participants whether or not to implement the pricing scheme. Therefore, there was no intention of collusion and price manipulation for violation of Article 14 of the *Price Law*. Besides that, it was argued that the minimum price was supposed to protect 95 per cent of the small and middle-sized enterprises in the industry that had to pay a higher purchase price for gold as a raw material for production, which was still under the control of the central government. Only a few companies with special rights could acquire gold directly from the People's Bank of China. They were capable of saving production costs and could sell at a lower price. A price competition on such a basis was unfair to those small and middle-sized competitors. A minimum price for pure gold jewellery would, to a certain extent, offset the negative effects of the unequal distribution of raw materials and improve the competitive strength of the small and middle-sized firms. The most disputed issue in the case was whether or not the associations who were involved in the price conference should be responsible for the conduct since the administrative decision was merely addressed to the undertakings. Most controversial was whether or not the self-regulation of prices by industrial associations fell under the legal activities of associations who are supposed to establish codes of conduct for member enterprises.[580] The appeal was brought to the administrative review office of Shanghai Municipality. Finally, the Price Bureau revoked its decision on the

[579] SAIC/CASS[国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 112.
[580] *Ibid.*, p. 113.

grounds of procedural defects. Thus, the first effort by the Price Bureau could more or less be regarded as having failed. [581]

The justification of the prevention of “destructive” pricing is popular with cartelists but hardly accepted in any antitrust jurisdiction because it has been always proven to be the excuse adopted by cartelists to charge a price that is higher than the competitive level. It is well acknowledged that competition is a process by which a reasonable market price is to be established according to the demand and supply of the market. No producers themselves are in a position to decide whether a price is reasonable or not. A so-called destructive price may occur when a dominant producer intends to drive his/her competitors out of the market by selling the relevant product below cost. Furthermore, there must exist the possibility that the loss incurred by the destructive price can be recouped at a later point, otherwise no rational producer would operate under such circumstances. However, in China this populist explanation has been put forward repeatedly by undertakings, even in recent cases.[582] The attitude of the responsible authority is unclear since there is no official comment available, but neither is there an absolute rejection of this justification.

The argument that the price cartel was established in order to protect the disadvantaged producers of gold jewellery, above all small and middle-sized enterprises who had to pay a higher purchase price for raw materials, was unique in the Chinese context. In the reform process of the Chinese economy, the deregulation of markets has been put forward gradually. The side effect of this incremental approach is that some markets are liberalized, whereas their neighbouring markets may still be under the control of the government. As shown in this case, the sale price for pure gold jewellery was market oriented, but the price for gold and its distribution was regulated by the Chinese People’s Bank.

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[581] Shanghai Zai Qi Jin Jia Zi lü Zhi Zheng [The Resurge of the Dispute over the Self-regulation of Gold Prices in Shanghai“上海再起金价自律之争”], available at http://www.chinawestnews.net/gb/westnews/cjkb/gdxw/userobject1ai234290.html, last visited on 2.3.2008.

[582] “Mai Ji Song Yi” Jiang Dan Chu Beijing Ru Pin Shi Chang [“Buy More One Free” will fade out of the Market for Dairy Products in Beijing“‘买几送1’将淡出北京乳品市场”], Xin Jing Bao [New Beijing Newspaper《新京报》], 20.7.2007, available at http://finance.jrj.com.cn/news/2007-07-20/000002447213.html, last visited on 2.3.2008.

Enterprises that have special access to the raw material are indeed privileged in competition. Nevertheless, the price cartel cannot be justified on this ground because it doesn't function as an adequate instrument for solving the real problem. The disadvantaged producers may set forth a higher price by establishing a cartel, but since this price is higher than that of the privileged producers, the cartelists are still less competitive in the market. Or, both the disadvantaged producers and the privileged agree on a cartel price so that the disadvantaged may also survive in the market by acquiring monopoly profits. However, such a cartel leads to a lessening of price competition, which functions as a key instrument in selecting those competitors who survive based on better business merits. In other words, inefficient producers may continue their production resulting in a waste of economic resources and a significant loss of consumer welfare. The price cartel is unable to drive out the privileged producers who are inefficient as well. Unfair competition as such can only be effectively resolved by a structural approach that eliminates unequal treatment in the distribution of resources. In the case in question, this justification was upheld by the sellers of pure gold jewellery rather than the producers, which demonstrates an obvious misuse by the cartelists since they were not all affected by the unfair distribution of resources.

The issue of the involvement of the associations and their liability was controversial in this case. The Price Bureau in Shanghai didn't condemn the concerned associations for coordinating the price conference. The undertakings contended that they were requested by the associations to take part in the meeting. The associations recognized their engagement but considered it to be lawful since it fell under the scope of their self-regulating activities within the industry.[583] Thereafter, a discussion on the function of industrial associations was raised in public.

The role of industrial associations is ambiguous in China. In theory, they are designed as organizations established on the free will of the undertakings to stand for the interests of members. However, in the

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583 Ge Shuo Ge De Li "Shanghai Jin Jia Zi lü" Feng Zheng Yi Ran [Each Insisting on its Viewpoint, Dispute over the "Self-regulation of Gold Prices" continues "各说各的理 '上海金价自律'纷争依然"], available at http://news.xinhuanet.com/fortune/2002-02/05/content_268817.htm, 06.02.2002, last visited on 2.3.2008.

Chinese context, industrial associations could include representatives of undertakings. In many cases they were viewed as an external administrative body of the government facilitating the implementation of certain administrative measures by means of imposing compulsory obligations upon their members. Hence, they have been variously entitled “second government”, “half government”, and “new ‘mother-in-law’ for enterprises”. [584] Consequently, it is hard to make a clear distinction as to whether they are acting for member companies or are taking action on behalf of the government. In the latter case, undertakings are left with little latitude to make their own decisions. This is why the undertakings were arguing that they were in fact organized by associations, and therefore “innocent” in the case.

The complicated identity of industrial associations has come into being during the transitional process of Chinese society, particularly in the reform of the Chinese administrative structure. As a huge number of administrative organs were cut back during the administrative reform, some of the former governmental bodies were transformed into industrial associations.[585] It has been the conventional practice that the roles of chairman or directors of industrial associations are held by current or former governmental officials.[586] There is a hazy interrelationship among administrative bodies, industrial associations and enterprises, though efforts have been made to confine the boundary of associations’ power. For instance, the Shanghai Municipality enacted the first specific regulation in this regard on the local level, which defines industrial associations as non-profit institutions created voluntarily by undertakings and prohibits governmental officials from holding leading positions in these associations. [587] However, things cannot be changed overnight.

[584] Hang Ye Xie Hui: Guo Hao Zheng Fu Guan He Qi Ye Guan [Industrial Associations: Overcome the Hurdles set by the Government and Enterprises “行业协会：过好政府关和企业关], available at http://www.snet.com.cn/news/sdbd/200302/Index.htm, last visited on 2.3.2008.

[585] Ibid. available at http://www.snet.com.cn/news/sdbd/200302/Index.htm, last visited on 2.3.2008.

[586] Ge Shuo Ge De Li “Shanghai Jin Jia Zi lü” Feng Zheng Yi Ran [Each Insisting on its Viewpoint, Dispute over the “Self-regulation of Gold Prices” continues “各说各的理 上海金价自律纷争依然], available at http://news.xinhuanet.com/fortune/2002-02/05/content_268817.htm, 06.02.2002, last visited on 2.3.2008.

[587] Art. 2 and Art. 7(4) of the Temporary Provisions for Industrial Associations in Shanghai, enacted by Shanghai People’s Government, 2002.

With regard to the case in question, though the influence of industrial associations was noticeable, it was still not enough to argue that the participating firms were obliged by the associations to enter into the cartel. In contrast, there are sufficient facts proving that the price conference was initiated by the associations upon the request of some of the jewellery sellers. Furthermore, the agreement maintaining a minimum price was concluded by the participants themselves.[588] The liability of the participants is well grounded by the Price Bureau, regardless of the liability of the involved associations. As to the legality of the associations, the Price Bureau in Shanghai found it difficult to assess the nature and the scope of the self-regulation in pricing activities by industrial associations provided for in Article 17 of the *Price Law*. However, the majority of the commentators from academic circles condemned it as anti-competitive.[589] Indeed, Article 17 of the *Price Law* obliges industrial associations to comply with the *Price Law* and the relevant rules and to reinforce the self-regulation in pricing. Obviously, the self-regulation by associations is to be construed in the context of disciplining the pricing activities of member enterprises so as to conform to the *Price Law*. By virtue of a supervisory obligation, industrial associations shall in fact not only themselves refrain from any engagement in price cartels but also prevent their members from cartel practices, which is nevertheless the contrary in this case. It was a flaw that the negative finding was solely addressed to the undertakings without carrying out any investigation regarding the associations' responsibility for the infringement. Even more questionable was that the initial decision of the Price Bureau was subsequently revoked by it because of some procedural defects during the administrative review.

The defeat of the Price Bureau of Shanghai in the first cartel case shadowed the later administrative actions against price cartels in China. In 2004, the Shanghai Gold & Jewellery Trade Association, the

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[588] Shanghai Huang Jin Shi Pin Qi Ye Lian He Xian Jia De Long Duan Xing Wei Zao Dao Chu Fa [Sanctions on Concerted Price Fixing as Monopoly Practice by Enterprises selling Gold Jewellery in Shanghai "上海黄金饰品企业联合限价的垄断行为遭到处罚", available at http://economy.enorth.com.cn/system/2001/12/25/000226861.shtml, last visited on 2.3.2008.

[589] Hang Ye Xie Hui Neng Bu Neng Gao "Jia Ge Xie Yi"[Can Industrial Associations make "Price Agreements" "行业协会能不能搞'价格协议'"], available at http://www.ica.gov.cn/llyj/llyj2002/llyj0205-1.htm, last visited on 3.2.2008.

same association involved in the above-mentioned case – again issued a statement on the self-regulated prices for gold jewellery in which a standard price, adjustable weekly to the estimation of the Association, was proposed. The sellers of gold jewellery could set forth their prices without exceeding the 3 per cent limit of the standard price. For the sake of supervision, a hotline was established for complaints. The concerned distributors could be sanctioned in case of non-compliance. The Price Bureau of Shanghai didn't take any action on this occasion, though the responsible official held personally that such a price restriction by the association, in particular the minimum price, might curb the free reduction of prices by enterprises which could be a matter of price collusion. Whether or not the self-regulation by associations may violate the freedom of undertakings in their pricing activities is another issue, which is irrelevant for the discussion here. It won't be explored in further detail at this point.[590]

The ambivalence that resulted from the defeat of the authority in the first case led to confusion in the practice. A few of the cartels were cracked down upon by local price bureaus,[591] whereas quite a number of alleged collusions exposed to the public were not dealt with until the summer of 2007.[592]

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[590] Shanghai Zai Qi Jin Jia Zi lü Zhi Zheng [The Resurge of the Dispute over the Self-regulation of Gold Prices in Shanghai "上海再起金价自律之争"], available at http://www.chinawestnews.net/gb/westnews/cjkb/gdxw/userobject1ai234290.html, last visited on 2.3.2008.

[591] Shang Jia Lian He Gao Ti Jia Bei Zhi Zhi, Zhu Zhou 20 Duo Jia Mi Fen Chang Bei Cha Chu [The Annulment on undertakings jointly increasing Prices, over twenty Producers for Rice Flour were punished "[illegible]], available at http://finance.news.tom.com/1001/1005/2004313-46619.html, last visited on 2.3.2008；

Xie Che Ye Ji Ti Zhang Jia She Xian Long Duan [The Collective Increase of Prices in the Car Wash Sector leads to suspicion of Monopoly Behaviour "[illegible]], available at http://www.hbqnb.com/news/html/HqLocalnewsSimple/2007/530/07530313430868JAD9H09AFAGC9CJ0.html, last visited on 2.3.2008.

[592] Guo Nei Hang Kong Gong Si Da Cheng Jia Ge Lian Meng, Ji Piao Jia Ge Pu Bian Shang Zhang [Domestic Airlines agreed on Price Collaboration, Prices for Flight Tickets are increasing"[illegible]], available at http://finance.sina.com.cn/chanjing/b/20050404/07401484238.shtml, last visited on 4.4.2005; "Jia Ge Tong Meng" Neng Zou Duo Yuan? [How far can the "Price Collaboration" go? "'[illegible]],available at http://news.xinhuanet.com/fortune/2002-04/30/content_378737.htm, last visited

The turning point occurred while the draft AML was being discussed at the People's Congress. In July, several key producers in the instant noodles industry, together with the China Branch of the International Ramen Manufacturers Association, hereinafter referred to as "IRMA (China)", announced a joint increase in prices for their noodles, which aroused great public concern. Upon complaints from consumers, the NDRC carried out an investigation and found that the IRMA (China) had organized three meetings with the participation of major producers to increase prices for instant noodles in different quality categories from 2006 to 2007. The conference memos were printed in the periodical so that information on prices was made available for all undertakings. The producers involved subsequently raised their prices. The NDRC requested the IRMA (China) to correct its excessive practices, make an open statement to eliminate the negative effects and annul the decision regarding the collective price increase agreed in the conference memos.[593]

It is notable that for the first time an administrative action on the level of the central government was taken, while the previous ones were typically undertaken by local officials. It shows that the NDRC, and even the State Council, were becoming aware of the issue of price cartels in the Chinese market. Thereafter, a series of punishments for cartel activities was carried out by the local officials in China.[594] It is noteworthy that the growing concern regarding the harmful effects of

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on 1.1.2006; Rong Er Shou Che Shi Bei Zhi"Jia Ge Tong Meng"[An alleged"Price Collaboration'in the Market for Second-hand Cars in Rong ("榕[illegible]), available at http://www.fjxf315.com/news2.asp?unid=23725, last visited on 2.3.2008; MAO Xiaofei, Xiao Fei Zhe Bu Neng Wei Hang Ye Zi lü Mai Dan [Consumers shall not pay the Bill for the Self-regulation in Industries "消[illegible]单], Xin Jing Bao [New Beijing Newspaper 《[illegible]], 22.07.2007.

[593] NDRC [国家发改委], Guo Jia Fa Gai Wei Dui Fang Bian Mian Jia Ge Chuan Tong An Diao Cha Qing Kuang Tong Bao [A Notice concerning the Investigation of the Price Collusion for Instant Noodles on 16.8.2007 "国家发改委对方便面价格串通案调查情况的通报2007/08/16"], available at http://www.ndrc.gov.cn/xwfb/t20070816_154142.htm, last visited on 2.3.2008.

[594] Fa Zhan Gai Ge Wei Gong Bu Jia Ge Chuan Tong, Hong Tai Wu Jia He Jia Ge Qi Zha Dian Xing An Li [The NDRC published Typical Cases of Price Collusion, Malicious Price Increase and Price Cheating"发展改革委公布价格串通、哄抬价格和价格欺诈典型案例"], available at http://www.gov.cn/zxft/ft38/content_729143.htm, last visited on 2.3.2008.

price collusions to the detriment of consumers imposed great social pressure on the government to take action.[595] The occurrence of cartel cases was coincident with a rapid increase in the price of food products where the standard of living for the average person was significantly affected. As the NDCR noted, the price increase even incurred a rush to purchase among consumers in some areas.[596] Unlike the case of gold jewellery, the decision by the NDRC was addressed directly to the concerned association but not to the enterprises, which implies a tougher attitude toward associations playing an unfavourable role in the most pernicious anti-competitive practices. Ultimately, an explicit provision was incorporated into the AML (Article 16) to obstruct the involvement of the associations in cases of cartels as well as other monopoly agreements.

2.2. A controversial competence of the SAIC and its local offices

In 2002, the SAIC office of City X initiated an investigation into an alleged cartel involving seven gas suppliers and the Association of Gas in the local market. It was found that a unanimous wholesale price for gas was negotiated, facilitated by an allocation of market shares among participants. A working group was set up to supervise this. Subsequently, the wholesale price for gas was raised from 38 RMB per can to 40 RMB in the city. The local SAIC office held that the joint action of the seven gas companies constituted an infringement of Article 18 of the *Regulation against Unfair Competition of Zhejiang Province, hereinafter referred to as "UCR<Zhejiang>"*[597] enacted by the local People's Congress to implement the LUC. Article 18 bans any distribution of markets, restriction of trading partners and production, or

[595] Fang Bian Mian Ji Ti Zhang Jia, Bei Zhi Yi Jia Ge Long Duan [The Collective Price Increase for Instant Noodles suspected as Monopoly Pricing"方便面集体涨价 被质疑价格垄断"], available at http://info.yidaba.com/economics/cjzx/227985.shtml, last visited on 2.3.2008.

[596] NDRC[国家发改委], Guo Jia Fa Gai Wei Dui Fang Bian Mian Jia Ge Chuan Tong An Diao Cha Qing Kuang Tong Bao [A Notice concerning the Investigation of the Price Collusion for Instant Noodles on 16.8.2007 "国家发改委对方便面价格串通案调查情况的通报2007/08/16"], available at http://www.ndrc.gov.cn/xwfb/t20070816_154142.htm, last visited on 2.3.2008.

[597] The rule was passed on 25.8.2000 and took effect on 1.12.2000.

other practices impairing fair competition by means of contracts, agreements, proposals, etc. Fines were imposed on the participating companies.

The parties disagreed with the decision and appealed to the District Court of City X. They argued that Article 18, as the legal basis for the administrative sanction, doesn't conform to the *Administrative Punishment Law*[598] (APL) in China. By virtue of Article 11(2) of the APL, where an administrative punishment for the misconduct is provided for in laws and regulations on the central level, the specification thereof by local laws and regulations must be in line with the form, the type and the degree set forth in the upper laws and regulations. Since there is no provision contained in the LUC corresponding to Article 18 *UCR<Zhejiang>*, local legislators are not entitled to extend the scope of the LUC by establishing new types of anti-competitive practices and relevant sanctions. It was further contended that even if the joint action had constituted a price cartel, it had to be sanctioned pursuant to the *Price Law* for which the local Price Bureau, but not the SAIC, is responsible.[599]

The local SAIC office insisted on the legality of its decision on the grounds that the stipulation of Article 18 is based on the *Legislative Law*[600] in China which permits local governments to enact local laws and regulations on issues that are not ruled by the central government according to the particular circumstances and factual necessities in the region.[601] This opinion was upheld by the courts both on the first and second appeal.

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[598] The Law was passed on 17.03.1996 and took effect on 1.10.1996.

[599] SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, pp. 116–117.

[600] Art. 64(2) of the Legislative Law, passed on 15.03.2000 and took effect on 1.7.2000.

[601] SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 117.

The overlap of the authorities' competence in some respects is well displayed in this case. The legality of the SAIC in treating hard-core cartel cases, in particular those with relevance to price collusion, is questionable, though the courts in the city confirmed the competence of the local SAIC office. The problem is to be understood against the background of the complicated legislative structure in China. As we can see, both the central and local governments have the power to make laws and regulations. Local rules are subordinate to those issued on the central level. However, in the absence of upper laws and regulations, local governments may enact special provisions to adapt to the regional circumstances. In this case, there was no comprehensive Anti-monopoly Law available on the central level, and the regulation on anti-monopoly issues contained in the LUC is not exhaustive. Indeed, local governments have the right to stipulate specific rules according to "*specific circumstances of the region and the factual necessities*". It is debatable whether this condition of Article 64(2) of the *Legislative Law* was fulfilled in the given case. Another restriction on the legislative power of local governments in this regard is that local governments are not authorized to regulate issues reserved for the legislation of the central government, provided for in Article 8 of the *Legislative Law*. According to No. 8 of Article 8, issues concerning the fundamental economic system are to be regulated by laws of the People's Congress. Differing legal opinions could be held on the point of whether the content of Article 18 *UCR<Zhejiang>* is concerned with the fundamental economic system or not.

Furthermore, Article 18 *UCR<Zhejiang>* is worded broadly so that an overlap with the application of Article 14 of the *Price Law* may occur, particularly in the case of price collusion. In general, Article 14 shall prevail due to the doctrine of *lex specialis*. The Price Law doesn't empower the SAIC, but in fact empowers the NDRC and local price bureaus to deal with price cartels. It is reasonable that the gas companies questioned the competence of the SAIC. But in this case, besides the price fixing, the market share of each participant was allocated. The latter conduct could be viewed as a component of a price cartel but not necessarily so, which means that it may in itself constitute anti-competitive behaviour to which Article 18 *UCR<Zhejiang>* is applicable. It is common in practice, as shown in this case, that a scheme of price fixing among competitors may consist of several anti-competitive measures. For example, parallel to the coordination in pricing, a distribution of product volumes may be agreed by cartelists as

well. Therefore, it would have been adequate to have a general provision proscribing hard-core cartels. A fragmented legal framework is always prone to generate potential conflicts.

This case raised, on the one hand, the dispute over the competence of the SAIC in this regard; on the other hand, it created in fact an alternative for combating cartels in practice.[602] However, due to the legal ambiguity stated above, the practice of the local offices of the SAIC is inconsistent. The local office in City X, after its first decision was confirmed by the local courts, continued its efforts in punishing cartel behaviour, while other local offices remained inactive.

2.3. A structural change in the prohibition of rig bids

Before the year 2000, rig bids were completely banned by the LUC.[603] The SAIC and its local offices were therefore the authorities having the exclusive right to deal with such cases. However, the *Tender Law* was promulgated in 2000, which also embodies a prohibition of rig bids in Article 32. Different administrative agencies are responsible for its enforcement, depending upon in which sector the concerned collusion in bidding occurred. In most cases, the power rests with the respective ministries for various industries such as construction, railway, telecommunication and post, etc. Hence, institutional tension between the SAIC and other ministries surged as the *Tender Law* took effect. As a response to the problem, the Commission Office of the Central Communist Party for Institutional Arrangement released a decision, whereby it is made clear that the undue practices in tendering, including rig bids, shall be handled by the administrative agencies in the related industries that are affected by the alleged practices.[604] Where there is

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[602] *Ibid.,* p. 217.

[603] Art. 15 of the LUC.

[604] Zhong Gong Zhong Yang Bian Zhi Wei Yuan Hui Ban Gong Shi [The Commission Office of the Central Communist Party for Institutional Arrangement 中央机构编制委员会办公室], Guan Yu Guo Wu Yuan You Guan Bu Men Shi Shi Zhao Biao Tou Biao Huo Dong Xing Zheng Jian Du De Zhi Ze Fen Gong De Yi Jian [An Opinion of the State Council for the Supervision of Tendering Activities on the Allocation of Responsibilities to Relevant Authorities "关于国务院有关部门实施招标投标活动行政监督的职责分工的意见"], distributed by the Secretary of the State Council [国务院办公厅], State Council Official File

no sector regulator, the SAIC and its local offices are responsible. Along with this structural change, the power of the latter is reduced on a large scale. It is illustrated in a sudden decline in the number the cases of rig bids – falling from 229 to 131 for all of China in 2001 and 2002. But it didn't cause the complete withdrawal of the SAIC and its local offices from this area. In some cases, they currently seek to cooperate with the relevant sector authorities to carry out investigations.[605]

3. Abusive practices

In the Chinese anti-monopoly practice, actions against enterprises abusing market dominance have been primarily focused on public enterprises and undertakings with legal monopoly status granted by laws and regulations. Privately owned companies were rarely challenged. The reason is that a general prohibition on the restrictive behaviour of public enterprises and undertakings with legal monopoly status is expressed in the LUC. Article 6 stipulates that such enterprises are banned from restricting others to purchase products from appointed business operators, thereby excluding other undertakings from fair competition. Private undertakings are only prohibited from selling products under cost and from bundling products or imposing other unreasonable conditions under Article 11 and Article 12 of the LUC. Since "market dominance", a key notion in the antitrust law, was not well established in China, the condemnation of private undertakings for predatory pricing and tie-ins was restricted to a considerable extent.

Though "market dominance," or any other comparable concepts such as "market power" or "superior market position," is not inscribed in the LUC, it doesn't necessarily mean that the basic conception relating to abuses in the sense of antitrust law was unknown to the Chinese

[2000]No. 34, in KONG Xiangjun [孔祥俊]: Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [An Understanding and Application of the current Chinese Anti-monopoly Law 《中国现行反垄断法理解与适用》], 2001, pp. 368–369.

605 SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 213.

lawmakers. In contrast, it was well acknowledged that strong market power may be misused by undertakings to distort competition. The Legislative Affairs Commission (LAC), an influential working group in the legislative process which is affiliated to the People's Congress, pointed out that "*the meaning of this provision [Article 6] is that public enterprises or other undertakings with legal monopoly status shall refrain from abusing their superiority to impair fair competition of other undertakings. An abuse of such a superior position refers to the situation where such undertakings may engage in unfair competition due to their positions, but others (customers) are not capable of leaving or challenging them. For instance, if one wants to get telephone access, one is obliged to buy devices provided by the telecommunication supplier. Or, if one wants to get hot water, one must purchase the particular appliance required by the gas supplier*.[606] Thus, it was presumed under Article 6 that public enterprises and undertakings with legal monopoly status have superior market power compared to their competitors and trading partners. As shown in the following analysis, in most cases, no serious efforts were made to investigate the market power of the concerned enterprise when ascertaining abuses, with a few exceptions. In other words, the presumption has been treated almost as irrebuttable. As a result, instead of the concept of "market dominance" in modern antitrust law, "public enterprises" and "undertakings with legal monopoly status" constitute the central elements relating to the sanction of abusive practices in China.

3.1. "Public enterprise" and "undertaking with legal monopoly status"

The term public enterprise is not defined in the LUC. Instead, it is specified in a directive issued by the SAIC called *Several Provisions on Prohibition of Anti-competitive Conduct by Public Enterprises* (hereinafter referred to as "Several Provisions").[607] Pursuant to Article 2, public enterprises are undertakings engaged in supplying public utilities including water, electricity, heating, gas, post, telecommunication,

[606] LAC, Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa Shi Yi [Interpretation ofthe Law Against Unfair Competition of the People's Republic of China《中国人民共和国反不正当竞争法释义》], HU Kangsheng (ed.), 1993, p. 18.

[607] It was issued on 24.12.1993.

transportation, etc. This definition is in line with the perception of the LAC.[608] Public enterprises are characterized by the nature of their business activities and their involvement in supplying public utilities. The public utilities sectors are illustrated by examples that are not exhaustive. In practice, the SAIC adheres to the listed examples without extending the scope. In cases where an alleged undertaking may not fall under the catalogue, the SAIC seeks to construe them as "undertakings with legal monopoly status", which will be explored at a later point.

Public enterprises are not necessarily stated-owned enterprises (SOEs), albeit in many cases they are concerned with the same entity in the background of the strong state economy in China. But it was reinforced by the SAIC in one case that the qualification of a public enterprise rested upon the business activity of the concerned party rather than upon its ownership. In that case, a natural gas company was punished for compelling its customers to buy its gas appliances when supplying natural gas. The concerned company contended in the investigation that it shouldn't be qualified as a public enterprise because it was privately owned. The local SAIC rejected the defence by arguing that "*the major criterion for judging a public enterprise is whether the concerned enterprise is engaged in a business activity of public utilities and whether it is exclusive and non-competitive. It has nothing to do with its state ownership, the proportion of state capital or the form of its legal liability*".[609]

"Undertakings with legal monopoly status" is not defined in any legal documents after the promulgation of the LUC. The LAC explained the notion by providing merely two examples: the undertakings involved in transportation and those involved in the sale of cigarettes and

[608] In the interpretation by the LAC, public enterprises are also categorized as companies engaged in providing public utilities such as water suppliers, gas companies and electricity suppliers, etc. See LAC, Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa Shi Yi [Interpretation of the Law Against Unfair Competition of the People's Republic of China 《中国人民共和国反不正当竞争法释义》], HU Kangsheng (ed.), 1993, p. 18.

[609] SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 30.

tobacco,[610] which are nevertheless not very illuminating for the application. The SAIC has adopted essentially a case-by-case approach in practice.

In 1997, the SAIC was confronted with the first case on this issue, upon the request of the local SAIC office of Sichun Province. The local SAIC office initiated an investigation against a credit cooperative in the town of Lidian in Muchuan County. It was alleged that the Lidian credit cooperative granted loans, designed for agricultural use, to applicants under the condition that the latter had to purchase fertilizer from an appointed supplying company. Instead of receiving cash, the applicants were given loan certificates issued by the credit cooperative, with which they had to buy all their fertilizer from the appointed supplier. The key question at issue was whether the concerned credit cooperative could be construed as an undertaking with legal monopoly status under Article 6 of the LUC.[611] The SAIC confirmed the monopoly status of the concerned party by arguing that credit cooperatives were special financial institutions established and regulated by financial laws. They had an exclusive position in managing loans for agricultural use. The constraint imposed on applicants to purchase fertilizer violated Article 6 of the LUC.[612] Pertaining to the reply of the SAIC, the local office

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[610] LAC, Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa Shi Yi [Interpretation of the Law Against Unfair Competition of the People's Republic of China《中国人民共和国反不正当竞争法释义》], HU Kangsheng (ed.), 1993, p. 18.

[611] KONG Xiangjun, Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [Understanding and Application of the Current Chinese Anti-monopoly Law, 《中国现行反垄断法理解与适用》], 2001, pp. 71–75.

[612] SAIC, Guan Yu Xin Yong He Zuo She Xian Ding Dai Kuan Ren Gou Mai Qi Zhi Ding Jing Ying Zhe De Shang Pin De Xing Wei Ding Xing Chu Li Wen Ti De Da Fu [Reply to the Question on How to Deal with the Trust Association Forcing Loanee to Purchase Products Provided by the Appointed Undertakings《关于信用合作社限定贷款人购买其指定经营者的商品的行为定性处理问题的答复》, SAIC Official File [1997] No. 170, in: SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 309.

imposed a fine of 50,000 RMB. The Lidian credit cooperative appealed to the local court, but the court upheld the SAIC's decision.[613]

Thereafter, the SAIC identified the undertakings operating cable television stations[614] and providing insurance services[615] as having legal monopoly status. Until 2000, in the reply for the case concerning the status of a Xinhua bookstore, the SAIC sought to define "undertakings with legal monopoly status".

The Xinhua bookstore at the Jianlin County of Jinzhou City in Hubei Province was found to require all the primary and middle schools in its distribution area to purchase books and learning materials, supplementary to the compulsory textbooks for students, at the beginning of the new semester in 1999. To sanction the non-compliance, the Xinhua bookstore refused to provide textbooks for the schools. The question was whether the concerned Xinhua bookstore could be qualified as an undertaking having legal monopoly status so

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[613] KONG Xiangjun, Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [Understanding and Application of the Current Chinese Anti-monopoly Law, 《中国现行反垄断法理解与适用》], 2001, p. 73.

[614] SAIC, Guan Yu You Xian Dian Shi Tai Shi Shi Qiang Zhi Jiao Yi Xing Wei Ding Xing Chu Li Wen Ti De Da Fu [Reply to the Question on How to Deal with the Cable Television Station Conducting Forced Dealing 《关于有线电视台实施强制交易行为定性处理问题的答复》], SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 309.

[615] SAIC, Guan Yu Zhong Bao Cai Chan Bao Xian You Xian Gong Si Ning Xia Fen Gong Si Zai Bo Li Puo Sui Xian Li Pei Zhong Zhi Ding Shi Yong Fu Yao Bo Li Shi Fou Gou Cheng Bu Zheng Dang Jing Zheng Xing Wei Wen Ti De Da Fu [Reply to the Question on Whether the Ningxia Subsidiary of the China People's Property Insurance Co. Ltd. Limiting Consumers to Use Glass Provided by Fuyao in Insurance Claims can be Construed as Anti-competitive Practice 《关于中保财产保险有限公司宁夏分公司在玻璃破碎险理赔中指定使用福耀玻璃是否构成不正当竞争行为问题的答复》], SAIC Official File [1999] No. 176, in SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 311.

that Article 6 would be applicable. The local SAIC office in Hubei Province submitted the question to the SIAC.

In its administrative reply, the SAIC put forward an interpretation by which "*'undertakings of legal monopoly status' are not public enterprises but are those granted with monopoly rights to business operations for certain products including services by means of laws, regulations, directives or other legal regulatory documents. The monopoly status refers to the circumstances where the concerned undertaking is the monopolist, or operates without sufficient competition restraints, or upon whose products customers or consumers are strongly dependent*."[616] It was clear in the statement that, first, undertakings with legal monopoly status are those who do not fall under the scope of public enterprises.[617] Second, there must be a legal basis granting the monopoly status. The description of monopoly status is noteworthy because it encompasses not only the pure monopoly with a single undertaking but also the circumstances where no effective competition is perceivable or a strong dependence between customers including consumers and providers exists. The monopoly status was broadly interpreted, almost equal to the concept of "market dominance."[618] Regarding the concerned bookstore, the SAIC ascertained its legal monopoly status on the grounds that the exclusive right of the Xinhua bookstore to distribute textbooks for primary and secondary schools was provided for in several rules. Pursuant to Article 2 of the *Regulatory Rules on Distributing Textbooks for Ordinary*

[616] SAIC, Guan Yu Ru He Ren Ding Qi Ta Yi Fa Ju You Du Zhan Di Wei De Jing Ying Zhe Wen Ti De Da Fu [Reply to the Question on How to Identify Undertakings with Monopolistic Status 《关于如何认定其他依法具有独占地位的经营者问题的答复》], SAIC Official File [2000] No. 48, available in: SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 318.

[617] KONG Xiangjun, Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [Understanding and Application of the Current Chinese Anti-monopoly Law,《中国现行反垄断法理解与适用》], 2001, p. 64.

[618] KONG Xiangjun, Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [Understanding and Application of the Current Chinese Anti-monopoly Law,《中国现行反垄断法理解与适用》], 2001, p. 67.

Primary and Middle Schools issued by the Chinese State Education Commission (now the Ministry of Education) and the Administration of Press and Publication, Xinhua bookstores were responsible for the subscription and distribution of textbooks for primary and middle schools. The rules enacted by the local government reinforced the monopoly rights of the local Xinhua bookstores and banned any other undertakings from carrying out this activity.[619]

The perception of the SAIC relating to undertakings with legal monopoly status in the Xinhua Bookstore case reflects the development of the idea of market dominance and the awareness of an economic approach in practice, at a minimum, on the central level of the SAIC.[620] However, since the market dominance is not an indispensable constituting element required, it was then up to the local SAIC office to decide how to address this issue in individual cases. Hence, there is an inconsistency among local SAIC offices. A few local offices made investigations over the market power of the concerned undertaking, whereas the majority attached less importance to the issue.[621]

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[619] See SAIC, Guan Yu Ru He Ren Ding Qi Ta Yi Fa Ju You Du Zhan Di Wei De Jing Ying Zhe Wen Ti De Da Fu [Reply to the Question on How to Identify the Undertakings with Monopolistic Status 《关于如何认定其他依法具有独占地位的经营者问题的答复》], SAIC Official File [2000] No. 48, in: SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 318.

[620] KONG Xiangjun, Zhong Guo Xian Xing Fan Long Duan Fa Li Jie Yu Shi Yong [Understanding and Application of the Current Chinese Anti-monopoly Law, 《中国现行反垄断法理解与适用》], 2001, p. 67.

[621] Compare the case “X Subsidiary of X Airline Co. Ltd. restricting Competition” with the case “X Gas Co. Ltd. in Shanghai selling Insurance by Tie-Ins”, in SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement 《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, pp. 33 and 21.

3.2. Abusive practices

In principle, a business practice always entails certain limitations on trading partners in terms of the conditions for supply, payment, maintenance, etc. It is the freedom of enterprises in economic activities. However, for public enterprises and undertakings with legal monopoly status, this basic principle is reconciled. As noted above, they are prohibited from imposing restrictions impeding competition on the presumption that they possess superior market positions.[622]

Instead of continuing the abuse of market dominance, conducts of public enterprises and undertakings with legal monopoly status were condemned because of the coercive nature in the Chinese antitrust practice. Pursuant to Article 6 of the LUC, public enterprises and undertakings with legal monopoly status shall not constrain others to purchase products from the appointed undertakings. The key point is whether the concerned enterprise imposes any restrictions on its customers. But to determine what measures are restrictive is a difficult issue because it must be kept in mind that public enterprises and undertakings with legal monopoly status must not be deprived of their reasonable business autonomy. In one administrative reply, the SAIC defined "restrictions" as "*direct or indirect coercive measures, such as compulsory requirements, hurdles on services, constraints, suggestions and unequal treatment, etc., adopted by public enterprises and enterprises with legal monopoly status to compel others to acquire products from the appointed undertakings*".[623] In the concerned case, a

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[622] LAC, Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa Shi Yi [Interpretation of the Law Against Unfair Competition of the People's Republic of China《中国人民共和国反不正当竞争法释义》], HU Kangsheng (ed.), 1993, p. 18.

[623] SAIC, Guan Yu Dian Xin Ju Dui Bu Cong Gai Ju Gou Mai Shou Ji Ru Wang Zhe Duo Shou Ru Wang Fei De Xing Wei Shi Fou Gou Cheng Bu Zheng Dang Jing Zheng Xing Wei Wen Ti De Da Fu [Reply to the Question on Whether the Post and Telecommunication Bureau Charging Consumers Using Cell Phones from Other Providers a Higher Network Fee is an Anti-competitive Practice《关于电信局对不从该局购买手机入网者多收入网费的行为是否构成不正当竞争行为问题的答复》], SAIC Official File [1999] No. 190, in: SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-

public enterprise providing mobile network access in Shangdong province was found to be involved in a discriminatory practice. For authorization of access to the mobile network, it charged its customers a fee of 1,000 RMB for cell phones provided by its company, but 2,500 RMB for cell phones that customers bought from other suppliers. Thereby, unequal treatment was qualified as a form of restriction. In practice, several typical restrictive measures have been established which will be explored below.

(i) Abusive pricing

The Electric Company of Qihe County charged local farmers additional prices for material costs, installation fees, transportation expenses and subsidies for its own employees, as it upgraded the electricity network in the rural area from 1999 to 2000. After having carried out investigations on the facts of the alleged excessive pricing, the local SAIC office of Dezhou City in Shandong province submitted the question to the SAIC as to whether the pricing activity was abusive as defined by Article 6 of the LUC. The SAIC held it as abusive for the reason that the electric company was the sole enterprise that was authorized to upgrade the electricity network for the farmers of Qihe County in the concerned region. This monopoly position was misused by the alleged company to charge prices exceeding the level set forth by the government. In this regard, the State Council and the relevant regulatory agencies had issued several decrees and directives making it clear that the upgrading project was subsidized by the government. Except for cables connecting the electric energy meter to home appliances, no other prices in the form of material fees, installation fees, maintenance fees, etc., should have been paid by the farmers.[624]

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monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 311.

[624] SAIC, Dui Gong Dian Bu Men Qiang Xing Shou Qu Bu Gai Shou Qu De Fei Yong Xing Wei Ding Xing Chu Fa Wen Ti De Da Fu [Reply to the Question on How to Deal with the Electricity Supply Department Charging Unreasonable Price《对供电部门强行收取不该收取的费用行为定性处罚问题的答复》], SAIC Official File [2001] No. 175, in: SAIC/CASS[国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, pp. 13–16 and 323.

Therefore, the additional prices imposed by the concerned company were abusive.

It was shown in this case that, unlike abusive pricing condemned in common antitrust regimes, the excessive pricing was not reasoned on the calculation of any costs, neither marginal costs nor average costs. It was still established on the fact that the pricing activity infringes the relevant pricing rules issued by the state. Therefore, the condemnation of monopoly pricing in the Chinese practice was in fact different from that excepted in the modern antitrust law.

Furthermore, such an approach resulted in overlaps with the application of the LUC and other administrative laws, in particular the *Pricing Law*, for which the NDRC and the local price bureaus are responsible. Conflicts as such did occur between the two authorities. It was resolved in a practical way, that is, the authority who is first informed of the claim is to be in charge.

(ii) Tying

A typical case of tying is that the local SAIC office in City X of Liaoning province sanctioned a local company as a wholesaler for cigarettes and tobacco in 2001. The concerned company was condemned for obliging the retailers for cigarettes and tobacco in the region to purchase cigarettes of certain brands which were not required by the latter. Since the concerned company was the only authorized supplier for cigarettes in the local market, this means that it had a monopoly status, and the customer was in fact forced to buy the tied products. Such a practice not only impeded competition in the local cigarette market but also caused harm to consumer welfare.

The second type of tying case in China is notable for its “altruistic” character, which means that the tying arrangements were carried out by the concerned party not to benefit the production or sales of its own products but for those of other companies. For example, in 1999, Ningxia Property Insurance Company, a subsidiary of the Chinese Property Insurance Co. Ltd., required all its affiliates in the regional market to follow a unanimous policy when paying insurance benefits in the case of broken car windows. By virtue of this policy, all new windows were to be supplied and installed by the Fuyao Glass Engineering Group Ltd., hereinafter referred to as “Fuyao.” As to the indemnity for broken windows of insured cars, the calculation of prices was subject to

the *Price List of Car Windows* jointly issued by the Chinese Property Co. Ltd. and Fuyao. There were no disputes over the point that Ningxia Property Insurance Company was an undertaking with legal monopoly status under Article 6 of the LUC in the local market of Ningxia, since its parent company monopolized the whole Chinese insurance market for property pursuant to the relevant laws and regulations. The measure adopted by the local subsidiary was aimed at bundling the insurance service with the sale of car window glass provided by Fuyao. It was anti-competitive because customers had no other alternative but to choose glass from Fuyao, as otherwise the damages would not be compensated by the insurance company. Other producers of car window glass were virtually restricted in competition as a result of the restrictive measure. As noted above, the concerned practice was not benefiting the car insurance service provided by the company but facilitating the sale of car window glass by Fuyao. The bizarre phenomenon as such can only occur in a monopolized market where the monopolist has no fear of losing customers when carrying out restrictive measures.

(iii) Unequal treatment

In 2005, the SAIC office of Wulanbucha made a finding of a discriminatory practice by the local subsidiary of an oil company X in Wulanbucha. From 2003 to 2005, the concerned company provided petroleum and diesel to its associated gas stations at a wholesale price, whereas other gas stations had to pay a much higher price – the full retail price. The company was an enterprise with legal monopoly status since it was the sole supplier for petroleum and diesel in the local oil market. The price discrimination distorted competition among gas stations in the region because the non-associated gas stations were placed in a disadvantaged position in competition due to the higher costs resulting from the unequal treatment. Based on these facts, the local SAIC decided that the discriminatory pricing adopted by the concerned company infringed Article 6 of the LUC. The concerned company was sanctioned by the confiscation of its illegal gains amounting to 836,927 RMB and a fine of 100,000 RMB.

3.3. Problem with the current transition to the concept of market dominance

As a whole, the doctrine of market dominance hasn't been fully established in competition enforcement, albeit this perception was reflected by legislators and administrative enforcers on several occasions. Under the absolute state economy prior to the economic reforms, public enterprises were state-owned companies and simultaneously monopolists in the relevant market. No doubts were cast on this presumption at the earlier stage of the administrative enforcement as the public utilities sectors were not open to any effective competition, or even monopolized by one SOE. This structure has undergone a change as barriers to market entry are gradually reduced and more and more private undertakings are introduced into the market to compete with public enterprises. It makes the rigid application of Article 6 of the LUC, without taking the market power of the concerned enterprise into account, questionable.

This issue was discussed in the case where the decision of the local SAIC office in Shanghai was challenged in the local court. The local SAIC office made a finding that the concerned gas company was a public undertaking since it engaged in supplying gas, which falls under public utilities. From 1997 to 2000, the gas company sold insurance for gas cans to its customers as it provided liquefied gas to the local residents, which was held as restrictive by the SAIC office in Shanghai. The gas company contended that it shouldn't be construed as a public enterprise in the meaning of Article 6, which requires that an enterprise shall have a monopoly position in the relevant market. On the contrary, there were still six other liquefied gas companies in the same area competing with this company. It had no market strength to force its customers to buy any insurance service. The court favoured the general approach applied by the SAIC through the years. However, it was indeed worth considering whether the non-economic assessment would even impose restrictions on new entrants entering into the markets for public utilities. Regardless of this, the local SAIC office lost the case on the other point.

As we can see in this case, there is a need for a conceptual change in the Chinese anti-monopoly practice as the Chinese economy is becoming more liberalized.

4. Merger control

The control over mergers and acquisitions in China has been greatly influenced by the conception of the socialist market economy. On the one hand, the Chinese government is still deeply involved in the management of SOEs. In respect to M&A, most of the transactions of SOEs have been carried out by the state as part of the reform program. In 1994, the central government restructured large and middle-sized SOEs in 100 cities. In 1997, 120 giant groups of enterprises were created in industries of strategic importance to constitute the "national fleet" under the direct supervision and guidance of the State Council. Measures were taken on the local level as well. For example, 75 per cent of the enterprises owned by Shanghai Municipality were reorganized.[625] The M&A of SOEs has constituted the basic form of merger in China since the 1990s. On the other hand, the idea of a socialist market economy implies the liberalization of the market with the involvement of private enterprises. At the end of the 1990s, China adjusted its policy toward foreign investment to encourage more foreign investors to acquire domestic companies so as to accelerate the pace of reforming Chinese enterprises.[626] The policy permitted not only the direct establishment of enterprises in China but also the acquisition of shares of the existing domestic firms on the stock market. Thus, the merger activities by foreign investors contribute to a significant part of M&A in China. The third major form of M&A includes those among private domestic companies which, compared to the aforementioned two forms, plays a subordinated role because of its limited scale of transactions.

M&A of SOEs have been considered as measures to reform the uncompetitive structure of the former state economy and increase economies of scale by reallocating resources to efficient enterprises. From the perspective of the government, it in itself is an effort to improve the competition situation in the market. Therefore, no additional

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[625] LIN Ping [林平], Zhong Guo Qi Ye Jian Bin De Fan Long Duan Kong Zhi [The Anti-monopoly Control on M&A of Enterprises in China《中国企业兼并的反垄断控制》], in WANG Xiaoye [王晓晔], Jing Ji Quan Qiu Hua Xia Jing Zheng Fa De Xin Fa Zhan [New Development of Competition Laws under Globalization《经济全球化下竞争法的新发展》], 2005, p. 27.

[626]OECD, Zhong Guo Kua Guo Bing Gou Zheng Ce Bao Gao [Investment Policy Reviews CHINA《中国跨国并购政策报告》], 2006, p. 25.

assessment in this regard is necessary. Little attention has been paid to M&A among private domestic enterprises, since the transaction volumes in most cases appear to be relatively low. On the contrary, merger activities of foreign enterprises are noteworthy due to the high volumes of transactions, which may give rise to serious concerns of competition threats particularly to domestic competitors.

Early in 1999, the Chinese authorities issued a decree on the merger and separation activities of enterprises with foreign investments.[627] A review on the matter of competition related to a merger was stipulated for the first time. It is generally provided for in Article 24(2) that if the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) holds that the proposed merger "*tends to monopolize an industry or may constitute a predominant position in the market*", the review time can be extended to 180 days. However, since no substantial competition assessment was seriously carried out in the practice, this provision was only a perfunctory one.[628]

A more detailed merger review system, established as *The Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (hereinafter referred to as "Interim Provisions"),[629] was jointly issued by four Chinese authorities.[630] Since the rule only targets the M&A by foreign investors and is not applicable to Chinese enterprises, it has been regarded as discriminatory.[631] The Interim Provisions system was amended in 2006; the provisions regarding

[627]The Provisions on the Merger and Division of Enterprises with Foreign Investment, enacted by the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce on 23.9.1999.

[628] YE Jun [叶军], Wai Zi Bing Gou Zhong Guo Qi Ye De Fa Lü Fen Xi [An Analysis of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors – From a Legal Perspective《外资并购中国企业的法律分析》], 2004, p. 318.

[629] It was enacted on 2.1.2003 and took effect on 12.4.2003.

[630] The four authorities are the Ministry of Foreign Trade and Economic Cooperation (later the Ministry of Commerce), the State Administration of Taxation, the State Administration for Industry and Commerce and the State Administration of Foreign Exchange.

[631] HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws《中国并购法报告》], Vol. 2007, 2007, p. 33.

merger control were kept intact.[632] Indeed, there is unequal treatment with regard to the effects of M&A on competition since anti-competitive harm may be incurred by merger activities, regardless of the national identity of the enterprises. The Interim Provisions illustrate the Chinese government's concern about the foreign enterprises' deep involvement in the Chinese market. The different treatment has been abolished in the newly enacted Chinese *Anti-monopoly Law*, which is, indeed, a great improvement and one to be welcomed. As the phenomenon of oligopoly markets is becoming noteworthy with the proceeding of the restructure of SOEs, considerable importance shall be attached to the acquisitions by giant SOEs, which may increase the anti-competitive danger subject to this kind of market structure. Furthermore, with the growth of private undertakings, their business operations also turn out to be influential on the market.

In the following, the controversial Interim Provisions and the implementation practice by the Chinese authorities will be explored.

4.1. Interim provisions

The Interim Provisions system is designed to stipulate various issues concerning the takeover of domestic companies by foreign investors, such as the requirement on foreign investors and the issue of foreign exchange and taxation in M&A, where the competition review is only one component thereof. Unlike the vague rule of 1999, the Interim Provisions system is more detailed and practical. Specific thresholds for notification and a substantial test for competition appraisal are provided for, albeit there are obvious loopholes when compared to merger control in other well-developed antitrust regimes. For example, though a pre-notification system for merger control is provided, there is no sanction on its infringement to safeguard the effective enforcement. Therefore,

[632] The amended Interim Provisions system was issued jointly by the Ministry of Commerce, the State-owned Assets Supervision and Administration Commission of the State Council, the State Administration of Industry and Commerce, the China Securities Regulatory Commission and the State Administration of Foreign Exchange on 8.8.2006 and took effect on 8.9.2006. Merger control is provided for in Articles 51 to 54 of the new Interim Provisions, while it was dealt with in Articles 19 to 22 in the old version.

there is an inconsistency in the notification practice among foreign enterprises.

It is provided in the Interim Provisions that the concerned undertakings shall notify their merger proposals to the MOFCOM and the SAIC. It is reported that there were over 300 cases of M&A notified to the MOFCOM,[633] whereas the SAIC announced only over 200 applications.[634] This discrepancy strengthens the impression that the SAIC is less involved in the merger review than the MOFCOM. The latter played a key role in almost all the important merger cases disclosed to the public.[635] It was also the MOFCOM who organized the first hearing for merger control in the case of SEB/Supor. [636]

4.1.1. Definition of M&A

The term “M&A” is defined in Article 2 of the Interim Provisions (2006) as follows:

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[633] Shang Wu Bu Guan Yuan Jie Du Fan Long Duan Fa [MOFCOM Official reading the Anti-monopoly Law “商务部官员解读反垄断法”], available at http://finance.jrj.com.cn/news/2007-10-08/000002754887.html, last visited on 2.3.2008.

[634] Chuang Xin Zhi Fa Li Nian, Yan Ge Yi Fa Xing Zheng, Fan Long Duan Fa Cheng Guo Xian Zhu [New Perceptions for Enforcement Work, Strengthening the Rule of Law in Administration, Significant Achievements in the Anti-monopoly Enforcement “[illegible] [illegible] [illegible] available at http://www.gov.cn/gzdt/2007-07/05/content_673503.htm, last visited on 2.3.2008.

[635] Carlyle cuts its stake to 50 per cent in Xugong takeover bid, 19.10.2006, China Daily, available at http://english.mofcom.gov.cn/aarticle/newsrelease/commonnews/200610/20061003455893.html, last visited on 2.3. 2008; Guo Mei Yong Le He Bing Reng Zai Shen Cha Zhong [The Acquisition of China Paradise by Come still being reviewed “[illegible]], available at http://finance.sina.com.cn/chanjing/b/20061107/00303053948.shtml, last visited on 2.3.2008; Gome Finances Acquisition of Rival Dazhong, available at http://english1.mofcom.gov.cn/aarticle/newsrelease/commonnews/200712/20071205286998.html, last visited on 2.3.2008.

[636] HUANG Yong [[illegible] Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China “[illegible]], in SHI Jiansan [[illegible] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws《[illegible]], Vol. 2007, 2007, p. 33.

"For the purpose of the Provisions, mergers and acquisitions of a domestic enterprise by foreign investors shall mean that foreign investors, by agreement, purchase equity interest from shareholders of domestic enterprise with no foreign investment (hereinafter referred to as the "Domestic Company") or subscribe to the increase in the registered capital of the Domestic Company with the result that such Domestic Company changes into a foreign investment enterprise (hereinafter referred to as "Merger and Acquisition by Shares"); or the foreign investors establish a foreign investment enterprise and then, through such enterprise, purchase the assets of a domestic enterprise by agreement and operate such assets, or the foreign investors purchase the assets of a domestic enterprise by agreement and use such assets as investment to establish a foreign investment enterprise to operate such assets (hereinafter referred to as "Merger and Acquisition by Assets")."

As we can see, there are two forms of merger – "M&A by Shares" and "M&A by Assets"– provided for in the above definition, both of which are nevertheless inadequate from the perspective of merger control. "M&A by Shares" requires that a takeover shall enable a domestic company to be changed into a "Foreign Investment Enterprise." That is the case when the acquisition results in the foreign investment of no less than 25 per cent of the company's total equity interest, pursuant to the relevant laws and regulations in China.[637] With such restriction, a great number of merger cases that may cause competition problems are ignored. For instance, a foreign investor increases its stake in a company, which is already registered as a Foreign Investment Enterprise in China, from 25 to 60 per cent, which enables the foreign investor to have control over the latter replacing the Chinese shareholders. In fact, the change of control in the same company may also have an impact on competition in the relevant market. However, this transaction doesn't fulfil the constituent element of the definition, and thus does not need to be approved by the responsible authority. The narrow form of acquisition by shares has virtually restricted the scope of merger review to a great extent.

[637] Art. 18 of the Rule on Implementing the Law on Chinese-foreign Equity Joint Ventures, approved by the State Council on 7.8.1995, promulgated by Order No. 6 of the Ministry for Foreign Trade and Economic Cooperation on 4.9.1995; Art. 4 of the Law on Foreign-Capital Enterprises, enacted on 1.7.1979, last amended on 3.15.2001.

The second form, "M&A by Assets", sets no substantial condition for the notification. It means that even a minor purchase of assets of a domestic undertaking by foreign investors, for example buying merely some products from the domestic enterprise, could be qualified for a notification, albeit no negative effects on competition in the relevant market can be expected. This may lead to an excessive merger review, which not only produces unnecessary administrative costs for enterprises but also an overload for the authorities.

Furthermore, it is criticized that other forms of acquiring control of one enterprise over the other, such as by appointing key members in the board of the latter as well as other contractual means, are not encompassed in the definition.[638] The reason for the inadequacy lies mainly in that the definition in the Interim Provisions is not designed for merger control, but for a general scrutiny of foreign investment in China.

4.1.2. Thresholds for notification

With regard to thresholds for notification, a differentiation is made between onshore (Article 51)[639]and offshore transactions (Article

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[638] HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws《中国并购法报告》], Vol. 2007, 2007, p. 31.

[639] Article 51 provides that in case of any of the following occurrences in connection with the merger or acquisition of a domestic enterprise by foreign investors, the investors shall submit notification to the MOFTEC and the SAIC: (1) the revenue of a party to the merger or acquisition in the domestic market for the current year exceeds RMB1.5 billion; (2) the foreign investors have merged with or acquired more than ten domestic enterprises in aggregate engaging in the related businesses within one year; (3) the market share of a party to the merger or acquisition in the domestic market has reached 20 per cent; or (4) the market share of a party to the merger or acquisition in the domestic market will reach 25 per cent as a result of the merger or acquisition.

Even without the above occurrences, the MOFCOM or the SAIC may still require the foreign investors to submit notification upon the request by any competing domestic enterprise, relevant functional department or industrial association, if the MOFCOM or the SAIC finds that the merger or acquisition will involve a huge market share, or if there is any other material aspect of the

53).[640] The reason for the different treatment is that the Chinese government seeks to review those merger activities taking place outside the territory of China that could impede competition in the domestic market. It has been the international practice that merger control by the national competition authority can be extended to overseas transactions that may affect the national market. This is known as the effect doctrine. Since the Interim Provisions system as a whole is not extraterritorially applicable, a special provision permitting the review of offshore M&A was introduced. However, Article 53 doesn't stipulate any requirement for a noticeable effect of the concerned merger in the domestic market but merely requires the notification where at least one of the conditions listed is satisfied by the parties involved. Consequently, a great number of M&A, which may not even affect the Chinese market, would have been notified to the Chinese authorities. For example, Coca-Cola, whose turnover in the Chinese market exceeds *ca.* US$208.3 million[641] in the current year, could purchase a local vodka producer in Russia

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merger or acquisition that might severely affect market competition, the national economy or people's livelihood and national economic security. The above-mentioned "party to a merger or acquisition" shall include any affiliated enterprise of foreign investors.

[640] Article 53 provides that in case of any of the following occurrences in connection with an offshore merger or acquisition, any party to the merger and acquisition shall, prior to its public announcement of the plan for the merger or acquisition or together with its application to the regulatory authorities of the country where it is located, submit to the MOFCOM and the SAIC the plan for the merger or acquisition. The MOFCOM and the SAIC shall examine whether the merger or acquisition might cause over-concentration of the domestic market, impair fair competition in the domestic market or damage the domestic consumers' interests, and decide whether to approve the plan:
(1) the assets owned by a party to the offshore merger and acquisition within China exceeds RMB 3 billion;
(2) the sales of a party to the offshore merger or acquisition in the domestic market for the current year have exceeded RMB 1.5 billion;
(3) the aggregate market share in the domestic market by a party to the offshore merger or acquisition and its affiliated enterprises has reached 20 per cent;
(4) the aggregate market share in the domestic market by a party to the offshore merger or acquisition and all of its affiliated enterprises in the domestic market will reach 25 per cent as a result of the offshore merger or acquisition; or
(5) as a result of the offshore merger or acquisition, a party to the offshore merger or acquisition will hold, directly or indirectly, equity of more than 15 foreign investment enterprises engaging in the related businesses within China.

[641] The exchange rate applied for the calculation is 1US$ to 7.2 RMB.

that has no sales in China. Under the Interim Provisions, such an acquisition scheme would be submitted for approval. Nevertheless, a review on notification wouldn't make any sense since the impact of the transaction can be almost ruled out at the outset.

The basic concepts of thresholds reflected in Articles 51 and 53 will be examined in the following, without addressing each provision separately, since most of the thresholds are identical, at least conceptually. The criteria are applied alternatively, which means the notification is necessary when one of these requirements is fulfilled.

(i) Turnover

Both Article 51 and Article 53 embody the same turnover standard. This means that when the turnover of one of the merging undertakings reaches 1.5 billion RMB (*ca.* US$208.3 million), the proposed merger shall be submitted to the responsible agencies for approval. The turnover is generally applied as a filter for merger notification in many antitrust regimes, albeit the instrument itself is not perfect. The critique, in particular by overseas commentators, focuses on its application to offshore transactions.[642] As stated above, without the requirement for noticeable effects of the concerned merger in the Chinese market, the turnover requirement alone brings excessive control on overseas M&A, which may have no relevance to the competition situation in China.

(ii) Asset

The asset standard is only provided for in No. 1 of Article 53 for offshore transactions. Should the assets owned by a party for the offshore merger with China exceed 3 billion RMB (*ca*. US$416.6 million), the proposed merger is to be notified to the MOFCOM and the SAIC. This threshold results in the same problem as the turnover standard since there is no noticeable effect in the Chinese market required as well.

(iii) The number of required domestic enterprises

Both No. 2 of Article 51 and No. 5 of Article 53 make the notification dependent upon the number of the domestic enterprises taken over by the acquirer in the corresponding sectors – for onshore

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[642] Moritz Lorenz, Chinesische Fusionskontrolle [Chinese Merger Control], WuW 12/2006, p. 1248.

mergers 10 domestic companies and offshore mergers 15. In cases of onshore acquisitions, it is further required that the subsequent takeovers shall succeed in one year, whereas there is no time limit for offshore activities. It was pointed out by commentators that this threshold cannot reflect the competitive circumstances in the market, and appears to be "*ill-grounded and unnecessary*".[643]

(iv) Market share

As for the market share standards in No. 3 and No. 4 of Article 51 regarding onshore transactions (No. 3 and No. 4 for offshore), they are difficult to apply in practice because, before ascertaining the market share of the merging party, the relevant market must be first identified. However, the scope of the relevant market at issue is seldom clear from the outset. On the contrary, in most cases it can only be outlined during the investigation, which first requires a formal notification. Moreover, the issue of relevant market is always extremely controversial. It can't be expected that the concerned enterprises would voluntarily make a notification on the grounds of the high market share.[644]

(v) Notification upon request

Beyond the aforementioned thresholds, Article 51(1) also enables the MOFCOM or the SAIC, upon the request of domestic competitors, regulatory bodies or industrial associations, to ask the concerned foreign investors to notify a merger or an acquisition, which would affect a large scale of market share. Article 51 also expects investors to reveal other important concerns in the perspective of the officials. Obviously, it gives more discretion to administrative bodies to

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[643] HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, p. 32. See also LIN Ping [林平], Zhong Guo Qi Ye Jian Bin De Fan Long Duan Kong Zhi [The Anti-monopoly Control on M&A of Enterprises in China 《中国企业兼并的反垄断控制》], in WANG Xiaoye [王晓晔], Jing Ji Quan Qiu Hua Xia Jing Zheng Fa De Xin Fa Zhan [New Development of Competition Laws under Globalization 《经济全球化下竞争法的新发展》], 2005, p. 27.

[644] HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, p. 32.

extend the scope of merger control. The restriction of the qualification of a complainant upon domestic competitors displays the attitude of the lawmakers to give more attention to Chinese companies, since foreign competitors who could also be affected by the merger as participants in the Chinese market wouldn't be granted the opportunity.[645] As to the involvement of the relevant regulatory bodies in this regard, it is held critically that this power could be misused by local governments to protect the fiscal interests of local enterprises.[646] In practice, however, there has been no single merger case that has been notified upon request.[647]

4.1.3. Substantial competition test

If a merger may "result in over-concentration", "impair fair competition" or "damage consumers' interests" according to the assessment of the MOFTEC and the SAIC, the proposed merger shall be prohibited.

It is not specified further how the over-concentration is to be assessed; therefore, it is unclear whether the examination of concentration shall be limited only to factors such as the addition of market shares and the increase of concentration ratio. Otherwise, a comprehensive evaluation of the effects on competition is to be carried out so that other important parameters such as market barrier entry may also be taken into account. In practice, it can be seen that the MOFCOM pursued an overall assessment because it was required in its guideline for notification that the applicant should make a detailed description of the competition situation in the relevant market.[648]

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[645] LIN Ping [林平], Zhong Guo Qi Ye Jian Bin De Fan Long Duan Kong Zhi [The Anti-monopoly Control on M&A of Enterprises in China 《中国企业兼并的反垄断控制》], in WANG Xiaoye [王晓晔], Jing Ji Quan Qiu Hua Xia Jing Zheng Fa De Xin Fa Zhan [New Development of Competition Laws under Globalization《经济全球化下竞争法的新发展》], 2005, p. 36.

[646] See OECD, Zhong Guo Kua Guo Bing Gou Zheng Ce Bao Gao [Investment Policy Reviews CHINA《中国跨国并购政策报告》], 2006, p. 34.

[647] Moritz Lorenz, Chinesische Fusionskontrolle [Chinese Merger Control], WuW 12/2006, p. 1250.

[648] See the Guideline on the Notification of Foreign Investors' M&A of Domestic Enterprises, issued on 8.8.2006.

As to the impediment of fair competition, doubts were raised by commentators as to whether it is an adequate standard for the competition appraisal since the concept of "fair competition" is a term conventionally applied in the LUC.[649] It must be acknowledged that no rigid distinction can be drawn between laws against unfair competition and antitrust laws since in many competition regimes they are integrated into one comprehensive competition law. However, there is a significant difference between the two legal areas. That is, a practice is deemed as unfair pursuant to the LUC if it acts "unduly" or "improperly" against certain business customs without any reference to the market position of the undertakings and the structure of the relevant market. By contrast, anti-competitive conduct in the sense of antitrust laws must be generally judged under the circumstances of the relevant market. In particular, merger activities cannot be labelled as "fair" or "unfair" since most of the mergers are pro-competitive. Some mergers are regarded as "bad." But "bad" mergers are not in themselves unreasonable; rather they are "harmful" to competition in the context of the market circumstances where they are embedded. Therefore, "unfair competition" in the definition of the Interim Provisions is no other than the market status where (effective) competition is restricted by M&A.

The notion of "damaging consumers' interests" is also ambiguous because it can be either narrowly understood as concrete rights of consumers which are protected in various laws, for example, the *Law on Protecting Consumers' Rights and Interests*[650] or the *Law on Quality of Products.*[651] Consumers' interests can also mean "consumer welfare" – a term which is more commonly used in antitrust terminology. In such cases, consumers' interests are not treated as individual rights but mostly protected as a whole. This results from the competitive process. Therefore, it could sometimes be misleading if the same terminologies are applied in different contexts.[652]

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[649] HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, p. 30; see also Moritz Lorenz, Chinesische Fusionskontrolle [Chinese Merger Control], WuW 12/2006, p. 1250.

[650] It was enacted on 31.10.1993.

[651] It was enacted on 22.2.1993 and last amended on 8.7.2000.

[652] See also HUANG Yong [黄勇], Wo Guo De Qi Ye Bing Gou Fan Long Duan Gui Zhi Wen Ti Yan Jiu [A Study of the Anti-monopoly Regulations on M&A of

4.1.4. Justifications for exemption

The prohibition of the proposed merger or acquisition may be exempted if one of the four justifications contained in Article 54 is fulfilled: (1) the merger or acquisition can improve the conditions for fair competition in the domestic market; (2) the merger or acquisition can restructure the enterprise running at a loss and ensure employment; (3) the merger or acquisition can absorb advanced technologies and management professionals and enhance the international competitiveness of the domestic enterprise; or (4) the merger or acquisition can improve the environment.

The first justification – the improvement of conditions for fair competition – entails a trade-off between pro-competitive and anti-competitive effects related to the merger or acquisition. The argument of efficiency can be taken into consideration on this point.

Exemptions on the grounds of No. 2 to No. 4 are granted in consideration of other economic or social interests. No. 2 provides for an exemption if the takeover may solve problems resulting from the bankruptcy of a domestic undertaking, such as the loss of assets and the issue of unemployment. In such cases, the authorities have to balance not only economic benefits but also social interests in terms of increased unemployment caused by competition. The national industrial policy is reflected in the justification of the international competitiveness of domestic enterprises (No. 3), and the environment policy is pursued in No. 4. Concerns are raised about the question of whether or not the responsible authorities are capable of striking a balance between competition concerns and other social or economic interests, which would make the complicated competition appraisal even more unpredictable.[653]

4.1.5. Procedural rules

Enterprises in China "我国的企业并购反垄断规制问题研究"], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, p. 32.

[653] *Ibid.* p. 33.

A general rule for merger control is provided for in Article 52. It simply sets a time limit of 90 days for a review by the MOFCOM and the SAIC. A quick review, commonly 30 days or one month for cases that are unlikely to raise competition concerns, is not stipulated in the Interim Provisions. A hearing can be held by authorities with the involvement of the relevant departments, organizations, enterprises and other related parties.

The procedural rule is obviously simple because important issues concerning the qualification of applicants and the documents required are not even mentioned. Moreover, the authorities are empowered with great discretion to decide how long the review shall actually take within the 90 days. It entails a legal uncertainty for undertaking a merger. Furthermore, an unreasonably long review period, particularly in less problematical merger cases, may hamper the economic activities of enterprises.

In 2007, the MOFCOM issued *The Guideline on the Notification of Foreign Investors' M&A of Domestic Enterprises* to specify the procedural requirements[654] (hereinafter referred to as "Guideline"), which will be examined in the following.

According to the Guideline, the acquirer is in general obliged to notify the transaction, while the acquired may also be the applicant under certain circumstances. Where more applicants are involved, the notification can be made either jointly or respectively. The applicant may apply in its own name or through an authorized Chinese law firm.

As to onshore mergers and acquisitions, the notification shall be done before transactions are made known to the public. Concerning offshore transactions, it is to be undertaken at the same time as it is notified to the responsible authorities in the countries where the involved enterprises are registered.

The Guideline specifies the general rule on the review period by the MOFCOM in that a two-stage procedure is provided for. The first stage of merger review is to be finished in 30 working days after the completed documents are submitted. If the applicant doesn't receive a notice for further review, the transaction is deemed to be approved.

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[654] The Guideline was issued on 8.3.2007 by the MOFCOM. There is no similar document available by the SAIC.

Where the applicant isn't informed of further scrutiny, the review will be prolonged to 90 working days.

For a successful notification by the MOFCOM, the following information is required:

i. the application(s),
ii. the Identify Card(s) of the applicant(s) or the certificate of registration,
iii. the authorization letter(s) for the law firm(s) and the introduction letter(s) for the representing lawyer(s) issued by the law firm(s),
iv. the basic information on the parties to the merger,
v. the names and a brief introduction on the related enterprises of the parties to the merger,
vi. certificates and business licences of the enterprises established by the parties to the merger, the standing representative offices, affiliated undertakings and other entities registered in the territory of China,
vii. a description of the transaction(s),
viii. the definition of the relevant market(s),
ix. the turnovers and market shares of the concerned parties to the merger in the last two accounting years,
x. the names of the five largest competitors in the relevant market,
xi. the supply and demand structure of the relevant market,
xii. the statement on the competition situation in the relevant market,
xiii. the M& A agreement(s),
xiv. the audited financial reports of the parties to the merger in the previous accounting year,
xv. documents for the request of exemption if necessary,
xvi. information on the industrial associations in the relevant market,
xvii. the notification of the concerned merger in other jurisdictions,
xviii. other information that needs to be disclosed to the responsible authority,
xix. the statement on the truthfulness of the information and the accuracy of its sources.

Before the formal notification, an informal consultation between the applicants and the MOFCOM can be undertaken to improve the efficiency, transparency and predictability of the merger review, which is influenced by the practice of the European Union.

Obviously, the MOFCOM Guideline provides more detailed rules on notification, which improves the legal certainty for parties involved in M&A to a great extent. Presumably, it will shed light on the future enforcement of merger control in the AML.

4.2. "SEB/Supor"

Since the Interim Provisions took effect, the MOFCOM has carried out detailed investigations on several M&A cases, which also attracted public attention. Among them, the takeover of Supor by SEB is historical since it triggered the first hearing in the history of Chinese merger review.[655]

On 14 August 2006, Shanghai SEB International Co. Ltd. (hereinafter referred to as "SEB"), wholly owned by the French home appliance giant SEB S.A., agreed with Zhejiang Supor Co. Ltd. (hereinafter referred to as "Supor") on a framework of strategic investment. Supor is a listed company on the Shenzhen Stock Market and wholly owned by the Supor Group. Supor is regarded as a leading manufacturer of pressure cookers, woks and other kitchenware in China.

Pertaining to the acquisition agreements, SEB subscribed 40 million normal (A) shares at a price of 18 RMB per share by means of the targeted issuing by Supor. Furthermore, it purchased 9.17, 4.24 and 0.43 per cent of the equities from Supor Group, SU Zengfu, Su Xianze, respectively, which amounts to 25,320,116 shares. Finally, SEB acquired between 48,605,495 and 66,452,084 shares from other shareholders of Supor through a partial tender offer on the stock market. With all the above transactions, SEB held 52.4 to 61 per cent of Supor's equities and become the controlling shareholder. The A shares held by SEB were not to be transferred for 3 years. The deal was worth around US$296 million.[656]

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[655] Shang Wu Bu Qi Dong Supor Bing Gou An Fan Long Duan Shen Cha Cheng Xu [The MOFCOM initiated the Anti-monopoly Review Procedure on the Acquisition of Supor "商务部启动苏泊尔并购案反垄断审查程序"], available at http://finance.sina.com.cn/chanjing/b/20061024/07463012759.shtml, last visited on 2.3.2008.

[656] CHEN, Yingming [陈瑛明], Wai Guo Zhan Lue Tou Zi Bing Gou Zhong Guo Shang Shi Gong Si De Fa Lü Wen Ti [Legal Problems on the Acquisition of the

After the takeover was made known to the public, concerns on competition rose among competitors and several related industrial associations. It was feared that "*the acquisition may create a monopoly in the market and bankrupt most of the country's cookware manufacture*".[657] The MOFCOM initiated the review procedure and held a hearing with the participation of the concerned undertakings, related industrial associations as well as representatives of local governments on different levels.

On 4 November 2007, the MOFCOM issued the approval of the acquisition of Supor by SEB China. The consent decision was almost identical to the proposed transactions.[658]

Listed Companies in China by Foreign Investors by Means of Strategic Investment 《外国投资者战略投资并购中国上市公司的法律问题》], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, p. 69.

[657] Government urged to block Supor Sale, available at http://english.peopledaily.com.cn/200608/24/eng20060824_296334.html, last visited on 2.3.2008.

[658] The decree reads: "It is generally approved that Zhejiang Supor Co. Ltd. issued to the target client – French SEB International Co. Ltd. 40 million normal (A) shares at a price of 18 RMB per share; it is generally approved that Supor Group, SU Zengfu, Su Xianze sell respectively to French SEB International Co. Ltd. at a price of 18 RMB per share with 9.17, 4.24 and 0.43 per cent of its equities, amounting to 25,320,116 shares; it is generally approved that French SEB International Co. Ltd. acquire not less than 48,605,495 shares, no more than 66,452,084 shares by means of partial tender offer. After the strategic investment of French SEB International Co. Ltd. on Zhejing Supor Co. Ltd., French SEB International Co. Ltd. will hold 52.4 to 61 per cent of the equities and become the controlling shareholder. The A shares held by French SEB International Co. Ltd. shall not be transferred for 3 years. This decree is effective within 180 days of the date of issue.", MOFCOM, The general Approval on Zhejiang Supor Co. Ltd. introducing overseas strategic Investors, No. 649 (2007) MOFCOM, 11.4.2007, available in CHEN, Yingming [陈瑛明], Wai Guo Zhan Lue Tou Zi Bing Gou Zhong Guo Shang Shi Gong Si De Fa Lü Wen Ti [Legal Problems on the Acquisition of the Listed Companies in China by Foreign Investors by Means of Strategic Investment 《外国投资者战略投资并购中国上市公司的法律问题》], in SHI Jiansan [史建三] (ed.), Zhong Guo Bing Gou Fa Bao Gao [A Report on Chinese M&A Laws 《中国并购法报告》], Vol. 2007, 2007, pp. 70–71.

In this case, two issues were intensively discussed. The first one is the definition of the relevant market. However, neither definition for relevant market nor a formula for the calculation of market shares is stipulated in the Interim Provisions.[659]

For the competitors of SEB/Supor, the relevant product market involved shall be the market for pressure cookers. The relevant geographic market is defined as the different regional markets in cites. In accordance with this definition, SEB/Supor held a market share of 41.94 per cent based on the statistic released by the Chinese Center for Publication of Information on Enterprises in Industries.[660] SEB/Supor insisted on a broader relevant product market that covers the whole range of products in the cookware market, where pressure cookers make up only a segment of the market. It was argued that there is high substitutability of different cooking devices and the market entry is easy due to the low barriers for new entrants. By virtue of the need of demand, the availability of outlet channels as well as the supply model of products, no single cooking appliance may constitute a relevant product market. In respect to the relevant geographic market, SEB/Supor considered it to be the national market since there are no differences in relevant laws and regulations ruling the business conditions and technical specifications in different regions. Moreover, the sales circumstances are almost identical so that producers and distributors can set up production bases and sales networks everywhere. Consumers have the opportunity to choose the competing products.

Merely from the arguments presented above, both the definition of the competitors and that of the SEB/Supor seem to be problematic. The market for pressure cookers brought about by the competitors is too narrow since pressure cookers can be replaced by other cookers, for instance, the traditional pots without pressure techniques or electric cookers. However, the broad definition of SEB/Supor appears to neglect the simple fact that pressure cookers are not interchangeable with water cookers, though both of them fall under the category of cookware. Yet,

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[659] OECD, Zhong Guo Kua Guo Bing Gou Zheng Ce Bao Gao [Investment Policy Reviews CHINA《[illegible]], 2006, pp. 33–34.
[660] The data are based on the result of a survey on the sales of pressure cookers in 70 per cent of all department stores in 15 large and middle-sized cities throughout China.

there is no official statement by the MOFCOM available on this critical point. Therefore, it is unclear how the authority had made the evaluation. The finial decision shows us that the argument by SEB/Supor could have been accepted since the merger was approved just as notified. But as stated above, the broad definition by SEB/Supor is questionable.

Secondly, the acquisition gave rise to an intense debate over issues that have social dimensions, in particular the maintenance of national brand names and the matter of national economy security among the public.

The opponents held that there have been sufficient cases in sectors such as cosmetics and toothpaste, where national brand names disappeared after the completion of takeovers. Foreign investors had utilized the distribution network of the purchased firm just to sell products of their own brands to replace the Chinese brands. Thereby, the acquired Chinese enterprises were merely transformed into the production units for foreign products.[661] However, Supor assured that the Chinese brand name (Supor) wouldn't disappear from the market. On the contrary, the financial and technical support from SEB would assist the further development of Supor in the domestic market and open overseas markets.[662]

Regarding the economic securities, it was a concern that acquisitions as such would curb the growth of national companies. The price war incurred thereafter in the sector would drive domestic producers out of the market. It is also reported that the local government of Zhejiang Province has launched surveys on the tide of foreign enterprises' takeover of privately owned Chinese companies in Zhejiang. The aim of the project was to carry out an analysis on the

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[661] Bing Gou Shi Min Zu Pin Pai Xue Zang Hai Shi Zeng Qiang, Yi Kou Guo De "Zhan Zheng" [Acquisition of National Brand Names Means a Snow Freezing or a Power Gear, a "War" on a Cooker "并购是民族品牌雪藏还是增强一口锅的'战争'"], available at http://news.xinhuanet.com/fortune/2006-09/10/content_5072317.htm, last visited on 2.3.2008.

[662] Supor Jing Bao: Wai Zi Bing Gou Chu Ji Fan Long Duan Jie Xian [Supor Warning: the Takeover by Foreign Investors challenges Anti-monopoly limits "苏泊尔警报：外资并购触及反垄断界限", available at http://finance.sina.com.cn/chanjing/b/20060903/16362880303.shtml, last visited on 2.3.2008.

scope of such acquisitions and their potential negative effects on the competitive process in the related sectors as well as the influence on brand names of the privately owned companies. This "danger" was viewed by supporters of the merger as "*a narrow-minded nationalism in the economic sense*". "*Even the issue of 'a cooker' would have affected national securities; there will be then no way for China to proceed with the reform and opening policy*".[663]

5. Abuse of administrative power

A special characteristic of the Chinese anti-monopoly practice is that it also condemns administrative measures having anti-competitive effects. This is not covered by many antitrust jurisdictions such as the US antitrust law. Article 7 of the LUC prohibits governmental bodies from restricting others to purchase products from appointed undertakings impeding the business activities of other undertakings. The application of this provision by the SAIC has proven to be difficult, as shown by statistics. There have been only 335 cases dealt with by the SAIC, while the number of cases concerning public enterprises and undertakings with legal monopoly status reaches 5,188.[664] The reason for this notable discrepancy is not necessarily that there was less misconduct taking place in this regard, rather it was because of the difficulty faced by the SAIC and its local offices to challenge governmental agencies in the Chinese political and social background.

The sanction on such abuses is also relatively moderate, as is shown in the following case. In 1998, the Housing Fund Management Center of City X (hereinafter referred to as "Center") in Jiangsu Province, adopted an interim measure that required the applicants for

[663] Supor Chu Rang Fa Guo SEB Zhe She Min Qi Di Er Dai Xuan Ze [Takeover of Supor by French SEB reflects the Choice of the Second Generation of Private-owned Enterprises "苏泊尔出让法国SEB折射民企第二代抉择", available at http://finance.sina.com.cn/g/20060906/08402888867.shtml, last visited on 2.3.2008.

[664] SAIC/CASS [国家工商行政管理总局公平交易局/中国社会院国家法学研究中心], Fan Long Duan Dian Xing An Li Ji Zhong Guo Fan Long Duan Zhi Fa Diao Cha [Selected Anti-monopoly Cases and the Investigation and Analysis of the Chinese Administrative Anti-monopoly Enforcement《反垄断典型案例及中国反垄断执法调查》], MAO Xiaofei (ed.), 2007, p. 207.

public housing loans to buy insurance from the local subsidiary of the People's Insurance Corporation when submitting applications. The insurance fee consists of property insurance, liability insurance and guarantee insurance. The local SAIC office in the city ascertained that the Center involved was a governmental body of the city that was authorized to manage public housing funds – an administrative responsibility of the government. The restriction it imposed on applicants had anti-competitive effects because it curbed other insurance companies from providing the same services. As a result, competition in the insurance market was distorted by this administrative measure. The local SAIC office informed the Municipality of City X about the issue. The latter asked the Center to annul the anti-competitive policy.

6. Conclusion

As we can see, the Chinese authorities have gathered some experience in previous anti-monopoly issues, which means that the enforcement of the AML doesn't have to start at zero. But on the other hand, the authorities have to struggle with the "old habits" of the past, where laws and regulations with somewhat different objectives and conceptions to those of the AML were applied. As shown in many cases handled by the SAIC, the definition of relevant market and the assessment of market power were hardly addressed in investigations. This old approach, which rested upon the LUC, shall be abandoned since "market power" constitutes the key element of abusing dominant market positions. As to merger review, the new substantial legal test is to replace the one applied in the current competition assessment. Presumably, there will be a transitional period for the Chinese authorities to adopt a new approach that is consistent with international standards.

The issue concerning the shared enforcement power by different administrative bodies, and thus the conflicts and inconsistency between them, is not clarified in the AML. As a compromise, a new authority, the Anti-monopoly Commission, has been created by lawmakers to coordinate individual enforcers in problematic cases. Whether or not this institutional arrangement will function as an effective instrument to solve those past problems is left to be evaluated in future anti-monopoly practice.

PART E:

Dealing with Specific Anti-competitive Practices

ESTIMATION OF ANTITRUST DAMAGES AND ITS EFFECTS ON ANTITRUST POLICY IN DEVELOPING COUNTRIES: A CASE STUDY OF A TURKISH YEAST CARTEL[665]

Alper Karakurt and Ussal Şahbaz[666]

1. Introduction

This study quantifies damages from an anti-competitive practice in the Turkish yeast market[667]. The overcharges and the deadweight loss for the whole market are computed using before-after methodology. The magnitude of fines is compared with the damages within an optimal deterrence perspective. Damages for households are also estimated in order to assess the effect of the infringement on household budgets. After reviewing the reasons why households are not responsive to damages resulting from competition infringement in the Turkish yeast market, the role of market assessment in solving this problem is emphasized.

To our knowledge, this study is the first attempt to quantify damages from an anti-competitive practice in Turkey. Section 2 deals with the optimal deterrence theorem. Section 3 outlines the competition legal framework in Turkey. Section 4 describes the yeast market and the anti-competitive conduct. Section 5 shows damage calculations for the whole market and for households. Sections 6 and 7 discuss the market

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[665] The authors are case officers at the Turkish Competition Authority (TCA). The views expressed herein are those of the authors and do not necessarily reflect the views of the TCA. The authors are grateful to Ebru Gökçe of UNCTAD, Gülin Yurdakul, Yaşar Tekdemir, Ümit Görgülü and Meltem Bağış Akkaya of the TCA.

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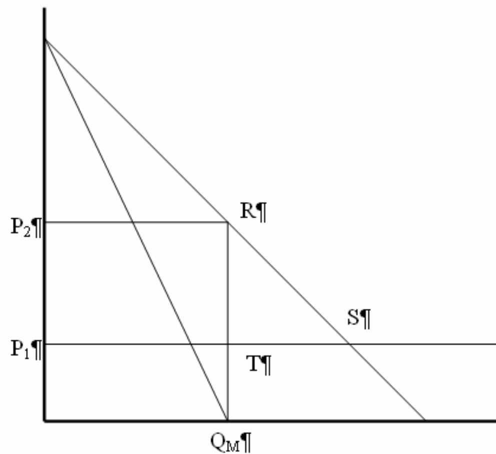
[667] The decision of the TCA has been criticized on various grounds. However in this chapter there is no attempt to take a position regarding whether or not an anti-competitive practice exists. Given the decision of the TCA, this study intends to quantify the damage caused by the practice in question.

assessment tool. Finally, Section 8 provides policy recommendations and the concluding remarks.

2. Optimal deterrence theory and importance of damages

The major goal of competition law enforcement is to increase social welfare by maximizing total surplus in a given industry, which is defined as the sum of producer and consumer surpluses[668,669]. Competition policy makers should take this major goal into account in assessing the magnitude of fines imposed by public bodies and courts in assessing the scale of damages. Hence, anti-competitive conduct should be deterred to the extent that deterrence maximizes social welfare. The optimal deterrence model (OD-model) provides a framework for assessment of the magnitude of fines and damages such that anti-competitive conduct, which results in social loss, is deterred.

Figure 1: Overcharge and deadweight loss



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[668] Massimo Motta. *Competition Policy*. Cambridge University Press (2004) See the same source for discussion of other objectives.

[669] It is difficult to asses whether a consumer welfare standard is preferred over a total welfare standard in application, or whether it should be preferred; however, this does not result in a major change in the consequences of the economic analysis that are discussed below.

The OD-model follows the seminal paper of Gary Becker[670], which proposes that a conduct should be deterred if and only if the social cost of conduct is higher than the gains from the conduct plus the enforcement cost. In parallel, the OD-model suggests that penalties for anti-competitive conduct should equal "*the net harm to persons other than the violator*"[671]. Any increase in prices due to a cartel or to monopoly pricing brings two types of cost to consumers: the overcharge and the deadweight loss. Assume that, in Figure 1, as a result of a cartel agreement, the price increases from P_1 to P_2. In this case, the area P_1TRP_2 represents the overcharge, which is transferred from the buyer to the cartel members or monopoly. On the other hand, the area RTS represents the deadweight loss. This cost occurs because some buyers discontinue buying the product at the cartel (monopoly) price. The deadweight loss is lost by consumers, and does not represent a gain to producers. It is a net social loss.

Although how much of the overcharge constitutes a social loss is controversial from a deterrence perspective, the penalty should be set equal to the sum of the overcharge and deadweight loss, which corresponds to the area P_1SRP_2 in Figure 1. A simple numerical example demonstrates this. Assume that the overcharge is US$10 and deadweight loss is US$5. The gain of the infringer from the anti-competitive conduct is US$10. If the penalty is set at the deadweight loss (US$5), the net gain of the infringer will be 10-5 = US$5; therefore the conduct will not be deterred. Obviously the magnitude of the penalty should be higher than US$10. The question is how much it should be.

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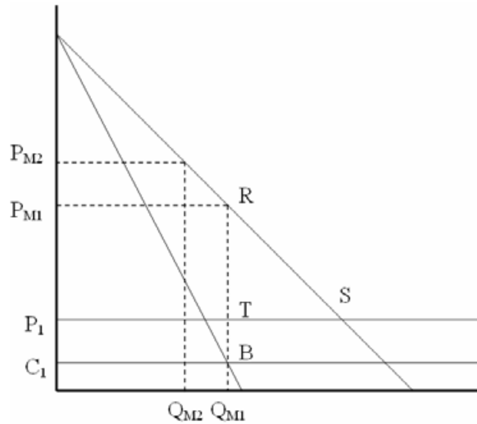
[670] Gary Becker. *Crime and Punishment: An Economic Approach*. 76 J. of Political Economy 169 (1968).

[671] William Landes. *Optimal Sanctions for Antitrust Violations*. 50 U. Chi. L. Rev. 652 (1983).

Figure 2: Overcharge, deadweight loss and efficiency



The answer to this question should take into account any efficiency that an anti-competitive conduct may create. Assume that the cartel lowers the marginal cost from P_1 to C_1 in Figure 2. Considering that under perfect competition marginal cost equals price at equilibrium, this change in price causes an efficiency represented by the area C_1BTP_1. Assume that the monetary value of this efficiency is US$4. Now the gain of the infringer is US$14 while the net social cost of the conduct is 5 (deadweight loss) – 4 = US$1. A penalty equal to the sum of the overcharge and deadweight loss will still deter this anti-competitive conduct. If the C_1BTP_1 area equals US$5.1, now the gain of the infringer (10 + 5.1 = US$15.1) will exceed the penalty and the conduct will not be deterred. Obviously, any conduct that creates net social cost will be deterred by a penalty comprising the overcharge and deadweight loss, and any conduct that does not create a net social cost will not be deterred by it. Therefore, this penalty formulation results in optimal deterrence.

The above discussion presumes that the detection and conviction probability for any anti-competitive conduct is one. Of course, this is not the fact for some anti-competitive practices, especially for cartels. Although it is hard to estimate this probability, various studies

estimate it as being lower than 20 per cent[672]. In this case, optimal penalty can be assessed using the following formula[673,674], which results in a higher magnitude than the sum of overcharge and deadweight loss:

$$\text{optimal penalty} = \frac{1}{\text{probability of conviction}} \times \text{net harm to the persons other than the violator} \quad (1)$$

The optimal penalty mentioned above is, in practice, the total of any fines that the infringer will face through public law enforcement and any damages it will be forced to pay through private litigation. Private damage actions constitute the major enforcement tool in the United States[675], but it is not well developed in Europe[676] and other jurisdictions.

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[672] Gary Becker. *Crime and Punishment: An Economic Approach*. 76 J. of Political Economy 169 (1968).
The detection possibility for cartels is estimated as 13-17 per cent for the US [P.G.Bryant and Eckard E. Woodrown. *Price Fixing: The Probability of Getting Caught*, 73(3) The Review of Economics and Statistics 531-536 (1991)] and 12.9-13.3% for the EU [Emmanuel Combe, Contance Monnier and Renauld Legal. *Cartels: The Probability of Getting Caught in the European Union*. Available:
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1015061 (2007)].

[673] Robert Cooter and Thomas Ulen. *Law and Economics*. Addison Wesley Longman (2000, 351). Mitchell Polinsky and Steven Shavell. *Punitive Damages: An Economic Analysis*. 111 Harvard Law Review 869 (1998).

[674] For an application to cartel cases, see John Connor. *Optimal Deterrence and Private International Cartels*. Department of Agricultural Economics. Purdue University (2005).

[675] In recent decades, private damage actions constitute more than 90% of antitrust suits filed in the United States [Herbest Hovenkamp *Federal Antitrust Policy: The Law of Competition and Its Practice*. Second Edition. West Group. 593 (1999)].

[676] See the recent Green Paper *Damages actions for breach of the EC antitrust rules*, published by the Commission of the European Communities, "*this area of the law in the 25 Member States presents a picture of total underdevelopment*" (p. 4).
http://ec.europa.eu/comm/competition/antitrust/actionsdamages/documents.html #greenpaper

3. Legal framework in Turkey

This section introduces the legal framework in Turkey that regulates anti-competitive agreements and concerted practices as well as fines and private damage actions for those practices. The *Act on the Protection of Competition*[677] (the Act) includes provisions on agreements, decisions and concerted practices, which prevent, restrict or distort competition; abuse of dominant position and anti-competitive mergers/acquisitions. The Act was enacted in 1994 and became operational in 1997 with the establishment of the Turkish Competition Authority (TCA).

The undertakings that engage in anti-competitive practices, upon investigation by the TCA, are fined up to 10 per cent of their annual turnover. When assessing the amount of the fine, factors such as existence of intent, the severity of fault, the market power of the undertaking or undertakings upon which a penalty is imposed, and the severity of potential damage should be taken into consideration[678]. However, no standard procedure exists to reflect those considerations into the magnitude of the fine.

Private damage actions are also possible against the undertakings that engage in anti-competitive practices[679]. In certain cases where fault is severe[680] treble damages can also be awarded. However, no damages in private actions have been awarded in the ten-year application of the Act.

4. Yeast case

In 2005, the TCA received a complaint claiming that the yeast producers operating in Turkey were engaged in concerted practices. The yeast market has an oligopolistic structure with four players. The

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[677] The *Act on the Protection of Competition* (Date: 7 December 1994, No: 4054). http://www.rekabet.gov.tr/word/ekanun.doc

[678] Article 16 of the Act.

[679] Article 57 of the Act.

[680] Article 58 of the Act. Although the wording of the Article is not clear, many scholars support the view that treble damages can be awarded only in cases where the fault of the infringer is severe.

customers are 15,000[681] bakeries in Turkey. Upon the complaint, an inquiry was initiated, and as a result of a dawn raid and other examinations, the TCA decided[682] that, between February 2003 and November 2003, the yeast producers raised their prices as a result of an anti-competitive concerted practice. The four yeast producers were fined by 1 per cent of their annual turnover. The fines for these undertakings are as follows (thousand YTLs):

Pakmaya	1,217
Özmaya	906
Maurimaya	134
Akmaya	455
TOTAL	2,712

Fresh baker's yeast is one of the main ingredients used in bread production (the others being flour, salt, and warm water). It has a relatively short life of two to three weeks. A vast majority of the fresh yeast is used by bakeries in producing bread. During the investigation, the relevant market has been determined as the "fresh baker's yeast market," which is from now on referred to as the "yeast market."

Since yeast is a highly homogenous product, bakers do not take brands into consideration when they select their yeast providers. Thus, many of the bakeries source their yeast requirements from different suppliers at the same time, shifting to another supplier without a problem. In such a market structure where brand dependence is at a negligible level, price is the only means for competition.

The reason to elaborate on this case is that yeast prices are directly related to the price of bread, which is a staple food for low-income people. The bread market does not have a competitive structure – bakeries usually form cartels[683] and fix bread price at the

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[681] Source: Bakeries Federation of Turkey

[682] Decision Date: 23.9.2005, No: 05-60/896-241

[683] There had been four investigations that penalized bakery cartels [İstanbul Ekmek (Date: 04.08.1999, No: /99-37/376-241), Kütahya Ekmek (Date: 17.08.2004, Number: 04-54/750-187), Ankara Ekmek (Date 18.01.2005, No: 05-06/52-21), Gaziantep Ekmek (Date: 07.01.2005, Number: 05-02/18-9)]

recommended level, which is announced by the local chambers[684] and is usually calculated on a cost basis. Therefore it is fair to assume that any increase in yeast prices will in turn be reflected in bread prices. With this assumption, in addition to computing the amount overcharged in the next section, the financial burden on bread consumers resulting from the anti-competitive practice in the yeast market will be demonstrated.

Another reason for the selection of the yeast case is that it is one of the rare cases that data necessary for damage calculation have been collected during the investigation. It should be emphasized that these data have been collected not for damage calculation, but for the analysis of oligopolistic interdependence. As damage calculation is not a standard part of fining procedure in Turkey, after the investigation is over, it is hard to find related data for many anti-competitive practices.

5. Damage estimation

This section is the empirical part of the study where damages in the yeast case are estimated. Although estimation of damages is a hot topic in EU competition policy circles, damage estimation techniques have mostly developed within the US private litigation system. In this section, first, the US legal standards in damage estimation, which are widely shared by different jurisdictions, are reviewed. Then the damages in the yeast case are estimated.

In the US private litigation system, the plaintiff proves the existence and amount of antitrust damages. Once the existence of damages is proved, the determination of the amount of damages requires a less rigid standard of proof. The Supreme Court reasoned that for a calculation of damages, it is sufficient to show "*the extent of the damages as a matter of just and reasonable inference, although the results be only approximate*"[685]. This relaxed standard of proof, however, does not allow for damage estimates that are based on "*speculation or guesswork*". In damage calculations, "*there must be a reasonable basis for assumptions employed in the […] model*"[686].

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[684] Article 62 of the Act Numbered 5362 and Article 12 of the Act Numbered 5174.
[685] *Story Parchement Co. v. Paterson Parchment Paper Co.,* 282 U.S. 555, 563 (1931).
[686] *Hobart Brothers Co. v. Malcolm t. Gilliland, Inc.*, 471 F.2d 894, 903 (1973).

The Supreme Court's relaxation of standard of proof stems from its position that "*the vagaries of marketplace usually deny us sure knowledge of what the […] situation would have been in the absence of […] antitrust violation*"[687]. Moreover, it is recognized that "*if there is uncertainty, the defendant should bear the burden of uncertainty because his unlawful actions created it*"[688].

The overcharge is the difference between the cartel price and the price that would occur but for the violation. Therefore, measurement of overcharge requires estimation of the price had the violation not occurred. There are two major established methodologies for this estimation: The before-after method compares the period before violation with the period during violation. The yardstick method compares a similar business in a similar market (often a nearby geographical market) in which a violation did not take place with the business and market affected by the violation[689]. As the infringement in the yeast case affected the whole national market, there exists no similar market that can be a benchmark. Therefore, the before-after method is used.

Yeast producers, during the investigation, reported their monthly average price and quantity data, along with the average monthly cost data for four major variable costs (molasses, chemicals, electricity and packaging) for the period of June 2002–November 2003 (18 observations per each of four firms). The price figures are plotted in Figure 3. First a regression model is estimated with the price as the dependent variable for the period before the violation (June 2002–Feb 2003). Then, using this model, but-for prices are predicted for the period after violation has started (Mar 2003 – Nov. 2003).

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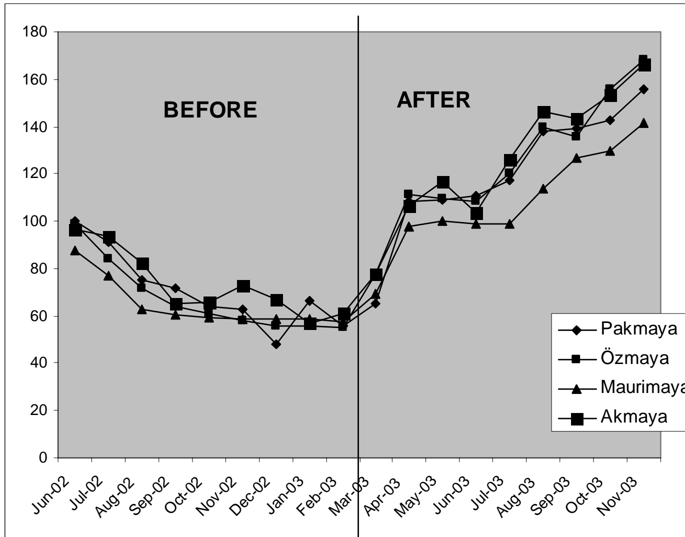
[687] *J. Truett Payne Co., Inc. v. Chrysler Motors Corp.*, 451 U.S. 557, 566 (5th Cir. 1981).
[688] *Malcolm v. Marathon Oil Co.,* 642 F.2d 845, 864 (5th Cir. 1981).
[689] For a detailed explanation about these methodologies and their applications in the US, see William Page. *Proving Antitrust Damages: Legal and Economic Issues*. American Bar Association (1996).

Figure 3: Yeast prices (YTL/kg, Pakmaya June 2002 = 100)



Ideally cost items and demand for yeast might be used as independent variables to predict the prices. However quantity demanded is simultaneously determined with the price and using quantity in our regression will result in biased estimates. On the other hand, the reaction speed for fermentation is proportional to the temperature, hence in hot weather demand for yeast falls. Consequently quantity demanded and temperature are highly correlated (-0.77), while correlation between temperature and price is low. As a result, temperature is used as an instrument for quantity demanded. The monthly average temperature data are retrieved from the Turkish State Meteorological Service. All variables are in logarithms (Cm: Cost of molasses, Cc: Cost of chemicals, Ce: Cost of electricity, Cp: Cost of packaging, TEMP: temperature in degrees Celsius). The following model is estimated:

$$P_{ti} = \beta_0 + \beta_1 Cm_{ti} + \beta_2 Cc_{ti} + \beta_3 Ce_{ti} + \beta_4 Cp_{ti} + \beta_5 TEMP_{ti} \qquad (2)$$

The methodologies developed to estimate damages are only useful for estimating the overcharge. However, there exists no standard methodology for estimation of the deadweight loss as it is not recoverable[690]. Its estimation requires knowledge about actual and but-for prices and quantities along with the shape of the demand curve between R and S (in Figure 1). Various methodologies have been developed for an accurate estimation of deadweight loss[691], but they have extensive data requirements. Leslie proposes that[692] for damage calculation purposes, in line with the "just and reasonable inference" standard, it may be reasonable to presume that the demand curve is linear from R to S in Figure 2. If demand and supply curves are perfectly linear, the monopoly overcharge is equal to twice the deadweight loss[693]. If the demand curve is concave, which is the case in many markets, then damages will be greater. While estimating deadweight loss, it is assumed that the demand curve is linear. Hence the estimates in this study constitute a lower threshold.

Table 1: Regression results to predict but-for prices

	Coefficient	St. error	p-value	95% confidence interval	
Cost of molasses (Cm)	0.209	0.287	0.467	-0.354	0.771
Cost of chemicals (Cc)	0.160	0.157	0.308	-0.148	0.468
Cost of electricity (Ce)	0.228	0.248	0.358	-0.258	0.713
Cost of packaging (Cp)	0.367	0.610	0.547	-0.828	1.563
Temperatures (TEMP)	0.186	0.056	0.001	0.076	0.295

N = 32.
R^2 = 0.58.

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690 *Id.* at 195.

691 Jerry A. Hausman, *Exact Consumer's Surplus and Deadweight Loss*, 71 American Economic Review 662 (1981); Vincent Requilart and Michel Simioni, *Welfare Losses Due to Market Power: Hicksian Versus Marhallian Measurement*, 83 American Journal of Agricultural Economics 157 (2001).

692 Christopher R. Leslie. *Antitrust Damages and Deadweight Loss*. 51 The Antitrust Bulletin. 521-568 (2006).

693 Hovenkamp, *supra* note 11, at 653.

The results of the panel data regression to predict but-for prices are shown in Table 1. But-for prices in the violation period are predicted using these estimates. The price predictions are shown in Appendix 1. 95 per cent confidence intervals for price predictions are also calculated.

Table 2: Overcharge estimates (thousand YTLs)

	Unadjusted to inflation			Adjusted to inflation		
	(1) High	(2) Average	(3) Low	(1) High	(2) Average	(3) Low
Pakmaya	20,769	17,190	12,670	24,152	19,987	14,724
Özmaya	19,407	15,899	11,393	22,574	18,498	13,262
Maurimaya	8,883	6,757	4,009	10,330	7,858	4,666
Akmaya	9,749	7,885	5,264	11,326	9,164	6,126
TOTAL	58,809	47,732	33,337	68,382	55,506	38,778
Deadweight	29,405	23,866	16,669	34,191	27,753	19,389
Optimal penalty	88,214	71,598	50,006	102,573	83,259	58,167

These predictions yield three scenarios for but-for prices: (1) high but-for price, (2) average but-for price, and (3) low but-for price. Overcharges are calculated by subtracting but-for prices from actual prices and multiplying them by the quantity purchased. Summing over 9 months of the violation period, three total overcharges are calculated for each scenario: (1) low overcharge, (2) average overcharge, (3) high overcharge. Deadweight losses are also calculated as half of the overcharge. These estimates are demonstrated in Table 2.

The following calculation shows the overcharge per kilogram of bread using the overcharge magnitudes in the average scenario: As mentioned above, yeast is one of the ingredients of bread. When producing bread, 100 kg of flour are mixed with an average 3.5 kg of yeast; 100 kg of flour are mixed with 58 kg of water to produce 122 kg of bread[694]. Hence it is necessary to use 3.5/122 = 0.0286 kg of yeast to produce one kilogram of bread. The total quantity of yeast sold during the conduct is 86,342 kilograms; and using the total overcharge in scenario 2 in Table 2, an average overcharge of 0.552 YTL/kg is calculated (47,732/86,342 = 0.552). Keeping our presumption that the

[694] Source: Bakeries Federation of Turkey.

overcharge is fully passed on to bread prices, average overcharge of bread is 0.0158 YTLs (0.0286 x 0.552 = 0.0158). The average price of bread during the conduct was 1.2 YTL. Therefore the price of bread increased by around 1.3 per cent due to the conduct (0.0158 / 1.2 = $\approx$0.013).

It is also possible to calculate the share of this overcharge in the household budget. Estimates for allocation of a poor household budget relying on minimum wage[695] suggest that 30 per cent of household consumption is allocated for bread consumption. Although this estimate seems to be high, even in this case, the effect of the anti-competitive conduct on a poor family's consumption will be 0.30 x 0.013= $\approx$0.4 per cent.

The damages and fines issued to undertakings are compared in Table 3. Even in the low-damage scenario, which is shown in Table 3, the fines that undertakings face are far less from the overcharges. The estimate for total overcharge is 12 times higher than the fines imposed. The optimal penalty estimate, which also includes the deadweight loss, is more than 18 times higher than the fines. It should be noted that, if we also take the fact that the probability of conviction is less than one, the optimal penalty would be much higher (Equation 1 in Section 2). Apparently, the fines are not high enough to be a deterrent of anti-competitive behaviour.

Table 3: Comparison of unadjusted damages in low scenario with fines (thousand YTLs)

	Damages	Fine
Pakmaya	12,670	1,217
Özmaya	11,393	906
Maurimaya	4,009	134
Akmaya	5,264	455
TOTAL	33,337	2,712
Optimal penalty	*50,006*	

[695] Minimum wage was around US$160 per month at the time of the infringement.

For fines to be a deterrent, the magnitude of fines should be linked to damages. Although the Act mentions the severity of potential damage as a factor in assessing the magnitude of fines, this is not standard procedure in practice in Turkey. Nevertheless, even if the legal maximum fine of 10 per cent of turnover is imposed, the total fine would be 27,120 YTL, still lower than the damages. Therefore, to attain optimal deterrence, the administrative fines should be accompanied by other measures against infringers.

Private damage actions can be another factor in increasing the liability that infringers would face. The legal framework includes such actions in Turkey, as stated above, but no damages have been awarded up to now. Various factors in the European legal framework hinder private damage actions[696], but another factor is lack of capacity in damage calculation[697]. It should be noted that the low magnitude of damages relative to the price of the product (1.3 per cent per kilogram of bread) or relative to the household consumption budget (0.4 per cent in the worst case for the poorest family) is another factor that constitutes a disincentive for private damage actions. Allowing for class action suits[698] will be a good way for initiation of more private damage actions against anti-competitive practices that harm consumers. Private damage actions, in this way, will also bring competition law/policy closer to the consumers.

As seen from the above calculations, in contrast to the high amount of the overall damage caused, the infringement results in a relatively low value of damage per consumer. More interestingly, the anti-competitive behaviour took place in the yeast market, where the

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[696] See Green Paper, *supra* note 12.

[697] Damage calculation capacity, development of which is among the purposes of this study, is not adequately present in the competition enforcement agencies as well.

[698] A class action is a procedural device used in litigation to determine the rights of and remedies for large numbers of people whose cases involve common questions of fact by aggregating a large number of individualized claims into one representational lawsuit. In antitrust damage class actions, injured parties from an infringement seek for damages as a class. Class actions avoid "*the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights*", *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997).

buyers are bakeries, whereas the damages were borne by bread consumers. Hence, the market where the violation occurred is different to the market where the damages appeared. Because of these two facts, households did not respond to the competition infringement in the yeast market. It is obvious that competition authorities operating in developing countries need an instrument to make the micro-damages resulting from infringements visible to a large number of consumers. “Market assessment,” which is a component of competition advocacy, is one of the instruments that can be employed in generating awareness and responsiveness among consumers to competition restrictions caused by undertakings.

6. Market assessment

Competition advocacy is different from competition law enforcement. Competition advocacy deals with policy measures to create a competitive business environment and promote a competition culture in society. Competition advocacy may be achieved through active participation of stakeholders in the preparation of regulatory proposals, public consultations, and reports on the state of competition in the economy. The review of the literature on competition advocacy indicates that there is an emphasis on encouraging active participation in the preparation of regulations and public consultations. However, market assessment has been ignored or, at least, has not been given due attention.

Market assessment[699], seeking to analyse the market structure from a competition perspective, serves in determining the current competition level in the market, uncovers the results of limited competition, and demonstrates the ways that possibly enhance competition. Furthermore, market assessment drives the attention towards competition and strengthens it by giving local market examples. It is very important for an antitrust authority to raise awareness among stakeholders on gains resulting from competition. As such assessment seeks to define the causes and consequences of competition restrictions, the natural outcome would be that the affected parties become more sensitive to competition restrictions and tend to take action against them. In this way, it may be possible to establish a local mass that reacts to competition infringements and supports antitrust authority.

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[699] **Market assessment** is different from **competition assessment**. The aim of competition assessment is to focus on public policies that distort or prevent competition in the market.
It appears that, so far, a very limited number of general and comprehensive templates have been publicized to guide competition assessments. The 2007 report of the Organisation for Economic Co-operation and Development (OECD) entitled *Institutional Options for Competition Assessment* sheds light on competition assessment, based on government regulations, rules and/or laws that hinder competition in the market. Recently, the Office of Fair Trading (OFT) (2007) published an outstanding template, entitled *Completing Competition Assessments in Impact Assessments*, for policy makers to help them assess whether or not the proposed policy is likely to have a significant impact on competition. In contrast to the OECD's report, the OFT focuses on the scope and structure of the relevant market to some extent. But mainly, the OFT struggles to identify the impact of existing legislation on competition as well. In the light of these studies, it can be claimed that competition assessment is directly related to rules and regulations that have the potential to restrict competition in the market.
It is also apparent that both documents mentioned above have a narrow approach, which considers competition assessment as a tool that enables antitrust authorities only to evaluate other public policy instruments that deter or impede competition. On the contrary, market assessment examines the full range of restrictive factors regardless of their sources. Both public-policy-originated and market-oriented restrictions fall under the scope of market assessment. Therefore, market assessment has a broader scope than competition assessment.

In this context, two points are noteworthy. First of all, it should be recognized that the creation of public opinion about the importance of competition is not an easy task. Therefore, any action or instrument contributing to this process merits attention. It should be kept in mind that if a competition authority fails to create strong public opinion that supports its work, undertakings subject to competition cases or firms whose interests are adversely affected by competition advocacy will divert public opinion on competition.

Furthermore, market assessment generates a spillover effect on future enforcement activities by providing essential information for case work, as competition assessment extracts the sector-specific information embedded in the market. This practical information is essential for case-law applications. Thus, market assessment allows an agency not only to evaluate competition restrictions in effect but also to estimate potential anti-competitive behaviour. In this way, market assessment sends signals to an agency keeping it informed about possible strategies of firms in the future.

Market assessment provides another benefit for developing countries by revealing the full range of effects of competition as well as factors that determine the competition level in the market. These are helpful indicators for policy makers, which can be exploited in a decision-making process. The study by McMillan *et al.*[700] indicates the importance of market assessment implicit in the policy-making process. The said authors worked on the distributional and efficiency consequences of the reform in Mozambique's cashew sector. This sector was liberalized in the early 1990s through the removal of quotas and a decrease in export tax. The aim of liberalization was to create a double benefit: an efficiency gain arising from the reversal of adverse resource allocation and a distributional gain arising from the rise in farm-gate prices for the poorest households in Mozambique. The study concludes that the multilayered marketing chain and the monopsony position of India resulted in low benefits to cashew farmers. In other words, the market structure in this specific case together with liberalization efforts caused frustration among the farmers.

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[700] Margaret S. McMillan, Dani Rodrik and Karen Horn Welch. When Economic Reform Goes Wrong: Cashews in Mozambique. NBER Working Paper No. W9117 (2002).

This example demonstrates that market assessment may produce meaningful indicators that should be taken into consideration by the decision makers in designing an appropriate policy for a given sector. In many cases, it is observed that the outcomes of public policies have been influenced by the competition landscape of the given market. Public policies established without taking the market structure into consideration may bring about undesired outcomes[701].

Another important issue to look at is the necessity of market assessment to demonstrate the damage borne by consumers even if this damage (or the efficiency loss) is very small.

Market assessment helps to determine the competition level in the market and to demonstrate the ways that possibly enhance competition. It can be said that the final aim of assessment is to increase efficiency gains by providing useful information that can be used to support competition. At that point one can say that any market assessment contributes little to overall efficiency gains. The calculation below gives insight into the importance of boosting competition with the help of market assessment for economic growth in the long run. The study done by Sala-i-Martin and Barro is an example to illustrate the consequences of small differentials in growth rates when accumulated over long periods of time[702]. In this study, the authors calculated what the GDP of the United States would be in 2000 if it had grown at 0.8 per cent per year since 1870, which is one percentage point per year below its actual rate[703]. If the United States had begun at a real *per capita* GDP of US$3,340 in 1870 and had then grown at 0.8 per cent per year over the next 130 years, its *per capita* GDP in 2000 would have been $9,450, only 2.8 times the value in 1870 and 28 per cent of the actual

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[701] Market assessment may generate another benefit. As long as any antitrust authority has a strong position in terms of institutional capacity, advocacy conditions evolve in favour of an antitrust authority. Market assessment displays talents and in-depth knowledge of the authority about markets. Comprehensive assessment carried out by an antitrust authority is an indicator of mastery of the market and so gives credibility to the antitrust authority from an institutional perspective.

[702] R.J. Barro and Xavier Sala-i Martin. *Economic Growth*. Cambridge: MIT Press (2004).

[703] The real *per capita* gross domestic product in the United States grew by a factor of 10 from US$3,340 in 1870 to US$33,330 in 2000. This increase corresponds to a growth rate of 1.8 per cent per year.

value of US$33,330 in 2000. Then, instead of ranking second in the world in 2000, the United States would have ranked 45th out of 150 countries. To put it another way, if the growth rate had been lower by just 1 percentage point per year, the US *per capita* GDP in 2000 would have been close to that in Mexico and Poland.

The authors demonstrate the impact of small differentials in growth rate on the overall economic growth over a long period of time. The study does not elaborate on the effect of efficiency gains due to competition on economic growth. Nevertheless, this example helps us to understand how a complete set of competition assessments may play a vital role in increasing efficiency and thereby supporting economic growth in the long run.

7. Elements of market assessment

This section examines the components of “market assessment” in order to clarify the concept itself. Market assessment requires three filters: market structure and conditions, public policies, and firm behaviour/strategies. Market outcome is defined by the interaction of these three elements. In this part of the study, these components, except public policies, will be analysed in order to illustrate how they determine the competition landscape in any market.

In the first part of market assessment, the market structure is examined. The concept of relevant market is a crucial step in analysing the market structure. Actually, a well-defined relevant market helps in understanding market structure questions in general and the following issues related to the market power in particular. The relevant market establishes the scope of competition assessment. Other connected markets such as upstream and downstream markets or aftermarkets may also be taken into account, as the competitive process in the relevant market is shaped by conditions pertaining to other markets. Alternatively, the conditions under which the relevant market operates can be deeply manipulated by another market. In some instances, defining the relevant market and analysing connected markets - upstream and downstream markets or aftermarkets - may still not be sufficient to fully evaluate competitive conditions. Technology and

innovation markets[704] also have special positions in marking out the competitive environment.

Some sectors, even if not directly related to the relevant market, have a potential to considerably affect competition in the relevant market. As for the financial infrastructure, Stiglitz[705] claims that the United States has clearly been worried about the possible deleterious effects of banking practices that limit competition among firms. Banks can serve, and have served, the function of limiting competition in product markets, as they are in an ideal position for coordinating decision making. The rationale behind this fear is that the more likely fierce competition is, the higher the number of inefficient firms within the market that will go bankrupt, increasing the possibility that some loans may not be reimbursed. This obviously illustrates the possible side effects of financial markets for all markets.

The aforementioned explanations reveal the fact that it is essential to adopt a holistic approach while making a market assessment. It is not sufficient to focus only on the relevant market without examining other markets, including aftermarkets, upstream and downstream markets, technology and innovation markets, which in some way affect the functioning of the relevant market.

After defining the markets that should be covered by market assessment, the next step is to analyse market factors to understand the competitive structure. There exist many factors that influence the competitive environment in a given market. If these factors can be categorized, a user-friendly analysis with in-depth information can be made. These factors are separated into three categories: market-based, product-based and firm-based factors.

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[704] The relevant technology market includes technologies that are regarded by licensees as interchangeable with or substitutable for the licensed technology, by reason of technologies, characteristics, their royalties and their intended use (Commission Regulation (EC) No 772/2004 of 24 April 2004 on the application of Article 81(3) of the Treaty to the categories of technology transfer agreements). An innovation market consists of research and development directed at particular new or improved goods or processes, and the close substitutes for that research and development (Department of Justice and Federal Trade Commission, 1995 *Antitrust Guidelines for the Licensing of Intellectual Property*).

[705] J.E. Stiglitz. *Whither Socialism*. Cambridge: MIT Press (1996:222).

There are a number of **firm-based factors** that should be borne in mind in making market assessment. One of them, relying on the structure of firms and connections between undertakings, has an importance in the process that aims to uncover the competitive structure of the market. For instance, if the number of competitors becomes relatively small and their market position (size, costs, R&D potential, etc.) is rather similar, this market structure may increase the risk of collusion. On the other hand, if firms have any connection such as a joint venture in any part of the market, the likelihood of getting a competitive market structure becomes less. The study done by UNCTAD, in this context, is a great example unveiling the importance of connections among market players[706]. UNCTAD believes that the global water market has been controlled by three big groups and these actors can be dominant alone or collectively in a bidding process after a reform process. Joint ventures established by these three global actors lead to a lower number of potential bidders. According to UNCTAD, failures of water privatizations have been resulting from this specific trait of the water provision market.

Another firm-based factor is the concentration level. It is one of the most informative indicators that should be utilized when examining the market structure. While highly concentrated markets do not necessarily imply a shortage of competition in the market, it is generally agreed that market concentration is one of the most important determinants of competitiveness. For example in the banking sector, the relationship between market concentration and competitiveness has been examined in detail for many countries, and the results indicated that high concentration tends to reduce competitiveness in this sector[707]. Although most of the empirical works in the literature are built on data from developed economies, some other studies related to the banking sector arrive at the same conclusion for developing economies.

In many cases, concentration ratio is not a sufficient explanatory component of market outcomes. Khawaja and Musleh-ud Din[708] studied the determinants of interest spread in Pakistan. Given the specific

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[706] UNCTAD. FDI and Development: The Case of Privatization-Related Services FDI: Trends, Impact and Policy Issues. United Nations Trade and Development Board. TD/B/COM.2/EM.14/2 (2003).

[707] Richard J. Gilbert. “Patents, Sleeping Patents and Entry Deterrence”, in Strategy, Predation and Antitrust Analysis (1984:223-255).

[708] I. Khawaja and Musleh-ud Din, Determinants of Interest Spread in Pakistan, PIDE Working Papers 22 (2007).

characteristics of the banking sector in Pakistan, such as the lack of financial intermediaries, it was concluded that the inelasticity of deposit supply to banks works as a determinant of interest spread. Another important finding is that concentration does not have a positive and significant impact on interest spread.

Another firm-based factor consists of barriers to entry. Today, some business strategies have become critical in market entry decisions. For instance, in "patent fences" strategy, an initial innovator may seek to build a "fence" around its position by securing additional patents on near substitutes, thereby blocking follow-on innovators from designing around the initial patent or raising their R&D costs. Under a pure "fence" strategy, the patentee would have no intention either to license the substitute patent technologies or to develop them on its own. The only goal would be to keep rivals out. A related strategy, which might be designated as "patent extensions", involves efforts to extend patent protection beyond the life of an initial patent by accumulating patents on improvements[709]. Another strategy - "patent flooding" - that covers efforts to build a sufficient patent portfolio to induce others to share their technology through cross-licences may shade into more aggressive strategies. When rivals obtain patents on trivial variants of an initial innovation, "patent flooding" becomes possible. Under this strategy, *"[t]he flooder 'surrounds' a competitor's patent or technology . . . so that over time, the competitor finds itself 'unable to maneuver.'"*[710].

An example for **market-based factors** is transparency that may allow undertakings to restrict competition in the market to some extent. In the Turkish yeast case, there is a close relationship between yeast producers and bakeries. The fact that fresh yeast loses its effectiveness shortly after production requires yeast firms to deliver the product on a frequent but short-term delivery basis. During very large number of deliveries, yeast producers have contacts with bakeries and discover rivals' sales conditions, which results in a very transparent market structure. Besides, due to the homogeneity of fresh yeast, product differentiation is not an effective strategy to compete in this market. Hence, yeast producers have difficulty in maintaining long-term

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[709] Federal Trade Commission. *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*. England. (2003:35).
[710] Sri Krishna Sankaran. *Patent Flooding in the United States and Japan*. 40 IDEA 393 (2000).

relationships with bakeries. Under these market conditions, each yeast producer has the potential to easily control the price offered by its rivals.

Another market-specific condition appears in the water sector. A widespread metering network in the water sector is an essential element for competition[711]. Helm and Jenkinson[712] found that the failure to meter the consumption level of water by consumers who have low demand blocks the competitive process in the lower segment of the market in England.

As to **product-based factors**, it should be pointed out that the nature of the product plays a critical role in assessing the competition level in the market. It is important whether products on the market are more homogeneous or heterogeneous, whether the product is cheap, taking up a small part of the consumer's budget, or is expensive and whether the purchasing process of the product is repeatedly ongoing or not. Examining the cement industry in general, we see that although a huge fraction of cement consumption is attributable to the building industry, costs for cement amount to about 1 per cent of the overall building cost. Since any movement in cement price will slightly affect demand, demand for cement can be seen as highly inelastic.

The strength of barriers to entry depends on the nature of the product. In some cases, the homogeneity of the product leads to the elimination of certain entry barriers. This is the case for the yeast market. As mentioned above, bakers, being industrial users, do not take brands into consideration in selecting their yeast provider. In such a market form, where brand dependence is at a negligible level, entry barriers such as product differentiation and advertisements would not bring about the expected impact on yeast sales. Therefore, price is the only tool to be competitive in the yeast market.

In fact, all of these (market, product and firm-based factors) contribute to the process of shaping the competition landscape. Therefore, without taking these factors into account, it is not possible to

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[711] OECD. Competition and Regulation in the Water Sector. Paris: Working Party No. 2 on Competition and Regulation. DAFFE/COMP/WP2/WD(2004)1.

[712] D. Helm and T. Jenkinson. The Assessment: Introducing Competition into Regulatory Industries, Oxford Review of Economic Policy 13. (1997:1-14).

make a comprehensive market assessment that provides the decision makers with useful and critical information about the market structure.

8. Concluding remarks

The estimations on the magnitude of the damage caused by the anti-competitive conduct in the Turkish yeast case show that the fines issued to the undertakings are much lower than the amount necessary to deter the anti-competitive conduct. Even though the magnitude of the fine issued was the maximum provided by the Act, it would still not suffice. In order to increase deterrence and ensure that consumers benefit from competition law enforcement it is essential to encourage private damages actions. However, the relatively low amount of individual damages does not provide sufficient incentives for consumers to file suits.

Market assessment is another useful instrument for raising awareness among consumers. Market assessment, seeking to analyse the market structure from a competition perspective, serves in determining the current competition level in the market, uncovers results of limited competition, and demonstrates the ways that possibly enhance competition. One of the reasons for insufficient support is the ignorance of consumers with regard to the damage of competition infringements imposed upon them. This ignorance stems from the relatively low value of harm per consumer and the fact that consumers are generally not proximate to the markets where infringements occur. Undertaking market assessments by competition enforcement agencies may help them overcome this problem. As a matter of fact, by seeking to define the causes and consequences of competition restrictions, market assessment allows competition agencies to encourage the affected parties to be more responsive to anti-competitive practices and to raise awareness about the damages caused by competition infringement.

Appendix 1. Price prediction for infringement period

Figure A1. Predicted prices for Pakmaya (price Feb 2007 = 100)

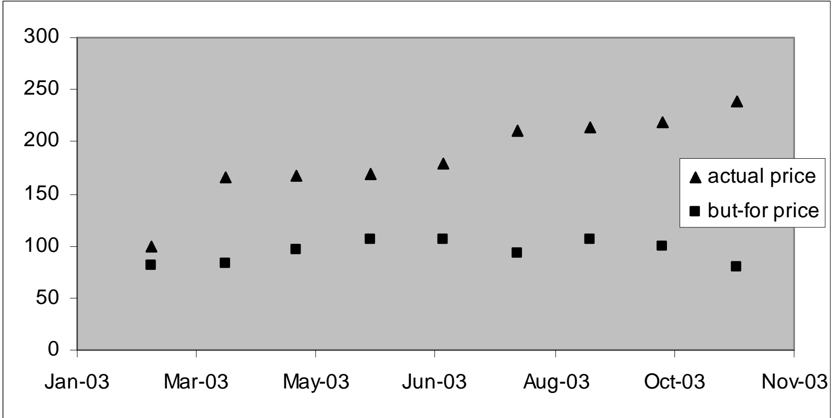


Figure A2. Predicted prices for Özmaya (price Feb 2007 = 100)

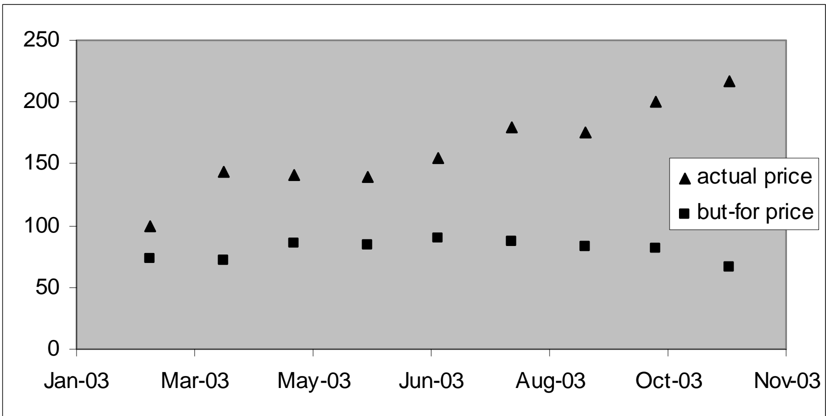


Figure A3. Predicted prices for Maurimaya (price Feb 2007 = 100)

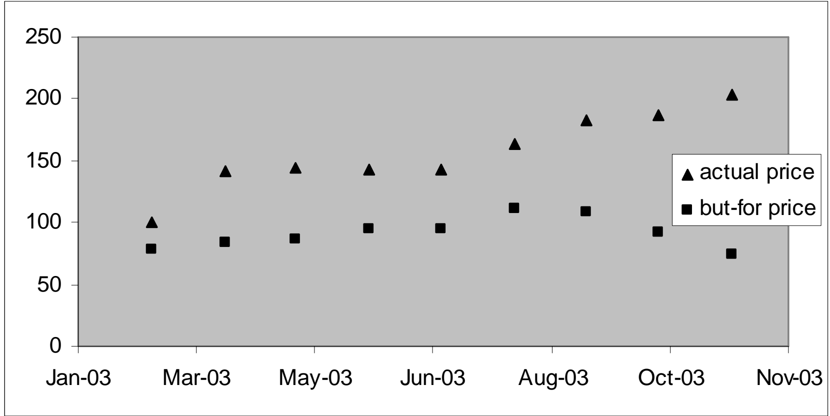
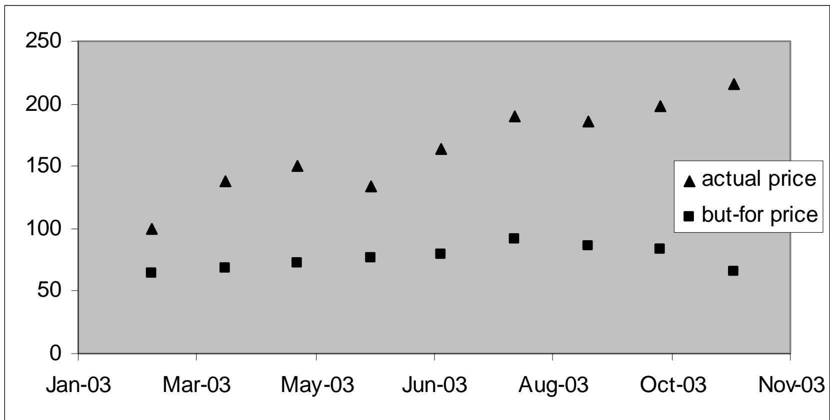


Figure A4. Predicted prices for Akmaya (price Feb 2007 = 100)



ABUSE OF DOMINANCE AND ITS EFFECTS ON ECONOMIC DEVELOPMENT

Michael Adam and Simon Alder

Abstract

Rules on abuse of dominance are used to find a balance between three objectives: 1) ensuring enough competition between firms in order to force them to be efficient and to compete on merit, 2) allowing a certain degree of profitability so that companies have incentives to become more efficient, and 3) achieving an equal distribution of wealth and business opportunities among different sectors of society. While the discussion in developed countries focuses on the first two aspects in order to maximize innovation and growth, developing countries may also want to consider the third dimension and include the reduction of inequality and poverty as objectives of abuse of dominance laws. But even the relationship between the first two aspects tends to vary among regions, because investment depends on factors that differ between developing and developed countries. These factors sometimes contradict each other and it is crucial to find a sound balance between them. Firstly, since developing economies often have smaller markets and, therefore, a lower equilibrium number of firms that can exploit economies of scale and operate efficiently, markets in developing countries are more likely to be concentrated. Furthermore, entry barriers tend to be higher and capital markets are often less developed, which causes obstacles for firms trying to compete with a dominant company. Secondly, large firms play a different role regarding their investment activity in developing countries than they do in more developed economies. Established firms can be important for less developed economies to have a sufficiently high level of investment in production. In such countries, the benefits of increased investments may outweigh efficiency losses that can arise from a more lax treatment of dominant firm conduct. Thirdly, distributional aspects may be especially important for developing countries. Smaller firms, which often represent poorer sectors of society, may have to be given better chances to compete against large dominant companies. Competition law can be used for

such public interest issues, but it is crucial that the law gives clear guidance on how these objectives should be balanced against other objectives such as efficiency. The comparison of the EU and the US regarding abuse of dominance shows that significant differences exist even among developed countries. One reason for the disparity is differing assumptions about what types of conduct are harmful and how difficult it is to differentiate them from other conduct. The 'access to market principle' of the EU arises from the assumption that restrictions of market access are harmful to the economy and that a harmful conduct can be distinguished from other, not harmful, conduct. On the other hand, the 'non-intervention principle' of the US is based on the assumption that the distinction of such conduct is difficult, that there is great danger of prohibiting behaviour that is efficient and that the unnecessary prohibition of efficient conduct is severe. One conclusion from the comparison is that these assumptions should be analysed and be grounded on the economic reality. How likely and severe errors of competition authorities are can, for example, be assessed in an analysis of past decisions and their effects on the economy. Support of developing countries' competition authorities in analysing their own cases and the impact of their decisions on the economy would therefore be valuable.

1. Introduction

The fundamental goal of competition policy is to increase welfare. Competition policy aims to accomplish this goal by defining appropriate rules for business conduct, but the impact of competition on welfare is complex and may differ between countries. On the one hand, competition can improve the efficiency of firms and consequently increase the welfare of consumers. On the other hand, unfettered competition may augment an unequal distribution of assets, power and business opportunities which exist in many countries and reduce growth. This aspect is particularly important for developing countries, which face poverty and inequality as their most pressing issues.

Laws on abuse of dominance are central to both aspects of competition, i.e. the efficiency of the firms and the equal distribution of opportunities. Outperforming competitors and achieving a position of dominance that allows making profits is the key incentive for firms to do their best in serving their clients and thus to become more efficient: "*It is*

precisely the prospect of enjoying some market power (i.e. of making profit) that pushes firms to use more efficient technologies, improve their product quality, or introduce new product varieties."[713]. But welfare is reduced if a firm abuses its dominant position to keep more efficient competitors away or exploit its costumers. Maximizing the efficiency therefore requires a careful trade-off between providing incentives and limiting abuses. Given that market structures are different in developed and developing countries, the outcome from this trade-off is likely to be different across countries and regions. For example, higher barriers to entry, less developed capital markets and asymmetries of information reduce the opportunities of firms and thus the dynamic of competition particularly in developing countries[714]. Authorities in these countries may choose to adopt a stricter approach towards dominant firms. On the other hand, investments in production made by established firms are important for less developed economies, this being an argument for developing countries to be more in favour of dominant firms than developed countries. Laws on abuse of dominance are also crucial for the distributional aspects of competition. Many developing countries may find it important to include rules that focus on reducing the foreclosure of markets. The objective of such an approach can be to give better opportunities to small firms often representing poorer parts of society to engage in the economy and to increase the income of their owners and employers.

The purpose of this study is to link the discussion about the appropriate competition policy for developing and emerging economies to the specific issue of abuse of dominance. To establish this link, we first briefly provide an economic and legal background of abuse of dominance. We then look at the situation of different developed, developing and emerging economies and make recommendations for future cooperation between institutions and organizations to improve the legal framework.

[713] Motta (2004: 64).
[714] Anderson and Heimler (2007: 61).

2. The scope of the prohibition of abuse of a dominant position

2.1. The United Nations Set of Principles and Rules on Competition

The abuse of a dominant position is addressed in the United Nations Set of Principles and Rules on Competition and naturally also in individual jurisdictions worldwide.

The United Nations Set of Principles and Rules on Competition – like the majority of national competition authorities – defines dominance in a behavioural way, although many structural criteria are still used in practice: *"Dominant position of market power refers to a situation where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control a relevant market for a particular good or service, or groups of goods or services"*[715]*.* The set then lists a number of acts from which dominant firms must refrain.

Box 1: Section D.4 of The United Nations Set of Principles and Rules on Competition

Enterprises should refrain from the following acts or behaviour in a relevant market when, through an abuse or acquisition and abuse of a dominant position of market power, they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries:

(a) Predatory behaviour towards competitors, such as using below-cost pricing to eliminate competitors;
(b) Discriminatory (i.e. unjustifiably differentiated) pricing or terms or conditions in the supply or purchase of goods and services, including by means of the use of pricing policies in transactions between affiliated enterprises which overcharge or undercharge for goods or services purchased or supplied as compared with prices for similar or comparable transactions outside the affiliated enterprises;
(c) Mergers, takeovers, joint ventures or other acquisitions of control, whether of a horizontal, vertical or a conglomerate nature;
(d) Fixing the prices at which goods exported can be resold in importing countries;
(e) Restrictions on the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i.e. belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence and where the purpose

[715] UNCTAD (2000).

of such restrictions is to maintain artificially high prices;
(f) When not for ensuring the achievement of legitimate business purposes, such as quality, safety, adequate distribution or service:
(i) Partial or complete refusals to deal on the enterprise's customary commercial terms;
(ii) Making the supply of particular goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods;
(iii) Imposing restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported;
(iv) Making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier or his designee.

UNCTAD: *The United Nations Set of Principles and Rules on Competition*. United Nations. Geneva. 2000.

2.2. Different competition laws in developed and developing countries

Most developing countries have adopted laws on abuse of dominance that have been inspired by the rules of the European Union (EU), i.e. Art. 82 of the EC Treaty. According to EU case law, dominant firms have the "special duty" not to exploit consumers and not to exclude competitors by anti-competitive means[716]. The idea of a special responsibility of dominant companies is founded in the view that competition is already weakened when one company dominates the market. The decreased level of competition is balanced by stricter rules on the conduct of the dominant firm, which should not be able to take advantage of this situation. The European concept of special responsibility of dominant firms is in conflict with the rules on dominance in the US, where dominant companies are granted greater freedom.[717] Developing countries often have highly concentrated markets with sometimes only one or two companies offering a certain product or service[718]. Therefore, there is a danger of dominant companies taking advantage of their position by charging higher prices, offering inferior products to consumers and foreclosing potential competitors thus consolidating their dominant position. This explains why it makes sense for many developing countries to opt for strict rules on the behaviour of

[716] Case 322/81, *Nederlandsche Banden-Industrie Michelin N.V. v Commission*, 1983 E.C.R. 3461, [1985].
[717] See Section 5.
[718] Lipimile (2004: 199, 201).

dominant companies and to invoke a special responsibility of dominant firms.

2.3. Theoretical concepts of abuse of dominance

There are two tests in the European framework for assessing whether the prohibition of the abuse of dominance applies:

1) the undertaking has to be dominant, and
2) it must be abusing that dominant position.

The first test raises two questions: the definition of the market in which the undertaking is alleged to be dominant, and whether it is actually dominant in this market.

2.3.1. Market definition

Before assessing whether an undertaking is dominant, the relevant market must be determined. This relevant market has two dimensions:

1. the product market, and
2. the geographic market.

As to the product market, it is examined if the product offered by the dominant company is interchangeable with other, similar products. If it is found that buyers would be ready to switch to an alternative product if the price of the first product increases slightly, these two products belong to the same product market. If buyers prefer paying a higher price for the first product rather than switching to another product, the two products are offered on different markets.

Box 2: Market definition in the EU

The basic principles for the market definition are for example laid down in the EU Commission Notice on the *Definition of Relevant Market for the Purpose of Community Competition Law* (Official Journal C 371, 09/12/1997 p. 5-13). According to Paragraph 2, market definition is a tool to identify and define the boundaries of competition between firms. Market definition is not an end in itself but is an analytical tool.
Paragraph 13 states that firms are subject to three main competitive constraints:

1. demand substitutability
2. supply substitutability
3. potential competition.

For the purpose of market definition, it is demand substitutability that is significant. One way of making this determination can be viewed as a speculative experiment, postulating a hypothetical small, lasting change in relative prices and evaluating the likely reactions of customers to that increase (the so-called SSNIP Test – **S**mall but **S**ignificant **N**on-transitory **I**ncrease in **P**rice).
Paragraph 25 relates to the evidence to be used in order to define the relevant market. There is a range of evidence permitting an assessment of the extent to which substitution would take place. In individual cases, certain types of evidence will be determinant, depending very much on the characteristics and specificity of the industry and products or services that are being examined. The same type of evidence may be of no importance in other cases. In most cases, a decision will have to be based on the consideration of a number of criteria and different items of evidence. The Commission follows an open approach to empirical evidence, aimed at making an effective use of all available information which may be relevant in individual cases. The Commission does not follow a rigid hierarchy of different sources of information or types of evidence. Evidence of substitution in the recent past, the views of customers and competitors, studies and consumer surveys, barriers and costs associated with switching demand to potential substitutes and the different categories of customers and price discrimination are factors that can be taken into account.

When defining the geographic market, a similar test is carried out: will buyers switch to a product from another geographic region if the price of the first product increases slightly? If transportation costs and other barriers are low, this is likely and the two products could belong to the same geographical market. If goods are perishable and cannot be transported or if transport is very costly, buyers are not able to switch to products from other regions, which therefore are offered on a distinct geographic market.

The outcome of the market definition is crucial in determining dominance. The same firm may be regarded as dominant if the market in which it is active is defined narrowly or it may be considered as not

dominant if the market is defined broadly. The key concept for the market definition is substitutability. A market should not simply be defined as a collection of similar goods, but of goods that can be used for the same purpose and thus exercise a competitive constraint on each other[719]. Other factors that have to be considered here are, for example, functional characteristics of the product or transportation costs[720]. All these factors are reflected in the willingness of the customers to switch to other products. It is therefore a straightforward way to define a market by investigating whether customers change to other products when the price of the product they normally purchase increases. This test is used in areas of antitrust such as merger control[721]. However, in the case of abuse of dominance, the test can be misleading, because the consumers' willingness to change supplier can be considerably influenced by the abusive conduct under consideration. If a firm has in the past undertaken abusive conduct such as excluding direct competitors, it is likely to have a dominant position and to be able to set higher prices. The consumers who are faced with this high price may switch to imperfect substitutes if they would have to pay an even higher price (which is hypothetically assumed in the test). This substitute would consequently be included in the market and, on this broadly defined market, the firm under consideration may appear to not even have market power[722]. Consequently, this test will be biased towards defining markets too broadly in abuse of dominance cases[723]. The assessment of dominance in cases of abuses is difficult and authorities will have to rely more than in other cases on the products' characteristics and their interchangeability in the individual case and they will have to take the distortions in observed prices into account. This reflects a more behavioural approach to dominance, which looks at the firm's ability to act to some extent independently from other market

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[719] Motta (2004: 102).

[720] Anderson *et al.* (1999).

[721] This is referred to as the Hypothetical Monopolist Test or the **S**mall But **S**ignificant **N**on-transitory **I**ncrease in **P**rice (SSNIP) Test. See Motta (2004: 102).

[722] This is referred as the Cellophane Fallacy. See also Motta (2004: 105).

[723] However, the test can still be used in a negative way. Evidence that two products are substitutes at current prices does not prove that they are in the same relevant market, but the failure to show that two products are substitutes at current prices does prove that they are not in the same market. See National Economic Research Associates (NERA) (2001: 24).

forces, as opposed to the structural approach, which looks at the market conditions[724].

2.3.2. Existence of a dominant position

Having defined the relevant product, geographical and temporal markets, the next issue is to decide what constitutes dominance. In *United Brands,* the EU Court of Justice defined dominance as "*a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of its consumers*".

The question remains, however, how to measure such market power. Market shares may be a useful indicator but there are several other factors that have to be taken into consideration such as market position, buyer power and entry conditions[725]. There are differences between markets regarding at what market share level a firm is dominant, but a lower bound (safe harbour presumption) and an upper bound (dominance presumption) can give guidance and predictability. However, an investigation that takes the characteristics of the case into consideration may be needed in an individual case. The size and market shares of competing firms also have to be considered. Secondly, entry barriers must be analysed, whereby special attention needs to be paid to those barriers that may be an outcome of the firm's abusive conduct itself [726]. Thirdly, buyer power needs to be considered in order to know whether the buyers can put a constraint on the dominant firms.

The more direct assessment of market power uses econometric techniques to estimate the elasticity of demand in response to price changes. Market power then is defined as the ability of a firm to raise prices above its marginal cost[727]. This ability depends on the elasticity of demand and estimating the elasticity therefore allows one to directly assess market power. The econometric analysis can become

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[724] For the discussion of the behavioural and structural definition of dominance, see Section 4.3.3.
[725] Motta (2004: 117).
[726] Anderson *et al.* (1999: 71).
[727] Motta (2004: 115).

complicated and demands a certain quality and quantity of data. The traditional indirect approach, which focuses more on the market structure (such as concentration), is therefore still widely used in practice[728].

Dominance not only exists if one company holds a paramount market position, but it can also be found with regard to several firms if certain conditions are fulfilled. Cases involving *collective dominance* have emerged in developed and in developing countries and posed significant problems in both.

[728] This was shown in International Competition Network (ICN) (2007: 43).

Box 3: Case 1 – Collective dominance in the Zimbabwean cement industry

In December 1998, the Competition Commission commenced a preliminary probe into various allegations of restrictive and unfair trade practices in the cement industry, which were leading to shortages and excessive prices of cement on the local Zimbabwean market. The allegations came from complaints made to the Commission by the cement trade and the general public, as well as from newspaper reports.

Four companies were involved in the production and distribution of cement in Zimbabwe: (i) Portland Holdings Limited (Unicem) of Bulawayo, (ii) Circle Cement Limited of Harare, (iii) Zimbabwe Cement Company (Pvt) Limited (ZimCement) of Norton' and (iv) Techniks (Pvt) Limited of Gweru. Only Unicem and Circle Cement were involved at all stages of cement production, from the quarrying of limestone to the final product. The other two companies were more involved in blending operations. A new cement manufacturing plant, under a joint venture between China and the Industrial Development Corporation (IDC), was nearing completion in Lalapanzi. The cement industry was found to be highly concentrated, with a Herfindahl-Hirschman Index (HHI) of 4,602. The two largest players in the industry (Unichem and Circle Cement) controlled a combined market share of over 90%.

The evidence gathered confirmed some of the allegations levelled against Unicem and Circle Cement, and others which came up during the course of the investigation, such as: (i) restricting the distribution of cement; (ii) enhancing or maintaining the price of cement; and (iii) supporting or promoting the distribution of cement by inefficient and uneconomical means. No evidence was found to support the allegations of: (i) prevention or restriction of entry into the cement industry; (ii) undue refusal to distribute cement; and (iii) collusive arrangements between the cement producers. With regards to allegations of collusion between Unicem and Circle Cement, it was found that the fact that Unicem was a more efficient producer than Circle Cement was clearly reflected in that company's lower retail prices on the market. It was also found that even though the two companies had natural markets in the northern and southern parts of the country, because of high transports costs of distributing their products, the companies' products were sold in either of their 'natural' markets.

The Commission therefore ordered Unicem and Circle Cement, in terms of Section 31 of the Competition Act, to discontinue and terminate the identified restrictive practices.

The Commission's investigation also identified other public interest concerns in the distribution of cement on the local Zimbabwean market, such as lack of transparency in the distribution of the product, lack of distribution outlets in remote rural areas, high import duties on cement raw materials and discriminatory sales tax regime in favour of large buyers. The Commission made appropriate recommendations to the relevant authorities and parties on the alleviation of the concerns.

Quoted from: UNCTAD: *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries: Thailand, Lao, Kenya, Zambia, Zimbabwe*. United Nations. New York and Geneva. 2005.

Defining when a collective dominant position exists is a difficult task. The case law in the EU has developed a rather specific definition that may be helpful for the treatment of collective dominance cases in developing countries as well. According to this definition, collective dominance exists if two independent firms act as a collective entity on the market and are as this entity not subject to substantial competition from other companies. Collective dominance exists mostly in oligopolistic markets and is therefore of special interest for developing countries, where markets are often highly concentrated. However, the existence of an oligopoly in itself is not enough to assume that collective dominance exists[729].

Box 4: EU case law regarding collective dominance

According to the case law of the EU Court of Justice, three conditions have to be met: [1]

1) The market has to be *transparent* enough for every member of the oligopoly to be able to quickly inform itself of the conduct of the other members.

2) There must be an *incentive for tacit and permanent coordination* between the members of the oligopoly. This means that all members must know that unilateral moves of one member with the objective of trying to increase its market shares - e.g. by cutting prices - would immediately provoke the same measure or sanctions by the other members, so that it would make no sense for the individual member to make moves of this kind.

3) The *oligopoly is not faced with substantial competition from outside the group* so that members can be sure that customers will not switch to other providers easily.

[1] ECJ, Judgment of 16 March 2000, Compagnie maritime belge, Joined cases C-395/96 P and C-396/96 P, ECR 2000 Page I-01365.

Substantial market power of few companies can make it especially difficult for small firms to remain in the market and even more to enter new markets. Markets in developing countries are often highly concentrated and dominated by – often foreign – firms that hold strong positions in these markets and are sometimes the only provider of a

[729] Another crucial issue is the role of the state, which may allow, facilitate or even create dominant companies. This issue will be discussed in more detail in Section 4.5.

certain good or service[730]. On the other hand, the local economy is often characterized by a large number of small business units that create employment for most of the population but lack economic power. Survival in the markets by these small, often newly created, companies is made difficult if dominant players abuse their dominant position in order to prevent market entry and competition by other players. In order to create a more level playing field and to protect smaller local companies from such abusive practices, rules on abuse of dominance are essential for developing countries.

2.3.3. Abusive conduct

There are two types of abusive unilateral conduct by dominant firms: exploitative abuses and exclusionary abuses[731]. The former refer to cases where firms charge excessively high prices from their customers, pay low prices to suppliers, or discriminate among consumers. The latter refer to cases where firms suppress competition by refusing to deal, engaging in predatory pricing or tying products in order to raise costs of entry and exclude competitors from the market to create or strengthen a dominant position. The difficulty with abusive conducts is that the same conduct can be pro- or anti-competitive, depending on the individual case. For example, refusals to deal may be necessary to ensure quality standards, and lower prices are, in principle, a fundamental goal of competition policy.

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[730] Lipimile (2004: 199, 201).
[731] Anderson *et al.* (1999: 72).

Box 5: Case 2 – Preliminary investigations into allegations of predatory pricing in the clear beer brewing and distribution industry in Zimbabwe

In December 1999, Nesbitt Brewery (Pvt) Limited of Chiredzi complained to the Competition Commission that National Breweries Limited was engaged in predatory pricing, having drastically reduced the price of its clear beer in Chiredzi to levels that were unprofitable, with the intention of driving Nesbitt Brewery out of the market. The investigations conducted by the Commission revealed that the clear beer industry in Zimbabwe is highly concentrated with an HHI (Hirschman-Herfindahl Index) concentration index in excess of 8,000. Nesbitt Brewery was a new entrant into the clear beer market challenging the long-standing monopoly position of National Breweries, which held a market share of 90%. National Breweries has a national distribution network while Nesbitt Brewery only operates in Chiredzi. The investigations further revealed that the National Breweries had run a beer promotion in Chiredzi from May 1999 to April 2000 when the Competition Commission started gathering information on the case. The promotion included free snacks and T-shirts, lucky-draw tickets, free beers and substantial price reductions. The promotion was only held in Chiredzi where Nesbitt Brewery is based and sells the bulk of its beer. The National Breweries retail prices for its beer in Chiredzi during the promotion period were below its normal landed prices in that town. The Commission found the alleged practices to be predatory within the terms of Section 2 of the *Competition Act*. Although National Breweries stopped the practices as soon as it became aware that the Competition Commission was investigating it, the Commission compelled it to formally undertake that it would desist from future practices aimed at driving Nesbitt Brewery out of the market.

Quoted from: UNCTAD: *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries: Thailand, Lao, Kenya, Zambia, Zimbabwe*. United Nations. New York and Geneva. 2005.

Box 6: Case 3 – The Coca-Cola Company (TCCC)/Zambia Bottlers (ZB) exclusive dealing arrangements

ZB notified its exclusive dealing arrangements to the Zambia Competition Commission (ZCC). The Board observed that ZB had in place both distributorship and cooler hire contracts into the trade. It was also found that ZB owned the distribution containers, the Strategic Sales Depots (SSDs), and appointed operators for public service after purchase of merchandise. ZB also had cooler hire contracts with retailers along with conditions not to sell competing products. The Board approved the exclusive dealing arrangements in so far as the SSDs are owned by ZB, on condition that they are devoid of price fixing, abuse of dominant position and that the cost of cooler repairs be met by ZB since maintenance fees are being paid. These conditions have also been made an essential part of the compliance programme regarding the takeover of Cadbury Schweppes (CS) brands by TCCC. The compliance programme will be monitored by ZCC.

Quoted from: Zambia Competition Commission: *Annual Report 1999*. Lusaka. March 2000.

Box 7: Case 4 – Microsoft's abuse of market dominance in the Republic of Korea

The Korea Fair Trade Commission (KFTC) reported to UNCTAD that, in 2000, Microsoft had tied its Windows Media Service (WMS) to the Personal Computers (PC) Server Operating System (OS). The Window Media Player (WMP) was first tied to the PC Operating System Windows 98 Second Edition in 1999, and since then, WMP has been tied to the succeeding PC Operating Systems. Additionally, the company combined MSN Messenger with Windows ME in 2000 and Windows Messenger with Widows XP in 2001. Under the *Monopoly Regulation and Fair Trade Act* (MRFTA) of the Republic of Korea, Microsoft has a dominant position in the market. Its market share of the PC Operating System was 99% in terms of domestic sales, as compared with a 50% threshold stipulated in the Act.

The investigation and analysis of the case revealed three factors. Firstly, the tie-in sales constituted obstruction of competitors' business, which is part of abuse of market dominance. The tie-in sales deprived companies of the opportunity to purchase PC OS without WMS, WMP, and Windows Messenger attached, even when they did not wish to purchase them. Moreover, the tie-in sales had the effect of driving competitors out of business by restricting competition in the market. The market shares of other players in the market, for example RealNetworks, Daum Messenger, Nate-On Messenger and others, continued to decline as Microsoft’s market share continued to rise in all aspects of its business.

Secondly, it was feared that the tie-in sales would significantly undermine consumer interest. Using dominance, Microsoft virtually forced consumers to purchase WMS, WMP, and Windows Messenger, even when they did not wish to do so. This is an infringement of the consumer's right to choice. Lastly, in the tied product markets, Microsoft's tie-sales constituted unfair business practices, as they restricted competition from competitors and consequently forced consumers to purchase the PC OS bundled with WMS, WMP or Windows Messenger.

The KFTC concluded that the company's tie-in sales were in violation of Articles 3-2 and 23 of the MRFTA ban on abuse of market dominance and unfair business practices that work against consumer interests and restrict or hinder competition in related markets.

On 7 December 2005, the KFTC imposed a series of corrective measures: (i) a surcharge of 33 billion Won (US$ 31 million); (ii) with regard to the tie-in of WMS, the KFTC ordered the company to strip WMS from the PC Server OS within 180 days from the date when the corrective order was imposed; (iii) for the bundling of WMP and Windows Messenger, the company was ordered to provide two different versions of the PC OS, whereby one version would have WMS and the Messenger programme removed from the PC OS while the other would keep WMP and Windows Messenger and allow customers to download competitors' products; and (iv) to ensure compliance with the decision of this case, the KFTC was to appoint a Supervisory Board composed of members nominated by the KFTC, the Minister of Information and Communication and Microsoft. The board was to be tasked with the responsibility of determining the specifics of the remedies and overseeing their implementation, while Microsoft was to bear all costs associated with the running of the Supervisory Board.

Quoted from: UNCTAD: *Recent important competition cases involving more than one country*. Report by the UNCTAD Secretariat. Geneva. 2007.

2.3.4. The possibility of objective justification

In some cases, an objective justification of an abusive conduct may be invoked. A company has the right to legitimate commercial behaviour and the defence of its legitimate interests. Under which circumstances a justification of otherwise abusive behaviour exists is determined on a case-to-case basis. Examples for such a justification can be efficiency increases or quality improvements that arise from the conduct.

3. Why should developing countries and countries in transition consider abuse of dominance?

3.1. The political economy dimension in developing countries

One of the reasons why rules on abuse of dominance are important for developing countries lies in the challenges many of them face as a result of their political institutions. Most developing countries have had economic systems with a relatively strong degree of command economy until recently. A command economy brings about the inherent existence of concentrated markets and of monopolies, because in many fields of the economy the state is the only actor and will not expose itself to competition. Nowadays, these systems have mostly been subject to the liberalization and privatization efforts of developing countries' economic systems[732]. In this process, the former public monopolies had to be abolished and the markets were supposed to be open to free competition of various private actors. However, what has happened in many cases is that large companies, often from developed countries, have been able to take over the position of the former state monopoly. Privatization has in many cases not led to more competition but simply to a substitution of public monopolies by private ones. This is one of the reasons for high market concentrations in developing countries[733]. Examples for this tendency exist in various sectors, for example in the field of sugar, beer, cement or packaging. These private companies have acquired a key position in many developing countries' markets. If they decide to engage in exploitative conduct – e.g. by charging overly high prices to customers or by offering only inferior products – or exclusionary conduct by excluding their competitors and thus consolidate their dominant position, developing countries' authorities need an instrument to tackle such business behaviour. This instrument is the existence of laws on abuse of dominance. Developing countries can only regulate efficiently the conduct of dominant firms if they create

[732] Lipimile (2004: 177).

[733] As to the high market concentrations, e.g. in the beer brewing and distribution and the cement distribution sectors, see the cases cited in Lipimile (2004: 199, 201).

and apply laws on abuse of dominance that allow them to tackle the anti-competitive behaviour of such firms to protect competition in their markets and, as a result of this, consumers. It is in this context that especially the EU approach, which attributes a "special responsibility" to a dominant company, suits rather well the interest of developing countries to gain control over dominant firms and keep their markets open to competition.

Another aspect that is linked to the political economy of developing countries concerns the role of the state. In newly liberalized economies, the role of government in the national economy typically remains strong. Many dominant companies are either state owned or controlled by the government; others are afforded a special protection by government policies. Such phenomena can especially, but not only, be witnessed in many network industries (railways, ports, electricity, telecommunications, etc.). The question of the role of the state in competition policy is delicate and difficult to handle, especially by public authorities that are themselves subject to government control. On the other hand, also, companies protected by governments should not be allowed to exploit consumers or to unduly restrain competition, which may lead to the exclusion of other players that offer better products or lower prices. Competition policy and, more specifically, rules on abuse of dominance are a useful instrument to treat this issue. By laying down general rules that apply to all companies with a paramount market position, a more level playing field can be created and it can be argued that governments also have to respect the basic rules of fair play in the markets which in the end will benefit the overall welfare and consumers.

3.2. Inequality, competition, and growth in developing and emerging economies

Laws against abuse of dominance can influence the distribution of assets, power and business opportunities. This distributional aspect of competition is particularly important for developing countries, where economic power and wealth are not fairly distributed. Competition policy may have to play the dual role of raising the power of underprivileged individuals and enterprises to participate in the process of competition and of creating a sound legal framework for free competition. If these objectives are not met, unfettered competition will simply help the big firms to monopolize domestic markets that are usually protected from

foreign competition[734]. The resulting inequality will lead to public dissatisfaction and the excessive market power has the potential to raise prices[735]. Dominance not only leads to an unequal distribution of market power, wealth and business opportunities, but has also a potential negative effect on growth and development if such power is abused. The abuse hampers the good functioning of markets and the efficient allocation of resources so that the economy cannot reach its growth potential. Developing countries with low growth rates are unable to catch up with industrialized economies and are unlikely to experience substantial and sustained poverty reduction. Growth is therefore a central goal of limiting abuse of dominance in developing countries. On the other hand, the possibility of achieving a certain degree of market power is necessary, because it allows firms to make profits and this gives them incentives to become more efficient. If the limits on dominant firms and their conduct are too restrictive, growth may be reduced.

Although the relationship between market structure and economic performance is complex, it is, particularly in developing countries, crucial to consider it in the context of abuse of dominance. The extreme view is "the market will fix it all", which is partly based on the theory of contestable markets[736]. According to this theory, even a firm that enjoys a monopoly position in a market cannot price above the marginal costs because new firms would enter the market as soon as they observe that profits can be made. But this outcome depends on strong assumptions: the monopolist cannot change the prices as a reaction to entry and there are no barriers to and sunk costs of entry. These assumptions obviously do not hold in many markets of developed and developing economies. A third reason why market forces may not be able to reduce market power is anti-competitive practices, which is at the focus of this study.

Even in newly liberalized economies where barriers to entry have been reduced substantially, incumbent monopolists may not be challenged by new entrants and foreign investments may remain low in many cases[737]. This could suggest that a stricter approach to

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[734] Fox (2003: 163).

[735] Economic theory predicts that the optimal pricing of a monopolist usually is above the welfare maximizing level.

[736] Motta (2004: 73).

[737] This situation has for example been observed lately in Albania.

dominance should be chosen, but it is clearly valuable to understand why there is no entry. Firstly, if the dominant position is unchallenged because of anti-competitive practices by incumbent firms or because obstacles to competition remain even after liberalization, then a stricter approach is appropriate[738]. Secondly, if dominant firms are not challenged simply because not enough profits can be made in the market, it would most likely be counterproductive to restrict incumbent firms and thereby reduce their incentives to invest in the development of the market.

Acemoglu *et al.* (2006) argue that less developed countries rely more on investment by incumbent firms and that less product market competition may be beneficial[739]. The reason is that established firms are important in order to have sufficiently high levels of investment in these countries, even if less intense competition is likely to have a negative impact on innovation. If there was fierce competition with new firms constantly entering the market and established, but less efficient ones leaving it, then the currently existing firms will be able to make smaller investments. Since less developed countries operate in sectors with generally lower levels of technology, they can use existing technologies and do not themselves need to innovate as much. Consequently, it is less important for them to have the most innovative and efficient firms selected by the competitive process, but rather to have large incumbent firms that can make investments in production. In less developed economies, the benefits of increased investments are therefore more likely to outweigh efficiency losses such as higher prices and less innovation that may arise from the dominant position. In developed countries on the other hand, it is more important that the competitive process selects the firms that are the most efficient and innovative, because they compete in sectors where innovation is a key factor of success. For this selection process to work, a fiercer competition policy may be required[740].

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[738] Related to this issue is the discussion about natural and state-created monopolies and how liberalization should be managed. It is important that the consequences for competition are considered when planning and implementing liberalization. See also Section 4.5.

[739] Acemoglu *et al*. (2006).

[740] It may be difficult to switch out at the right time of the setting that protects dominant firms, because those who have profited from the monopolization will use their economic power to influence the political process. This raises the

A special case of the trade-off between investment and competition is infrastructure. This is particularly relevant for governments with low budget resources, because they may rely on private firms to finance and build infrastructure such as roads and ports. Given that the infrastructure would not come into existence if not financed, owned and used by a private enterprise, it may be a crucial driver for development. But at the same time, the firm can strengthen its dominant position and exclude competitors if the infrastructure is an essential facility that is necessary for all other industry participants and is not easily duplicated[741]. As in the case of intellectual property, governments need to calculate carefully how much ownership they want to transfer to firms in order to give sufficient incentives to invest. It must be assessed for what sectors a monopoly should be allowed, how broad it must be, for what period it is granted, and if concessions can be renegotiated after a certain time or when circumstances have changed.

3.3. Exploitation of producers by dominant buyers

Dominance not only has the potential to exclude competitors or exploit consumers, but can also lead to exploitation of producers if they are faced with a dominant buyer. This is likely to be the case if a large number of small producers supply a relatively homogenous good, such as a commodity, to a small number of large buyers. Producers in developing countries may often find themselves in such a situation, where they have little choice as to which buyer they sell to and at what price because there is only one buyer, they have limited information about other possible buyers or switching to a different buyer involves high costs. It can therefore be important for developing countries to also have rules that apply to the abuse of buyer power.

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related issue of linkages between political and economic power and we will come back to this in Section 3.3.

[741] Motta (2004: 66). For example, a government can give a logistics enterprise the licence to build and maintain a port on a certain part of the coast. If this port cannot be duplicated nearby and if other firms need the port in order to compete, then the incumbent can exclude competitors by refusing them access to the essential facility.

Box 8: Buyer power of oligopsonistic cocoa traders *vis-à-vis* farmers

Abuse of market power may occur in the upstream market at the farmers' level. Local farmers do not have bargaining power *vis-à-vis* an "oligopsony" of cocoa traders as buyers. The buyers have enough buyer power to set cocoa prices at a level below what would be set under competitive market conditions. Economic analysis has shown that the abusive behaviour of firms with excessive buying power tends to disadvantage sellers while the excessive profit made due to such behaviour is not passed on to consumers in the downstream market to which these firms sell, regardless of the degree of competition in this market.[1] Thus, in the context of cocoa producers, the question would rather be how to deal with the buyer power of cocoa traders and processors.

[1] Peter C. Carstensen, *Competition, Concentration and Agriculture*. Statement to the Senate Committee on Agriculture, Nutrition, and Forestry, Agriculture Concentration and Competition Hearing, 27 April 2000.

Quoted from UNCTAD, *Cocoa Study: Industry Structures and Competition*. United Nations, forthcoming 2008.

3.4. The implementation of inequality considerations in developing countries

Fox (2000) analyses the trade-off between efficiency and distributional aspects of competition in the cases of South Africa and Indonesia[742]. The question that the examination of these two countries helps to answer is whether competition law can be used in practice to foster social and economic equality and if these goals are compatible with the goals of efficiency and growth.

[742] The discussion of South Africa and Indonesia in Boxes 9 and 10 is based on Fox (2000).

Box 9: South Africa

During the apartheid regime in South Africa, the white minority had political and economic power. Markets were extremely concentrated and cartels and monopolies largely controlled the economy[1]. When the apartheid regime ended in the mid-nineties, the process of democratization was accompanied by reforms of the competition law in order to reduce discrimination and inequality, but also to foster efficiency. For the most part, the competition law adapted rules and principles that were already successfully applied in developed countries[2]. But besides the common objective of efficiency, the new policy also wanted to "*(…) ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and (to) promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons*"[3]. However, these objectives are balanced against the impact on competitiveness so that the additional clauses are only likely to be decisive in cases where there is doubt as to whether a conduct is efficient.

[1] OECD: *Competition Law and Policy in South Africa. An OECD Peer Review*. OECD. Paris. 2003. at p. 10.
[2] UNCTAD: *Handbook on Competition Legislation*. Note by the UNCTAD Secretariat. Intergovernmental Group of Experts on Competition Law and Policy. 2007.
[3] *Ibid*. p. 6.

Box 10: Indonesia

The International Monetary Fund (IMF) intervened in Indonesia in the late nineties because of the Indonesian financial crisis. This crisis was caused by a political elite, which controlled important parts of the economy and put a large debt burden on the country. One requirement after the intervention was the adoption of a competition law. This law included a large number of rules against certain conducts such as price discrimination and vertical foreclosure. The law generally contained more rules to promote equality than the South African law, but it gave less guidance on how the potential conflict between efficiency and equality should be resolved. There is therefore great responsibility on the courts to find a sound balance between the different goals[1].

[1] Eleanor M. Fox: *Equality, Discrimination, and Competition Law: Lessons from and for South Africa and Indonesia*. Harvard International Law Journal. Vol. 41. 2000. at p. 592.

3.5. The balance between different objectives

What becomes clear from the study of the two countries is that if competition policy should play a role in reducing inequality in developing countries, there needs to be clear guidance on how to balance efficiency and equality[743]. The two cases of South Africa and Indonesia also show that the current political environment strongly influences the competition law. In both countries there was, in the beginning, a politically or economically powerful minority that had every reason to protect its position and to allow its enterprises to dominate the economy and restrict smaller competitors. Once the political situation changed and the links between political and economic power broke, politicians' incentives may have moved towards protecting the smaller businesses of their supporters. Good political institutions are needed to make sure that there are incentives to follow long-term goals in both political environments.

4. Cross-country differences and their implications for developing countries

4.1. Abuse of dominance laws in the general context of unilateral conduct laws

Abuse of dominance refers to cases in which a firm has a dominant position and then engages in harmful conduct. It is related to the concept of unilateral conduct, which focuses on single-firm action and its potential anti-competitive effects, including the creation or strengthening of dominance, but that does not always require a prior existence of a dominant position.

The following section now gives an overview of how abuse of dominance and unilateral conduct are assessed in a number of developing and developed countries. A range of differences persists, and the recent EU Microsoft judgement of 17 September 2007[744] and

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[743] Fox (2000: 594).

[744] *Microsoft v Commission*, T-201/04 [2007]. Judgement under: http://curia.europa.eu.

the US reaction to it have highlighted again that within the developed world also there are significant differences as to the treatment of dominant market players[745]. On the other hand, there are also areas of convergence. In this context, the International Competition Network (ICN) identified several issues that merit further research and cooperation[746]: objectives of unilateral conduct laws, assessment of dominance, and state-created monopolies.

4.2. Objectives of unilateral conduct laws

The objectives of unilateral conduct laws differ across competition systems. In most unilateral conduct regimes, more than one objective is considered relevant. Objectives include: ensuring an effective competitive process, promoting consumer welfare, maximizing efficiency, ensuring economic freedom, ensuring a level playing field for small and medium-sized companies, promoting fairness and equality, promoting consumer choice, achieving market integration, facilitating privatization and market liberalization, and promoting competitiveness in international markets.

In many countries, ensuring an effective competitive process is considered an objective on its own. The competitive process is seen as a dynamic, self-initiating market phenomenon that requires competition agencies' intervention only when obstructed. In other systems it is seen as a means to achieve other desirable goals such as consumer welfare, economic freedom or efficiency. In some cases it is both an objective and a means to achieve such goals. Apart from ensuring the competitive process itself, the most commonly used goals seem to be the economic goals of promotion of consumer welfare and enhancing efficiency. One example of the difficult relationship between these goals is the discussion about the 'more economic approach' to unilateral conduct rules in the EU[747]. This discussion focuses on whether the European rules of unilateral conduct should be interpreted in a more economic way thus aligning with current US law. This would essentially mean looking at the type of effects of a certain practice on consumers rather

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[745] Vickers (2007).
[746] Parts of the discussion below are based on International Competition Network (ICN) (2007).
[747] European Commission (2005).

then at the market structure and the abusive behaviour in question, which were relevant criteria in the traditional European approach to unilateral conduct[748].

In developing countries, the objective of competition law and more specifically of unilateral conduct rules is sometimes also to protect domestic firms by seeking to prevent powerful foreign firms from using their power in order to eliminate local competitors[749]. In principle, countries are free to choose the objectives they see appropriate for unilateral conduct rules. This is a political decision that stakeholders in every country have to take, considering the economic realities in their markets. However, different standards across jurisdictions represent obstacles not only for companies with cross-boarder business, but also to the effective enforcement and cooperation in the field of competition policy. A certain degree of harmonization may therefore be desirable[750].

The relationship between the objectives of intellectual property and unilateral conduct rules remains another possible field of conflict, where further work is required. Also, the widespread practice of exemptions from unilateral conduct rules may create a conflict with the very goals of these rules.

4.3. The assessment of dominance

Significant differences exist in the way the surveyed jurisdictions assess dominance and also what the finding of dominance then implies for a dominant firm and its conduct. The following sections give an overview of the differences between countries and illustrate the situation with examples from individual countries.

4.3.1. Finding of dominance as a filter for anti-competitive effects

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[748] Dreher and Adam (2006: 259 *et seqq.*).
[749] Gerber (2007: 707, 721).
[750] The notion that domestic firms should be protected until they are able to compete against foreign competition leads to an industrial policy that wants to foster national champions. Section 4.5 discusses the relationship of industrial policy and competition policy in greater detail.

In the majority of countries the finding of dominance serves as a first filter for separating conduct that has anti-competitive effects from conduct that does not. However, it is not dominance itself that is prohibited, but the anti-competitive unilateral conduct of dominant firms. The underlying assumption is that such a conduct would not harm competition if exercised by a non-dominant firm or that such a firm cannot even enter into the conduct. Some countries do not use the existence of a dominant position as a filter, but the existence of a dominant position is nonetheless often a criterion in the assessment of the conduct[751].

4.3.2. Interventions against unilateral conduct by firms without strong market power or against the creation of dominance

In total, 15 out of 35 jurisdictions in the ICN report have prohibitions against anti-competitive unilateral behaviour by non-dominant firms or firms that attempt to acquire a dominant position[752]. These standards are also often related to fair trade laws. The examples of intervention against firms that do not have a dominant position show that dominance is not necessarily the decisive test in cases of unilateral conduct. But even in jurisdictions where dominance is not required as a precondition for considering unilateral conduct cases, it still has a role to play as a criterion in the assessment of the conduct and its potential for harm.

Box 11: Examples of interventions against unilateral conduct by firms without strong market power or against the creation of dominance

The Sherman Act in the US prohibits “attempts to monopolize” and “monopolization”. The former is the anti-competitive conduct with the specific intent to acquire a dominant position and with the high probability of doing so. The latter is the use of anti-competitive conduct either to acquire or to maintain a dominant market position. The existence of a dominant position prior to the conduct is therefore not required for attempts to monopolize. An example is the US Microsoft case where the Court of Appeals had to investigate whether

[751] Marsden (2006: 292).

[752] International Competition Network (ICN) (2007: 60–61).

Microsoft had unlawfully harmed Netscape's Internet Navigator browser in order to protect the monopoly position of its Windows operating system (monopolization) or to leverage the monopoly position of Windows to the browser market (attempt to monopolize)[1].

Brazil and Chile contain a general prohibition of restrictive trade practices. The French competition law sanctions abuses of economic dependence on the basis of reputation, access to essential facilities or the structure of the business relationship. Similarly, the German law prohibits that one undertaking hinders another without objective justification if it has relatively more market power than the other one. An example would be sales under costs or under acquisition prices. Also, the Japanese law does not require dominance when prohibiting unfair trade practices, e.g. unjust refusals to deal.

[1] *United States v Microsoft*, 253 F.3d 34 (D.C. Cir. 2001). Section 5.2. will look at the US approach in more detail. For the above also see UNCTAD: *Model Law on Competition*. UNCTAD Series on Issues in Competition Law and Policy. United Nations. New York and Geneva. 2007.

4.3.3. Behaviour vs structural definition of dominance

Twenty-eight out of 35 jurisdictions in the ICN survey use a behaviour definition for dominance that focuses on a firm's appreciable freedom from competitive constraints. This freedom is sometimes referred to as independence (e.g. EU) and in other cases as the ability to profitably raise prices (e.g. Canada, US[753]). Many authorities also consider the durability of this freedom. Only five out of 35 use a structural definition, which means that dominance is primarily defined by structural criteria.

Although most of the countries state that they use a behaviour definition, many of them still use structural criteria for the assessment of dominance. The following section illustrates that many of the most frequently used criteria are structural. The fact that the vast majority of countries name their general definition 'behavioural' consequently loses some significance, because a different – more structural – definition seems to be used for the actual assessment of dominance.

[753] See discussion on 'hypothetical monopolist test' in Section 2.1.

There is little doubt that structural criteria have an advantage in the practical application[754]. It seems easier for competition authorities to observe a current situation such as the market structure than to look at the behaviour of actors in the market. This concern of practicability is especially important for competition authorities in developing countries, because their means to assess dominance are more limited. On the other hand, the behaviour approach to defining dominance is theoretically more exact, because it focuses on the target variable, which is the actual and potential behaviour of firms. The downside of this approach is that it requires more case-specific analysis.

4.3.4. The criteria for the assessment of dominance

Table 1 shows that structural criteria are important for the assessment of dominance in most jurisdictions.

Table 1: Criteria for assessment of dominance		
Which of the following criteria do you use?	**Yes**	**No**
- Market share of the firm and its competitors	32	0
- Market position and market behaviour of competitors	32	0
- Barriers to entry or expansion	32	0
- Buyer power	32	0
- Economies of scale and scope/network effects	32	0
- Access to upstream markets/vertical integration	32	0
- Durability of market power	30	2
- Market maturity/vitality	30	2
- Access to essential facilities	29	3
- Financial resources of the firm and its competitors	23	9
- High prices (at absolute or comparative level)	23	9
- Profits of the firm	17	15

Source: ICN (2007).

The first three criteria are also those most often mentioned as being among the most important criteria. However, this is not the case for some large jurisdictions such as the UK, the US and Japan[755].

[754] Dreher and Adam (2006: 259 *et seqq.*).

[755] This observation will be discussed further in Section 5, which concerns the US and EU laws.

Market shares:

Market shares are a relevant criterion for the assessment of dominance, because they are a close approximation of how a firm stands *vis-à-vis* its competitors. It is not a perfect approximation for market power because the latter depends on a number of other factors. Even a firm that has more than a 50% market share may have little market power if there is only one buyer or many possible entrants. Therefore, the significance of a certain market share depends on the characteristics of the market.

Market share thresholds are levels of market shares above which market power is assumed and below which it is not assumed. The use of market share thresholds has both advantages and disadvantages. The most obvious advantage is legal certainty and predictability. If the procedure of the competition authorities is sufficiently transparent, firms can to some extent predict how the authorities will define the market and what market share they will assume. A market share threshold then allows them to assess whether they are assumed to be dominant or not and consequently if their conduct could be prohibited. This higher degree of legal certainty allows them to invest more efficiently, because they know when an activity is likely to be profitable. The apparent disadvantage is that market share thresholds are generalizations across a large number of special cases. Consequently, they need to be defined conservatively, i.e. levels for safe harbours must be rather low to take into account that in some instances even firms with relatively low market shares can be dominant, and thresholds to assume dominance must be high in order to consider the possibility that firms with large market shares have no market power. However, when the levels are defined too conservatively, the market share thresholds lose their significance, because few firms can actually use them. It becomes evident from these considerations that the definition of the optimal thresholds is a difficult task. The benefits of thresholds are particularly high for jurisdictions with less experienced competition authorities that profit from a more structured approach. However, the definition of the accurate threshold is likely to be very difficult for these countries as well. Table 2 shows that in our sample less developed countries in terms of gross domestic product (GDP) *per*

capita are more likely to have market share thresholds, but they are not necessarily higher or lower than in developed countries[756].

Nineteen out of 35 jurisdictions in the ICN survey use market share thresholds to assume dominance or safe harbours. Interestingly, some countries have a differentiated approach to thresholds for dominance, since they apply a lower benchmark for a rebuttable presumption and a higher mark for a non-rebuttable presumption (South Africa, Ukraine). The majority of jurisdictions that use safe harbours only have 'soft' safe harbours, because their presumption is rebuttable.

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[756] Our sample consists of countries referred to in the ICN report, the UNCTAD model law, and one additional country. Two identical thresholds do not necessarily imply the same treatment, because some jurisdictions make them dependent on other conditions.

Table 2: Market share dominance					
Country	**Dominance presumption**	**Safe harbours**	**Country**	**Dominance presumption**	**Safe harbours**
Australia*			Lithuania**	40%	
Brazil*	20%	20%	Mexico*		
Bulgaria*	35%	20%	Mongolia**	50%	
Canada*	80%	35%	Netherlands*		
Chile*			New Zealand*		20%
Croatia***	40%		Pakistan*	33%	
Czech Republic**	40%		Poland**	40%	
Estonia*	40%		Portugal**	40%	
EC*			Romania*	40%	
France*			Russia*	50%	20%
Germany*	33%		Singapore*		
Hungary*		20%	Slovakia*		
India*			South Africa*	45%	n.a.
Indonesia**	50%		Spain*		
Ireland*			Sweden*	40%	
Israel*	50%		Switzerland*		
Italy*			Turkey*		
Jamaica*	50%		Ukraine*	35%	35%
Japan*			United Kingdom*		
Republic of Korea*	50%	10%	United States*	70%	50%
Latvia*		40%	Zambia**		40%

Data: *ICN (2007), **UNCTAD (2007), ***country legislation.

Barriers to entry:

Apart from market shares, dominance is also linked to the ease of entry and thus to the existence of entry barriers. Entry barriers make it more difficult for potential competitors, i.e. new firms or firms that are currently active in other markets, to enter the market under

consideration. Entry barriers can for example be legal barriers in the form of licences or structural in the form of high sunk costs that make entry either more costly or more risky[757]. If such barriers exist, the firms already in the market are protected from potential competition and thus enjoy more market power. Most agencies look not only at the theoretical possibility of entry, but also at whether entry is likely, timely and sufficient. Some respondents stated that barriers must be put into a dynamic perspective, where the changes in barriers are observed over time.

Buyer power:

The profitability of a firm is not only threatened by its competitors who take away its costumers, but also by the costumers themselves, because buyers bargain with the sellers to get lower prices. If the bargaining power of a buyer is high, for instance if there is only one buyer but many potential sellers, the sellers have to lower the price until it only covers costs[758].

The ICN survey shows that buyer power is one of the most important criteria for competition authorities in the assessment of dominance. The EC stressed that strong buyers can discipline the dominant seller if they actually switch to new entrants when the incumbent offers bad deals. In doing so, they ease the entry of new firms that are willing to sell at lower prices and therefore also benefit other, smaller, buyers. Competition authorities in developing countries should pay special attention to this, because small and poor buyers are likely to suffer from the abusive conduct by dominant firms.

4.3.5. Market size and economies of scale

Developing countries, and especially the least developed countries, are mostly characterized by a low GDP, which has important implications for competition policy. Due to economies of scale, firms must be of a certain size to be cost-efficient. Small markets naturally

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[757] Sunk costs can arise when a firm must make an investment, e.g. in infrastructure, to enter a market, but cannot recoup the investment if the market entry fails. This is especially the case if the investment cannot be used for other purposes.

[758] This is conceptualized in Porter's five forces analysis. See Besanko (2003).

enable fewer firms to be large enough to produce at the efficient scale and consequently there will be higher levels of concentration in small economies.

For some industries the domestic markets may be too small to allow even one firm to be efficient and if it does, the resulting monopoly is likely to be inefficient exactly because it is a monopoly[759]. Openness to trade is therefore crucial for such countries in order to enlarge their markets and allow their firms to exploit economies of scale[760]. It is argued that due to this need of openness to trade, small economies are likely to have lower barriers to entry and that higher levels of concentration on domestic markets should be tolerated[761]. However, small economies are not always open, and it is therefore necessary to make a distinction between open and isolated small economies. This also becomes clear in the ICN survey: "*There was a general consensus among the respondents that if an economy is small and isolated from external trade, this may result in higher barriers to entry which could facilitate a finding of dominance or substantial market power. On the other hand, the presence of free-trade agreements can be seen as lowering an economy's entry barriers to new or potential competition, and thus making the exercise of market power in the economy's markets less likely.*"[762].

Most respondents agreed that in small economies the same type of criteria for the assessment of dominance is appropriate, but that the size of the economy significantly influences the outcome. They didn't agree on the question of whether small economies should generally assume dominance at lower or higher levels of concentration, which is not surprising in view of the argument made above that countries are not equally open to trade and therefore have different entry barriers. The necessity to take into account openness to trade when defining tolerable concentration levels shows that the appropriate level of concentration needs to be defined by each country individually and that the markets are defined correctly.

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[759] Monopolies can for example be inefficient because they set prices too high or do not innovate enough.
[760] Alesina *et al.* (2000).
[761] The definition of the market is crucial here. When economies are open and their markets expand beyond their political borders, the market should be defined accordingly and concentration levels will be lower.
[762] International Competition Network (ICN) (2007: 58).

4.3.6. Examples of dominance assessment in developed and developing countries and countries in transition

Box 12: Examples of dominance assessment in developed and developing countries and countries in transition

The presumption contained in the 1991 Law of the Czech Republic is **40%**, which is also the case in Portugal and Poland. In the Czech Republic, provided that the **other indicators** mentioned in the Act do not show otherwise, a competitor or competitors with joint dominance that have not achieved the 40% market share in a given period are **considered not to have a dominant position** on a market.

In Estonia, an undertaking in a dominant position is one that accounts for at least **40%** of the turnover in the relevant market or whose position enables the undertaking to operate in the market to an appreciable extent independently of competitors, suppliers and buyers. Undertakings with special or exclusive rights or in control of essential facilities are also undertakings in a dominant position.

Under Lithuanian law, a **40%** market share establishes a presumption of dominance; in addition, the new law creates a presumption of joint dominance when the three largest firms in a market have a collective market share of 70%.

Under Canadian law, it must be shown that the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially.

In Germany, the legislation contains several presumptions, namely: at least one enterprise has **one-third** of a certain type of goods or commercial service; three or fewer enterprises have a combined market share of 50% or more; five or fewer enterprises have a combined market share of two-thirds or over.

In the *"Akzo" Judgement*, the Court of Justice of the European Communities considered **that highly important parts (of the market)** are by themselves, except for extraordinary circumstances, the sole proof of the existence of a dominant position. In the *Michelin Judgement*, the Court of Justice of the European Communities stated that under Article *82* of the EEC Treaty a dominant position refers to a situation of economic strength that gives the enterprise the power to obstruct the maintenance of effective competition in the market concerned because it allows the enterprise to conduct itself in a way that is independent from its competitors, clients and, finally, consumers. **In addition to market shares**, the **structural advantages** possessed by enterprises can be of decisive importance. For example, the Court of Justice of the European Communities in the *United Brands Judgement* took into account the fact that the undertaking possessed a high degree of vertical integration, that its advertising policy hinged on a specific brand (Chiquita), guaranteeing it a steady supply of customers and that it controlled every stage of the distribution process, which together gave the corporation a considerable advantage over its competitors. In consequence, dominance can derive from a **combination of a number of factors,** which, if taken separately, would not necessarily be determinative.

In the United States, monopoly power is not defined by statute but courts have traditionally defined it as being "*the power to control market prices or exclude*

competition." (*United States v E.I. du Pont de Nemours & Co.*, 351 US 377, 391 (1956)). **The market share** is not the only factor considered in determining whether monopoly power exists. **Other factors**, such as the absence of entry barriers, may indicate that a firm does not have monopoly power even if it does account for a large share of the relevant market.

The Indian *Competition Act* 2002 defines, 'dominant position' as a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to: (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect in its favour its competitors or consumers or the relevant market. The Competition Commission of India, while inquiring whether an enterprise enjoys a dominant position or not, has due regard to all or any of these factors.

The legislations of Mongolia and the Ukraine consider that dominance exists when a single entity acting alone or a group of economic entities acting together account constantly for **over 50% of supply** to the market of a certain good or similar goods, products or carried out works and provided services.

In Zambia, under Section 7 (2) of the Act, an enterprise is considered to be dominant if it has a level of market power that allows it to behave independently of competitive pressures (e.g. pricing and distribution strategies). An **important but not conclusive factor** in determining dominance is the **share of the market** that the undertaking has. An undertaking is **unlikely** to be dominant if its market share is **less than 40%** – although this rule will largely depend on the circumstances of the case.

The Saudi Arabian Implementing Regulations on Competition Law state in Article 1 that dominance exists where an entity or group of entities are in a position to influence the prevailing price through controlling a specific percentage of the total supply. A specific **threshold is not mentioned**.

The Indonesian *Competition Law* (Law No. 5) defines dominance in Article 25 as a situation in which one business actor or a group of business actors controls over **50%** of the market segment of a certain type of goods or services; or if two or three business actors or groups of business actors control over 75% of the market segment.

The *Competition Act* of Trinidad and Tobago defines in Section 20 monopoly power in a market as a situation in which an enterprise, by itself or together with an interconnected body corporate, occupies a position of economic strength that will enable it to operate in the market without effective constraints from its competitors or potential competitors. The Act contains **no threshold for the positive presumption** of dominance, but states in Section 22 (2) that the Commission should not investigate cases unless it is satisfied that the enterprise controls 40% of the market or more or such percentage as the Minister may by order prescribe. This can be labelled as a **"negative presumption"**.

Source: UNCTAD: *Model Law on Competition*. UNCTAD Series on Issues in Competition Law and Policy. United Nations. New York and Geneva. 2007.

4.4. Examples of abusive practices

Once dominance has been found, authorities need to investigate whether a certain conduct should be prohibited. The following are some examples from both developing and developed countries of practices that are considered abusive.

4.4.1. Predatory pricing

Box 13: Some examples of rules on predatory pricing from country legislations

Hungary prohibits the setting of extremely low prices that are not based on greater efficiency in comparison with that of competitors and that are likely to drive out competitors from the relevant market or to hinder their market entry.

The *Law for Countering Unfair Competition* in the People's Republic of China states that an operator (i.e. enterprises or individuals) may not sell its or his or her goods at a price that is below the cost for the purpose of excluding its or his or her competitors.

In the United States, the Supreme Court has held that two elements must be present in order to establish predatory pricing. First, the prices complained of must be "*below an appropriate measure of cost*", and second, the competitor charging low prices must have a "*dangerous probability*" of recouping its investment in below-cost prices.[1] The US Supreme Court has stated that it is important to distinguish between pro-competitive price cutting and anti-competitive predatory pricing because "*cutting prices in order to increase business often is the very essence of competition*"[2].

Predatory pricing is also prohibited in the European Community. The European Court of Justice defined in TetraPak[3] that pricing is predatory if the price is set below the average variable costs[4].

[1] *Brooke Group Ltd. v Brown & Williamson Tobacco Corp.*, 509 U.S. (1993). See also *Cargill Inc. v Monfort of Colo., Inc.,* 479 U.S. 104, 117 (1986).
[2] *Matsushita Elec. Indus. Co. v Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).
[3] *Tetra Pak v Commission*, [1996] ECR I-5951 (ECJ).
[4] For the above see also UNCTAD: *Model Law on Competition*. UNCTAD Series on Issues in Competition Law and Policy. United Nations. New York and Geneva. 2007.

Box 14: Case 5 – Predatory pricing in the Zambian beer brewing industry

On 8th June 2001, the Official agents of the Zambian Breweries lodged a complaint, with the Commission alleging that MetPress Zambia Limited, t/a Metro Wholesalers was wholesaling the Zambian Breweries "Mosi" and "Castle" clear beers at prices lower than the manufacturer's, i.e. predatory pricing. This conduct was allegedly forcing members out of business. It was observed that the firm was actually taking over business in various parts of Lusaka. The complainants alleged further that the local distributors did not have the financial power to compete with such pricing strategies from Metro. Metro is part of the Metro Cash & Carry, which operates in at least 15 countries. The conduct by Metro appeared to be in breach of Section 7(2)(a) of the *Competition and Fair Trading Act* (the Act), which requires enterprises to refrain from predatory behaviour towards competition including the use of cost pricing to eliminate competitors.

Metro was a new entrant in the market and was growing at a fast rate aided by its below-cost pricing (which was used as a market penetration strategy). It purchased its clear beer from Zambian Breweries as did other distributors. However, it appeared that its selling price was below the purchase price and there appeared to be no objective justification for the conduct. Zambian Breweries confirmed that they had no unique "trade arrangement" with Metro. The selling price from Zambian Breweries was uniform.

The Commission considered that while Metro was not a dominant player, its pricing strategies had an effect on the smaller distributors, hence the intervention. Although the *Competition and Fair Trading Act* provides that any form of price resale maintenance is anti-competitive it was in this situation found to be special to justify its continuity. A resale price maintenance was proposed (the "minimum price") to avoid future breaches. As noted already, the business relies heavily on volume sales and small disparities in price can and do have significant effects on other players. The favourable credit period awarded to Metro by Zambian Breweries was ordered to be discontinued and or be extended to all the other distributors.

Quoted from: UNCTAD: *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries: Thailand, Lao, Kenya, Zambia, Zimbabwe*. United Nations. New York and Geneva. 2005.

Box 15: Case 6 – Abuse of dominance cases in Jamaica

The FTC (…) considered, under the abuse of dominance provisions, three complaints regarding predatory pricing. In its decision regarding price reductions of Super Plus Food Store, it found that the list of items for promotion was limited and the duration of the sale was short such that predation did not occur. With regard to the allegation that Tank-Weld Metals Limited (TWM) was selling nails at predatory prices, it concluded that TWM was dominant but, except for one month, its prices were above average variable costs. It thus found there was no evidence of predation. The last case involves an advertisement by Telstar Cable Ltd. for three months of free cable service to subscribers who switch from another cable company within the month of December 1999. The FTC found that the pricing was not below costs and the duration of the offer was not long enough to have an appreciable effect on competition.

Quoted from: UNCTAD: *Voluntary Peer Review on Competition Policy: Jamaica*. United Nations. New York and Geneva. 2005.
FTC, Fair Trading Commission.

4.4.2. Resale price maintenance

Box 16: Some examples of rules on resale price maintenance from country legislations

In the Swedish Competition Act, setting minimum prices that have an appreciable effect on competition is prevented through the prohibition of anti-competitive cooperation. An economic approach has been chosen concerning resale price maintenance

In the United States, the Supreme Court has held that minimum resale price maintenance is *per se* illegal under Section 1 of the Sherman Act, but there must be an actual agreement requiring the distributor to adhere to specific prices[1]. Because maximum resale price maintenance may lead to low prices, the Supreme Court has recently ruled that maximum resale price maintenance is not *per se* an offence.

Resale price maintenance is also prohibited for example in India, New Zealand, the Republic of Korea, and the United Kingdom.

In the European Community, fixing the resale price of goods is normally

prohibited if competition between Member States is affected.[2]

[1] See *Business Elecs. Corp. v Sharp Elecs. Corp.*, 485 U.S. 717, 720, 724 (1988).

[2] For the above see UNCTAD: *Model Law on Competition*. UNCTAD Series on Issues in Competition Law and Policy. United Nations. New York and Geneva. 2007.

Box 17: Case 7 – Carbonated soft drinks sector in Kenya

The Minister of Finance directed the Commission to investigate the carbonated soft drinks sector, believing that it might feature one or more factors relating to unwarranted concentrations of economic power. The Minister had received complaints from other companies and was aware of the dominance of Coca Cola and its vertical integration with its bottling operations and its distributors. The Commission conducted an investigation that included interviews with the major players in the industry and a sample of 85 distributors.

The investigation found that Section 23(1)(a) of the Act, which deals with the control of a chain of distributing units, the value of whose sales exceeds a third of the relevant market, was relevant to the activities of Coca Cola East Africa Limited. Section 23(1)(b), which concerns companies that control two or more physically distinct units that manufacture substantially similar products and that supply more than one-third of the value at ex-factory prices of the domestic market, applied to Coca Cola Holdings Limited. Finally, Section 23(1)(c), which applies to a person who has a beneficial interest exceeding 20% in a manufacturing enterprise and simultaneously has a beneficial interest in one or more wholesale or retail enterprises that distribute products of the manufacturing enterprise, is relevant to ICDC and Softa Bottling Company.

During the investigation, several potential restrictive trade practices came to light and were addressed in a draft consent order. These included possible resale price maintenance, territorial allocation, exclusive dealership arrangements and tied selling. However, the Commission suspended its investigation under Section 23 when some of the complainants took the matter to the High Court. The High Court proceedings have not been concluded.

Quoted from: UNCTAD: *Voluntary Peer Review on Competition Policy: Kenya*. New York and Geneva. 2005.

4.4.3. Exclusive dealing

Box 18: Case 8 – Exclusive dealing arrangements in the poultry sector in Zambia

During investigations into alleged cartel activities in the poultry industry in Zambia in 1998, the Commission became aware that there existed restrictive business arrangements involving Hybrid Poultry Farm (HPF – a day-old chicks (DOCs) rearer with 60% market share then), Galunia Holdings Limited (GH – a commercial chicken broiler rearer), and Tamba Chicks (Tamba – a (DOCs) rearer with 30% market share then). ZCC advised the parties to notify the said exclusive agreements as required under the *Competition and Fair Trading Act* Cap 417 of the laws of Zambia. At the time, parallel investigations were launched on the sale of Tamba Chicks. GH management was interviewed.

During the investigations it was revealed that in the sale of Mariandale Farm, which specializes in the raising of DOCs into table birds, HPF required GH to only purchase DOCs from itself. Further, GH was also required to consider HPF's right of first refusal should it intend to resell Mariandale Farm. GH was also not allowed to raise any type of poultry, at the farm, apart from broiler chickens, including the provision not to go into the business of a chicken hatchery. The parties also agreed that GH should be accorded the right of first refusal should HPF intend to sell some of its shares and that HPF should be given the first right of refusal to participate in an outgrowers scheme should GH come up with one. The ZCC noted that the parties to this transaction are the two leading players in the poultry sector's upstream (HPF) and downstream (GH) subsectors. HPF is the dominant producer of DOCs in Zambia with a 60% market share. GH with its Mariandale and Diamondale Farms has an uptake of 48,000 DOC per week and hence is the largest buyer in the poultry sector.

The exclusive dealing arrangements appear to have been over and above the offers each party made and hence the considerations made by the other. The excesses hinge on the ulterior motives of the parties in as far as the poultry sector is concerned. The parties seem to have taken advantage of their dominant market positions upstream and downstream – where each party was dominant. The parties were, both by motive and concerted practices, foreclosing competition both in the DOCs, table birds (broiler) and frozen chicken markets.

These practices were in direct contravention of Section 7 of the Act and have the tenets of distractive cartel behaviour. The Board of Commissioners found all the exclusive dealing provisions in the sale and purchase agreements by the parties anti-competitive and nullified them.

UNCTAD: *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries: Thailand, Lao, Kenya, Zambia, Zimbabwe.* United Nations. New York and Geneva. 2005.

4.5. State-created monopolies and national champions

4.5.1. Sectors with state-created monopolies

In many countries certain companies derive their dominant position from government support or are even publicly owned enterprises. The ICN report identified postal services, lottery, airports, and commodities as the most frequent sectors where monopolies have been created by the government[763]. Table 3 shows that both developing and developed countries have such sectors[764].

Table 3: Sectors with state-created monopolies	
Sector	**Countries**
Postal services	Australia, Brazil, Bulgaria, Canada, Czech Republic, Germany, Hungary, Italy, Jamaica, Japan, Jersey, Republic of Korea, New Zealand, Slovak Republic, Spain, Switzerland, Turkey, UK, US
Lottery	Brazil, France, Germany, Hungary, New Zealand, Slovak Republic, Spain, Sweden, Turkey
Airports/Airport infrastructure	Australia, Canada, Czech Republic, Jersey, Spain, UK
Commodity	Australia (rice, wheat, sugar, barley), Canada (wheat), Pakistan (rice), Turkey (opium)
Ports	Jamaica, Jersey, Israel, Pakistan, Spain, UK, Turkey
Insurance	France (insurance companies in social services), Germany (social insurances), New Zealand (accident), Pakistan
Airlines	Jamaica, Israel, Pakistan, Spain, Turkey
Public transport	Australia, Chile, France, Jamaica
Highways	Brazil, France, Russia
Tobacco	France (retail trade), Spain, Turkey
Mining	Chile, Serbia, Turkey
Alcohol retailing	Sweden
Alcohol products	Turkey

[763] International Competition Network (ICN) (2007: 64). This report only covers state-created monopolies, not natural monopolies.
[764] The table provides a non-exhaustive list of sectors where state-created monopolies existed or still exist.

Table 3: Sectors with state-created monopolies	
Sector	**Countries**
Hospitals	Germany
Pharmaceuticals	Sweden
TV/Radio centres	Russia
Motor industry/automobile production	Serbia
Table from ICN (2007).	

4.5.2. Objectives of creating monopolies by the state

These monopolies were usually created by governments in order to fulfil a public service mission or to play an active role in coordinating the economy instead of relying on free markets. Table 4 provides a non-exhaustive list of the objectives that the various jurisdictions stated.

Table 4: Objectives of creating monopolies by the state	
Objective	**Country**
Public service obligations ensuring citizens have access to important/essential services	Australia, Czech Republic, France, Germany, Hungary, Japan, Republic of Korea, Serbia, UK, US
The state made necessary investments in infrastructure and important sectors as part of a previous economic policy based on import substitution	Brazil, Turkey
Safety standards	Switzerland
In order to align with the recommendations of the European Commission	Czech Republic
Prevent illegal gambling and ban excessive gaming incentives and exclude commercial profit-making purposes	Germany, Hungary
Marketing in an orderly manner grain grown and leveraging the size to obtain the highest price	Canada
Operation of state liquor monopolies in order to prevent over-consumption by limiting economic incentives for liquor sales	US
Public safety in taxi cab monopolies	US

Table 4: Objectives of creating monopolies by the state	
Objective	**Country**
Public interest: government intervention is warranted if the private sector fails to produce the desired outcome	Netherlands
Insuring traffic security in air, space, naval transportation; meteorological service, including its satellite component	Russia
Table from ICN (2007).	

Public service missions may be particularly important in developing countries that face problems of severe poverty and lack of infrastructure. Governments in such situations may find it more often necessary to create or hold ownership of firms that fulfil these public service missions, but at the same they should keep restrictions on competition as low as possible.

4.5.3. Natural monopolies and state-created monopolies

In some industries, state intervention is due to natural monopolies that arise because the market size and the cost structure of production allow a monopoly to produce more efficiently than if production was split among several firms. The market failure is evident in this case because the resulting monopoly position will lead to inefficiencies and therefore regulation is needed. Where a monopoly is accepted (and possibly regulated) for such reasons, it is crucial to define the market correctly in the vertical dimension. For example, if economies of scale are highly important in the distribution, but not so much so in the production, then it has to be ensured that a distribution monopoly is not allowed to vertically integrate into production. A possible solution is the approach of the European Commission that intends to split the production and distribution of energy[765].

4.5.4. National champions

Section 4.5.2 has shown that there are also industries without a natural monopoly justification, but where the state still intervenes and

[765] European Commission (2007a).

creates a monopoly in order to reach other political or economic goals. One such goal can be the creation or protection of 'national champions'. This is subject to a lot of debate and is often related to the infant-industry argument for developing countries. Those in favour of such protection argue that certain national firms must – at least for a certain period – be protected in order to become internationally competitive. It is often suggested that firms with small domestic markets have a disadvantage because they cannot exploit economies of scale and that they should be protected until they reach the critical size that allows them to compete globally against firms with larger home markets. A second argument is that some sectors are strategically important or that they produce positive externalities – such as innovation spillovers or supply capacities – on other sectors. One counter-argument is that competition on domestic markets is the best condition for firms to become internationally competitive, because they are forced to be innovative in order to succeed. Having incentives to become competitive is likely to be more important for productivity and growth than only having the ability to do so based on government protection. Secondly, it is difficult for governments to choose the sectors and firms that may deserve protection. In particular those firms that already receive support are likely to use their influence to get government assistance. Thirdly, the support that one country gives to its national champions generates pressure on other countries to also support their businesses. If every national champion receives support from its government, the relative positions between these firms remain the same, but resources are lost at the expense of private citizens and consumers. When all this is taken together, it becomes clear that the risks and costs that the support of national champions involves are often greater than the benefits[766].

4.5.5. Competition policy in sectors with state-created monopolies

In some jurisdictions actions of public companies are exempted under a state action doctrine, others treat public companies as they would privately owned entities. The special treatment of public enterprises is usually justified by the 'public service mission'. In these cases, the powers of competition authorities are often limited to advocacy activities and other 'soft' enforcement tools[767].

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[766] Paul A. Geroski: *Competition Policy and National Champions*. March 2005.
[767] International Competition Network (ICN) (2007: 87).

Box 19: Case 9 – Preliminary probe into allegation of abuse of dominant position in the steel sheet industry in Thailand

In 2002, there was a complaint lodged by end-users of steel sheet products that the alleged party and its wholesalers raised the price of their hot-rolled steel sheet every week and certain hot-rolled steel sheet products were not available on the market. Those end-users who tried to import such products were threatened by the alleged party that the supply would be cut off. The investigations conducted by the officials at the office of the Competition Commission revealed that the alleged party distributed its steel sheet through three channels. The first one was through its distributors (12%). The second one was through wholesalers (26%) and the third one was the direct sale to end-users (62%). During August 2002-December 2000, the alleged party adjusted its price up and down below the controlled-price ceiling (steel sheet is a "controlled product" under the *Price Control Act* of 1999). The price adjustment of the alleged party led its distributors, wholesalers, to do the same thing. The officials concluded that the price adjustment conduct of the alleged party did not violate the *Price Control Act* of 1999 because the price was below the controlled-price ceiling for steel sheet. Also, there was no evidence to support the allegation of abuse of market dominance by setting an unjustly high price.

Quoted from: UNCTAD: *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries: Thailand, Lao, Kenya, Zambia, Zimbabwe*. United Nations. New York and Geneva. 2005.

Most agencies stated that they determine dominance in the same way as for privately owned and managed firms. The past has shown a tendency towards privatization and liberalization to foster efficiency and competition, which is implemented either by a general privatization law or by a sector-specific law. During privatization, competition authorities should have an advocacy role to ensure that the markets work properly after the privatization. For this advocacy to be effective, the competition authorities should be in a position to give binding recommendations in defined areas.

5. Best practices from the US–EU discussion regarding abuse of dominance

While other areas of competition law have experienced significant convergence, rules on unilateral conduct differ considerably across jurisdictions[768]. The EU and the US are good examples of this as is illustrated by the diverging Microsoft rulings in the two jurisdictions[769].

5.1. Objectives and criteria of unilateral conduct laws in the US and the EU

Almost all countries in the ICN report agree that ensuring an effective competitive process is an important goal or means to achieve other goals[770]. The survey also showed that the EU and the US have almost the same objectives (the EU has the additional objective to 'achieve market integration'). Even the list of criteria used for assessing dominance seems similar, with the EU using two additional criteria 'high prices' and 'profits of the firm' which the US does not use. However, when asked what the most important criteria are, significant differences are revealed between the US and the EU In the EU, 'market share', 'barriers to entry', 'market position and behaviour of competitors' and 'buyer power' are very important, but the US authorities mention none of these criteria as the most important one and focus instead on consumer harm. The first conclusion therefore is that both jurisdictions say that they pursue the same goals but use different approaches to reach them. These differences may be justified not only due to the historic and political context, but also because of different business environments[771].

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[768] Vickers (2007).

[769] *United States v Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) and *Microsoft v Commission*, T-201/04 [2007].

[770] International Competition Network (ICN) (2007). See also Section 4.3, which concerns the assessment of dominance.

[771] Well-developed capital markets provide an example for this. It is more accurate to trust in the well functioning of competition if access to capital is relatively easy because it enables the creation and expansion of firms that can enter into the market. See Anderson and Heimler (2007: 71).

Table 5 illustrates the features that the US and EU laws have in common and where they differ:[772]

Table 5: Differing features of US and EU unilateral conduct laws	
EU (Article 82 EC)	**US (Sherman Act Section 2)**
"Access-to-markets principle" • Contestability of monopolized markets • Fear of blockage of markets	"Non-intervention principle" • Privilege to single-firm action • Fear of false positives

5.2. Harm to competition vs harm to competitors

Article 82 of the EC Treaty prohibits the abuse of a dominant position. The authorities have to establish that a dominant position exists and that there is anti-competitive conduct. The counterpart in the US is Section 2 of the Sherman Act, which prohibits the monopolization and attempts to monopolize. There is a different approach to dominance in the US, because it is not the existence of dominance that requires the dominant firm to refrain from an anti-competitive conduct, but the anti-competitive attempt to create or maintain this position, which is forbidden by Section 2 of the Sherman Act. Hence, there must be a causal link from the anti-competitive conduct to market power[773].

The legal standards in the two jurisdictions differ considerably, but how much their approaches differ in practice depends crucially on how the terms are defined and interpreted. Harm to the competitive process for example is prohibited in the EU because it is assumed that the outcome of a sound competitive process is generally favourable to consumers. But harm to the competition process such as from foreclosure may also involve a strengthening or creation of a dominant position and consumers may be hurt directly, which are the necessary conditions in the US, so that the two standards may overlap in many respects.

[772] The following discussion is based on Fox (2003: 149 *et seqq.*, 2006a).
[773] Vickers (2005: 247).

5.2.1. The US view

The US Supreme Court followed the view of the US Department of Justice and the Federal Trade Commission that Section 2 of the Sherman Act is not an abuse of dominance law. Even monopolists who control a facility that competitors need have no duty other than to refrain from increasing their monopoly power by anti-competitive means. They have no duty of refraining from leveraging their market power in other markets, of fair dealing, or of providing a level playing field to competitors[774]. The framework that the US authorities follow is based on the harm to consumers and this harm is only expected when either prices increase or output decreases. If this is not the case, the unilateral conduct by a firm is said to only hurt competitors, not competition. Behaviour that increases efficiency and thereby benefits consumers is not prohibited by Section 2 even if that behaviour harms the competition process[775]. In the US Microsoft case, the Court of Appeals had to decide whether Microsoft had unlawfully tied its web browser to its operation system[776]. The Court of Appeals rejected the ruling of the lower court that had found the tying *per se* illegal and it demanded from the lower court a rule of reason evaluation that shows the anti-competitive effect. The Court of Appeals would probably require a showing that the tying increased or maintained the monopoly in the operating system market or that it decreased output and therefore directly harmed consumers[777]. This illustrates that even if a monopolist significantly suppresses the chances of competitors, the conduct is not necessarily illegal in the US The next section will show that in the EU, on the other hand, such conduct is likely to be illegal.

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[774] Fox (2006b: 69). Leveraging market power means that the dominant position in one market is used to exercise power in a related market. For example, a firm that has market power in one market can tie its product for this market to a product that it sells in another market where it initially does not have market power.

[775] Bloch *et al.* (2005: 331).

[776] *United States v Microsoft*, 253 F.3d 34 (D.C. Cir. 2001). For a description of the case, see Motta (2004: 511). The case not only involved tying, but also monopolization and attempted monopolization.

[777] Fox (2006a: 737).

5.2.2. The EU view

Article 82 EC prohibits all conduct that is covered by the Sherman Act Section 2 and in addition covers conduct by dominant firms that is not increasing market power. In the EU, dominant firms have the special duty not to exclude competitors by anti-competitive means, because it is assumed that a conduct that excludes firms from competing may harm the competition process[778]. This can be explained by the 'access-to-markets principle' mentioned above and is illustrated in Table 6. Harm to the competition process refers to situations where the behaviour of a firm reduces the intensity of competition, for example by putting constraints on the entry of new competitors, but does not have an immediate effect on consumers by limiting output or raising prices.

Table 6: The EU *vs.* US view

Harm to Competition		**Harm to Competitors**
(Outcome) Business conduct limits output, raises prices	(Process) Business conduct unnecessarily blocks competition on the merits	Efficient business conduct hurts competitors. Enforcement against this conduct will protect competitors and harm consumers.

Table based on Fox (2006b).

In a recent ruling, the European Court of First Instance considered the tying of the Windows Media Player to the Windows operating software[779]. The court found that Microsoft had foreclosed competition because other providers of media players could not compete on the merits and that Microsoft had tied the two products without objective justification. The diverse decision of the Microsoft case

[778] This is expressed in the case law of the European courts, but there is currently a discussion about a re-orientation of the European rules in the sense of a 'more economic approach'. See Dreher and Adam (2006: 259 *et seqq.*, 2007).

[779] *Microsoft v Commission*, T-201/04 [2007]. The case also involved the refusal to supply interoperability information.

in the US and the EU are illustrated in Table 6. The US authorities tend to assume that if a conduct does not directly harm consumers, it is only harmful to competitors, not to competition. Harm to the competition process is not investigated if there is no harm to consumers. The European authorities on the other hand are concerned with the foreclosure of markets and thus harm to the competition process. But harm to the competition process is difficult to distinguish from harm to competitors and there is a risk that they unnecessarily prohibit a conduct that is not harmful.

5.2.3. Identifying harmful conduct

The US courts and agencies assume that this probability of error is high because they consider it to be difficult to distinguish conduct that is harmful to the competition process from conduct that only hurts competitors. Furthermore, they assume the damage of over-enforcement to be greater than that of under-enforcement and are more sceptical towards the capabilities of enforcement agencies[780]. Their approach is therefore mainly a fear of false positives (incorrectly prohibiting conduct that belongs to the right-hand column of Table 6) and they do not consider harm to the competition process (i.e. assume it to be within the right-hand column of Table 6). The follow-up question is whether this leads to too many false negatives, because if cases of harm to the competition process are frequent, firms are allowed to behave anti-competitively. This shows the differences between the approaches in the two jurisdictions. The US law gives preference to single-firm action and not to possible harm to the competition process, because it considers it difficult to distinguish it from not harmful conduct. The EU law privileges the contestability of markets and thus investigates cases where markets are blocked. As pointed out above, the divide between the two jurisdictions is also due to differing assumptions about the consequences of considering or not considering a conduct. A possible answer would be a more detailed analysis of cases in the middle column of Table 6, i.e. those that concern the competition process[781]. Empirical work should be done to assess the effects of

[780] Kovacic (2007: 70).
[781] Fox (2006b: 76).

exclusionary practices and to quantify the dynamic losses from harm to the competition process[782].

Other competition authorities are more likely to be successful in the implementation and application of abuse of dominance laws when they are aware of the various possible conducts and their impacts in their country-specific context. Instead of following one of the approaches discussed above, competition authorities in developing countries should assess the consequences of, for example, considering or not considering harm to the competition process. If they choose to consider such cases, it will need more resources and may in some cases result in the prohibition of conduct that is not harmful. On the other hand, not considering them will allow certain dominant firms to foreclose the market and thus increase inequality, which may have particularly negative consequences in developing countries. Knowing the actual impact of these cases on the economy helps to find the optimal balance between the advantages and disadvantages of different approaches and legal standards.

5.3. Assessing error costs of competition enforcement

A possible approach to analyse the impact on the economy is an empirical assessment that estimates the error costs and the probability of errors based on the analysis of past cases[783]. Table 7 illustrates schematically the types of errors that can be made. One type of error is to declare a practice that is actually not harmful to competition to be illegal (dark grey). The other type is to declare a conduct that is harmful to competition as legal (light grey).

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[782] This is another question addressed by a study on the quantitative effects of anti-competitive practices in developing countries, which is currently being undertaken by UNCTAD.
[783] Kovacic (2007: 71). Such an error-cost framework must constantly be updated to take into account that the investigation techniques of the authorities are improving and the economic environment changing.

Table 7: Error costs of competition enforcement		
	Harm to Competition (should be illegal)	**Harm to Competitors (should be legal)**
Declared illegal	**Correctly prohibit** conduct that harms competition	**Incorrectly prohibit** conduct that does not harm competition, but only competitors
Declared legal	**Incorrectly allow** conduct that harms competition	**Correctly allow** conduct that doesn't harm competition, but only competitors
Table based on Evans and Padilla (2004) [784]		

Evidence about the probability that a certain conduct is assessed incorrectly should be provided. Together with the costs of each incorrectly decided case, these probabilities provide evidence on the accuracy of the present law and can give guidance on what changes should be made, because it will give competition authorities as well as policy makers a better picture of the economic reality in their jurisdiction. An illustrative example is the use of market share thresholds. Once authorities know how likely and costly it is to incorrectly find or not find dominance with the current standard, they know if they should change the threshold or use more behavioural criteria. Other costs, such as increased inequality, social instability, etc., should also be given a weight and be included in the framework. This will allow basing the legal standards on empirical evidence, but it will also increase the capacity of less experienced authorities and courts to use economic analysis in the decision making in future cases and therefore advance their competence and lead to convergence in the approaches between countries. It is clearly a demanding exercise and the lack of accurate data will form an obstacle to many jurisdictions, especially in developing countries. However, the discussion above showed that the benefits are likely to be significant and competence in the application of economic analysis is increasingly an essential skill for the competition authorities.

[784] Evans and Padilla (2004).

6. Recommendations

Abuse of dominance refers to cases in which a firm has a dominant position and then engages in a harmful conduct. It is related to the concept of unilateral conduct, which focuses on single-firm action and its potential anti-competitive effects, including the creation or strengthening of dominance, but does not require a prior existence of a dominant position. Abuse of dominance can be seen as an approach that uses the criterion of dominance as a filter to only analyse cases in which harmful effects are likely, because it is assumed that only dominant firms can engage in such conduct or that the conduct is only harmful if entered into by a dominant firm.

To find dominance, the relevant market first has to be defined. One problem here is that the often-used criterion 'willingness of the consumer to switch to other products' (substitution) is biased by the firm's conduct, which has already taken place and possibly allowed the sellers to set prices above the competitive level. Consumers who are then faced with an even further price increase might easily be willing to switch to other suppliers. When this criterion is used for the market definition, then the suppliers to which consumers switch are included in the relevant market under consideration because it is assumed that these producers sell close substitutes. But actually the switch to other suppliers is due to the fact that the price of the original product is already too high. The relevant market is then defined too broadly and other criteria, which focus more on product characteristics, have to be given more weight. On the basis of the market definition, it needs to be established that a dominant position exists. This assessment includes the analysis of market shares, entry barriers, position of competitors, vertical integration, economies of scale, buyer power, and access to infrastructure.

The second element of abuse of dominance is the abusive conduct. There are generally two types of abusive conduct: exploitive conduct and exclusionary conduct. The former refers to cases where firms charge excessively high prices from its customers, pay low prices to suppliers, or discriminate among consumers. The latter refers to cases where firms suppress competition by refusing to deal, engaging in predatory pricing or raising costs of entry in order to exclude competitors from the market and thus to create or strengthen a dominant position.

The difficulty here is that the same conduct may be harmful or efficient, depending on the individual case.

After looking at what abuse of dominance is and how it is approached in theory, we turned to the role of laws on abuse of dominance in developing countries. Such laws have to find a balance between three objectives: ensuring enough competition between firms in order to force them to be efficient, allowing a certain degree of profitability so that they have incentives to invest and innovate, and achieving an equal distribution of wealth and business opportunities among different parts of the society. While the discussion in developed countries focuses on the first two aspects in order to maximize innovation and growth, developing countries may also want to consider the third dimension and include the reduction of inequality and poverty in their objectives. But even the relationship between the first two aspects tends to be different in developing countries than in other regions, because they depend on factors that differ between developing and developed countries.

Firstly, since developing economies often have smaller markets and therefore a lower equilibrium number of firms that can exploit economies of scale and operate efficiently, it is more likely that one finds more concentrated national markets. One argument is that smaller markets allow fewer firms to operate efficiently and that higher concentration should therefore be accepted. The opposite view is that since small economies are more vulnerable to abuse of dominance, a stricter approach should be followed. The optimal solution differs from one country to another, because it depends on a number of individual characteristics such as barriers to entry. A stricter approach prevents high levels of concentration and this may be more accurate in cases where barriers to entry are high and where the economies are isolated from international trade. But this approach would have significant disadvantages for open economies with low barriers to entry if the market was not defined accordingly, because it can prevent firms from reaching an efficient size. Each country therefore must choose the optimal approach and define the relevant markets according to its situation. In general, in developing countries there are higher barriers to entry, less developed capital markets and more information asymmetry, which make the good functioning of competition more difficult than in developed countries.

Secondly, large firms play a different role regarding their investment activity in developing countries than they do in more developed economies. Established and possibly dominant firms can be important for less developed economies to have a sufficiently high level of investment in production. Long-term relationships and profitability make it easier for incumbent firms to invest. If there was fierce competition with constantly new firms entering the market and established, but less efficient ones leaving it, then the currently existing firms would not be able or willing to make sufficient investments. The dominant positions may have a negative impact on innovation, but since less developed countries generally operate in sectors with less advanced technology, they can use existing technology and innovation is not as important for them. Therefore, it may be less important for them to have the most innovative and efficient firms, but rather to have large incumbent firms that can make investments more easily. In less developed economies, the benefits of increased investments are more likely to outweigh efficiency losses that arise from a dominant position, because investments in production are relatively more important. As economies become more developed, it is increasingly crucial that the competition process selects those firms that are the most efficient and innovative. Countries therefore need to switch out of the more protective setting at the right time and expose their firms to more competition.

A related issue concerns investment in infrastructure. A government may not have sufficient resources to make investments in infrastructure and therefore may allow private firms to exercise a monopoly position in markets such as port, airport, or even road infrastructure. If the infrastructure is an essential facility for other enterprises, this firm has the power to exclude competitors or demand high prices. There needs to be a balance between the firm's incentives to invest and efficiency losses. It must be carefully assessed for what sectors the monopoly is allowed, how broad it needs to be, for what period it should be granted, and if concessions can be renegotiated after a certain time or situation.

Thirdly, distributional aspects may be important for developing countries. Smaller firms, which often represent poorer parts of society, may have to be given a better chance to compete against large dominant firms. Enforcement against exclusionary practices of dominant firms may therefore have to be fiercer. Competition law can be used for such public interest issues, but it is crucial that the law gives clear

guidance on how these objectives should be balanced against other objectives such as efficiency. Comparing this to the investment argument above shows that there are justifications for more but also for less strict standards in developing countries. These justifications naturally contradict each other and therefore necessitate a sound balance.

After analysing the role of abuse of dominance laws in developing countries, we took a broader perspective and compared the approaches to abuse of dominance across a number of developed and developing countries. A survey by the ICN investigated the differences between countries regarding the objectives of unilateral conduct laws and the assessment of dominance. It found that 'effective competitive process' and 'consumer welfare' are objectives that almost all jurisdictions share. There are, however, considerable differences in other objectives such as 'ensuring a level playing field' and ‘promote fairness and equality’.

The assessment of dominance is very much based on the criteria mentioned above. Most countries rank 'market shares of the firm and its competitors' and 'barriers to entry or expansion' among the most important criteria. These criteria are structural criteria, because they do not directly look at the firms’ behaviour, but at the market structures that influence their behaviour. The use of more structural criteria has the advantage of giving more clear-cut rules, which may be important particularly for developing countries and less experienced competition authorities. But even apparently clear rules such as market share thresholds for the assessment of dominance can make demanding case-specific analysis such as market definition necessary.

Developing countries often look at the situation in developed countries for possible ways to design their own competition laws. Examples could be the US or the EU, but particularly in the area of abuse of dominance, these two jurisdictions differ significantly. It is therefore beneficial to look at the differences in the two approaches in order to derive some lessons for developing countries. The first difference is that in the US Section 2 of the Sherman Act is not regarded as an abuse of dominance law, but as a unilateral conduct law. It does not always require a prior existence of a dominant position, but there has to be a causal link from the conduct to the creation or maintenance of a dominant position. A second difference is that the EU law wants to protect the competition process, while the US law only intervenes when

there is direct harm to consumers. The legal standards in the two jurisdictions differ considerably, but how much their approaches differ in practice depends crucially on how the above-mentioned terms are defined and interpreted. Harm to the competition process for example is prohibited in the EU because it is assumed that the outcome of a sound competition process is generally favourable to consumers. But the harm to the competition process may also involve a strengthening or creation of a dominant position and consumers may be hurt directly, which are the necessary conditions in the US, so that the two standards overlap in many respects. A reason for the disparity are differing assumptions about what types of conduct are harmful and how difficult it is to differentiate them from other conduct. The 'access to market principle' of the EU probably arises from the assumption that impediment to this access is severe and that it can be distinguished from other, not harmful, conduct. On the other hand, the 'non intervention principle' of the US is rather based on the assumption that the distinction of such conduct is difficult, that there is great danger of prohibiting behaviour that is not harmful, and that the unnecessary prohibition of efficient conduct is severe. One conclusion from the comparison is that such assumptions should be analysed and be grounded on the economic reality. How likely and severe errors of competition authorities are can, for example, be assessed in an analysis of past decisions and their effects on the economy. The impact of decisions should be assessed *ex post* in order to know if the rules need to be revised. The resulting country-specific error-cost framework can be an important input for competition authorities in developing countries, because it allows basing the rules on empirical evidence. Support of competition authorities in analysing their own cases and their impacts would therefore be valuable.

The insights from quantitative analysis are also crucial for finding a sound balance between the different objectives of competition policy. For example, incentives to innovate arise from the possibility to make profit and therefore depend to some extent on dominance, but this must be weighted *inter alia* against price increases by dominant firms. A second example is that developing countries often also have to consider distributional aspects of laws on abuse of dominance and therefore need to assess whether there exists a trade-off with efficiency considerations. Quantitative analysis will help competition authorities to understand the economic and political context in which their decisions and rules take place.

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STRIKING A BALANCE BETWEEN COMPETITION LAW ENFORCEMENT AND PATENT POLICY: A DEVELOPING COUNTRY'S PERSPECTIVE

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1. Introduction

The intersection of competition law and intellectual property rights (IPRs) is one of the most complex areas of competition law[785]. These two areas of law share a potentially conflicting relationship, as competition law restricts the abuse of substantial market power while IPRs may confer market power. Commentators in developed countries have proposed various ways to resolve this conflict. Some of them give primacy to competition law, while others emphasize the importance of protecting IPRs[786]. Yet some others advocate solutions that require balancing the policy considerations underpinning these two bodies of law, while scholarship from developed countries is didactic on how developing countries should resolve this conflict[1]. In a well-known article in 1984, Louis Kaplow proposed a complex analytical framework for balancing the conflicting policy goals of competition law and patent policy. (*See generally* Kaplow, *supra* note 785.) Developing countries

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[785] Kaplow characterizes the intersection of competition law and patent law in particular as "*a source of perpetual confusion and controversy*" and as a conflict "*even more deep-seated than is generally perceived*". *The Patent-Antitrust Intersection: A Reappraisal*, 97 HARV. L. REV. 1813, 1815–16 (1984).

[786] Ward Bowman, Jr. was one of leading proponents of minimal competition law restrictions on the exercise of IPRs, while William Baxter advocated a stronger role for competition law in regulating the exercise of patent rights. *See generally* WARD S. BOWMAN, PATENT AND ANTITRUST LAW (1973); William F. Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267 (1966).

must be mindful of their own unique policy considerations. The main justification for protecting IPRs, especially patents, is to generate incentives to innovate. This justification is persuasive in developed countries, where most of the potential inventors in the world are located. It carries much less weight in developing countries, most of which possess limited capacity to innovate. In resolving the conflict between competition law and IPRs, developing countries must recalibrate the balance struck by developed countries.

Although all the major IPRs grant their owners some proprietary rights, the focus of this research is primarily on patents. Of the three major types of IPR — patents, copyrights and trademarks — patents grant the strongest protection. A patent gives a patentee the exclusive right of exploitation, which entitles the patentee to exclude others from copying or commercializing an invention that falls within the scope of the patent. Patents are also more likely than copyrights and trademarks to endow their owners with substantial market power. As will be discussed in greater detail later, whether an IPR creates market power, and hence potentially raises competition law issues, crucially depends on the availability of substitutes for the product incorporating the protected intellectual property[787]. In the absence of substitutes, the producer of such a product will wield substantial market power. An example will illustrate this point. Assume that a patentee has obtained a patent on a new drug that cures a rare disease. The patented drug is currently the only cure for that disease. Under these circumstances, the patentee will possess substantial market power in the market for treatment for that rare disease. In practice, it is not altogether rare for a patented technology to be the only one capable of performing a certain function or possessing a unique quality desired by consumers. Patent protection of such a technology would create market power and raise competition law issues.

In comparison, with the exception of software copyrights, copyrights are less likely to create substantial market power[788]. This is

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[787] The focus here is on competition law issues in product markets incorporating intellectual property, and not on technology markets and innovation markets. While the latter two are undoubtedly important, the economics literature and legal thinking on them still remain to be developed. Moreover, these two types of markets are likely to have less salience for developing countries.

[788] In many ways, software is different from other types of materials that are copyrightable in that software is mostly valued for its functionalities and not its

due to the fact that copyrights offer a narrower scope of protection[789]. While a patent prohibits an unauthorized third party from replicating a protected technology, even if that is done with no assistance from the patentee or with no knowledge of the patentee's know-how, copyright protection poses no bar to independent creation of protected content. Copyright law merely prohibits a third party from copying and reproducing the content created by the copyright holder. Moreover, copyright-protected materials rarely constitute the only product in a relevant market. Even in the case of most popular fiction, a novel such as *The Da Vinci Code* is but one of many popular adult thriller novels in the market. If the price of *The Da Vinci Code* doubled, some readers might switch to other novels, or to other forms of entertainment, such as films or music, altogether.

Trademarks are similarly unlikely to give rise to substantial market power. A trademark rarely possesses such unique qualities that it faces no competition from other trademarks. It is important to distinguish between the substitutability of the trademark and that of the underlying product. One may argue that a desktop computer operating system bearing the Microsoft mark has few meaningful substitutes. However, it is the underlying product of a desktop computer operating system, not the Microsoft mark that lacks substitutes. Presumably, if Windows were manufactured by, say, Sun Microsystems instead of Microsoft, consumers would be happy to purchase it from Sun. Two prominent U.S. competition law commentators have concluded that "*IP other than patents, secret know how or software copyrights, is unlikely to yield sufficient economic power to give (sic) rise to serious Section 2 [monopolization] issues*"[790]. In light of the preceding discussion, the focus is on the conflict between competition law enforcement and patent policy.

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creative content. Due to a variety of reasons, such as network externalities, software may possess unique properties and functions that give it a very low degree of substitutability in the eyes of consumers. In terms of market effects, a software copyright is similar to a patent. This may explain why software is often protected by patent as well as copyright.

[789] Pierre Régibeau & Katharine Rockett, *IP Law and Competition Law: An Economic Approach*, in THE INTERFACE BETWEEN INTELLECTUAL PROPERTY RIGHTS AND COMPETITION POLICY, 541 (2007).

[790] LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 831 (2000).

At this juncture, it is important to clarify the scope of this research. It does not address the relationship between competition law and economic development. The question of whether competition law enforcement may promote economic development has received considerable attention in recent years. It has been argued that by improving consumer welfare and encouraging domestic enterprises to become more efficient, competition law enforcement helps developing countries to progress economically. It is certainly possible that the balance between competition law enforcement and patent policy may have general implications on development, and that possibility is itself a worthwhile object of research. However, the scope of this research is narrower. It is confined to how developing countries should strike a balance between competition law enforcement and patent protection as a matter of sound competition policy, taking into account both allocative and dynamic efficiency considerations. The perspective adopted is one of competition law, and not one of development.

Part 2 explains the prevalent views in developed countries on the intersection of competition law enforcement and patent policy, with a special focus on the framework advocated by Louis Kaplow. Part 3 examines the problems with applying Kaplow's framework to developing countries, and suggests necessary modifications based on lessons from development economics literature. Part 4 reviews some practical issues arising from the implementation of the modified framework and suggests how developing countries may use this framework to help them balance competition law enforcement against patent policy.

2. The balance between competition law enforcement and patent policy in developed countries

The fundamental cause of the conflict between competition law enforcement and patent policy lies in the fact that competition law restrains the abuse of substantial market power that patents sometimes create. Competition law constrains a dominant firm's choice of competitive conduct. As the European Court of Justice (ECJ) has repeatedly asserted, a dominant firm bears a special responsibility towards the competitive process[791]. While the U.S. courts have

[791] In *Michelin*, the ECJ stated that a dominant firm "*has a special responsibility not to allow its conduct to impair genuine undistorted competition*" in the market.

generally given dominant firms greater freedom of action,[792] it is nonetheless true that in U.S. antitrust jurisprudence, there exists a class of competitive conduct that a firm without market power is free to pursue, but which may ran afoul of competition law when undertaken by a dominant firm[793]. Meanwhile, by granting a patentee the exclusive right to exploit an invention for a certain period of time, a patent may give rise to market power. The existence of market power must be determined on a case-by-case basis. As discussed earlier, one of the main determinants is whether there are close substitutes for a patented product. Early U.S. case law suggested that patent ownership created a presumption of market power on the part of the patentee[794]. This presumption had long been criticized by economists and competition law scholars as being inconsistent with economic reality. In 1995, the U.S. Department of Justice and the Federal Trade Commission announced in the *Antitrust Guidelines for the Licensing of Intellectual Property* that they would not, as a matter of enforcement policy, apply this presumption to a patentee[795]. Finally, in 2006, the U.S. Supreme Court adopted the same view in the Illinois Tool Works case[796]. After elucidation of the fundamental cause for the conflict between competition law enforcement and patent policy, what follows is a review of the divergent approaches suggested by commentators to resolve the conflict.

2.1. Patent policy trumps competition law enforcement

Some commentators have suggested that patent policy trumps competition law conflict. Bowman is a prime example. His competitive superiority test "*assumes the propriety of allowing a patentee to use any method of charging what the traffic will bear if, and only if, the reward to*

Case 322/81, *NV Nederlandsche Banden-Industrie Michelin v. Commission* [1983] ECR 3461, [1985] 1 CMLR 282, para. 57.

[792] *See Verizon Communications v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

[793] See *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).

[794] See, e.g., *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 16 (1984); *United States v. Loew's, Inc.*, 371 U.S. 38 (1962).

[795] Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property*, 4.

[796] *Independent Ink, Inc. v. Illinois Tool Works, Inc.*, 547 U.S. 1002 (2006).

the patentee arising from the conditional use measures the patented product's competitive superiority over substitutes"[797]. This test favours patent policy by giving a patentee enormous freedom of action. Under this test, "*a licensee's or buyer's willingness to accept a restriction as a condition*" to a patent licensing transaction is treated "*as affirmative evidence of legitimacy*"[798]. In fact, according to Kaplow, Bowman's test is so permissive that "*pure horizontal cartelization is virtually the only behavior he would prohibit*"[799].

Régibeau and Rockett propound a similarly pro-patent view. They advocate for "independence" of patent law from competition law enforcement. In particular, they argue that "*competition law should respect the rights granted by (intellectual) property law and that the trade-off between static and dynamic efficiency is not a primary concern of competition law*"[800]. They provide two main justifications for their position. First, they argue that patent law, and intellectual property law generally, has struck an appropriate balance between static efficiency and dynamic efficiency considerations, with which competition law should not tinker[801]. Second, they argue that patent law focuses on the *ex ante* incentives to innovate whereas competition law evaluates the competitive effects of a business practice *ex post*. More information is always available in the *ex post* scenario, when competition law intervenes. With the benefit of hindsight, a competition authority often will be tempted to take away the rewards that induced an inventor to pursue the innovation *ex ante*. In fact, Régibeau and Rockett assert that "*the optimal level of monopoly power ex post is none*"[802]. However, falling for this temptation would "*wreck the delicate balance achieved by IP law*"[803].

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797 Bowman, *supra* note 786, at x; *see id*. at 88.
798 Kaplow, *supra* note 785, at 1849–50.
799 *Id*.
800 Régibeau & Rockett, *supra* note 789, at 524.
801 *Id*. at 523.
802 *Id*. at 524.
803 *Id*.

2.2. Competition law enforcement trumps patent policy

Another common view is that competition law enforcement takes precedence over patent policy, although this view is usually asserted less forcefully than is the patent primacy view. One of the early proponents of this view is Baxter, who put forward the comparability test as a solution to the competition law–patent conflict. Under this test, competition law should ensure that a patentee receives benefits that are roughly comparable to the ultimate value of the patent[804]. Kaplow characterizes Baxter's test as reflecting "*a bias toward minimizing the infringement upon antitrust policy*" and as tending "*toward results favoring [the] antitrust side of the conflict*"[805]. In a variety of contexts, the U.S. Supreme Court has expressed a similarly pro-antitrust view. In *Kodak v. Image Technical Services*, the Court, addressing the issue of leveraging monopoly power from one market to another, stated that "*power gained through some natural or legal advantage such as patent, copyright, or business acumen can give rise to liability if a seller exploits his dominant position in one market to expand this empire into the next*"[806].

On the other side of the Atlantic, the European Community courts have propounded similar views favouring competition law in a number of landmark refusal-to-deal cases. In the Court of First Instance (CFI) Microsoft decision, the CFI concluded that the fact that Microsoft's workgroup server interoperability information was protected by patent and trade secret laws did not relieve the company's refusal to supply competitors with such information from competition law scrutiny[807]. Under certain conditions, "*an undertaking in a dominant position may be required to grant a license covering its intellectual property rights*"[808]. In *IMS Health v. NDC Health*, the ECJ laid down the conditions that must be established to compel a dominant firm to license its IPRs to competitors: first, the refusal to license prevents "*the emergence of a new product for which there is a potential consumer demand*", second,

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[804] Baxter, *supra* note 786, at 313.
[805] Kaplow, *supra* note 785, at 1853–54.
[806] *Eastman Kodak v. Image Tech. Servs.*, 504 U.S. 451, at 480, n. 29 (1992).
[807] Case T-201/04, *Microsoft v. Commission* [2007] ECR 00, [2007] 5 C.M.L.R. 11, para. 283–290.
[808] *Id.* at para. 290.

the refusal "*is unjustified*", and third, the refusal excludes "*any competition on a secondary market*"[809]. Two observations of this judgment are in order. First, even though the IPR at issue in the IMS case was a copyright and not a patent, the ECJ did not limit its conclusions to copyrights. The ECJ spoke of IPRs generally in the judgment[810]. The ECJ's characterization of an intellectual property that may be subject to a special duty to supply is also more reminiscent of a patent than of a copyright. The ECJ asserted that only an intellectual property that is indispensable to competitors' ability to compete with the dominant firm is subject to this duty[811]. The ECJ defined indispensability by the following two criteria: "*whether there are products or services which constitute alternative solutions, even if they are less advantageous, and whether there are technical, legal or economic obstacles capable of making it impossible or at least unreasonably difficult for any undertaking seeking to operate in the market to create, possibly in cooperation with other operators, the alternative products or services*"[812]. Copyrighted materials rarely enjoy such a degree of indispensability; patented subject matter is more likely to do so. Therefore, the ECJ's statements in IMS are likely to apply with equal force to patented products. The CFI's invocation of the IMS criteria in the Microsoft case, which involved patent and trade secret protection, corroborates this view.

The second observation is that the three conditions laid down in the IMS case are very stringent and the judgment therefore should not be read as an unequivocal endorsement of the competition law primacy view. However, the fact remains that the European Community courts have generally taken a pro-competition law stance on the conflict between competition law enforcement and patent policy. This is all the more apparent when one compares the European Community's approach to refusal to license IPRs to that in the U.S., where some have argued for a *per se* right to refuse to license[813].

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[809] Case C-418/01, *IMS Health GmbH v. NDC Health GmbH* [2004] ECR I-5039, [2004] 4 C.M.L.R. 28, para. 38.
[810] *Id.* at para. 23, 25.
[811] *Id.* at para. 28–29.
[812] *Id.* at para. 28.
[813] SULLIVAN & GRIMES, *supra* note 790, at 848–53.

2.3. Striking a balance by weighing allocative efficiency losses against dynamic efficiency gains

While there are some merits to the views that either competition law enforcement or patent policy should reign supreme, these are nonetheless overly simplistic. Kaplow has insightfully pointed out the deficiencies in Bowman's and Baxter's tests, which will not be repeated here[814]. Moreover, the assertion by Régibeau and Rockett that competition law should not be concerned with balancing static efficiency with dynamic efficiency is plainly mistaken. Competition law regularly takes into account the effects of a business practice on innovation, and balances dynamic efficiency against static efficiency. Merger review is one prime example. It would be untenable to argue that competition law should ignore dynamic efficiency considerations only in its interface with patent policy, which is arguably the area of competition law in which these considerations are the most important. These commentators fail to take into full account the fact that both competition law and patent law incorporate allocative efficiency and dynamic efficiency considerations. A sensible resolution of the competition law–patent conflict would require a careful balancing of these considerations.

Despite their different purposes, both competition law and patent law take into account allocative efficiency and dynamic efficiency considerations, albeit with different emphases[815]. Competition law is primarily focused on allocative efficiency, i.e. ensuring that consumers obtain the goods they desire the most at the lowest possible price and that producers produce the goods that consumers desire in the most cost-efficient manner. However, competition law recognizes the importance of dynamic efficiency and the fact that the most significant improvement in consumer welfare often results from technological innovations that give rise to new or better products, and not from keener competition in the provision of existing products. Therefore, as mentioned earlier, competition authorities and courts do consider gains in dynamic efficiency when assessing the competitive effects of a business practice. Patent law grants exclusivity in exploitation in order to induce potential inventors to innovate. This exclusivity results in losses in allocative efficiency, because patented products are likely to be produced below the competitive level. However, these losses are

[814] *See* Kaplow, *supra* note 785, at 1845–55.
[815] For a more detailed discussion of this issue, *see id.* at 800–07.

deemed to be the necessary price that must be paid to induce innovations. The balance to be struck in patent policy is how to offer potential inventors sufficient incentives without incurring excessive losses in allocative efficiency. Therefore, both bodies of law balance allocative efficiency against dynamic efficiency, which forms a useful starting point for the resolution of the conflict between them.

Having established a common ground between competition law and patent law, it remains to be seen how precisely this common ground can be used to resolve the conflict between them. Kaplow provides the most elegant framework for the resolution of this conflict[816]. Two fundamental premises underpin Kaplow's framework. First, there are two main policy dimensions to the competition law–patent conflict — the length of the patent term and the scope of patent protection and permissible exploitation, the latter of which is governed by a variety of patent and competition law rules[817]. Second, society should set the first dimension by maximizing the net social benefits of granting patent protection, and the second dimension by comparing the reward that redounds to a patentee from adjusting a particular rule on patent exploitation with the allocative efficiency loss resulting from the adjustment. The second dimension, which is the principal concern of this research, is set taking the optimal patent life as given, even though the two dimensions ideally should be determined simultaneously.

With respect to the second dimension, the fewer and the more lax are the restrictions imposed by competition law on patent exploitation, the greater is the patentee reward from an invention, and therefore the greater is the inducement to potential inventors. With respect to the first dimension, the net social benefits of patent protection are maximized when the difference between the total social benefits and the total social costs of patent protection is the greatest. This difference is maximized when the marginal social benefit of patent protection equals its marginal social cost. The social benefits of patent protection include the consumer welfare derived from the emergence of a new

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[816] The following discussion is based on Kaplow's article, "*The Patent-Antitrust Intersection: A Reappraisal*". Unless otherwise indicated, the ideas are attributed to pp. 1821–1845 of that article, *supra* note 785.

[817] Although he does not discuss the possibility, Kaplow's model presumably can be used to determine other dimensions to the scope of patent protection, such as the breadth of the patent misuse doctrine.

product or the improvement of an existing product, and the possible future inventions that are built upon the current invention. The most important social cost of patent protection is the deadweight loss resulting from the exclusive exploitation of a patent. Exclusive exploitation is likely to result in production below the competitive level. Whenever that happens, society suffers a loss in allocative efficiency, known as the deadweight loss.

The pivot of Kaplow's framework is the ratio test, which is defined as patentee reward divided by monopoly loss. This test is used to determine the second dimension discussed above, i.e. whether competition law should permit a particular patent exploitation practice, such as an exclusive license. Patentee reward and monopoly loss refer to the incremental reward and loss from allowing the patent exploitation practice at issue. When setting the optimal patent life, the policy maker will implicitly also determine an optimal patentee reward–monopoly loss ratio, which represents the reward–loss trade-off made when extending the patent life by the last incremental year. The implicit determination is explained by the fact that the marginal social benefit of patent protection is dependent on the incremental patentee reward, and the monopoly loss is one very important component of the marginal social cost of patent protection.

Once the optimum patent life has been set, what the ratio test seeks to answer is "*whether the total reward to the patentee implicit in the optimal patent life can be achieved at a lower cost*"[818]. The answer is obtained by comparing the ratio associated with a particular patent exploitation practice with the optimal ratio. A patentee reward–monopoly loss ratio can be computed for every patent exploitation practice[819]. The optimal ratio represents the most cost-effective way in which society can induce inventions by adjusting patent life. If the ratio for a particular patent exploitation practice is lower than the optimal ratio, the practice

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[818] Kaplow, *supra* note 785, at 1831.

[819] Strictly speaking, there is a ratio associated with every patent exploitation practice for every patent, because patentee reward depends on "*a number of factors, including the market value of the invention, the structure of the market involving the patented process or product, and the attributes of the patentee (such as marketing and production capacities) that determine its range of options within that market*." *Id*. at 1823. However, for ease of application, it is assumed that there is a generalized ratio for every type of patent exploitation practice.

should be prohibited. Society would be better off prohibiting the practice at issue and keeping the last incremental year of patent life. If the ratio for a particular patent exploitation practice is higher than the optimal ratio, the practice should be allowed, subject to the requirement that patent life should accordingly be shortened. Society would be better off obtaining the incremental patentee reward by allowing a particular patent exploitation practice than by granting the last incremental year of patent protection.

Despite the theoretical elegance of his model, Kaplow himself acknowledges that there are considerable obstacles to applying his model in real-world contexts. First and foremost, the optimal patentee reward–monopoly loss ratio that serves as the benchmark for comparison is very difficult to ascertain. Kaplow remarks that "*our knowledge is inadequate to inspire great confidence even in the desirability of having a patent system at all, much less in the ability to make the subtle measurements of marginal effects that determine the ratio implicit in the optimal patent life*"[820]. As a second-best solution, Kaplow proposes a cost-effectiveness analysis, which requires the competition authority to derive the ratios for all possible patent exploitation practices and align them from the highest to the lowest. A comparison can then be made of the practices that are currently allowed and prohibited to ensure that the total patentee reward is obtained from practices that have the highest ratios. This analysis is so named because the goal of the exercise is to obtain the same total reward in the most cost-effective manner, i.e. by incurring the least aggregate monopoly loss.

Even this second-best formulation of his ratio test, however, is too difficult to apply. Therefore, Kaplow suggests a number of factors that can be used as proxies to facilitate the application of the test. These factors include "*the extent to which the reward is pure transfer, the portion of the reward that accrues to the patentee, and the degree to which the reward serves as an incentive*"[821]. The first of these factors requires some explanation. By a pure transfer, Kaplow refers to a situation in which a patent exploitation practice results in transfer of surplus from one group in society to another, such as licensees to the licensing patentee, without an attendant increase in deadweight loss. In

[820] *Id.* at 1833–34.
[821] *Id.* at 1842.

the case of a pure transfer, the patentee reward may increase substantially without a corresponding increase in monopoly loss. Therefore, all else being equal, a patent exploitation practice that results in a pure transfer is to be preferred to one that does not.

Given the difficulty in quantification, in the concrete applications of the ratio test in his article, Kaplow does not attempt to calculate any ratios. Instead, he analyses qualitatively the effects of a patent exploitation practice on the ratio's denominator and numerator. This is often done with reference to the three factors mentioned in the last paragraph. If a practice is likely to result in a substantial increase in the numerator, patentee reward, without an attendant substantial increase in the denominator, monopoly loss, Kaplow concludes that competition law should permit it. An example would be a practice that results in a pure transfer. If a practice is likely to result in a substantial increase in the denominator without an attendant increase in the numerator, competition law should prohibit it. An example would be a price-fixing cartel disguised as a licensing arrangement with price restrictions.

Even though Kaplow's ratio test and its alternative formulations are difficult to apply in practice, they provide useful insights into how the balance between competition law enforcement and patent policy should be attained. When assessing a patent exploitation practice, a competition authority must consider both its effects on patentee reward and hence innovation incentives, and its social costs in the form of deadweight loss. This insight proves to be useful in balancing competition law enforcement and patent policy in developed and developing countries alike.

3. The balance between competition law enforcement and patent policy in developing countries

3.1. Adapting Kaplow's model to developing countries — relevant considerations

Having introduced an analytical framework for balancing competition law enforcement and patent policy in developed countries, it is important to articulate why adjustments are needed to adapt Kaplow's framework to the developing country context. At this point, one should

recall that one of the basic premises of Kaplow's framework is that patentee reward induces potential inventors to engage in research and development. The ratio test compares patentee reward against monopoly losses resulting from allowing a particular patent exploitation practice. The underlying policy judgment is that some static efficiency loss in the form of monopoly loss should be sustained to generate patentee reward to induce innovative activities. However, depending on the country at issue, what is a sound policy decision in the context of a developed country may not be so in a developing country. As noted by Correa, "*the static-dynamic efficiency rationale applicable to a developed country does not necessarily hold in low income countries*"[822]. In the case of least developed countries, "*the present sacrifice of static efficiency finds no justification in future gains of dynamic efficiency as domestic innovation is unlikely to occur and foreign innovation depends on larger markets in developed countries*"[823].

The fundamental reason that Kaplow's framework requires adaptations is that, oftentimes, the potential inventors are not located in developing countries, but in developed countries. This is especially true of countries with little capacity to innovate. The implications of this are twofold. The first concerns the domestic welfare impact of favouring patent policy. Increasing patentee reward by adopting more permissive competition law standards for patent exploitation practices may not spur innovation in some developing countries because there may not be any potential inventors to whom to provide incentives. These developing countries may legitimately question whether the trade-off of between allocative efficiency and dynamic efficiency is worth making. Moreover, adopting more permissive competition law standards for patent exploitation practices may impede domestic producers' ability to imitate a foreign technology. For instance, under a stringent competition law standard — one that imposes significant restrictions on a patentee's freedom of action — a developing country may make it easier for domestic firms to obtain a compulsory licence from a foreign patentee. This could be achieved by adopting a liberal interpretation of the

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[822] Carlos M. Correa, *Intellectual Property and Competition Law—Exploring Some Issues of Relevance to Developing Countries*, ICTSD INTELLECTUAL PROPERTY AND SUSTAINABLE DEVELOPMENT SERIES ISSUE PAPER NO. 21, 6 (2007).
[823] *Id.*

essential facilities doctrine, as is advocated by Correa[824]. Such a policy, which favours competition law enforcement, will enhance a developing country's imitative capacity. Adopting a contrary policy in the name of promoting dynamic efficiency will hurt domestic imitative capacity. Whether this is a relevant consideration depends on the extent of imitation taking place in a particular developing country.

The second implication concerns the international incentive effects of favouring patent policy. With the exception of a few developing countries, potential inventors are much more likely to be found in developed countries. Therefore, favouring patent policy will only increase reward to foreign patentees and induce foreign inventors to innovate. A developing country may justifiably ask whether and why it should sacrifice domestic consumer welfare and perhaps imitative capacity in favour of foreign inventors, especially those in developed countries. Even if the answer is in the affirmative, the competition authority of a far-flung developing country may still wonder whether a potential inventor in a developed country would take into account the incentives provided by its competition law regime. The answer to this question will depend on the size of the economy of the developing country at issue, among other factors.

If adjustments were to be made, would one set of adjustments suffice? The answer seems to be no. Correa's comments crucially suggest that developing countries cannot be treated as a monolith. The question is how one should categorize developing countries for our present purpose. In order to do so, one must distinguish between production capacity, imitative capacity, and innovative capacity[825]. The

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[824] Correa, *supra* note 822, at 8–13.

[825] Carlos A. Prima Braga and Carsten Fink of the World Bank distinguish between production capabilities and innovative capacity. *See The Relationship Between Intellectual Property Rights and Foreign Direct Investment*, 9 DUKE J. COMP. & INT'L L. 163, 167 (1998). Economists have distinguished between imitative and innovative capacities. See, e.g., Carmelo Pierpaolo Parello, *A North-South Model of Intellectual Property Rights Protection and Skill Accumulation*, 85 J. OF DEV. ECON. 253 (2008); Yongmin Chen & Thitima Puttitanun, *Intellectual Property Rights and Innovation in Developing Countries*, 78 J. OF DEV. ECON. 474 (2005); Edwin Lai, *International Intellectual Property Rights Protection and the Rate of Product Innovation*, 55 J. OF DEV. ECON. 133 (1998); Yong Yang, *Why do Southern Countries Have Little Incentive to Protect Northern Intellectual Property Rights?*, 31(4) CANADIAN. J. OF ECON. 800 (1998).

meaning of the first and the last capacities should be apparent. Regarding the second capacity, economists have observed that imitation itself requires considerable know-how and human capital. Therefore, some developing countries may only have the technical capacity to produce and not to imitate.

Some developing countries may have little imitative and innovative capacities, and only engage in production of the simplest kind. The least developed countries are examples of such countries, which may be called "production" countries. Some developing countries may possess both production and imitative capacities, but not innovative capacity. Even though imitation requires know-how and human capital, the technological sophistication required for innovation is higher than that required for imitation. Therefore, some developing countries may only possess the technical capabilities to imitate and not to innovate. Most developing countries are likely to belong to this category of "imitation" countries. Finally, some developing countries may possess all three capacities. South Korea, with its prominent electronics and shipbuilding industries, and Taiwan, with its strength in the computer and the semiconductor sectors, come to mind. China, which has become one of the top five countries of origin for Patent Cooperation Treaty applications at the World Intellectual Property Organization (WIPO), is another example[826]. These countries may be called "innovation" countries. The importance of patentee reward in Kaplow's ratio test, and more generally, the importance of dynamic efficiency considerations in the competition law–patent balance, understandably differs for various categories of developing countries. The balance must be struck differently for each of them.

3.2. Review of economics literature

To understand precisely the kind of adjustments needed to be made to Kaplow's framework, it is didactic to consult relevant economics literature. Unfortunately, there is scant economics literature that examines the relationship between the competition law–patent balance

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[826] World Intellectual Property Organization, *WIPO Patent Report: Statistics on Worldwide Patent Activity (2006 Edition)*, available at http://www.wipo.int/ipstats/en/statistics/patents/patent_report_2006.html#P70_1820.

and the incentive to innovate in developing countries. However, based on stylized models, economists have studied the impact of heightened IPR protection on the incentives to imitate and innovate in developed and developing countries. Heightened IPR enforcement will render it more difficult for competitors to imitate a protected technology, hence increasing patentee reward. Even though this body of literature does not directly address the competition law–patent balance, it is nonetheless highly relevant. Recall Kaplow's insight that adjusting the length of patent life and modifying the scope of permissible patent exploitation under competition law are two means to the same end[827]. Stated more generally, as long as a policy decision raises patentee reward, whether it is made in the realm of patent policy by lengthening the patent life or by intensifying patent enforcement, or in the realm of competition law by adopting more permissive standards on potentially anti-competitive patent exploitation practices, that policy decision will boost incentives to innovate.

In keeping with the prevalent approach in the development economics literature, known as the international product cycle, Parello constructs a model, which assumes that developed countries innovate and developing countries imitate the technology created by developed countries, to study the impact of heightened IPR protection on the rate of innovation in developed countries and the rate of imitation in developing countries. Parello elaborates two scenarios, one in which imitation is the only means of technology transfer, and one in which technology transfer takes place both by imitation and through foreign direct investment (FDI)[828]. In his model, firms in developing countries only compete with those in developed countries by imitating the technology of the latter[829] Parello concludes that in the absence of FDI, improved IPR protection induces a short-term slowdown in the innovation rate in developed countries (even though there is no change in the long-term innovation rate), and impedes technology transfer by imitation[830]. Parello does not draw any definitive conclusions regarding the rate of innovation and the rate of imitation in the presence of FDI[831].

[827] Kaplow, *supra* note 785, at 1831–37.
[828] Parello, *supra* note 825, at 255.
[829] *Id.* at 260.
[830] *Id.* at 255, 265–66.
[831] *Id.* at 255.

One key analytical step in Parello's model is that improved IPR protection affects producers in developing countries by raising the costs of imitation[832]. The causal link between improved IPR protection and the costs of imitation is likely to be strong. Even though the causal link between adopting more permissive standards for patent exploitation practices and the costs of imitation may not be as strong, it is nonetheless substantial. For example, as mentioned earlier, by making it harder for domestic producers to obtain a compulsory licence from a foreign patentee, a developing country raises the costs of technology transfer to its producers and hence the costs of imitation. Moreover, by allowing a developed country patentee to use exclusive dealing arrangements to foreclose imitating domestic competitors, a developing country similarly raises the costs of imitation by making it harder for its domestic producers to market their products. The costs of imitation determine the ease and likelihood of imitation by a developing country producer. In Parello's model and other models considered below, once a developing country producer successfully imitates a foreign technology and produces the same product to compete with the developed country patentee, the patentee's profit from his invention falls. The patentee reward diminishes, thereby reducing a potential inventor's incentive to innovate. Therefore, favouring patent policy in the competition law–patent balance has a similar effect to raising IPR protection in Parello's model. The fact that the variable at issue is different does not undermine the relevance of his conclusions.

Lai supplements Parello's analysis by examining the effect of enhanced IPR protection in developing countries on the rate of innovation in developed countries when the means of technology transfer consists of both imitation and FDI. Again, Lai assumes that only developed countries innovate and developing countries can only imitate technologies created by developed countries[833]. When imitation is the only means of technology transfer, Lai's conclusions are similar to Parello's. They both find that the rate of innovation in developed countries and the rate of imitation in developing countries fall as a result of heightened IPR protection in developing countries[834]. Meanwhile, when technology transfer is accomplished through FDI, Lai finds that both the rate of innovation and the rate of imitation rise in response to

[832] *Id.* at 261.
[833] Lai, *supra* note 825, at 134.
[834] *Id.* at 135.

enhanced IPR protection in developing countries[835]. The difference in results is due to the fact that in the former case, heightened IPR protection in developing countries will induce inventors in developed countries to invest in more innovation, raising their demand for skilled labour in their countries[836]. Wages for these workers rise raising the costs of innovation[837]. This increase in costs will in fact overwhelm any gains to the inventors from the enhanced IPR protection in developing countries, causing the overall rate of innovation to drop[838]. More importantly, Lai concludes that, when technology transfer is accomplished through both imitation and FDI, the rate of innovation in developed countries and the rate of imitation in developing countries will increase in response to improved IPR protection in developing countries so long as certain conditions are met, including that the rate of FDI is sufficiently high[839].

Yang focuses on a different aspect of the relationship between IPR protection in developing countries and the incentive to innovate in developed countries. Yang posits that only developed countries have the capacity to create the technologies for which developing countries are the main source of demand[840]. An example of such a technology is the cure for a tropical disease that is most commonly found in developing countries, such as malaria. The question that Yang seeks to answer is that, under these circumstances, how developing countries can induce developed country inventors to invest in these technologies by offering adequate IPR protection to these technologies in their countries. Yang finds that because of their incentive to freeride on each other's IPR protection, developing countries must cooperate with one another[841]. One of Yang's key insights is that it is not worthwhile for a developing country to offer IPR protection to developed country technologies alone[842]. The welfare loss from the enhanced IPR protection will more than outweigh the gains from the increased inflow of developed country technologies, given that one country's enhanced protection will provide negligible incentives to developed country

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835 *Id.*
836 *Id.*
837 *Id.*
838 *Id.*
839 *Id.* at 147.
840 Yang, *supra* note 825, at 802.
841 *Id.*
842 *Id.*

inventors. In the ideal world, all the developing countries would cooperate to offer IPR protection to developed country technologies. Given the practical difficulties in achieving that goal, some of the developing countries should form "*cooperation coalitions*"[843]. Countries within these coalitions offer higher protection than those outside of the coalitions[844]. In fact, non-coalition developing countries are likely to lower their IPR protection to freeride on the effort of the coalition countries[845]. However, once the number of countries in these cooperation coalitions is large enough, developed country inventors will receive sufficient incentives to invest in technologies needed by developing countries[846].

Yang leaves unanswered an important question, which is how one goes about deciding which developing countries should join these cooperation coalitions. Yang merely suggests that a "*practical approach*" would be to start with "*WTO member countries*"[847]. He does not distinguish developing countries by their ability to induce R&D investment by developed country inventors. However, given the varying sizes of the economies of developing countries, one would most certainly expect some of them to have greater ability to induce investment by developed country inventors.

Chen and Puttitanun construct a model that examines both the imitative and the innovative capacities of a developing country. Their model includes two sectors, the import sector and the local sector[848]. The import sector consists of two firms, a foreign firm from a developed country, which possesses a patented technology, and a domestic firm which competes by imitating the foreign firm's technology[849]. The local sector consists of two local firms, one of which engages in innovation and the other of which only imitates[850]. The variable in the model, again, is the level of IPR protection. In this model, heightening IPR protection is a double-edged sword for a developing country. It both benefits and harms it. On the one hand, it renders it more difficult for the domestic

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843 *Id.* at 807–10
844 *Id.*
845 *Id.*
846 *Id.*
847 *Id.* at 807.
848 Chen & Puttitanun, *supra* note 825, at 476.
849 *Id.*
850 *Id.*

firm in the import sector to imitate the foreign firm's technology, thereby reducing competition in that sector[851]. The price of the good in the sector increases and consumer welfare is harmed[852]. On the other hand, heightening IPR protection also increases incentives for the innovative firm in the local sector to innovate, as it is now more difficult for its domestic competitor to imitate its technology[853]. A developing country must balance the effects in these two sectors and find an optimum level of IPR protection.

Chen & Puttitanun's conclusion is that the optimal level of IPR protection for a developing country is related to its level of economic development. In particular, they find that the relationship between these two variables is captured by a U-shaped curve. For a country with a low level of economic development, "*an initial increase in [the] country's technological ability has a greater impact on the efficiency of imitating northern [developed countries'] technologies than on the efficiency of domestic innovations, which makes it desirable for the country to lower [the protection of] IPRs*"[854]. However, at some point in economic development, the "*imitation effect is dominated by the innovation effect, and the optimal protection of IPRs increases with the level of development*"[855]. Their empirical study shows that the bottom of the U-shaped curve — the point at which the innovation effect begins to dominate the imitation effect and developing countries should start to enhance IPR protection — is US$854.06 in *per capita* GDP in 1995 prices[856]. This is a rather low level of development, suggesting that it is beneficial for most developing countries to enhance IPR protection.

3.3. Conclusions from the review

Recall the three types of capacity — production, imitative, and innovative — distinguished by economists and the categorization of developing countries based on their possession of these capacities proposed earlier. The discussion for now proceeds by examining the

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[851] *Id.*
[852] *Id.*
[853] *Id.*
[854] *Id.*
[855] *Id.*
[856] *Id.* at 487.

developing countries individually, and not in the aggregate as "*cooperation coalitions*" as suggested by Lai. It focuses on the domestic welfare effects of a shift in the competition law–patent balance, in particular, on how such a shift affects the domestic rate of imitation and the domestic and foreign rates of innovation.

Nothing in the economic models seems to refute the obvious conclusion that the "production" countries have little to gain by favouring patent policy. Since there is no domestic innovation to be had, monopoly loss should not be traded off to increase patentee reward and to create incentives to innovate. Unless the patentee reward provided by these countries is a strong inducement to developed country inventors, these countries should favour competition law enforcement in the balance. For the remaining two categories of countries, the trade-off in shifting the competition law–patent balance is between the allocative efficiency loss plus the reduced domestic imitation on the one hand, and the increased domestic innovation on the other hand. For the "imitation" countries, since once again there is no domestic innovation to be had, they should favour competition law enforcement over patent protection. This conclusion is subject to the same caveat as that for "production" countries regarding inducements to developed country inventors. The trade-off becomes difficult for the "innovation" countries. Chen & Puttitanun suggests that these countries have much to gain from domestic innovation, even though their domestic imitative capacity suffers. These countries may strike a more neutral balance between competition law enforcement and patent protection.

The picture becomes more complicated for all three categories of developing countries if the incentive effects on developed country inventors are considered. Here, the main distinction among developing countries is whether they receive substantial foreign direct investment as a means of technology transfer. For those that do not receive much FDI, Parello's model is most salient and suggests that favouring patent policy will give little boost to the incentive to innovate in developed countries. These countries should continue to favour competition law enforcement. For those that do receive substantial FDI as a means of technology transfer, Lai's model is more relevant and suggests that these countries could boost the incentive to innovate in developed countries by favouring patent protection. Lastly, if one considers technologies that only developed countries have the capacity to develop — the scenario examined by Yang — one may conclude that at least

some developing countries should tilt the balance in favour of patent protection. Recall that Yang offers no guidelines on how to decide which countries should join the "*cooperation coalitions*". The most one can say for now with some confidence is that developing countries with large economies are likely to offer the most substantial inducements to developed country inventors, and hence should join these coalitions. The least developed countries are likely to freeride on these large developing countries' effort. China, Brazil and India are probable candidates for these cooperation coalitions.

In sum, both "production" and "imitation" countries with little FDI should favour competition law enforcement in the balance. "Production" and "imitation" countries with significant FDI, and "innovation" countries of all kinds need to take greater care in striking the balance. Lastly, to induce developed country inventors to create technologies required by developing countries, developing countries with larger economies may need to shoulder the responsibility to favour patent protection.

One observation here is in order regarding the causal link between a policy change and the incentive to innovate in the economic models explained above and in Kaplow's framework. In most of these economic models, the policy decision at issue is the intensity of IPR enforcement, which determines the costs of imitation for producers in developing countries, which in turn affects the patentee reward and the incentive to innovate. Most of these models assume that once imitation begins, it is no longer profitable for the original inventor in the developed country to produce the product. The developing country producer has lower costs of production, due to its lower wage costs, and therefore can undercut the developed country producer by charging a lower price. As soon as that happens, the developed country producer will shut down its production. Therefore, a change in the intensity of IPR enforcement has a direct and immediate effect on patentee reward and the incentive to innovate.

Meanwhile, not every type of patent exploitation practice regulated by competition law has such a direct and immediate effect on patentee reward and the inventive to innovate. In fact, most of them do not. Take the practice that is likely to have the most direct impact, compulsory licensing, as an example. A developing country may adopt permissive standards for compulsory licensing that allow domestic imitators to obtain such licences from developed country inventors

easily. Such a policy obviously will have a significant impact on patentee reward, as patentees now must face competition in the market for their products. However, even under these circumstances, the extent of the impact may be less than expected. As long as the licence fee is set at such a rate that it compensates the patentee for its loss of profit from increased competition in the supply of the product, the patentee reward may not be drastically affected. In fact, the licence fee could be set at such a rate that the patentee is indifferent between commercializing the patent itself and licensing it to developing country producers. In that case, the patentee reward will not be reduced at all. One may question how likely it is that a developing country intent on providing easy access by its domestic producers to a patented foreign technology would set the licence fee at such a high level. The point remains that the causal link between adjusting competition law restrictions on patent exploitation practices and patentee reward is more tenuous than the effect of altering the level of IPR protection in the economic models examined in the previous section.

The causal link may be further weakened by the fact that a potential inventor does not look at actual reward, but expected reward, when deciding whether to undertake certain research and development. In general, a potential inventor is likely to be more aware of his/her entitlements under the patent system than of the scope of his/her permissible exploitation practices under competition law. Kaplow notes that "*the wholesale abolition of patent rights would likely have a greater negative influence on expectations of reward, and hence on innovative activity, than would a severe cutback in the range of permissible licensing practices*"[857]. To sum up, even though the economic models examined in the last section suggest that strengthening IPR protection in developing countries may induce both domestic and foreign innovation, cutting back competition law restrictions on patent exploitation practices in developing countries may in reality offer weaker inducement effects than is the case in these models. The paramount conclusion from this discussion — a modification of Kaplow's framework — is that, whatever is the appropriate competition law–patent balance in developed countries, developing countries, especially those with little innovative capacity but considerable imitative capacity or neither capacity, should tilt it more in favour of competition law enforcement. Developing countries have stronger policy justifications than do

[857] Kaplow, *supra* note 785, at 1838.

developed countries for imposing more stringent competition law restrictions on patent exploitation practices.

4. Practical implementation of Kaplow's framework to developing countries

The above discussion of the competition law–patent balance — both Kaplow's original framework and the suggested modifications based on the development economics literature — still needs to be put into practice in developing countries. The obstacles to implementing these ideas are many. First, recall that Kaplow's framework itself faces considerable practical difficulties in implementation. The patent reward–monopoly loss ratio implicit in the optimal patent life is very difficult to calculate[858]. The alignment and comparison exercise that he calls the cost-effectiveness analysis is similarly difficult to undertake[859]. If an advanced competition law jurisdiction with more than a hundred years of enforcement experience such as the US has difficulty applying its framework, developing countries with newly instituted competition law regimes will have little hope. However, this does not mean that the above discussion was an unproductive endeavour. The key insight from Kaplow's framework that a competition authority must balance patentee reward and monopoly loss when assessing the legality of a patent exploitation practice remains valid. While a precise quantitative weighing of the two is unlikely to be easy, a general qualitative balancing should be the guiding principle in a competition authority's assessment.

What about the modifications to Kaplow's framework suggested by the development economics literature? The modifications suggested in Part 2 would require the competition authority of a developing country to take into account a variety of general economic factors, such as the imitative and innovative capacities in the country, the extent to which technology transfer is achieved through FDI as opposed to direct imitation, or even whether there is international cooperation in IPR protection in the form of "*cooperation coalition*" between that country and other developing countries. One may legitimately question whether any competition authority has the capability to incorporate such a wide variety of general economic factors in its analysis. One may further

[858] Kaplow, *supra* note 785, at 1833.
[859] *Id.* at 1833–34.

question whether such general economic factors should determine the outcome of a case. Prohibiting a particular patent exploitation practice on the grounds that the dominant mode of technology transfer in that country is imitation may justifiably cause uneasiness.

Further complicating the matter is the fact that the dominant mode of technology transfer in any developing country probably differs sector by sector. This suggests a possible need to strike a different competition law–patent balance on a sector-by-sector basis. This need is substantiated by the fact that the existence of the three capacities likely differs not on a country-by-country basis, but on a sector-by-sector basis. Calling developing countries "production", "imitation", and "innovation" countries is a gross simplification. The reality is more likely to be that a developing country will possess only production capacity in some sectors, but imitation capacity in some other sectors. While a sector-by-sector approach may be most consistent with the theoretical implications of the development economics literature, it is also susceptible to allegations of inconsistent enforcement, and worse still, regulatory capture and corruption. It would be much easier for a competition authority to justify arbitrary enforcement by arguing that the same patent exploitation practice in various sectors demands disparate analysis in light of sectoral differences. This state of affairs would undermine competition law enforcement in many developing countries, where competition law is still in its early stages of development.

The most practical implementation of the lessons from the development economics literature is for the legislature of a particular developing country to calibrate the competition law–patent balance for the general economy, taking into account all the relevant factors highlighted in Part 2. This will lead to overly stringent competition law standards with respect to patent rights in some sectors but overly lax standards in other sectors. However, that is an inevitable price to pay to attain more consistent enforcement. Based on the lessons learned in Part 2, many developing countries are likely to come to the conclusion that tenuous dynamic efficiency gains do not justify substantial allocative efficiency losses and reduced imitative capacity in their countries, and are likely to impose stringent competition law restrictions on patent exploitation practices.

5. Conclusion

This research suggests a theoretical framework for calibrating the competition law–patent balance in developing countries. It takes as the starting point Kaplow's ratio test, and asserts that modifications to the framework are needed due to the fact that most developing countries have much weaker innovative capacities than do developed countries. Canvassing the relevant development economics literature, this research suggests some modifications to be made to Kaplow's framework, and concludes that different categories of developing countries must approach the competition law–patent balance differently. Despite this need for more nuanced approaches, overall, developing countries should favour competition law enforcement more than developed countries do in the balance between competition law enforcement and patent policy.