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COMPETITION, COMPETITIVENESS AND DEVELOPMENT: LESSONS FROM DEVELOPING COUNTRIES

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III

Competition policy as a stimulus for enterprise development

III.1. COMPETITION POLICY AS A STIMULUS FOR ENTERPRISE DEVELOPMENT

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Framing the issue

"Competition is always in danger. Since it is uncomfortable or even threatening, business tries to avoid it. To use a metaphor: Competition is not a weed that grows even if left alone; rather it is a cultural plant and needs continuous government attention".
Lachmann (1999: 19).

1. Introduction

Prior to 1990, most of the Southern African countries witnessed deterioration in their standard of living arising from the general decline in their countries' economic performance. Despite economic reforms of the late 1980s and 1990s, these countries continued to face the challenge of growing and diversifying their economy, while simultaneously addressing widespread and worsening poverty levels.

One of the widely recognized principal obstacles to economic growth has been a strong government presence in business through the huge parastatal sector, which was estimated to represent over 80 per cent of the industrial and commercial activities of the country. An evaluation of these economic arrangements proved that the parastatals were not contributing to sustainable economic growth and their contribution to the treasury was negligible in relation to the huge investment they represented. The parastatals were also not sustainable business ventures and in most cases required government financial support. The governments of these states, therefore, saw it as prudent to reverse the *status quo* by making fundamental changes in the organization of economic activity supported by the economic liberalization policies of the World Bank and the IMF. The timing and extent of these liberalization measures has varied between countries. The measures resulted in widespread privatization, deregulation and internal and external liberalization.

In most Eastern and Southern African states, the history on the enactment of competition law is still very recent. The advent of economic and political liberalization in the region, dating from the 1990s, witnessed far-reaching market-oriented reforms leading to considerable diminution in the direct role of the State in economic activity. The central theme of this process was the switch from the system of central planning or control of the economy to the use of market forces as the means to allocate resources. It was anticipated that the "free play" of supply and demand would, in the long run, determine market prices throughout the economy, allowing productive resources to be allocated in an efficient manner. Structural adjustment programs were adopted that included market-oriented reforms notably in the areas of deregulation of prices, including the reduction or elimination of subsidies, administrative allocation of key product inputs, privatization of public enterprises or state companies, as well as the liberalization of trade and investment regimes. The common aspiration underlying these reforms was that reduction of government's direct involvement or intervention in economic activity would, by providing enterprises with more freedom and stronger incentives, stimulate entrepreneurial activity, business efficiency, productive investment and economic growth. It was also seen as a means of enhancing consumer welfare through improved quantity and quality of goods and services at prices determined by the market rather than by administrative decisions. It was accepted that market liberalization within appropriate regulatory and competition frameworks is essential to sustain enterprise development.

In recognition of the major role of competition law and policy in the success of the policy reforms, governments adopted competition policies and enacted competition laws. For example, in the COMESA/SADC region, there are now six countries out of 22 that have adopted competition laws, most of which were introduced in the 1990s. Competition rules were primarily designed to preserve an unrestrained interaction of competitive forces that will yield enterprise development through the efficient levels of investment in discovering new production technologies, new production processes and new products. The role of competition law and policy was, therefore, seen to provide strong incentives for achieving enterprise development through:
(i) Enhancing market access for new investors
(ii) Protecting the economy from restrictive business practices
(iii) Fostering economic efficiency and consumer welfare.

Lack of adoption of an appropriate competition law and policy, and the continued protection of vested interests in developing countries has tended to have the negative effect of hindering enterprise development. This has resulted in lack of innovation, increase in costs of production, slow adjustments and destruction of jobs.

This chapter seeks to provide a general overview of how national competition policy promotion and the related challenges faced by developing countries have furthered enterprise development. The paper starts with a brief discussion on the need for the adoption of competition law and policy by developing countries[1] (with an emphasis on the COMESA region). The chapter further discusses some of the problems encountered during the introduction of competition law and policy in these economies. Firstly, how has competition interacted with other enterprise development policies such as privatization, investment and small, medium and micro-enterprises (SMMEs) policies? Secondly, to what extent do anti-competitive or exclusionary practices inhibit enterprise development? To answer these questions, the chapter reviews a number of cases illustrating how the major elements of competition law, as contained in most legislation of developing countries, had an impact on enterprise development in the Eastern and Southern African countries. This has been illustrated by anti-competitive cases dealt with, particularly by the Zambian, Kenyan and Zimbabwean Competition Authorities.

2. A case for competition law and policy

After the transition to market economies, developing countries realized that the benefits of market-oriented reforms were likely to be fully realized only if enterprises acted under the spur of competition, to create a level playing field by reducing barriers to entry which originate from anti-competitive practices and that consumer wishes and opinions were reflected in market performance. It was further recognized that countries that had undertaken trade liberalization measures had every interest in ensuring that the welfare and efficiency benefits arising from such measures are not lost due to anti-competitive practices by firms. A well-functioning market mechanism is essential in this respect. For example, price liberalization in the market dominated by monopolies in the form of parastatal companies, unless specific efforts are made to ensure the existence of competition, will end up with monopolistic price rises without corresponding competitive price equilibrium. For the least developed countries, the poor benefit directly from lower prices of the staple food. It is now accepted that there is a link between measures to enhance competition in developing countries and economic growth. However, empirical evidence from most developing countries on mechanisms through which competition policy contribute to enterprise development is rather scarce.

Competitive markets enhance the welfare of the general community by fostering efficiency in production. Competition offers the promise of lower prices and improved choice for consumers, higher economic growth, and increased employment opportunities. This is why almost all developing countries are giving their full support to the enactment and the establishment of a strong and effective competition policy in their countries.

The ultimate objective of competition is the promotion of economic efficiency. In developing countries, competition policy has greatly assisted in bringing about the desired economic growth by introducing competitive measures and policies, which promote economic efficiency by eliminating business practices which harm economic efficiency. Competition policy “establishes broad principles that are designed to preserve an unrestricted interaction of competitive forces that yield the best allocation of resources, the lowest prices and high quality products and services for customers”. [2]

In other words, competitive markets will enhance the capability of enterprises in developing countries "to produce goods that consumers need, in the quantities they need, applying the most efficient production methods and marketed and distributed in the most efficient manner". [3]

It is through the introduction of competition in the markets of developing countries that enterprises will be compelled to re-invest in new production technologies, new production processes and new products. The promotion of productive, allocative and dynamic efficiency will make enterprises in developing countries achieve economies of scale, enhance international competitiveness and promote Research and Development capacities. At the same time, it should be recognized that it is not always the 'economies of scale' or the 'critical mass' that encourage enterprises to compete internationally, it is also important that there is domestic rivalry rather than national dominance to create enterprises that are internationally competitive. Competition stimulates increased efficiency in innovation, production, and resource use, which in turn leads to enterprise development and increased aggregate welfare. Further, competitive markets provide macroeconomic benefits. Competition provides enterprises with incentives to adjust to internal and external shocks, and these individual adjustments help reduce the cost of such shocks to the macroeconomy. [4]

3. Scepticism about the implementation of competition law and policy

Misconceptions, legitimate concerns, and in some instances, controversy have continued to persist regarding the introduction and enforcement of competition law and policy in developing countries.

There is still lack of clarity on the interface between industrial and competition policy. The two policies have tended to give incompatible objectives in their implementation. Whereas industrial policy may generally address the government's support for specific industries, mostly by enhancing economic consolidation and intervening in specific market sectors, competition policy on the other hand, tends to be more universally applied to all sectors of the economy, to protect the general competition process and not particular competitors. This is in contrast with the industrial policies of developing countries that justify the unequal treatment of various economic actors in order to achieve economies of scale and gain efficiency.

In most developing countries, competition has not been fully accepted as an economic tool. It is regarded as a 'foreign' concept brought about by the conditionalities of the World Bank and the IMF. To most developing countries, trade liberalization is largely perceived to be one of the IMF and World Bank retaining policies threatening their national policy space and largely favouring and being supported by multinationals. Given the unpopularity these policies are currently receiving in most developing countries, the introduction of competition has also continued to receive negative comments. As one newspaper wrote: "the acceptance of these World Bank and IMF terms is clearly a very painful decision by our government. We share the bitter feeling of impotence that our government has in the face of these problems and difficulties… We say this because the programmes and policies the IMF and the World Bank have been imposing on us and other poor countries have brought misery and social upheavals”. [5]

The overarching challenge confronting competition authorities in developing countries, as a result, relates to their stature and standing within the ranks of key stakeholders or interest groups as well as the public at large. They all, in other words, struggle with correcting the various negative misconceptions and it is this that constitutes the gravest challenge confronting competition authorities in developing countries. I shall attempt to reduce this diverse range of problems to a few main ones, which continue to cause difficulties to the implementation and enforcement of competition law and policy by competition authorities.

Box 1: **Support for the establishment of competition law and policy in the COMESA member states**

“The local business communities of most Southern African states do not share the idea that effective competition shall bring about the desired economic development in their respective countries. Results of interviews with businessmen and government officials in different COMESA member states showed that there was lack of knowledge or understanding of competition law and policy. Many were undecided about whether their governments should divert resources from other scarce priorities to introduce competition law and a competition authority in their country. With some exceptions, such as Kenya, Zambia and Zimbabwe, citizens were not even convinced that lack of a regional competition policy constituted an economic problem worthy of their respective government’s attention. While countries with national competition legislation were more likely to cite competition law and policy as an important economic tool, those who lacked the legislation were less likely to see competition as an important issue. The survey was carried out in the 22 COMESA member states”.

Source: COMESA Consultancy Report on the establishment of the Regional Competition Regulation, 2002

The introduction and enforcement of competition law and policy in developing countries has generated public concern. This disquiet has arisen because most developing countries have yet to acknowledge the role of competition in development. They do not see the benefits of competition to their fragile economies. “Developing countries have continued to argue that the enacting of competition law is a low priority worth considering only after other more urgent policy measures have been introduced”. [6] The policy makers did not appreciate that the introduction of competition was necessary for rural development and is one way to reduce poverty and hunger. Access to employment, education, health and social services still remain the major issues of concern. It is important in this regard to remember that most African states have pressing issues related to health, education and poverty alleviation and have to develop programmes in these areas. Further, it is also argued that there are equally important policies that promote competition without necessarily enacting a specific competition legislation and establishing a competition authority. This argument refers to other policies, such as liberalization of international trade, privatization and deregulation.

It is further evident that in most developing countries, competition policy is heavily overshadowed by the need to protect local industries. Many of these countries will strongly entertain the protection of certain industries under the misguided notion of "destructive competition". Their Governments continue to shield certain industries, especially those owned by Government, from competition pressures. This also relates to the question of unequal competition between large multinational corporations and domestic companies in developing countries. It is argued that the playing fields are tilted in favour of multinationals that invariably have considerable market power. On the other hand, the multinationals have accused governments of not creating a level playing field between themselves and national firms, which are government supported, hence the multinationals' demand for 'national treatment'.

It is generally felt, and rightly so, that local industries are not strong enough to withstand competition from foreign companies operating in the same markets. They strongly argue that free markets will result in the demise of local industries. The markets of the developing countries are characterized by inefficient technology that can be easily displaced by the superior and efficient technology of foreign firms entering the market. If trade protection were to be removed, these firms would collapse, as they cannot stand international competition. The introduction of competition into such weak economies would further limit their ability to base their economic development on the promotion of national champions or the development of local entrepreneurial capabilities and other industrial policy considerations. In a nutshell, protectionism of local industries is deeply rooted and highly publicized by the local community and local business. This is a matter of vested interests. The argument continues to receive great support from the politicians and non-governmental organizations (NGOs).

The above arguments have been in most instances used to justify why governments in developing countries should give industrial policy precedence over the need to effectively enforce competition law and policy. As a result, competition systems in most countries in the region continue to be distorted by the Government through regulations, interventions and lack of effective infrastructure.

On the other hand, it has been difficult, in those countries that have embraced the concept of competition law and policy, to clearly demonstrate convincingly that "competition works" in such economies and to show the actual benefits. The question is how does one explain the occurrence of a particular phenomenon and attribute the positive outcome to the enforcement of competition law and policy. It has become imperative for developing countries to show the positive effects of competition enforcement on the markets.

In summary, for the creation of competitive industries in market-driven economies, new competition regimes should not introduce just another form of regulation of the market. A competition regime, however, will only bring positive results if it is part of a broader industrial policy framework, which includes deregulation, trade and investment regulation, and privatization.

It is important to understand that competition is one among several other tools which government can utilize to bring about economic growth. Competition as an economic policy tool can be used in isolation or in combination with other policy tools, i.e. privatization, investment and deregulation. However, competition policy has an extensive interface with other government policies. The nature of this interface may be such that the aims of different government policies can be complementary, or be in conflict with competition policy. The presence of any form of government intervention on the other hand can be a factor taken into account in competition analysis.

4. Competition and privatization

In many instances, the objectives of the competition policy have always been in conflict with the desired objectives of privatization. In most developing countries, privatization, like competition, was strongly encouraged if not required under structural adjustment programmes of the World Bank and the IMF.

The uncoordinated approach by developing countries in the introduction and implementation of the privatization policy on the one hand and the competition policy on the other has continued to undermine their value in economic development. In most COMESA/SADC countries, the emphasis on the privatization programme initially overshadowed the need to address competition issues during the early stages of the liberalization programme. The delay in the introduction and implementation of competition laws resulted in a situation where the privatization of public companies had already commenced and was almost complete. The reason for this is simple. The World Bank, who dictated the structural adjustment programme, at the time and even up to now, had failed to recognize and appreciate at the time of implementing the privatization programme that the two programmes are complementary and that they should commence and be implemented at the same time.

Consequently, it was too late when it was realized during the privatization process that if the sale of state-owned enterprises does not take into account the competition principles, the whole privatization process would end up turning the state mo-

Box 2: Competition *versus* privatization

"The IMF argues that it is far more important to privatize quickly; one can deal with the problems of competition and regulation later. But the danger is that once a vested interest has been created, it has an incentive, and the money, to maintain its monopoly position, squelching regulation and competition, and distorting political process along the way… Whether the privatized monopolies were more efficient in production than the government, they were often more efficient in exploiting their monopoly position; consumers suffered as a result".[7]

Source: Stiglitz (2002).

nopoly into a private “hard-core” monopoly. This has now caused great worry to many governments. There was also a thorny issue of local participation of the indigenous people in the purchase of public companies. It was evident that the local people had no readily available local capital to purchase these companies. Further, it was realized that most of the indigenous people did not have the financial muscle required to buy these companies and later on invest in the capital goods and technology required to operate larger companies. In spite of these constraints, governments were still committed to the implementation of the privatization programme. The privatization programme above all, has become the most viable tool for attracting foreign direct investment in most developing countries. This is because it is multinational firms that participated in the privatization policy and bought most of these public companies.

The manner of sale of these public companies remains a major concern to competition authorities. In most developing countries, there was failure on the part of the policy makers to integrate the competition principles in the formulation of the privatization process. Firstly, there was a need for the privatization policy to clearly specify that during the privatization of state-owned enterprises, the privatization modes of sale chosen should ensure that monopolies are not created. Consequently, the privatization authority should be obliged to consult the competition authority on the competitive position of the market when selling a company, and/or there should be a provision to compel it to take into account competition considerations.

Secondly, there is a need to remove policy conflicts in the manner of sale of public companies. For a privatization authority, it does not matter to whom the privatized company is sold or whether such a sale will lead to a concentration which will create or strengthen a dominant position. Whereas for a competition authority, the important consideration is whether or not such a sale shall impede competition in the market. The privatization agency will seek to obtain the highest price for a state enterprise on sale. The competition authority will be concerned about the effect or the outcome of such a sale on the market. It is now accepted that it is not ownership *per se* which is the main determinant of economic performance, but rather the degree of competition in the market.

In this overall context, it is not difficult to accept why the need for competition policy becomes crucial in the privatization process. In the new privatized domestic economic environment, competition and regulatory policies become essential. The failures of the privatization programme and its unpopularity among policy makers has continued to impact negatively on any benefits associated with the introduction and enforcement of competition law and policy. The interface between the competition authority and the privatization agency should be clearly defined in the respective policies in order not to undermine each other or bring about a conflict of interests. In the event where both policies are in place, it is important for the policy makers to harmonize them by amending the relevant legislations to overcome this problem.

5. Competition and investment

From the above, it can be seen that competition and investment policies share a broadly compatible underlying rationale: they provide strong incentives for achieving economic efficiency. Both policies provide a framework for encouraging international flow of productive, long-term investment, which contributes directly and substantially to economic and technological development, employment and economic growth. Investment policy measures include microeconomic policy measures such as restriction on foreign direct investment and ownership requirements aimed at enhancing competition in the domestic and regional markets. In fact, a mainstream competition law provides domestic and foreign investors with some assurance that they will find a 'level playing field', thereby encouraging enterprise development and investment in general.

Box 3: General critique of the privatization policy

"To ensure that citizen's rights are protected, governments have the right and responsibility to regulate the national economy. These powers should include the right to protect strategic areas of their economies, finance, energy, and communication by establishing public enterprises. And the right to protect sensitive areas known as the 'commons' – the environment, health care, culture – through government-run public services".

Source: Post Newspapers, Zambia

The effective enforcement of competition law and policy is an important element of a successful industrial strategy since it opens up markets and places appropriate pressures on producers to become more efficient. In addition, the existence of a competition policy enhances a country's credibility and attracts foreign direct investment since, from the perspective of potential investors, it helps to create a stable and predictable environment. Foreign direct investment provides much needed resources for developing countries. These include capital and intangible assets such as technology, know-how, access to markets, brands, managerial skills and entrepreneurial ability that are essential for developing countries to industrialize, develop and create jobs to alleviate the poverty situation in their countries.

On the other hand, competitive market forces ensure that there are sufficient levels of investment in discovering new production technologies, new production processes and new products. Competition encourages firms to perform better since their chances of making a profit increase through innovations or technical advances while penalizing poor performance and inefficiency.

In most developing countries, there is usually specific legislation dealing with the investment policy of the country. It is important to note that FDI has been growing rapidly in the world to the extent that 'investment' has become the principal organ linking economies of the developed countries to a number of national economies of developing countries.

It has become evident that in the hope of creating a competitive environment, certain private-sector policies in the form of investment incentives have discriminated against the local industries or local investors. Most legislation in developing countries provides for certain measurable economic advantages (incentives) to categories of enterprises (mostly foreign firms) and, hence, has caused competition distortions in the markets. These distortions manifest themselves in general incentives such as tax holidays, exemptions from paying duties, site allocations, etc. This should not be mistaken for a case of advocating for the abolishment of incentives to foreign investment. Whenever incentives are offered to foreign investors, there should be a corresponding offer of the same incentives to the local companies. Competition policy requires that the treatment of investors should not be on discriminatory basis. The investment law and policy should be conducive and equally accessible to all enterprises, irrespective of nationality, i.e. whether foreign or local. It is important when awarding incentives to foreign investors that the local investors in the form of local firms enjoy the facilities as well as in cases where they make similar or substantial investments.

Lack of competition considerations in the investment codes has allowed discrimination against local investors. The local industries in developing countries lack access to foreign capital, technological know-how and a competition culture. Most of the investment laws require the local firms to bring into the country capital equipment and finance which is unaffordable if they have to qualify for the incentives. Consequently, it has always been the multinational companies and their affiliates who have continued to benefit from the incentives. This has put local firms without any connection to foreign capital at a competitive disadvantage. The introduction of competition law and policy has provided the disadvantaged local firms with an avenue where they can lodge complaints of unfair competition and receive redress.

In any case, foreign investors are likely to penetrate those markets where they are sure that there will be an effective legal framework to protect their investment. An effective enforcement of competition offers the desired protection.

6. Small, medium and micro-enterprises

There is a growing recognition of the importance of small, medium and micro-enterprises (SMMEs) to the economies of developing countries. The development of SMMEs is important for economic growth, poverty alleviation and the economic empowerment of the local communities. SMMEs tend to be concentrated in relatively labour-intensive activities, so they play an important role in employing the growing labour force and they alleviate the severe unemployment that threatens the survival of the poor.

Most competition laws of developing countries have a specific provision, which addresses the small-scale sector. In these countries, the promotion of SMMEs is set among the overall objectives of competition law and policy. This is because of the realization in developing countries that the development of SMMEs is an important factor towards the creation of jobs, generating wealth and the provision of satisfying carriers for a growing number of entrepreneurs. For example, the competition legislation of South Africa provides that: "the purpose of the Act is to promote and maintain competition in the Republic in order to ensure that small and medium sized enterprises have an equitable opportunity to participate in the economy". [8]

A competition law, which is properly enforced and applied universally across all sectors of the economy, is likely to benefit and market the operations of small firms more efficiently and contribute to the expansion of the SMMEs sector as a whole. However, there may be strong reasons for some developing countries to exclude SMMEs from the application of the law on the basis of objective and non-intrusive criteria. These countries have opted for the protection and nurturing of the SMMEs or have given some form of temporal protection to sunset industries from the application of competition law. The rationale behind this type of protection is often to consolidate the small-scale sector, thereby reducing the negative effect of domestic competition as well as preventing large or dominant firms from driving out the small firms. The Zambian, Malawian and Zimbabwean competition laws, which have included this as their objective, acknowledge that this is: "to expand the base of entrepreneurship".

In view of the weak, uncoordinated and fragmented nature of the SMME sector in most developing countries, it was felt prudent by the governments of these countries to exempt them from the application of competition law in order to accelerate the development of this critical sector in their respective economies. It is recognized that there is need to deliberately formulate policies and programmes whose implementation will eventually promote competition in the SMME sector. The governments also realize that there should be a deliberate policy at specifically integrating the promotion of competition in the SMME sector because without such a policy, the sector will not develop.

The main reason for the exclusion is that the objectives of SMME promotion go beyond the sphere of competition policy. It is realized that the SMME sector is an informal sector, which employs a considerable number of people. The small sector has all along been weak, uncoordinated and fragmented. Operators of small-scale industries are desperately lacking in resource endowments such as finance capital, access to credit, collateral security, as well as in basic artisanal production and business management skills. In this connection, SMMEs cannot withstand competition from multinational firms who reign superior on the market. Consequently, most developing countries have specific legislation on SMME development. These countries have seen the need to enact within their national laws a law which comprehensively addresses SMME issues and which aims to steer the development of a policy for this sector. In most developing countries the SMMEs have to a certain extent been able to:

- Create jobs at relatively low capital cost, especially in the fast-growing service sector;
- Provide a vehicle for introducing a more equitable income distribution;
- Develop a pool of skilled and semi-skilled manpower as a basis for future industrial expansion;
- Improve forward and backward linkages between economically, socially and geographically diverse sectors of the economy;
- Provide opportunities for developing and adapting appropriate technological and managerial approaches;
- Promote subcontracting arrangements and acting as ancillaries to large-scale enterprises.

However, it should be recalled that competition law aims at facilitating competition among potential rivals by reducing artificial barriers to competition and by allowing market participants to interact independently. Consequently, the protection of SMMEs may in many instances harm consumers and may entail costs for the country. The protection of inefficient firms is deliberately preserved in the market, without any guarantee that these SMMEs will succeed in being competitive and viable enterprises.

It is further important to mention that the competition *de minimis* principle affects the application of competition law to the SMMEs. Most of the competition laws require that for any conduct or practice to be within the ambit of the law, there must be an ‘appreciable’ effect on competition. An agreement or a practice, which has only a small or minor effect on competition in the relevant market, may be regarded as *de minimis* and, as such, outside the scope of the law. The *de minimis* principle by its limitation nature has the effect of causing the activities of SMMEs to fall outside the scope of competition law. It is common for competition authorities to introduce a quantitative test of appreciability whereby agreements or practices engaged in the production or distribution of goods, or in the provision of services do not fall under the prohibition of the law, if the aggregate market shares held by all of the participating undertakings (SMMEs) do not exceed a given threshold.

Competition has been the main guarantor for the sustained development of the small-scale sector. A successful SMME strategy requires that the SMMEs effectively compete with other operators in the market. The idea of protecting the SMME sector from the general application of competition policy has the effect of having a direct or indirect adverse impact on the development of enterprises in the national economy. However, “The fact that a sector or a firm is partly subsidized or is protected for industrial policy reasons does not mean that competition law cannot, as a matter of principle, be applicable to this sector or this firm. Competition law can be applied to practices which go beyond what is allowed by public authorities…”.[9] Competition policy offers an effective mechanism against anti-competitive practices or abusive conduct by large firms, whether competitors, suppliers or buyers. Consequently, the culture of competition should be embedded in the development and the running of the small-scale sector to enhance enterprise development. Any incentives to this sector should be done through completely separate legislation in order to preserve the process of competition in the economy.

In conclusion, it is not necessary or desirable for developing countries to give any special treatment to small and medium sized firms under their competition legislation because there is already a greater degree of implicit protection of SMMEs in the "rule of reason" approach. This in most cases is in addition to the *de minimis* rule; suffice to mention that hardcore horizontal agreements are prohibited *per se*, regardless of the size of the firm.

7. Main elements of competition law with direct impact on enterprise development

It is now important to look at the main elements of competition law as they are incorporated in the statutes of most Southern African states, while reflecting on how the implementation and enforcement of these provisions has contributed to enterprise development. The three major elements are the merger control provision, the restrictive business practices, and the abuse of dominant position. In general, the foregoing elements of competition law prohibit or provide a means for developing countries to address conduct that may hinder enterprise development. It enables developing countries to use the competition legislation to enhance enterprise development by prohibiting conduct that does, or is likely to, restrict output and increase price, impede market expansion or new entry, reduce product or service quality or stifle innovation. Competition can also prohibit firms from obtaining market power through mergers or any means other than skill, foresight, and industry.

7.1 Merger control provision [10]

In developing countries, mergers, if not properly monitored, can sometimes produce market structures which 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. This is because in these countries, there are fewer firms in the market; hence, it can become easier for them to collude. However, there is a belief in some countries, particularly those with smaller markets and economies, that merger control is not necessary because it impedes the restructuring of firms trying to obtain the "critical mass" necessary to compete in world markets, and that having a "national champion" even abusing a monopoly position on the domestic market allows it to be competitive in foreign markets. Therefore, merger-control provisions have a crucial impact on market structure and enterprise development in developing countries.

For some of the countries in the COMESA/SADC region, it can be argued that due to the smallness of the economy, and more so to their lack of a strong industrial or manufacturing base, they do not need a merger control regulation. Although this argument has significant merit, and is gaining growing recognition, the principle has serious shortcomings, which need to be addressed. For example, it has been found that monopolies might enjoy their monopoly rents at the expense of economic development and domestic consumers without necessarily becoming more competitive abroad. Studies have also shown that it is difficult for a business to become more competitive in the global market when domestic competition is weak. Also, other countries, again mostly developing countries, while acknowledging the importance of merger control, feel that they have limited resources to embark on the full merger investigations required for effective merger control.

On balance, the need for merger-control provisions is greater than the convenience of their absence. Apart from the need to identify and prevent those mergers that are harmful to competition, there is also the possibility that by not having a merger-control system, a country might deprive itself of the legal powers to challenge foreign and domestic mergers which might have an adverse effect on its territory and thus undermine both the national and global competitiveness of its export-oriented companies, including the 'national champions'. Through the merger-control regulations, developing countries are able to verify if the efficiencies produced by a merger are sufficient to compensate for the harm to competition. When reviewed properly by a competition authority, a merger can provide a better environment for or attract investment in the identified sectors, with beneficial impacts on employment levels.

Developing countries are ripe for active involvement in merger control given the government's agreed desire to embark on the privatization of the public enterprises into a vibrant private sector. Experience in countries such as Zambia, Zimbabwe and Malawi and many other developing countries that have undertaken the privatization process has shown that foreign firms tend to take over competing domestic firms. For example, a local public firm dealing in cement or sugar is likely to be taken over by multinational firms engaged in a similar business activity such as Lafarge or Illovo, respectively. Consequently, we have witnessed the turning of public monopolies to private monopolies. Privatization in most cases does not lead to greenfield foreign direct investment. Competition issues arise when local firms are at risk of being taken over by foreign firms dealing in the same business. This creates stronger private monopolies, which leads to market foreclosure. The merger-control provisions under national competition law guard against the stifling of enterprise development through anti-competitive mergers.

Mergers and other forms of acquisition have accounted for more than 80 per cent of direct foreign investment in the Southern African states. The merger-control provision has offered developing countries a facility to monitor and check the entry into the national market of undesirable business behaviour. This allows domestic firms not to be subjected to anti-competitive business practices which may lead to their demise.

Box 4: Coca Cola Company/Cadbury-Schweppes merger

In December 1998, Cadbury Schweppes Plc of the United Kingdom sold to the the Coca Cola Company (TCCC) of the United States of America its commercial beverage brands outside the United States, Continental Western Europe and certain other territories worldwide. In December 2000, TCCC submitted to the CC in terms of section 35 of the Competition Act a merger application for authorization of its proposed acquisition in Zimbabwe of beverage brands owned by Cadbury Schweppes Plc.

The brands acquisition transaction was evaluated as a horizontal merger as defined in section 2 of the Competition Act. Consultations were made with the parties and other competition authorities that had also considered the transaction in terms of their countries' competition legislation, i.e. the Australian Competition & Consumer Commission, the Zambia Competition Commission and the Competition Commission of South Africa.

The Commission identified from a consumer survey undertaken that the relevant product market was '*ready to drink*' *soft drinks of a carbonated and non-carbonated nature* (TCCC had submitted that the relevant product was all beverages, including tea and coffee, and even bottled water). In that market the merging parties' pre-merger market shares were 76.9 per cent (Coca Cola brands) and 12.5 per cent (Cadbury Schweppes brands) resulting in a combined post-merger market share of 89.4 per cent. It was however found that the proposed merger will not create a monopoly situation in the relevant markets, which is highly contestable, nor will it lessen actual competition in the soft drinks bottling and distribution industry. It was also found that the proposed merger had considerable public interest benefits in the form of generation of foreign currency from the continued export of local beverage brands such as the *Mazoe* brands, creation of employment, more efficient use of resources and the continued availability of Schweppes brands on the market.

The Commission therefore authorized the transaction subject to conditions, which included that the Coca Cola Company undertake to purchase Schweppes Zimbabwe Limited as a going concern and to establish an appropriate shareholding structure (to include indigenous shareholders) to oversee the operations of the new company to be formed; that the Coca Cola Company undertake to maintain the local *Mazoe* and *Calypso* brands on the Zimbabwean market and develop them into regional brands with wider circulation; and that the Coca Cola Company undertake to promote and develop Zimbabwean suppliers and supplies with respect to the raw materials necessary to produce the finished product brands.

An Undertaking to the above effect was signed between the Competition Commission and the Coca Cola Company on 30 May 2001.

Source: Competition Commission, Zimbabwe

Cross-border business transactions, including investment and business concentrations and alliances are now becoming the norm in the region, thereby justifying merger control at the national level. Without an effective national competition law and policy, the domestic firms may form anti-competitive alliances to make it difficult for foreign firms to penetrate the local markets. The merger notification approach of Zambia, Zimbabwe and Malawi has a lot of merit and could be justified to control anti-competitive mergers.

For instance, the global Coca Cola/Cadbury Schweppes merger was reviewed in the COMESA region by the competition authorities of Zambia and Zimbabwe. The merger was notified to, and reviewed by, the two competition authorities separately even though its effect was regional in view of the almost free trade between COMESA Member States. In the case of Zimbabwe, the merger was approved with certain conditions, which included partial divestiture and undertakings on the part of the merging parties to develop local beverage brands. In Zambia, the merger was also conditionally approved but with different undertakings "aimed at enhancing competition, including the obligation on TCCC (The Coca Cola Company) to notify its exclusive dealing arrangements, restrictive territorial allocation agreements and stop price fixing arrangements". In doing so, the competition authorities tried to ensure that the

Box 5: The takeover of Cadbury Schweppes by Zambia Bottlers Ltd

Introduction and relevant background

The Coca Cola Company (TCCC) and Cadbury Schweppes (CS) Plc signed an agreement for the purchase by TCCC of the CS commercial beverages brands and the trademarks outside the United States, continental Western Europe and a few other countries. In Zambia, TCCC lodged a notification under Section 8 of the Act to acquire Cadbury Schweppes Zambia (CSZ) Limited. TCCC produces carbonated soft drinks in Zambia, while Cadbury Schweppes produced both carbonated and non-carbonated drinks, as well as clear beer (whisky black).

Major findings

TCCC had a 92 per cent market share in carbonated soft drinks in Zambia, while CSZ had 8 per cent. Their products are almost perfect substitutes. Imports of competing products are negligible and are mainly done by Kazuma Enterprises on a niche-market basis, including Pepsi products from Namibia. The takeover of Cadbury Schweppes brands in Zambia by TCCC was to effectively eliminate competition and any possible entry into the carbonated soft drinks market in Zambia, especially since ownership and or authorized use of patents and know-how are key to success in the sector. However, Cadbury Schweppes Plc had not made substantial investments in Zambia and had only awarded the Zambian operation a franchise to use its trademark and beverage brands. The Zambian operation needed re-capitalization. The parties submitted that TCCC would infuse its expertise in the beverage sector and assist CSZ achieve efficiencies. Third-party concerns were raised regarding the concentration of economic power in TCCC in Zambia as well as the future of Goldspot in Ndola, which is an SME with a TCCC franchise for secondary brands.

Commission decision

There existed entry barriers in the carbonated soft drinks market in Zambia, even before the notification of this transaction. In Zambia, the transaction entailed elimination of a vigorous competitor by TCCC and consolidation of TCCC market power and likely abuse of the same in relation to distributors and retailers. However, CSZ required re-capitalization. CS had already sold the brands to TCCC and CSZ did not have the franchise to produce the brands. Closure of CSZ would have had worse effects on both the social and economic spheres in the country. The transaction was authorized with conditions, which included the following:

- TCCC was to cease operation of any exclusive dealing and territorial restraint arrangements in Zambia;
- TCCC shall not fix prices or excessively advertise the recommended price;
- TCCC and cooperating bottlers in Zambia would continue to comply with the provisions of the Competition and Fair Trading Act.

Source: Zambia Competition Commission

merger has not had a negative impact on enterprise development. It should, however, also be noted that while the merger affected other COMESA countries such as Uganda and Malawi, the absence of merger-control provisions in those countries prevented it from being notified and reviewed by the affected countries. As such, the countries could not obtain countervailing concessions on the merger's consummation as Zambia and Zimbabwe did. Enterprises in Uganda and Malawi could not be protected against potential negative effects of the merger

Box 6: Rothmans of Pall Mall/British American Tobacco merger

In January 1999, British American Tobacco (BAT) Plc of the United Kingdom announced that it had reached an agreement with the shareholders of Rothmans International, Compagnie Financiere Richemont AG of Switzerland and Rembrandt Group Limited of South Africa to merge their international tobacco businesses. Subsequent to the completion of the international merger between BAT and Rothmans International, Rothmans of Pall Mall (Zimbabwe) Limited in September 1999 applied to the Competition Commission in terms of section 35 of the Competition Act, 1996 for authorization to acquire the entire issued share capital of British American Tobacco Zimbabwe Limited.

The merging parties gave as one of the reasons to merge the declining market for cigarettes in Zimbabwe. It was presented that the Zimbabwean manufactured cigarette market had declined to such an extent that it was no longer big enough for the continued viability of two manufacturers as evidenced by the poor performance of BAT Zimbabwe Limited in its financial year ended 31 December 1998.

The case was evaluated as a horizontal merger as defined in section 2 of the Competition Act. Through its investigations, the Commission noted that although the merger would result in a creation of a monopoly situation in the relevant market (i.e. the manufactured cigarette market), it had other public interest benefits. Section 32(5) of the Competition Act includes as such benefits the creation of greater economies of scale resulting in more efficient use of resources, the generation of foreign currency through exports, and the stabilization of product prices on the local market. The *failing firm* defence put forward by the merging parties was also considered a strong point in this connection.

The Commission therefore authorized the merger with certain conditions aimed at alleviating the adverse effects of the monopoly situation created. The conditions related to the disposal of surplus cigarette-making equipment to third parties interested in entering the Zimbabwean cigarette-making industry and constant surveillance by the Competition Commission of future cigarette price increases, with price rises needing the Commission's justification, while the monopoly situation created remains in existence.

Source: Competition Commission, Zimbabwe

It is interesting to note that the same transaction, which was global in nature, was also assessed by the Zambia Competition Commission (Box 5). It is important to note that both Zimbabwe and Zambia in their respective assessment of the transaction had authorized the transaction on condition that the relevant market is not foreclosed by restrictive business practices by the merged firm. Zimbabwe further gave a condition that the merged firm undertakes to promote and develop Zimbabwean suppliers in the supply of the raw materials necessary to produce the finished products. It is evident that the competition authorities in their respective countries were addressing the need to promote enterprise development and linkages with the SMMEs.

The competition authorities of Zambia and Zimbabwe also separately reviewed the global Rothmans of the Pall Mall/British American Tobacco merger. The Zimbabwean authority approved the transaction with conditions of both a structural nature (partial divestiture aimed at promoting new entry into the cigarette-making industry) and behavioural nature (undertakings not to increase cigarette prices for a specific period of time). The Zambian authority unconditionally approved the merger since it was found that "the concentration was likely to enhance competition as market offerings were likely to be enlarged in terms of brands". In both cases, competition law was used to promote enterprise development through expansions of the sector.

Box 7: The takeover of Chilanga Cement by Lafarge of France

The Commonwealth Development Corporation (CDC) and Pan African Cement (PAC) notified the Commission under Section 8 of the Act of their intention to sell their 50.1 per cent shareholding in the Chilanga Cement PLC to Lafarge SA of France pursuant to a Sale and Purchase Agreement entered into by the parties on the 4th December 2000. The Commission first rejected the transaction because Lafarge had failed to show how the transaction was to produce benefits to the economy. Lafarge did not also give undertakings that guaranteed continued operation of the Chilanga Cement plants in the presence of fears of Lafarge using Chilanga Cement as a raw material source with supply of cement in Zambia coming from outside. Chilanga Cement is the only cement producer in Zambia, with substantial upstream and downstream integrations to SMMEs.

The Board of Commissioners reviewed the second submission from Lafarge and conditionally authorized the transaction after Lafarge gave substantive Undertakings to the Commission, which included the parties committing the following:

- To increase production at Ndola to 85 per cent capacity utilisation within the next 3 years of the date of this Undertaking.
- To supply cement to Burundi at an ex-works price no higher than Mbeya's ex-works price for the Burundi or Great Lakes Regional market.
- Recognizing the fact that Chilanga has capacity constraints, the supply of cement will be on a priority basis as follows: the first priority will be the local market, particularly on the Copperbelt, the second will be DRC and the third priority will be Burundi for Ndola works.
- While in pursuit of its corporate goals, Lafarge and Chilanga Cement PLC will endeavour to be compliant with the Competition and Fair Trading Act, CAP 417 of the laws of Zambia and implement a compliance programme under the management of a senior executive at both works as the Compliance Officer.
- Not to use methods of price announcements which have the effect of price fixing.
- Not to operate exclusive distribution contracts without notifying the Zambia Competition Commission.
- That within 3 months of the signing of this Undertaking, develop for consideration by the Commission, a Trade Practices Program.

Further, Lafarge was to make a mandatory share offer to the minority shareholders who would want to sell their shares, in accordance with the stock exchange regulations.

Source: Zambia Competition Commission

Other notable examples include the acquisitions by Lafarge of France of major cement companies in Zambia, Zimbabwe, Tanzania and Malawi. Even though the acquisitions had the effect of drastically changing the structure of the whole regional cement market, individual countries on national rather than regional considerations reviewed them separately. In Zambia, Lafarge had to give undertakings to the competition authority that due to capacity constraints; priority for the supply of cement shall be the local market before consideration of exports. There was to be an increase of productive capacity within a stipulated time, and that the price of cement in Zambia shall not be disadvantaged by the production of cement by other subsidiary plants in the region. Again, we witnessed pre-conditional approval of the mergers in Zambia and Zimbabwe who had competition laws in place. Both countries were aware that Lafarge the biggest producer of cement in the world, could, if not regulated properly, foreclose enterprise development in the sector. Lafarge was made to increase production by rehabilitating plant and machinery in their respective countries.

The research carried out by COMESA/SADC in its member states revealed that in countries without the enforcement mechanism of competition rules, mergers have produced market structures that have made it easier for a group of firms to cartelize the market, and this has enabled the merged entity to act more like a monopolist. It is evident that if Botswana had a competition law at the time of the merger of Metro and Safelina,[11] the merger could have been assessed differently. It was also observed that most of these countries have very few firms in their markets; hence, it is attractive for these few firms to merge in order to avoid competition among or between themselves.

Similarly, the Lafarge takeover of cement plants in Tanzania and Malawi could have received a competitive scrutiny if the national competition authorities had been operational. It is evident that the competition concerns which were addressed by both the Zambian and Zimbabwean national competition authorities could also be of concern in Tanzania and Malawi. Further, the undertakings given by Lafarge to both Zambia and Zimbabwe could have an uncompetitive effect in neighbouring countries especially those without competition law and policy. The conditionalities by both Zambia and Zimbabwe clearly show that a country is able to direct the FDI coming into the country, and that competition law can be used to stimulate development into sectors which were currently foreclosed.

The Southern African states require an effective merger-control regulation given the advanced stage they have reached in integrating the economic activities of the region, particularly in the area of trade cooperation. Cross-border business transactions, including investment and business concentrations and alliances, are now becoming the norm in the region, thereby justifying merger control at the regional level. There is, therefore, great need for an effective enforcement of the merger-control provisions in the national competition laws in order to deal with cross-border transactions and to direct investment in a competitive manner in the national economies. The majority of developing countries will find it difficult without national competition laws to stop anti-competitive behaviour by the local subsidiaries of merging multinationals in industrial countries. These multinational corporations may behave competitively in Europe because of the effective competition rules but may indulge in anti-competitive practices in developing countries.

Box 8: Pretoria Portland Cement/Portland Zimbabwe Merger

In August 2001, Pretoria Portland Cement Company Limited (PPC), a leading cement manufacturer incorporated in the Republic of South Africa, filed an application with the Commission in terms of Section 35 of the Competition Act for authorization to acquire the entire issued share capital of Portland Holdings Limited (Porthold or Unicem), the leading cement manufacturer in Zimbabwe. Anglo American Corporation, the largest shareholder of Porthold, wanted to re-focus its operations on its core business activities (principally mining) and was disposing of its non-core investments. PPC on the other hand wanted to increase its cement investments in the Southern African region in the face of stiff competition from Lafarge S.A. of France, which had recently acquired Blue Circle Industries cement plants in Zambia, Tanzania, Malawi and Zimbabwe.

Investigations revealed that this horizontal merger did not change the structure of the cement industry in Zimbabwe. Porthold remained the leading player with about 50 per cent share of the market, followed by Circle Cement (28 per cent), Sino-Zimbabwe (15 per cent) and ZimCement (7 per cent). The merger, therefore, did not create a monopoly situation nor did it lessen the degree of competition in Zimbabwe since PPC was then not a participant in the Zimbabwean cement market. PPC was only stepping into the shoes of Anglo-American Corporation. The Commission also accepted the efficiency reasons given for the merger and found other public interest benefits arising from the transaction such as: (i) additional efficiencies in production; (ii) introduction of a wider range of cement products; (iii) significant inflows of foreign currency into Zimbabwe from PPC's plant modernization programme; and (iv) promotion and maintenance of effective competition in Zimbabwe and the region. One concern raised from stakeholder submission, however, was the possibility that PPC, or any other company that could subsequently acquire Porthold from PPC, could close down the Zimbabwean plant and supply cement from South Africa given the surplus capacity existing in the South African cement market.

The Commission therefore authorized the merger on two conditions, that PPC should honour its commitment to maintain Porthold and continue the production of cement in Zimbabwe; and should PPC in future decide to dispose of Porthold by sale or otherwise, such disposal should be subject to the condition that Porthold will be maintained and continue producing cement in Zimbabwe, and that PPC should inform and consult the Commission of any such disposal before proceeding. The conditional authorization of the merger was accepted by PPC and was embodied in a written Undertaking between that company and the Commission.

Source: Competition Commission, Zimbabwe

7.2 Restrictive business practices

Most developing countries with competition policies have enacted laws, which identify a range of permissible and impermissible horizontal and vertical restraints and exercises of market power by firms in a dominant position. These restrictive business practices can, if left alone, not only harm the domestic economies and domestic consumers of developing countries but also harm enterprises seeking to develop or gain access to the international markets.

Consumers International observed that "rivalry between firms can take place fairly through striving for greater efficiency and innovation or through producing higher quality goods to secure a greater share of customers. But a company can also compete unfairly through predatory pricing, exclusive dealing, or forming cartels with its competitors in order to dominate the market".[12] These types of restrictive business practices are seen as unfair, or anti-competitive, because they distort competition in the market in order to maximize profits. It is competition law which regulates business activities in order to prevent and prohibit, in certain circumstances, anti-competitive behaviour which may hinder the growth of the economy in developing countries.

The COMESA/SADC market is endowed with a majority of countries without competition law and policy. In such a market environment, restrictive business practices often occur with the blessing or encouragement of the national governments. In these countries, exclusive dealing contracts and other exclusionary practices have effectively closed the markets and in some cases acted as barriers to a market.

The restrictive business practices in such an environment are also encouraged by lack of enforcement by domestic competition authorities. Moreover, lack of enforcement by a competition authority may also give tacit approval to private firms that their anti-competitive behaviour is allowable. "Government policy makers may even be more pro active and encourage firms to allocate market share or develop interlocking distribution networks in the belief that such actions will stabilize or benefit a domestic industry in the early stages of its development".[13]

One important factor of the COMESA market is the absence of a strong manufacturing sector. The structure of wholesale and retail distribution and the strong presence of South African retail franchises have evolved rapidly in recent years. Regarding distribution, the domestic market is characterized by the following trends:

- Concentration, expressed in terms of a reduced number of larger operators, and closer vertical links between manufacturers, wholesalers and retailers. This is the case in the sugar, beer, cement and energy sectors in most COMESA countries.
- Development of networks of independent traders, primarily in reaction to trends towards concentration and the growth of large integrated groups originating from South Africa. In general terms, retailers without dedicated facilities and the capacity to bypass the wholesaler (mostly the local businessmen) are unable to compete with the major retail groups (South African firms) in terms of price and service.
- A general reduction in the number of independent local distributors or traditional wholesalers, whereas the concept of wholesaling is slowly dying off and overtaken by strong multinationals.

- A series of transformation in the retail sector – an increase in number of hypermarkets, a rise in franchising and a proliferation of forms of distance selling which excludes local businessmen is a prominent feature.
- The above factors have the effect of hindering enterprise development in developing countries. That is why most competition laws address these restrictions in order to eliminate them from the market.

The economies of these countries reveal a special market phenomenon, which requires COMESA member states to focus their competition law to regulate markets efficiently. Most restrictive business practices are divided into either horizontal or vertical restraints practised by the major firms in the market. Given this dilemma, it is important to elaborate on those and other types of arrangements and competition cases, which are prevalent in the markets of some of these countries and have been found to be harmful to the growth of industries.

7.2.1 Vertical agreements and market access

Vertical restraints have repeatedly given rise to competition concerns in the COMESA/SADC region due to the several multinationals which possess market power operating in the region and the various agreements entered into by the key market players. Generally, vertical restraints refer to arrangements or agreements between operators at different stages of the production and marketing chain.

Before the introduction of competition laws, foreign and domestic firms operating in the COMESA/SADC region had entered into contractual arrangements with distributors of their products that placed some limitations on the ability of the distributors to handle the products of competing manufacturers or to sell products outside a particular territory. This was common with transnational firms who enjoyed a monopoly position in the region in the clear beer, cement, sugar and soft drinks sectors. In most cases, these firms inherited distribution chains all over the country, which were made possible by the previous parastatal status or government involvement in businesses.

Similarly, under such a market environment, vertical distribution practices also prevented a foreign entrant (as well as a domestic firm) from developing the distribution networks necessary to penetrate a market.

During the post-privatization period, it became apparent that the continuation of the restrictive business practices by the new private firms had the effect of restricting the growth of industries. For example, a new entrant firm was required to establish a new distribution network to run parallel with the existing one. This was the case of the monopoly status of the clear beer firms in Zambia, Malawi and Zimbabwe. It became difficult for new firms to enter the market due to the increase of the cost of entry or they were precluded from entry by existing dominant firms. During the assessment of the takeover of the Coca Cola Company by South African Breweries PLC, the competition authority in Zambia commented that: “the Commission has observed that the Coca Cola Company has in the past abused its dominant position mostly by means of vertical restraints. Through vertical restraints, the company strictly controls the contact of all downstream distributors… The practice is nothing more than a selective distribution and an exclusive distribution system where a distributor has the exclusive right to distribute a product within a specified territory or to a category of customers”. [14]

In Zambia, and most probably in the other countries in the COMESA/SADC region, there is evidence that the key monopoly firms in their respective markets have managed to keep imports out of their home markets. These firms have done this through the control of the local and regional distribution networks via vertical integrated structures in the respective countries in which they operate. They have further restricted the cross-border redistribution of their products among countries in the region. For example, through a company policy, a third-party resident in Zambia cannot import clear beer from South African Breweries in South Africa. The only authorized importer of South African Breweries beer products in Zambia is its subsidiary firm, Zambia Breweries. This has, as a result, foreclosed import competition in clear beer from South Africa.

The establishment of national competition authorities in these countries had to challenge the existence of anti-competitive practices by the private monopoly firms in their respective countries. The removal of the exclusive distributorship agreement and territorial restrictions allowed more entrepreneurs to enter the market. The competition authorities of Zambia and Zimbabwe compelled the brewery companies and other dominant firms not to use their dominant position as suppliers to coerce independent distributors and/or retailers from buying or distributing competitive imports or other products. In so doing, there was an expansion of entrepreneurship and the unemployed youth in the respective countries were able to engage themselves in businesses by distributing the various products. Further, due to the increased number of distributors, the products became easily available on the market and a distributor was able to keep various products from different manufacturers under one roof thereby offering the consumer a choice. The creation of employment also had a positive effect on poverty levels in the communities. In Zambia and South Africa, to comply with competition rules, the distribution network of clear beer and carbonated soft drinks has been contracted out to the local communities. To enhance competition among the distributors, the supplier has gone further to give loans to the micro-distributor to purchase vehicles. Such schemes have created employment and brought wealth into the communities.

7.2.2 Horizontal agreements

Horizontal Agreements refer to implicit or explicit agreements between firms competing with identical or similar products in the same market. Horizontal agreements commonly referred to as hardcore cartels may involve two or more domestic enterprises attempting to fix prices or otherwise limit competition in local markets through bid-rigging agreements, customer allocation agreements and output restriction agreements.

Box 9: Exclusive dealing arrangements between Hybrid Poultry Farm and Galaunia Farms Limited

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 rearer with 60 per cent market share then), Galunia Holdings Limited (GH – a commercial chicken broiler rearer), and Tamba Chicks (Tamba – a day-old chicks rearer with 30 per cent 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 Day-Old Chicks (DOC) into table birds, HPF required GH to only purchase DOC 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 out-growers 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 DOC in Zambia with a 60 per cent 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 DOC, table birds (broiler) and frozen chicken.

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.

Source: Zambia Competition Commission

The majority of developing countries, which have adopted competition laws, have despite significant differences in the scope of these laws, demonstrated clear consensus that hardcore cartels should be uncovered and prohibited. The rationale behind the prohibition is that such agreements serve no purpose other than to shift surplus from consumers to producers, at the cost of dead-weight losses, organizational inefficiencies and rent-seeking. In such a market environment, it is difficult for enterprises to register growth.

Box 10: Investigations into allegations of horizontal restraints between the Kenya Association of Hotel Keepers and Caterers *versus* Wines & Spirits Distributor (Coast Branch)

Pursuant to section 13 of the competition legislation the Chief Executive of the Kenya Association of Hotel-Keepers and Caterers (KAHC) lodged a complaint on 26th September 1994 to the Minister through the Commissioner, alleging that there was a meeting by the National Distributors of Wines and Spirits Association (Coast Branch) held on the 29th June and 7th July, 1994, at which resolutions were passed that contravened the Restrictive Trade Practices, Monopolies and Price Control Act section 7(1) (b)(iii) by recommending to its members to fix prices.

The evidence presented was a copy of the minutes of the proceedings, which revealed that the law, as stated above, had been contravened – the minutes had been signed by eight (8) members with their respective rubber stamps bearing their names and addresses. In this instance, the Commissioner invoked section 15 (1)(a) informing the distributors that allegations have been made and that specific evidence was presented to substantiate the allegations. Hence, the distributors were required to comment on the alleged resolutions and indicate what remedies they proposed to bring their trading practices into conformity with the Act within fourteen (14) days from the date of the Commissioner's letter.

Only one member responded within the stipulated time. The members also ignored a second reminder to deliberate on a consent agreement. The Commissioner then invoked section 16, which requires the holding of a hearing on the desirability and contents of proposed recommendations of a Ministerial order regulating the trade practices in question. This was to be done on 9th February 1996. However, this meeting was attended by only two of the expected eight members of the association. Consequently, the Commissioner, under section 17 of the Act, recommended that the following issues regarding the institution of a Ministerial order be formally gazetted:

(a) that the resolutions passed by the National Wines and Spirits Distributors (Coast Branch) during their meetings held on the 19th June, and 7th July, 1994 were in contravention of section 7(i) (b)(iii) of the Restrictive Trade Practices, Monopolies and Price Control Act in so far as trade agreements in restraint of trade are concerned and should therefore be rescinded immediately.
(b) that the distributors shall cease to make and enforce joint decisions that infringe any section of the Restrictive Trade Practices, Monopolies and Price Control Act, unless there is valid commercial reason that should be notified through the Commissioner after such decisions are made.
(c) that the distributors shall publish a circular in the three (3) local daily newspapers indicating that the decisions made during the said meetings shall not apply during the course of trade in Wines and Spirits within Kenya and a copy of such publication be sent to the Minister for Finance.

The Minister concurred with the said recommendations and hence the gazettement of the order on 27th February 1996 copies of which were sent to all member of the association. This case is still open because there is no evidence to show that the distributors complied with the Ministerial order especially part (c).

Source: Kenya Monopolies and Prices Commission

Although almost all the countries have legislation against hardcore cartels, the developing countries in Eastern and Southern Africa still suffer from the continuation of the legacy of the previous socialist system. The countries in the region are yet to fight against the vice of "price-control", which has the effect of "price fixing".

The phenomenon of price control is still widely acknowledged by most governments in the region due to the high poverty levels. There is still a fear that if prices are left to market forces, the firms through anti-competitive means may resort to exploitative pricing. Under the price-control regulations, the prices of most essential goods and services are statutorily controlled by the government.

The price-control statutes in spite of the introduction of the market economy and competition laws have not been repealed. The situation is such that governments have opted to maintain some degree of price controls in certain sectors while at the same time liberalizing prices in non-essential sectors. It will take time before we see the full liberalization of prices on all goods and services in the region.

The markets in most Southern African states to date are still characterized by various horizontal agreements between and among firms operating both at national and regional level. The competition authorities in the region have investigated several cases involving price fixing, output restrictions, market allocations, etc. It is evident that decisions by firms pertaining to these market prices are as a result of administrative decisions from the headquarters of the multinational firms in South Africa. There is a lack of consideration for local market conditions. The strategy by multinationals in the region is more of a regional strategy as opposed to national market considerations. This was revealed during the investigations against price fixing and transfer pricing in cement factories owned by CDC in Zambia, Malawi and Tanzania. It was found that prices are fixed in South Africa at the headquarters of CDC.

The developing countries have not been very successful in fighting cartels operating in their respective countries. This is despite the volume of commerce affected by the international cartels, which have pointed to their costly consequences for their markets.

The adverse impact of cartels has not spared the developing countries in the COMESA/SADC region. In spite of the great need for international cooperation in the enforcement of competition law and policy, the immediate danger facing developing countries is the effect of international 'hard-core' cartel activities on developing country consumers. There have been studies carried out on the effects of international cartel activities on developing countries. The conclusions and findings arising from these studies are of important relevance to developing countries, especially for the COMESA/SADC region.

The important questions to ask are:

1) Are the developing countries in a position to challenge and contain the cartel activities in their markets?
2) Are developing countries better equipped in terms of resources and logistics to prohibit cartel activities in their markets?

Box 11: The alleged collusion and price-fixing cartel in the petroleum sector by oil marketing companies (OMCs)

There was a fire incident at the Indeni Petroleum Refinery in May 1999 in Ndola, Zambia. Following this incident, the Government of the Republic of Zambia (GRZ) issued a statutory instrument no. 119 of 1999, which reduced the customs duty on imported petroleum products from 25 per cent to 5 per cent. Consequently, the Energy Regulation Board (ERB) issued licences for the importation of petroleum products to nine (9) OMCs, namely BP, Caltex, Mobil, Agip, Total, Jovenna, Engen, Ody's and Agro-fuel. Following the resumption of production at Indeni, the government of the republic of Zambia issued Statutory Instrument (SI) No. 54 of 2001 that reinstated the 25 per cent import duty on all petroleum products effective 18th May 2001. On 29th May, 2001 the ERB received a joint written complaint from the OMCs about the effects of the S.I. on their business. On receipt of the letter from the OMCs, the ERB brought to the attention of the government through the Ministry of Energy and Water Development (MEWD) the concerns raised by the OMCs. The Ministry in turn assured the OMCs that it would take up their concerns on customs duty to the relevant authorities. However, while the government was in the process of holding consultations with all stakeholders, the OMCs unilaterally increased the prices of petroleum products on 30th May 2001.

On 31st May 2001, ERB wrote to all OMCs individually directing them to revert to the old prices. The OMCs responded by asking for a meeting on 1st June 2001. Consequently, on 1st June 2001, the ERB held a meeting with OMCs. The OMCs stated that they would maintain the new prices for the next 3 weeks to recover anticipated losses. The ERB informed them that the directive to revert to the old prices while their complaint was being looked into remained in force. After the meeting, the OMCs responded through a joint letter informing the ERB that the new prices would remain in effect for 4 to 6 weeks thereby continuing to defy the directive given by the ERB. The ERB then responded to the joint letter individually re-stating that the directive remained in force.

The ERB Board Chairman further reiterated this directive during a press conference on 1st June 2001. During the press conference, he directed the OMCs to reduce the fuel prices to the original levels or risk having their licenses suspended or revoked. By Monday 4th June 2001 none of the OMCs had complied with the ERB order. In order to address this act of defiance from the OMCs, the ERB held consultations with ZCC. The two institutions reviewed the conduct of the OMCs.

The investigations conclusively determined that the OMCs were acting collusively in the conduct of their businesses as evidenced through their spokesman's letters to the ERB several times. The ERB had cautioned the OMCs but they defied it. The **motive** has been clearly to prevent competition amongst themselves and especially, price competition. During the period January to May 2001 it was demonstrated that price competition was possible in Zambia but was short-lived as the big players in the market managed to put it off through predatory pricing to the point when it hurt all OMCs. Cartel conduct was perpetrated under the leadership of BP and Caltex and the ultimate aim was to prevent competition amongst the OMCs.

Recommendations

All the OMCs, more especially BP, Caltex and Total, should be prosecuted under the Competition and Fair Trading Act for price fixing. There is evidence to show that:

i) there was an agreement on price increases;

ii) there was an agreement on a standard formula according to which prices will be computed;

iii) there was an agreement to adhere to published prices;

iv) there was an agreement to use a uniform price as the starting point for negotiations;

v) there was an agreement not to sell unless agreed-on price terms are met.

It was recommended that the trade association by the OMC serviced by Caltex should be abolished. The evidence induced so far shows that this association provides a forum for cartel activities. The association facilitates information sharing, adopting particular contracting or pricing practices that make it easier for a cartel to operate of for the OMCs which are in an oligopolistic market to avoid competing with each other, even without any explicit cartel agreement.

Source: Zambia Competition Commission

These are some of the important questions, which show how vulnerable the markets in developing countries are. It is really very doubtful whether a developing country at national level or individually can stand up against international cartel activity.

It is now evident that the negative impact of cartelization has been greater in developing countries, especially in those countries still without competition law or without an effective national competition policy. Although the impact of cartelization on the development of industries in developing countries is difficult to quantify, what we are certain of is that most of the many companies in Europe, which have investigated and prosecuted, are well established in Africa and have very long-standing trading ties with governments in developing countries. In some cases, major developing contracts have been awarded through bilateral and multilateral agreements with donor agencies to some of these companies.

The assessment carried out in 1997 reveals that developing countries imported US$ 81.1 billion of goods from industries which have seen a price-fixing conspiracy during the 1990s. These imports represented 6.7 per cent of imports and 1.2 per cent of GDP in developing countries.[15]

The introduction of competition laws in the region has contributed in the fight against hardcore cartels, hence promoting enterprise development in most developing countries. Although it can be argued that the enforcement of competition law in the region is generally too weak to make an impact in fighting cartels, sufficient deterrent has been achieved at national level (Boxes 10 and 11). Further, knowledge by private firms of the risks involved alone in violating the competition laws is sufficient to deter a company from engaging in cartel behaviour that it perceives as advantageous. The competition laws have increased public awareness about the detrimental effects of domestic and international cartels. “Without an effective competition policy framework, enterprises can too easily collude to create artificial shortages that boost prices to monopoly levels, rig bids, or divide markets by allocating customers, suppliers, territories or lines of commerce”.[16] The competition laws against cartels have contributed in the protection of consumers and enhanced enterprise development, especially the firms operating in developing countries with weaker economies from the harmful effects caused by hardcore cartels. The cases in Kenya and Zambia shown in Boxes 10 and 11 are incidences of the many cases of cartel activities in the region. They clearly demonstrate that various forms of cartels are prevalent in our markets and that they have created waste and distorted trade in our economies. The various forms of cartels have reduced the productivity capabilities of enterprises and hindered their development.

7.2.3 Abuse of dominant position

It is important to appreciate that most of the big firms or multinationals, which were operating in developing countries prior to the introduction of market reforms or the introduction of national competition laws, misused their market power to the detriment of other small firms and the consumers. The absence of competition rules in the market allowed dominant firms or monopolies to engage in anti-competitive practices, which amounted to abuse of market power.

Given the structure of the Eastern and Southern African countries' market, its oligopolistic nature gives rise to many firms being dominant in their respective sectors. Competition in a market with few suppliers, none of them controlling the market but each relatively large (oligopoly) is much more likely to be distorted if one of those suppliers takes over or acquires an interest in another, than in a market characterized by fierce competition among many suppliers. Consequently, there is lack of vigorous competition in most countries in Eastern and Southern Africa as the market is characterized by single dominance in the sugar distribution, cement manufacturing and distribution, diamond mining and marketing, beef market, wholesale and distribution, and in both clear and opaque beers. In addition, there is in most of these countries a concentration of South African franchises in the retail sector. This has led to some difficulties for the local businessmen to penetrate or participate in the commercial activities in their respective countries, especially the trading and manufacturing sector. In fact, evidence shows that the proliferation of the South African franchise trading chains has had an effect of eliminating competition from small indigenous firms and foreclosing market.

Box 12: Preliminary probe into allegations of predatory pricing in the clear beer brewing and distribution industry

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 per cent. 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 where 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 they became aware that the Competition Commission was investigating them, the Commission made them formally undertake that they would desist from future practices aimed at driving Nesbitt Brewery out of the market.

Source: Competition Commission, Zimbabwe

The big franchise trading chains have continued to abuse their dominant position through vertical restraints. They do this through market foreclosure and reduction in competition in a market. Market foreclosure means that entry into a market is made more difficult or more costly. Competition law enforcement has been used to prohibit enterprises from abusing their dominant position through vertical restraints. The cases in Boxes 12, 13 and 14 demonstrate how the use of competition law to abuse of dominance has enhanced enterprise development.

The COMESA/SADC region has continued to witness a situation where a monopoly company from one country has raised prices to consumers in another country above the levels that would prevail in competitive markets. For example, the national competition authorities have received several complaints against Multichoice Company, a DSTV service provider in the region. The allegation against the service provider is that it is involved in excessively high prices and discriminatory prices and other terms or conditions among subscribers of different countries in the region. This conduct has been found to be anti-competitive by some countries in the region because it exploits customers and other suppliers. Complaints have also been made against Lafarge in the cement industry (Box 13), and South African Breweries in the clear beer sector (Box 12). Both companies have been accused and found guilty by competition authorities of predatory behaviour, anti-competitive vertical restraint and/or refusing to supply existing or potential competitors.

The existence of market power or the possibility of such power being created or augmented is a key consideration in the analysis of many competition law cases. Generally speaking, abuse of dominant position 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 without an effectual competitive or countervailing response. It is in a market of this nature where the likelihood of abuse by dominant firms is prevalent. Such a market requires regulation to facilitate the competitive process and to prevent collusion among incumbent firms. Competition law is concerned not with the fact that a firm is dominant, but rather the abuse of that dominant position. A firm enjoying a dominant position can use its market power to adversely affect competition. It can:

- eliminate competition in a market where the firm is engaged;
- prevent the emergence of new competitors or restrict competition in a market in which a company is engaged by introducing barriers to entry;
- affect the terms and conditions of supply in a market;
- discourage or repel innovation in the relevant market.

The enactment of national competition laws in the region have attempted to address the problem of abuse of a dominant position by prohibiting firms from wilfully obtaining or attempting to obtain a monopoly by any means other than by a superior product or service, business acumen or historic accident. The competition rules have dealt with dominance by prohibiting abusive or exclusionary conduct. As a result, the distributors of products produced by monopoly firms have been able to deal with

Box 13: Investigation into allegations of restrictive and unfair trade practices in the cement distribution 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 per cent.

The evidence gathered section 28 of the Competition Act 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 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.

Source: Competition Commission, Zimbabwe

competing products and deal with competitors in the market. The foreign firms have been prevented from using their subsidiaries in developing countries to exploit their market positions unjustifiably. The introduction of competition rules has cleared the market of restrictive business practices to enable enterprises to freely carry out business and to develop.

Box 14: Allegations of abuse of dominant position: Mastermind Tobacco Kenya Limited (MTK) *versus* British American Tobacco (Kenya) Limited (BAT)

MTK lodged a complaint under section 13 of the Cap. 540 laws of the Kenya, which stipulates… "any person who considers himself aggrieved as a result of Restrictive Trade Practices may submit a complaint to the Minister, through the Commissioner…" MTK alleged that BAT had engaged in threatening to stop supplying wholesalers, stockists and retailers with its products if found stocking MTK's cigarettes; slanderous campaign against MTK and persuading farmers not to supply MTK with tobacco; BAT personnel had actively campaigned against MTK in major outlets like bars, retail and wholesale shops, kiosks, etc. to stop these important outlets from stocking MTK's products; intimidation of traders to the extent that the weaker ones had refused to stock MTK's products; and that BAT had engaged in a campaign of misinformation to discredit and damage the reputation of MTK in the tobacco-growing areas.

Investigations under Section 6(1)(i) and Section 14 of the Act, revealed that:

BAT had provided its distributors, stockists and retailers with free shelves and cigarette dispensers with strict instructions not to display competitor's cigarettes.

BAT paints the premises of its distributors free of charge as a way of advertising and to avoid competition.

BAT provided its distributors and stockists with free signboards with neon lights.

BAT had verbally threatened to withdraw supply to any distributor who handles competing products.

The Provincial Administration had allocated BAT and MTK areas of operation, for purposes of preserving peace and security in the areas affected by disagreements between the two companies. This was in connection with contracting farmers to grow and sell tobacco.

MTK was being pushed to marginal areas where the cost of production for tobacco was quite high.

Farmers welcomed the entrance of MTK into the market since it pushed tobacco prices up.

That MTK was buying tobacco illegally from BAT-contracted farmers.

On 24th July 1991, the Permanent Secretary, Finance, wrote to the Ministry of Agriculture and copied to the Office of the President informing the two about the contravention of the said section by the two ministries of which the Permanent Secretary, Agriculture, replied to and assured Treasury that zoning was a temporary issue pending the Commissioner's recommendations as to the lasting solution. Legal opinion on the gazzetment of zoning tobacco-growing areas was sought from the Attorney General's Office but was not given. The case has been pending waiting for the same.

Recommendations

To promote competition, distributors/stockists and retailers of cigarettes should be free to sell all brands of cigarettes produced in Kenya. Zoning is a dangerous precedent because in the long run companies may develop some sense of ownership to these zoned regions and therefore create barriers to entry for new forms. Further that farmers should be free to choose which company to sell their produce to depending on the prices and other contractual arrangements.

Source: Kenya Monopolies and Prices Commission

8. Conclusion

A recent report by the OECD agrees that lack of a competition culture among developing countries is the central impediment to the appreciation of the benefits of competition law and policy: "It appears that the 'lack of a competition culture' is due to the self-interest of those who expect to lose with the introduction of competition and who have the power to oppose it. Competition promotes and accelerates economic wealth".[17] The creation of competitive markets empowers the poor, provides them with productive employment, and increases their access to other productive resources.

Many developing countries have adopted trade liberalization measures and have in turn incorporated competition policy in the management of their economies. These countries agree that the market economy facilitates competitive markets, so as to promote economic efficiency.

In this chapter, we have attempted to demonstrate how the introduction and enforcement of competition in the Southern African countries has halted restrictive business behaviour and the subsequent effects on enterprise development. It has further demonstrated by evidence of cases how developing countries with competition legislation have become vulnerable to competitive restraints. The lack of competition regulation in economies of developing countries has continued to harm buyers, eventual consumers and the economy as a whole. However, countries with competition laws have been demonstrated to have the necessary tools to fight private anti-competitive behaviour.

The enforcement of competition has not only eliminated anti-competitive behaviour but has also offered tangible benefits to the community. At the Global Forum on Competition, the developing countries that were represented reported that: "Competition law and policy is not an end in itself. It is a key prerequisite for development through economic growth". It was further accepted that there are difficulties in demonstrating through advocacy work how enforcement against private anti-competitive conduct has contributed to economic development in developing countries. There are several reasons for this, which include: "the most important effects of competition law enforcement often appear only in a longer perspective, when the impact of halting a competitive restraint may be hard to isolate from other factors. Also, the indirect effects of law enforcement may be much more important than the direct effect on a particular anti-competitive behaviour. A third difficulty is that competition law enforcement often goes hand-in-hand with regulatory and structural reform, meaning that the observed effects of the liberalization of markets are due to the combination of law enforcement and other government action promoting competition".[18]

There is also need to clear the debate on the popular perspective of the developing countries on whether they need a competition law and policy. It is still argued at various economic *fora* that less-developed economies and small markets can, at best, sustain one or two firms in an industry capable of achieving economies of scale, undertaking research and development and securing world markets in competition with advanced trading partners and multinationals, as a stimulus for other sectors. This argument has been strongly used by developing countries to give industrial policy precedence over competition policy, given the low level of development and limited capital resources in developing countries.

This continued uncertainty on the benefits of competition law enforcement still requires greater attention by the policy makers, especially the executive arm of governments. The first issue to address should be the design of competition law and policy, and the enforcement mechanism in the market. It is important for developing countries that an optimal level of competition fits well with the industrial policy rather than having "excessive" competition. This approach will allow developing countries an opportunity to establish industrial capacity and achieve commercial success in world markets. This strategy, if applied in an apt manner, can bring about dynamic benefits to society. There is a danger of applying unfettered competition in the undeveloped markets of developing countries. There is always the undesirable possibility of too much competition leading to price wars and ruinous rivalry, which may be harmful to future investments. To avoid these fears, developing economies should observe that there is: "… an optimal degree of competition which would entail sufficient rivalry to reduce inefficiency in the corporate use of resources at the microeconomic level, but not so much competition that it would deter the propensity to invest".[19]

The approach was also accepted by BIAC when it submitted that: "for developing countries an effective competition law must be flexible enough to permit rationalization and consolidation that are frequently essential in order to maximize efficiencies and economic welfare in the course of structural adjustment. An overly ambitious application of competition law risks deterring socially desirable investments in innovation and technology transfers which rely on protecting intellectual property right".[20]

The enactment of competition laws in developing countries has become a necessity, since it is a matter of economic self-defence.[21] It is these countries that suffer more from the anti-competitive practices than developed countries, given their weak institutional infrastructure and the small size of their markets. It is also important that UNCTAD is given the required mandate to start the implementation of the Set of Multilaterally Agreed Equitable Principles and Rules for the control of Restrictive Business Practices (RBPs), which were adopted by the UN General Assembly in 1980, and reaffirmed by the Fourth UN Conference in Geneva in September 2000. "While universally applicable to all transactions in goods and services and all countries and enterprises, the Set provides that states, particularly developed ones, should take into account in their control of RBPs the development, financial and trade needs of developing countries, especially for promoting domestic industries or other sectors".[22] The vision of flourishing competitive economies in the COMESA/SADC region shall remain nothing more than a mere aspiration, if individual member states at national level, and the regional institutions at regional level, do not effectively enforce competition.

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Notes

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III.2. COMPETITION POLICY AND ENTERPRISE DEVELOPMENT: EXPERIENCE FROM SOUTH AFRICA

Trudi Hartzenberg

1. Introduction

Competition policy reform was high on the agenda of South Africa's new government after the first democratic elections in 1994. The African National Congress (ANC) had espoused strong socialist principles during the years preceding South Africa's democratic transition. However, by the time the ANC came to power, the winds of political and policy change had shifted substantially, internationally and in South Africa too. Instead of a policy of nationalization of private enterprises, the ANC looked to competition policy as an instrument to regulate private enterprise, and to address the legacy effect of apartheid and economic isolation on domestic markets. South Africa's Competition Act, no. 89 of 1998 (Government of South Africa, 1998), which was drafted and promulgated after an extensive and inclusive policy-making process of consultation and debate, reflects the political concerns of the ANC.

In addition to economic efficiency, the Competition Act explicitly includes equity and distributive goals. The preamble to the Act notes the high levels of concentration of ownership and control, ineffective checks on anti-competitive practices and restrictions on economic participation, especially by black South Africans due to apartheid laws and policies, and articulates a conviction that credible competition law and institutions to effectively implement the law are necessary for an efficient economy. Furthermore, the Act says that an economic environment balancing the interests of workers, owners and consumers will benefit all South Africans. A hallmark of the Act is thus its concern with public-interest issues, equity and justice, balanced with the traditional economic efficiency concerns.

This paper focuses broadly on the role of competition policy in enterprise development in South Africa, and more specifically on South Africa's new Competition Act and particular public-interest objectives, such as the promotion of small and medium enterprise (SME) development and empowerment of previously disadvantaged individuals. The purpose of this exercise is to draw lessons for developing countries as regards the role of competition policy in enterprise development.

Although South Africa's history is in many respects unique, there are important lessons that can be drawn from the legacy effect on markets, enterprises and consumers, and the implications for the competitive process for other developing countries. High levels of concentration are common, for example, not only in South Africa, but also in other southern and eastern African countries. Markets are small, consumers are not well informed of their rights, and the capacity to effectively implement competition policy and law is limited. Challenges of unemployment, low levels of domestic and foreign investment, as well as a history of excessive government regulation and its adverse effects on competition are also common to many developing countries.

2. Developing a competition policy for a new South Africa

South Africa's apartheid legacy and its consequent marginalization from the global economy produced very specific market structural characteristics, and concomitant competition policy challenges. In addition to the insular nature of the South African economy resulting from global marginalization, its domestic policy stance further compounded the competition challenges. Import substitution industrial policy and capital controls, for example, promoted local enterprise development through local content programmes, and limited outward investment opportunities.

High levels of concentration, both in ownership and control, and conglomerate organization structures coupled with strong vertical integration were typical of many industries and markets. Many firms had diversified their activities, investing in a variety of unrelated economic activities, and focused, almost exclusively, on the domestic markets, as a result of economic sanctions.

The South African economy was characterized by a dual structure with a modern, almost-exclusively white formal economy, and a less-developed, almost exclusively black, predominantly informal economy. This dichotomous economic structure, and the apartheid laws which prevented black South Africans from participating in certain economic activities and geographic areas, meant that participation in the formal economy, and opportunities to develop formal and growing businesses were limited for black South Africans. By contrast, the formal economy developed markets and industries that became in many cases highly concentrated with effective economic barriers to entry, in addition to the racial regulatory barriers of the apartheid regime.

It was recognized by the ANC that these challenges would have to be addressed by a range of economic and social policies and, in addition to a substantive focus on trade and industrial policies for transformation of the economy, competition policy became the policy option for the regulation and development of enterprise to enhance the economic opportunities and participation in the formal economy of black South Africans.

The ANC mapped out an extensive policy reform programme in the early 1990s, prior to the first democratic elections in 1994. The 1992 Policy Guidelines for a Democratic South Africa provided an overview of the policy revamp envisaged. As part of this process, an assessment of South Africa's competition challenges and the efficacy of the existing competition law was undertaken. A complementary initiative was a review of South Africa's industrial strategy (Joffe *et al.*, 1995). Key focus areas of the industrial strategy project were:

- Markets and ownership structures
- SMEs and the conglomerates

- Technological and institutional capacities
- Human resource development and workplace organization

Although this investigation into the development of an industrial strategy for South Africa focused narrowly on the manufacturing sector, the issues identified were also relevant to agriculture, mining and the services sectors. Many of the findings of this project related to competition issues, and in 1995, the new Department of Trade and Industry (DTI) started a 3-year programme of consultation with competition experts and a broad range of stakeholders in South Africa to develop a new competition policy. The product of this extensive exercise was put forward in 1997, as DTI's Guidelines for Competition Policy, intended to stimulate discussion and debate on the role of competition policy in the restructuring of the economy (Government of South Africa, 1997).

Another complementary policy area that enjoyed much attention during the policy reform process was small business development. In 1993/4, an extensive empirical and theoretical study was conducted to identify key constraints to small business development in South Africa. A number of small business support initiatives were developed to actively promote small business development, with the expectation that small business would become an engine of growth and employment creation. These initiatives included, *inter alia*, financial schemes (loans or credit guarantees), skills-support schemes and technology-transfer schemes (www.dti.gov.za).

The 1997 DTI Competition Guidelines considered the existing competition law of 1979, and found it inadequate in a number of respects to address the challenges at hand. The 1979 Maintenance and Promotion of Competition Act did not contain any provisions related to vertical or conglomerate configurations or concentration of ownership. There were no pre-merger notification requirements. The 1979 Act contained no explicit prohibitions, and the final yardstick for decisions was the "public interest", which was not defined in the Act. The *ad hoc* and inconsistent decisions of the Competition Board were thus not unexpected. The Competition Board was appointed by the Minister of Trade and Industry, and a special court was to hear appeals; but never actually heard any. A regulation issued by the Minister of Trade and Industry in 1984 declared some practices *per se* to be unlawful. These included resale price maintenance, horizontal collusion on price, terms or market share and bid rigging. There were, however, no prosecutions despite this regulation.

Effective implementation of a strong competition policy was viewed as an important tool with which to regulate private enterprise, given that the ANC's policy of nationalization, which had been espoused prior to its election, had been abandoned, when the ANC came to power.

Specific goals of competition policy included the dilution of the high level of concentration of economic power, on the grounds that this was detrimental to balanced economic development. In particular, competition law was to reduce the domination of the economy by a white minority, and to promote greater efficiency of the private sector.

After a comprehensive policy process, which included debates within the National Economic Development and Labour Council (NEDLAC), a new competition law, the Competition Act, no. 89 of 1998 (Government of South Africa, 1998), was promulgated and became effective in September 1999. The Act provides for the establishment of three specific institutions to implement the law: a Competition Commission, a Competition Tribunal and a Competition Appeal Court.

The Competition Act incorporates features which reflect the unique challenges facing South Africa's economic development. It permits and, in certain cases, requires consideration of equity issues such as empowerment, employment and impact on SMEs. Enterprise development is thus an important focus for South Africa's new competition policy and law. Although equity considerations are explicitly incorporated into South Africa's competition law, political channels are not permitted as a means of appealing these issues. There is also no ministerial power to override the decisions of the competition agencies, as there had been previously.

The introduction of South Africa's new competition policy and law took place within the broader context of a new industrial policy, a liberalized trade policy and revamped labour legislation in the second half of the 1990s. This was a new era in policy making for economic transformation.

3. Key features of South Africa's Competition Act

The Competition Act no. 89 of 1998 (Government of South Africa, 1998) covers all economic activity in South Africa, and has extra-territorial reach to the extent that the Act applies to "all economic activity within, or having an effect within, the Republic." The nature and extent of this extra-territorial reach has been tested in one case thus far; the Botash case dealing with the effect of an American export cartel exporting soda ash to Botswana (Competition Commission, 2003). Both Botswana and South Africa are members of the Southern African Customs Union (SACU); hence, with a common external tariff, imports into Botswana can be expected to have an effect within South Africa.

South Africa is a member of the SACU, and its members concluded a new Customs Union Agreement in 2002. This Agreement requires that all members of SACU have a competition policy and that they collaborate in the implementation of that policy.

This new SACU Agreement and its competition policy provisions are important in the context of regional integration developments in southern Africa. The SACU countries have a long history of economic integration (SACU is the oldest customs union in the world), and South African enterprises have extensive interests and operations in all the member countries. Recently, enterprises in the smaller SACU member states have raised complaints about the behaviour of South African enterprises in their countries, with requests for assistance via trade remedies. It may well be that this option is being sought because these countries do not have competition policy and implementation agencies, and no regional competition policy or institutions exist either. This situation raises the issue of competition policy and enterprise development in the southern African region, where only one member state currently has a competition law and implementing agencies. Without recourse to competition law remedies, enterprise development in the smaller countries could be adversely affected by the enterprises from South Africa.

Currently, South Africa is the only member of SACU that has an operational competition policy and law. Namibia passed a Competition Act in 2003, but has yet to establish the Namibian Competition Commission provided for in the Act. Both Swaziland and Botswana have draft competition laws, and Lesotho has embarked on an economic mapping exercise and the development of an inventory of laws affecting competition.

The new SACU Agreement is a framework agreement, requiring the development of several Annexes on specific issues. Articles 40 and 41 of the Agreement require that an Annex on restrictive business practices be developed. This Annex is expected to provide details on the nature and extent of collaboration in the implementation of competition policy in the customs union.

The South African Competition Commission is an investigatory body, to which competition complaints may be addressed. It also conducts preliminary investigations into merger impact assessments, and makes recommendations to the Competition Tribunal. The Competition Tribunal is an adjudicatory body (or court of first instance) to which the Commission may refer complaints for further investigation and adjudication, and which considers large merger transactions. The third institution is the Competition Appeal Court, which hears appeals arising from Tribunal decisions. This is a court dedicated to competition matters.

The overall purpose of the Competition Act is to promote and maintain competition, in order

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

(Government of South Africa: Competition Act, no. 89 of 1998)

The Act's policy purpose thus focuses in the first instance on economic efficiency. South African competition law also explicitly includes public-interest considerations, in the articulation of its purpose; it therefore attempts to balance efficiency concerns and the broader development priorities in the competition framework.

The focus on SMEs is important against the background of the structure of the South African economy. High levels of concentration, and the conglomerate structure of business in many sectors from mining, to manufacturing and services, are important challenges for small business development in South Africa, besides the common challenges that SMEs face more generally. The conglomerate structure of business in South Africa and the strong vertical linkages that exist in many industries can prove to be effective barriers to entry for smaller enterprises.

The goal of promotion of a greater spread of ownership, especially as regards historically disadvantaged persons, reflects the concerns about the skewed distribution of income and wealth in South Africa. South Africa had for many decades one of the most unequal distributions of income in the world, with strong racial fault lines through the distribution. Greater spread of ownership and SME promotion are deemed to be important to ensure longer-term balanced and sustainable development.

The Act's preamble refers to the political motivations that provided the rationale for the policy reform process of the new government. The particular problems facing competition law and its effective enforcement, including practices, some of which were promoted and supported by apartheid policies and laws, led to high levels of concentration of ownership and control, inequitable constraints on economic participation by the majority of South Africans, and ineffective restraints on anti-competitive trade practices. This legacy is viewed through an equity lens, rather than an efficiency lens. In the 1979 competition legislation, public interest, although included in the Act, had not been defined. The new legislation articulates four pillars of public interest. Perhaps the most distinctive pillar of public interest in the South African competition legislation is empowering historically disadvantaged persons. The Competition Act, in this respect, echoes the focus in South Africa's Constitution on full and equal enjoyment of all rights and freedoms, and enshrines the economic empowerment of black persons in South Africa in the Act.

Policy statements related to economic efficiency and consumer benefits provide for flexibility in application. References to adaptability and development of the economy extend beyond an interpretation of economic efficiency in a static welfare sense, to incorporation of dynamic considerations including market entry, firm mobility and innovation.

Consumer interests are also included in a broad sense; not only is price important, but consumer choice matters too. Thus, maintaining the scope of choice may possibly be supported despite perhaps higher prices. A particular challenge emerges from the lack of consumer organization in South Africa. Consumers in South Africa (and this is also the case in many other developing countries) are generally not well informed of their rights and the potential to pursue complaints through the competition authorities, and South Africa does not have specific consumer protection legislation. Advocacy is thus a key challenge for the South African competition authorities.

The rules of the Competition Act draw on international experience; the rules on restrictive practices derive from the EU Treaty and the merger regulation is similar to that of Canada. Besides select *per se* prohibitions, in general a violation of the Act is contingent upon demonstration of a net anti-competitive effect.

Exemptions which provide a counter to the prohibitions contained in the Act, also incorporate competition-plus issues. Exemptions, which have to be time-bound, may be granted for reasons which include the promotion of exports or the promotion of SMEs or firms controlled by historically disadvantaged persons. The scope for exemptions is broad; suggesting that even *per se* prohibited acts may be condoned if they contribute to the identified exemption factors.

A particular reason for consideration of an exemption application is "ensuring economic stability". The rationale for including this, potentially extensive consideration, was to facilitate ministerial input on industrial-policy concerns or issues of national interest. Ministerial designation is not sufficient to ensure an exemption on such grounds; this has to be considered by the Competition Commission, and it will decide if the statutory standard is met.

Merger control provisions are very detailed, and public-interest issues feature prominently in merger review. Specified merger thresholds will determine the process of notification and assessment. Large mergers are investigated by the Competition Commission, whose decision forms a recommendation to the Competition Tribunal that may accept, reject or amend the Commission's decision. Small and intermediate mergers are investigated by the Commission and a decision is made, which may be appealed to the Tribunal. Decisions by the Tribunal in all cases may be appealed to the Appeal Court and there is no ministerial override, as had been the case under the previous competition regime.

The merger evaluation process is clearly outlined in the Act. First, it has to be established whether the merger is likely to substantially prevent or lessen competition (SLC test). Second, if it has been decided that the merger will lessen competition, then it must be established whether the merger will result in "technological, efficiency or other pro-competitive gains" that will outweigh the anti-competitive effects of the merger. Third, irrespective of the outcome of the evaluation of the competition impact of the merger, a public-interest test has to be conducted. Thus, even though a merger may not have an adverse effect on competition, it still has to be reviewed on public-interest grounds.

Explicit criteria to consider in the SLC test are included in the Act (Section 12A (2)); however, a measure of flexibility remains with these. These criteria serve to some extent the purpose of general guidelines for the conduct of a merger assessment. They include barriers to entry, import competition, history of collusion, vertical integration and the "failing firm" argument.

If the authority decides that the merger is likely to substantially prevent or lessen competition it must then assess whether the merger transaction will result in any efficiency gains. The efficiency test is therefore included as a defence for an anti-competitive merger transaction. The nature of the balance between the SLC test and the efficiency test poses significant challenges to the authorities, in that a weigh-up of a competition compromise and efficiency benefits (both static and dynamic) has to be considered. It has been conceded that perhaps following the USA in bringing the efficiency test into the competition assessment, alongside other factors already included in the Act, may make the task of the authorities more manageable.

The public-interest test is mandatory in all merger assessments. Section 12A (3) of the Competition Act specifies the public-interest test:

"(3) When determining whether a merger can or cannot be justified on public-interest grounds, the Competition Commission or the Competition Tribunal must consider the effect that the merger will have on –

- a particular industrial sector or region
- employment
- the ability of small businesses or firms controlled by historically disadvantaged persons to become competitive; or
- the ability of national industries to compete in international markets."

(Government of South Africa, Competition Act (op cit))

The public-interest test in the South African Competition Act is distinctive for a number of reasons. First, the public-interest test is explicitly included in the Act, and also delineated very specifically in terms of the criteria above. This means that very select public-interest concerns enjoy a focus in the context of competition assessments. Second, the test empowers the competition authorities to prohibit or allow a merger that does or does not, respectively, pass muster on the SLC test. Third, the competence to allow or disallow a merger on the basis of a public-interest consideration is accorded to the competition authority, not any other Minister or stakeholder representative. The Act does, however, require that the Minister of Trade and Industry (or another Minister directly affected by the merger) be served a copy of the merger notification, so that they can plead the case before the competition authorities.

In the case of intermediate or large mergers, the primary acquiring firm and the primary target firm must provide a copy of the merger notice to any registered trade union that represents a substantial number of its employees, or the employees or their representatives if there are no registered trade unions. Any person, whether or not a party to the merger transaction may submit any document, or relevant information for consideration by the competition authorities. Also, the Minister of Trade and

Industry may participate in any intermediate or large merger as a participant to make representation on any public-interest matter.

Although there has been expected criticism concerning the inclusion of public-interest issues in the Competition Act, their inclusion has to be read in context. Major challenges to sustainable development in South Africa are employment creation and black economic empowerment. Explicit reference to these factors is thus to be expected in a significant area of policy and law such as competition, and in some sense provides a balance of considerations in the challenge to develop a set of complementary policies and laws to facilitate enterprise development and the achievement of broader socio-economic objectives.

Recognizing the importance of the interface between sector regulation and competition law, the Competition Act (as amended, 2000) specifies that the Competition Authorities and Sector Regulators have joint jurisdiction in relevant sectors. A Regulators' Forum is being established to implement this provision of the Act and it makes the Competition Commission responsible to "negotiate agreements with regulatory authorities to coordinate and harmonize the exercise of jurisdiction over competition matters" within a specific sector or industry.

Thus far, the Independent Communication Authority of South Africa (ICASA) and the Competition Commission have developed a memorandum of understanding, which delineates their respective jurisdictions, and the National Electricity Regulator (NER) and the Competition Commission have agreed to a workable collaboration arrangement.

4. Supporting enterprise development through competition policy

Substantively, the work loads of the Competition Commission and the Tribunal have overwhelmingly been concentrated on merger control. This distinguishes South Africa from developing and transition economies with new competition agencies, and highlights the political concerns in South Africa about the high concentration of economic power. Through pre-notification and merger assessment, a demonstration effect, in the area of merger control, provides evidence of South Africa's new competition law's strong impact. While the explicit consideration of public-interest concerns emphasizes their pervasive policy importance, checks and balances in the Competition Act ensure that decisions are transparent and void of direct political control. It is useful to reflect on the experience of South Africa since the implementation of the new Competition Act. As regards merger control, competition law practitioners indicate that, in the early days, merger notifications were mostly undertaken by lawyers (filling in the required information in forms provided by the competition authorities). Now no merger filing would be complete without a detailed impact assessment. Lawyers and economists now work together in an inter-disciplinary manner to assess the likely impact of the proposed transaction.

Competition law forms an important part of effective market governance. The rules of the market game, including competition rules, can enhance market outcomes by promoting not only the achievement of efficiencies, but also greater equity. To this extent South Africa's competition law is progressive in its explicit incorporation of public-interest considerations; whereas even mature jurisdictions shy away from such potentially contentious territory.

With South Africa's history, the inclusion of public-interest concerns makes good policy sense. The nature of the South African economy, its grossly unequal distribution of income and wealth, and hence, too, its inequality of economic opportunity have to be addressed by a coherent set of policy initiatives. Thus, employment creation, black economic empowerment and SME development are familiar objectives across a range of economic policies. A challenging question is to what extent different policies can impact on the promotion of SMEs – what specifically can be the contribution of competition policy in this regard.

It may be quite obvious that, especially in the short term, direct industry support policies, such as the provision of credit or marketing support, may be more visibly effective in supporting SMEs. However, the contribution of competition policy, while in some cases being more indirect, can play an extremely important role in ensuring that SMEs not only get access to specific market opportunities, but also do not fail because of anti-competitive practices.

Competition policy and the law which gives effect to this policy provide indispensable checks and balances to ensure that the market process works without being rigged by larger firms or firms that may have market power, which can be used to the disadvantage of other market participants. This does not mean that there should be no casualties of the market and the process of competition, but competition should be fair and without prejudice.

The following merger transactions and the decisions of the competition authorities will illustrate the impact of public-interest considerations in merger impact assessments. Specifically the cases will highlight the consideration of SME and empowerment concerns.

Pioneer Foods – SAD Holdings: small business impact

Pioneer Foods has diverse interests in milling, baking, poultry, animal feeds and branded consumer goods. The merger transaction involves the purchase by Pioneer of all shares in SAD and all of its subsidiaries. SAD has business interests in nuts, vinegar, dried flowers, dried fruit, wine and salads. This is a large merger transaction and, hence, it was first reviewed by the Competition Commission and then referred to the Competition Tribunal for further investigation and approval.

Assessment of the relevant markets of the two parties indicated that there are only two markets with product overlap and, hence, relevance for the merger assessment. These are ready-to-eat (RTE) cereals and jar vegetables (salads). The latter is a very small market with a third-party dominant producer: Tiger Brands. The RTE cereals market is one in which both small and large enterprises participate. International brand leaders such as Kellogg's are in this market, as are small home-based producers of RTE cereals for health-conscious consumers. There are, thus, various drivers of competition in the RTE market. And it may be argued that a finer delineation of more than one market is necessary to effectively assess the impact of the proposed merger transaction.

The geographic market for RTE cereals is defined as the South African national market, and there is limited import competition. This is because distribution and sales are primarily through supermarket chains which operate nationally.

The salad market proved to be a small market with low entry barriers contested by many small producers, and one large player. The Tribunal concluded that merger would not change the *status quo* in the salad market. This conclusion was based on an assessment of the nature of competitive activity, the role of the one large player and the contestability of the market. It therefore focused substantially on the RTE cereal market in its assessment of the merger impact.

Market definition proved an interesting exercise; breakfast cereals comprise hot cereals and muesli products. If the cereal market is taken as a single market, including both hot and muesli products, then Tiger Brands (which is not involved in the transaction) would be dominant. However, if branded cereals are defined as the relevant market, then Kellogg's is dominant. In the muesli market, taking a narrow market definition, then Nature's Source (which is a subsidiary of SAD, the primary target firm) is dominant.

The Competition Tribunal was persuaded that consumers display a high degree of substitutability especially among hot cereals and muesli products (the parties had submitted extensive price elasticity studies to indicate that the appropriate market definition was RTE cereals). Consumer demand was highly price elastic, and the cross-price elasticities indicated high degrees of product substitution.

It was concluded that even if muesli was defined as a separate "niche" market, this market demonstrated very low barriers to entry. This was an important consideration because on the one hand large-scale producers face significant barriers to entry, while on the other hand the barriers to small-scale producers were very low (many produced from home, and sold their products from specialist health shops or other non-retail chain outlets).

What became apparent to the Tribunal was that the small producers compete vigorously among themselves, and very few grow to the extent that they can attempt to compete with the likes of Kellogg's or Pioneer Foods. An important issue in this case was the nature of interaction between large-scale producers and the supermarket chains. The retail food market in South Africa is an oligopolistic one, with a few large chains of retail supermarkets competing actively with one another. They provide a strong source of countervailing power to the power of large-scale producers of consumer food products, including breakfast foods. One of their strong bargaining chips is allocation of shelf space in supermarkets. The market leader is accorded prime space, followed by the house brand, then the number two player follows and other players after that. Competition is thus intense as retail chains and suppliers bargain on price and shelf space, for example.

Taking into account these dynamic drivers of competition in the RTE market, the parties to the transaction argued that it was reasonable to conclude that far from reducing competition in the RTE market, the proposed merger may be expected to increase the level of competition as Pioneer Foods' bargaining power *vis à vis* the retail chains is likely to be strengthened, and that Kellogg's, the market leader, is likely to face more substantial competition.

The conclusion of the Tribunal was that the merger would not harm small business prospects, and the contestability of the RTE market would not be adversely affected by the merger. The merger was approved unconditionally. "It is possible for small-scale players to continue to enter the market by developing niche brands. The merger is not likely to adversely affect the potential of small-scale or niche entrants to the market" was the conclusion of the Tribunal.

This decision highlighted the fact that in some cases it may be possible to define the market not only in terms of product and geography, but it may be necessary to consider size of firms. In this case, the large firms (competitors of Kellogg's) can be said to operate in a market delineated from the market where small, niche (home) producers compete intensively with one another. It is quite unusual for small, niche producers to grow to the extent that they migrate to the large-firm market.

Two additional brief reviews of competition cases where SMEs were important considerations are noted here.

The *Bernina–Saskor* case (Competition Commission, 2002) arose from a complaint by an independent service provider alleging that Bernina–Saskor, the sole importer and supplier of Bernina sewing machine parts in South Africa, had instructed its franchisees not to provide the complainant with Bernina machine parts. The Commission concluded, and the respondent concurred that the respondent had contravened the provisions of the Act (Section 8(d) (1)) in that he had required a supplier not to deal with a competitor, and a Consent Order was concluded. In terms of the Consent Order, the instruction to franchisees was withdrawn immediately, and parts would be supplied to any customers. The machine parts would be used, typically, by small (often independent) enterprises repairing sewing machines. The restrictive practice was, thus, adversely affecting a niche market of small (even micro) service providers.

A group of 33 individually owned pharmacies (who had formed an association called Ring Pharmacies), are all SMEs. Ring Pharmacies had been engaging in joint marketing initiatives to assist them to compete with pharmacy chains. They applied for an exemption so that they could continue to conduct joint marketing initiatives to enable them to compete with established chains of pharmacies.

In recent years, in South Africa, pharmacy chains have proliferated, and the small individually owned pharmacy has become a rarity. The exemption was granted for 5 years to enable these SMEs to compete with the large chains. This decision recognizes the benefits of small, individually owned pharmacies, some of which may not have been targeted by the pharmacy chains as a result of their location of performance. The decision is thus pro-active support for small enterprises to compete in a market which has experienced a new reconfiguration as the chains have become commonplace.

Economic empowerment of historically disadvantaged persons is a key policy objective. Empowerment is achieved through many initiatives including employment equity requirements. The role of competition policy in empowerment is illustrated in a case that highlighted very different interpretations of this public-interest consideration by the Competition Commission and the Competition Tribunal.

Shell–Tepco Merger – Empowerment of historically disadvantaged persons

The Shell–Tepco merger took place in the oil industry. This industry is a high volume, low margin, capital intensive industry, and in South Africa also highly regulated.

Price control, especially retail price maintenance, and import control are key features of the regulatory dispensation. Maximum prices are set for petrol (gas), diesel and paraffin, from which dealers may discount. Stakeholders in the industry and the Department of Minerals and Energy have set goals to achieve Black Economic Empowerment (BEE) in the industry. At the time of the merger, BEE in the oil industry was in its infancy with BP being the leader in this regard. Shell was therefore very interested in this merger which would provide it with an empowerment partner.

Shell South Africa (SA) manufactures and markets petroleum and petroleum products directly and indirectly through subsidiaries and franchise outlets in South Africa. A distinction is made between the retail and commercial markets. The retail market is business-to-business which buys in bulk either on tender or contract or at negotiated prices. In the retail market, products are sold to consumers through retail franchise networks such as petrol stations. The geographic market for the commercial segment is national because of “hospitality” agreements among oil companies in terms of which they swap product (with regulated specifications) at different locations determined by the location of the refineries and customers. This means that a commercial customer can go to any depot with which the contracting oil company has a hospitality agreement.

The geographic market for retail is sub-national. Data were only, however, available at the magisterial district (local council) level, and hence this influenced the geographic market definition of the retail segment.

Shell is one of several oil majors operating in South Africa. At the time of the merger transaction, Shell SA was the second largest national player in the retail diesel and commercial paraffin markets, the third largest player in the retail petrol market and the fourth largest national player in the commercial petrol market.

Tepco, in contrast, was one of the smallest players in all relevant markets. Tepco is a wholly owned subsidiary of Thebe Investment Corporation. It markets and distributes petroleum and petroleum products as its main business.

An important consideration in this case was the role of government-induced regulation in the oil industry. Although the Department of Minerals and Energy has embarked on a process of managed liberalization, regulation still accounts for much of the distortion in the various markets in the industry. Another important consideration was that product specifications, specifically, are regulated. The relative product homogeneity facilitates substitution by consumers and thus enhances competition among suppliers. In the commercial market segment, where prices are not regulated, customers interviewed by the Tribunal indicated that they can negotiate prices with suppliers, and this prevents the abuse of even a dominant position in a narrowly defined geographic market.

The merger passed the SLC text – no lessening of competition was anticipated in the relevant markets, which were defined as the marketing and distribution of petroleum products nationally in South Africa.

However, the Commission conditionally recommended that the merger be approved, on the grounds that the merger would remove Tepco as an independent player in the petroleum industry, and would inhibit the ability of a firm owned or controlled by historically disadvantaged individuals to become competitive. The conditions for approval were:

- Tepco should remain an independent company jointly controlled by Thebe and Shell; and
- Tepco's brand should be maintained to ensure its independence.

The first condition would require a restructuring of the deal that the parties had put together, and neither wanted. Tepco indicated that it was experiencing structural difficulties and hence it wanted to be taken over by Shell – after the deal it would be owned and controlled by Shell.

The Tribunal criticized the Commission's recommendation as patronizing, indicating that empowerment is not "further obliging firms controlled by historically disadvantaged persons to continue to exist on a life-support machine".

The second condition was viewed as linked to the first by the Tribunal and subjected to the same criticism – there was no reason to prolong the existence of a non-viable brand. Tepco's locations were in high-risk markets that other suppliers were not prepared to supply. Thus, its exit from the market did not remove an effective competitor.

The Tribunal emphasized that the parties are free to make whatever deal they chose – provided that they meet the approval of the competition authorities.

The Tribunal overruled the Commission's recommendation, and approved the merger unconditionally. One of the reasons for the Tribunal's decision was that Tepco could drain the financial resources of its parent company if it were forced to remain independent in the market. The conclusion to the Tribunal's decision is instructive:

"The role played by the competition authorities in defending even those aspects of the public interest listed in the Act is, at most, secondary to other statutory and regulatory instruments – in this case the Employment Equity Act, the Skills Development Act, and the (Empowerment) Charter itself spring to mind. The competition authorities, however well intentioned, are well advised not to pursue their public-interest mandate in an over-zealous manner lest they damage precisely those interests that they ostensibly seek to protect." (www.comptrib.co.za)

This case raises very important considerations in the interpretation of the public interest in the context of a merger assessment. While public-interest concerns are explicitly incorporated into the merger assessment process, it is recognized that they should be interpreted very cautiously, and that the role of other policy initiatives in promoting those public-interest objectives may be far more important that that of competition policy and law.

A current case, concerns the privatization of state-owned enterprises and the role of competition policy. Perhaps one of the most challenging areas to address competition issues is in the realm of state-owned enterprises, and this is illustrated by the Telkom case. South Africa has embarked cautiously on the privatization route, and in those cases where state-owned enterprises have been privatized, a key consideration has been the maximization of asset value rather than the introduction of competition. This has important implications for enterprise development. State-owned enterprises in infrastructure service provision can have seriously deleterious effects on enterprise development; far more so than specific abuses of dominance or restrictive practices involving consumer products markets.

Advice from the Bretton Woods Institutions during the 1980s to governments in developing countries was to privatize and liberalize, with virtually no mention of competition policy and law. In developing countries with small markets, and in many cases larger foreign-owned enterprises or subsidiaries of multinational corporations, operating alongside many small and medium-sized domestically owned enterprises, the withdrawal of the state from productive economic activity left a lacuna which was readily filled by private concentrations of economic power, often private monopolies.

It was soon realized that market governance mattered very much, and perhaps especially so in developing countries. Rules are necessary for markets to function efficiently – and the competition rules were very important in this regard. The beginning of the 1990s heralded the era of regulatory reform, and soon the wave of competition policy and law development gathered momentum, more slowly perhaps, but also, in developing countries.

An interesting case which is currently being considered by the competition authorities concerns Telkom, the current sole provider of fixed-line telephony services. The South African Value-Added Network Services Association (SAVA) has lodged a complaint against Telkom, on grounds including the following:

- Telkom's refusal to provide telecommunications facilities to SAVA members to construct their networks
- Discriminatory pricing with respect to leased-line services
- Refusal to lease access facilities to value-added network services providers
- Bundling of services.

The Commission has found that Telkom has abused its dominant position, and the complaint has been referred to the Tribunal for determination. The outcome of this case has important implications for consumers and for business especially SMEs. Enterprise development can be seriously affected by providers of services such as telecommunications, transportation and other network-based services. Privatization in developing countries should be conducted with due recognition for the benefits of promoting competition in the provision of services previously provided by state-owned monopolies. These basic services provide an important infrastructure for enterprises and can impact significantly on the overheads of small enterprises, limit their ability to communicate with customers and suppliers and to market their products or services.

5. Conclusions

South Africa's experience in the development of its competition policy and law in the 1990s offers important lessons for other developing countries. First, the development of competition policy took place during a comprehensive policy reform programme. While this may not be feasible in other countries, it is important to note from this experience that due consideration for the policy synergies, perhaps among the collection of microeconomic policies such as trade, industrial, competition and labour market policies, is important.

Second, many developing countries are still engaged in, or planning to privatize state-owned enterprises. While an obvious concern in such a privatization exercise is undoubtedly revenue generation, and hence the protection or enhancement of asset value is key, the potentially negative effects on enterprise development across markets and sectors requires careful consideration of the promotion of competition in such markets.

Third, a very important aspect of the development of competition policy and law is the building of a competition culture. In some developing countries, economies are still in a transition from socialist-type or highly controlled economic systems. The private sector is an emerging one, and the benefits of competition may not be appreciated or be obvious to all stakeholders in the economy. An inclusive process of discussion and education around competition issues may assist to develop a competition culture that will enhance the benefits of enforcement.

Even in South Africa, where a comprehensive policy process involved a broad spectrum of stakeholders, competition law practitioners indicate that it is sometimes difficult to obtain information from even large enterprises, for merger filings or investigation of competition complaints. The perception seems still to be that competition law implementation is a bureaucratic process, a hassle factor for business. The collaboration of competition champions (perhaps larger businesses) to extol the virtues of effective implementation of competition can play a role in this regard. In South Africa, for example, South African Breweries, now a multinational beer producer, has a well-publicized compliance programme for managers, and this has assisted to raise the profile of competition policy in the private sector.

In merger regulation for example, trade unions are explicitly involved in the merger notification process. Thus, competition policy becomes not only an issue for management but also for employees.

Fourth, South Africa's experience in implementing competition has highlighted the importance of capacity building. In South Africa, as in many other developing countries, there is not a long tradition of collaboration between lawyers and economists. Lawyers seldom study economics and economists are not likely to study law either. Competition policy and law requires an inter-disciplinary approach, bringing lawyers and economists together. This is also a new area of study in South Africa, especially in the legal field, and this is probably similar in many developing countries.

A particular challenge as a result of the skills shortage has been the high rate of staff turnover at the Competition Commission. Commissioners with little more than a year's experience have become very sought after in legal firms and in the private sector. Capacity building should therefore be an ongoing exercise.

Fifth, the specific challenges faced in the case of South Africa at the end of the apartheid era also hold important lessons for developing countries. Distortions by government regulation, high levels of concentration in ownership and control, and vertically integrated conglomerate organizations were not conditions supportive of a strong competition culture and robust competition processes. This meant that the usual objective of competition policy to promote competition and economic efficiency was important, but at the same time, broader public-interest objectives were also important. Public-interest objectives mattered in the context of competition policy even though they were also to be pursued through other policy channels.

While public-interest objectives are important, their introduction into competition policy and law has to be handled very carefully. South Africa's experience with its 1979 Maintenance and Promotion of Competition Act offered clear lessons in this regard.

The 1979 Act put the public interest as the final criterion against which competition decisions would be tested, but did not define the public interest. This led to *ad hoc* and conflicting case law, and this was compounded by the political influence that could affect or override decisions by the Competition Board.

In the new Competition Act, the public interest is explicitly articulated. Specifically four public-interest pillars are identified, and bounds are placed on the permissible recourse to public-interest issues in competition cases.

For developing countries, this is important to note. While it may be desirable to include public-interest considerations explicitly to limit the scope of interpretation, care has to be taken both in the drafting of the law and in the implementation of that law. Caution must be exercised to ensure that decisions are credible and a consistent body of case law amplifies the letter of the law. Effective and consistent implementation of competition law is perhaps the most important advocacy tool in a developing country. There may be occasions where the promotion of public-interest objectives will be better served by policy interventions other than competition policy, and the competition authorities should be bold enough to hold back on such decisions (as was the case in the Shell–Tepco merger discussed earlier).

Developing countries should note that the specific pillars of public interest that are identified need careful consideration. The unique South African history led to the delineation of four pillars of public interest: small and medium enterprise development and black economic empowerment, employment, impact on a particular industry or region, and the ability of national industries to compete in international markets. In the implementation of competition law thus far, it is in the case of merger control, that employment, economic empowerment and small enterprise development have featured most prominently. The ability of national industries to compete in international markets has not yet been considered to be positively key in any merger assessment.

In general, and specifically for developing countries, it is important not to overload the competition policy agenda. There are objectives (including, in particular, public-interest objectives) that can be more effectively achieved through other policy channels. Policy coordination and inter-policy consistency is critical, especially for developing countries that are faced with the challenges of market development, with in some cases an emerging, rather than a robust, private sector, especially a small business sector. The number of public-interest issues included in the competition policy agenda should therefore be strictly limited, and through effective implementation of the competition law, synergies with other policy initiatives supporting these public-interest objectives should be developed.

Although the public-interest test in merger review is clearly specified, the Competition Tribunal has been cautious in its consideration of this test. This is a singular lesson for developing countries. If the credibility of the competition authority is to be established in the application of a public-interest test then cautious application is recommended.

The South African experience has also shown that, despite resistance at the multilateral level to engage in negotiations to determine competition rules, it is not possible to avoid competition issues in bilateral negotiations. South Africa (and SACU) is currently negotiating a free trade agreement with the United States and competition policy is definitely on the agenda, as it is also in the negotiations with the European Free Trade Area (EFTA) to conclude a free-trade agreement. It seems fair to say that such trade negotiations highlight the potential impact on domestic markets if competition policy does not exist.

The new generation trade agreements include trade-plus issues such as investment, and the entry of new firms, perhaps large ones, may have serious effects on the nature and intensity of competition in developing country markets. The absence of competition policy and law could mean that domestic firms do not have any armour should the newcomers engage in anti-competitive practices. So, while developing countries welcome and actively compete for foreign direct investment, they should ensure that competition policy and law is in place to ensure that competition is fair and that enterprise development is facilitated not frustrated.

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III.3. THE EVOLUTION OF COMPETITION POLICY AND ITS IMPACT ON ECONOMIC DEVELOPMENT IN KOREA[1]

Joseph Seon Hur

1. Competition policy and economic development[2]

For the 22 years that Korean competition law, the Monopoly Regulation and Fair Trade Act (MRFTA) of 1981), has been in effect, the Korea Fair Trade Commission (KFTC) has strived towards the formation of a market economy in Korea. As the government body in charge of competition law and policy, the KFTC has had immense influence on Korean economic development by correcting market failures stemming from imperfect competition and overcoming resistance and various obstacles to the market economy. This chapter has two purposes. One is to rethink the importance of competition policy as a core institution in the domestic economy and the other is to draw lessons from the Korean experience for the benefit of other developing countries with less, or no, experience in competition law enforcement. This will be done through analysis of how competition policies influenced Korean economic development in the last two decades.

The goal of national competition policies in a market economy is to increase economic efficiency and consumer welfare through promoting competition.[3] Since competition plays as crucial a role in a market economy as blood does in the body, government has an essential role to play in promoting and monitoring competition to ensure smooth development of the market economy. As the communist bloc collapsed and global integration of the world economy accelerated in the 1990s, a lot of developing countries and transition economies have been adopting competition law *en masse*. Developed countries are also reinforcing competition law enforcement policies. In light of such trends, we can be assured that, in the near future, competition policies will be core policies in those countries striving for sustainable economic growth regardless of their current economic status.

What lies beneath the adoption of competition law and its reinforcement in many countries is the belief that competition policies play a significant, positive role in economic development. That fierce competition among corporations has an important influence on economic development by enhancing efficiency and thus improving social welfare was proved valid to a certain extent by economic theories and empirical studies. It is difficult, however, to find straightforward data on the effect of competition policy on economic development.[4] Theoretically, it is not too hard to guess that competition policy would have positive effects on economic development since it promotes competition. However, there are certain limitations in proving this by empirical analyses. First, this is because other factors such as free trade and investment, regulatory reforms and privatization also contribute to economic development through promoting competition. These variants are so closely intertwined that it is not easy to differentiate between them. Secondly, the histories of competition policies in many countries are not long enough to make chronological analyses to see their relationship with economic development. Lastly, it is hard to discover appropriate variants that can measure the intensity of a country's competition policies.[5] Under these circumstances, it would be meaningful to see what influence competition policies have had thus far in the economic growth and development in Korea, which is known as a country of successful economic development.

In the next section, I will divide the Korean economic development process into three stages to examine the accomplishments and the problems of past economic policies. I will provide observations on past policies for the formation of a market economy and the developments of the MRFTA. The subsequent section will include analysis on how the KFTC has influenced Korean economic development and consumer welfare during its 22 years of competition policy enforcement. Finally in the conclusion, a few lessons from the Korean experiences will be discussed.

2. The Korean economic growth process and competition policy development

2.1. Government-led economic management: from the 1960s to the 1970s

2.1.1 Bright and dark sides of the fast economic growth led by the government

Throughout the 1960s and the 1970s, the Korean government pursued the so-called unbalanced growth strategy that strategically concentrated its financial and tax support on export-oriented industries. As a result, Korea achieved remarkable economic development, thereby increasing its GDP by 30-fold (US$ 21 billion in 1961, US$ 616 billion in 1979) and GDP *per capita* by 20-fold (US$ 81 in 1961, US$ 1647 in 1979) in less than 20 years.

This unbalanced government-led growth strategy is viewed as having been inevitable considering Korea's past economic status as a small market with a lack of resources and limited technology. However, when examined from the "competition perspective", this early stage can also be viewed as the period of government intervention and protection with limited domestic and international competition. In other words, this period was when market economic function was often substituted by government intervention. In the 1960s, government intervention was considered relatively neutral as government supported industry according to export performance. In the 1970s, however, government designated strategic industries and concentrated its support on certain companies so that it grossly distorted the market function. This resulted in unintended structural problems arising in various areas of the economy. The absence of competition distorted the operation of the market and allowed monopolistic/oligopolistic markets to take root while the concentration of economic power in the hands of a few (the *chaebols*) cast a dark shadow over the Korean economy as a whole. The reason why Korea was able to achieve high economic growth despite these structural inefficiencies is because conditions in the international economy were working to Korea's advantage at the time. Developed countries that advocated free trade turned a blind eye to the protectionism of developing countries under the GATT system.

2.1.2. Failed efforts to introduce competition law

There was certainly no lack of efforts to introduce the principles of competition in this period. In 1963, the so-called "three-powder case"[6] had provoked public opinion to the view that socio-political measures were necessary to deal with the abuse of monopolies. After that, proposals to legislate the Fair Trade Act were submitted to parliament in 1966, 1969 and 1971, with criticism on monopoly issues. These efforts, however, were thwarted every time. There was an absolute lack of general consensus on antitrust policies. Industries protested too, claiming that the most urgent problem in the Korean economy was to accumulate corporate capital and to produce an adequate supply of goods.

Finally, in 1975, the "Price Stability and Fair Trade Act" was legislated and was to precede the current MRFTA. Since the early 1970s, the domestic economy had been going through tough times due to price instability caused by augmentation of imported raw material prices and higher exchange rates. To tackle the problem, government legislated the "Price Stability and Fair Trade Act" in order to have flexible control over prices. This Act prescribed two contradictory objectives, price stability and observation of fair trade, though it focused more on the former than the latter. There were regulations on monopoly but they were mainly on cases of abuse, rather than on the issue of market structure. In practical terms, collective activities could not be regulated although they were prohibited due to the inherent shortcomings of the Act. The Act did not have the desired effects in the late 1970s either in terms of price stability or fair trade while Korea was struggling with an overheated economy and the second Oil Shock.

Finally, as we approached the late 1970s, ineffective over-investment was intensified by blind policy measures to protect the heavy and chemical industries. The Oil Shock and domestic political unrest aggravated the situation and brought about stagnation in the 1980s.[7] Economic stagnation in that period was unrelated to the cycle of economic ups and downs and its primary causes were the structural problems in the Korean economy that had accumulated during its compressed growth process. Accordingly, government started pursuing the legislation of a significant antitrust law to guarantee the clarity of the legal system and the efficiency of its operations.

2.2. Efforts to diffuse competition principles and economic crisis: from 1981 to 1997

2.2.1. Shift in economic policy trends and implications of the adoption of the MRFTA

Growth-oriented strategy led by government in the 1960s and 1970s subordinated the economy to politics and caused structural problems such as undue politicoeconomic ties, income inequality between social classes or regions and abuses of monopoly. As we entered the 1980s, along with the global promotion of deregulation and markets opening to foreign trade, Korea attempted to discontinue government-led growth policies. The change was attempted under three clear goals: liberalization, stability and market opening. With the process of liberalization came domestic competition stimulation and market opening with the introduction of external competition, and competition at last started to take root as a central concept in the management of the Korean economy.

Against this backdrop, Korea's basic competition law, the "Monopoly Regulation and Fair Trade Act" was legislated in December 1980 and enacted in April 1981, despite strong opposition from industry. The MRFTA was intended to change the government-led economy to a market economy. This was not merely an adoption of a legal mechanism. It signified a paradigm shift in national economic management. Through the MRFTA, the Korean government demonstrated its determination to actively adopt a market economy. Previously, several attempts had failed to introduce antitrust laws that could alleviate the side-effects of the past growth-oriented strategy and the paralysis of market functions. With greater economic expansion and complexity, however, the inefficiency of government intervention was clear. Monopolization was intensified with economic growth and this weakened the domestic economy to undermine Korea's international competitiveness.

The adoption of the MRFTA was a significant turning point that paved the way for the continuous development of the Korean economy. It can be regarded as a declaration introspective of past economic policies to revive market functions in the future. It also reflects the government's determination to renew completely the economic constitution which was weakened by intensified monopoly.

This shift in economic policy of the 1980s produced considerable results. Since 1982, prices have become more stable and a one-digit price increase rate has been maintained. From 1986 to 1989, Korea achieved an international accounts surplus for the first time. From 1981 to 1991, the average annual GDP growth rate reached a noteworthy 8.7 per cent.

2.2.2. Developments of competition policy

Since the enactment of the MRFTA in 1981, substances and priorities in Korean competition policy have evolved with market conditions and economic development stages. Accordingly, the organization and manpower of the enforcement authority, the KFTC, have steadily been reinforced[8] to enhance its status. While the first competition law was modelled on the systems of other countries, Korean competition policy has evolved to meet the needs of its own economic situation. This helped to gain public support for competition policy so that it can quickly and successfully take root in Korea.

First, to strengthen protective policies for SMEs (small and medium enterprises), the KFTC established the "Fair Subcontract Transactions Act" which was initially an article in the MRFTA. In 1986, the KFTC adopted the "Adhesion Contracts Act" to prevent large-scale consumer damages arising from unfair stipulations and to ensure fair trade.

At the end of 1986, a system aimed at dealing with the concentration of economic power in the *chaebols* was introduced in the MRFTA. It is true that the *chaebols* considerably contributed to the economic growth of Korea, but as the economy became market oriented in the 1980s, the *chaebols* became obstacles that hindered the diffusion of competition principles and social equity. *Chaebols*, born from the post-selective protection of the government, were worsening the monopolist market structure by expanding their economic power through unfair means of capital multiplication such as mutual shareholding. The government sought policy measures through the revision of the MRFTA in response to the national consensus on the seriousness of the issues and the urgent necessity for countermeasures. The economic power concentration control system enacted in 1987 is a system peculiar to Korean antitrust policies that was made to seek balanced development. It would suppress excessive concentration of economic power and enhance the vitality of domestic economy by making the *chaebols* focus on substantial growth rather than on unreasonable expansion.

In 1988, the KFTC was the first to declare "deregulation" and embarked on reforms in 18 industries. It was then that the KFTC's regulatory reform efforts really started. It aimed to abolish direct price control or market entry regulations by the government and to facilitate an environment where the market can function on its own.

The KFTC's enhanced status and reinforced functions since the enactment of the MRFTA meant that the direction of the government's economic policy steadily changed to focus on autonomy and competition rather than protection and regulations.

2.2.3. Change in the economic environment and the financial crisis

Though both domestic and international economic settings changed significantly since the beginning of the 1990s, the Korean government and industries missed the chance to restructure the economy as they contented themselves with their old practices, only to cause the 1997 financial crisis.

While the increase in demand from the foreign market stagnated from the beginning of the 1990s, many firms in developing countries emerged as strong competitors to Korean corporations in the global market. Domestically, competitiveness of export price has greatly decreased as the labour cost rose continuously. Amid all this, Korean corporations faced fiercer competition in the world market as the international economy integrated and borderless competition unfolded. From the mid-1990s, the WTO was in operation and Korea was admitted to the OECD. As these events intensified the market opening pressures and the waves of globalization, corporations encountered greater competition in the international market. Also, the need for pro-competition restructuring for the Korean economy was getting greater.

Korean corporations were losing the competitive edge in this context since their growth had depended to a great extent on government protection and assistance. *Chaebols* were unable to swiftly adapt to the changing environment. They were sticking to old growth strategies that had guaranteed success in the past, i.e. a strategy to multiply affiliated corporations by increasing production input financed through external loans. Hitherto, the KFTC had tried to reform the *chaebol* structure and business practices through controls on cross-shareholding and restrictions on the total amount of shareholding of other companies. However, those measures had little visible effects without a comprehensive control mechanism for *chaebol* activities. Though government attempted deregulation and market opening to remedy structural problems, much of the government-led economic system, operating through regulations and protection policies, still remained. Structural problems and inefficiency persisted in the Korean economy and strategic industries were gradually losing ground.

Although the KFTC made early efforts to restructure the Korean economy based on market economic principles, it failed to make fundamental changes in government policies and corporate behaviour. For example, the KFTC attempted to ban cross-debt guarantees between companies affiliated to one of 30 *chaebols*, only to meet resistance from industry and the relevant government authorities that led to failure.[9] From the beginning, the KFTC's functions and status were continuously evolving and it made progress in encouraging competition within the overall economy. However, it had not attained the authority and resources to determine the path of national economic policy.

Still, we cannot conclude that the achievements of applying antitrust policy was thus far trivial because the primary cause of the 1997 economic crisis can be traced back to structural problems, i.e. a weak market competition system. If we look at the Korean economy in the 1990s, before the financial crisis from the competition perspective, competition policy was more or less taking root in the product market, though it was unsatisfactory in the production factors market and enterprise ownership market. If we could say that competition has been taking root in every aspect of the economy during the post-crisis restructuring process, this would be the achievement of the KFTC's past efforts to instil the pro-competition mentality in every corner of its economy.

2.3. Towards the advanced market economy: from 1998 to the present

2.3.1. Structural reforms and strengthened enforcement of competition law

The 1997 economic crisis has generated national consensus that market competition should be the core economic principle. Under these circumstances, the Korean government has promoted reforms in four main sectors, corporations, finance, labour and public services, after the crisis. We can assess that, as a result, structural defects that had been fixed for 30 years have been significantly removed and that the pivotal point was laid for the market economy. First, in the corporate restructuring case, increase of small shareholders' right, introduction of external board members and reinforcement of accounting standards have improved the corporate governance structure and transparency. Cross-debt guarantees between affiliates of *chaebols* have been completely eliminated and the debt ratio of manufacturers has been pushed below 200 per cent. A permanent restructuring system run primarily by the board of bondholders has been set up. In the case of the financial institutions, the soundness and profitability have improved through the large-scale investment of public funds and their supervisory functions have advanced. In the public sectors, efficiency has increased through reduced manpower and consistently promoted privatization. As for labour problems, the situation continues to improve through increased flexibility due to the constant system improvements and the common culture of competition law and principles is being accepted widely.

The KFTC has played a pivotal role in corporate restructuring. It provided the basic environment where various means of interconnected *chaebol*-style management could be replaced by independent management systems, by reinforcing controls on the concentration of economic power.[10] During the process, law enforcement by the KFTC, such as the corrective measures against cartels and prohibited activities of trade associations, was made much stricter[11]. The KFTC provided the foundation for market economy to be settled also by actively promoting competition advocacy that ensures market competition through participating in regulatory reforms and a privatization process for public enterprises.

2.3.2. Reform accomplishments and the remaining tasks

Korea overcame the financial crisis and swiftly regained international credibility by carrying out comprehensive reforms. Since 1999, it attained high economic growth rates and a large national economic surplus while maintaining stable consumer prices. It made its final debt repayment to the IMF in August last year, 3 years earlier than planned. Korea is now one of the top five countries with the highest foreign currency reserves with US$ 100 billion compared to US$ 4 billion at one point in the financial crisis. International Financial Information Services are upgrading Korea's credibility to the level prior to the crisis.[12] Foreign media and investment institutions are also speaking highly of Korean restructuring achievements.

However, it is difficult to say that these changes are sufficient for continued steady growth, even though competition policy and restructuring efforts have prepared a foundation for sound development of the market economy. In particular from the competition policy perspective, the market economic principles have not been established in every part of the economy. The Korean market still has many sectors with high market concentration. Businesses have only begun to renovate through M&A and select managers through competition. The level of competition is also low in markets for labour and capital, for example. Therefore, we must continue to push for reform towards greater competition.

3. Impact of competition policy on economic growth and development

The competition policies that Korea employed for the last 22 years have had a significant impact on how the Korean economy works and what course of development it has taken. The most straightforward way to estimate the impact on economic growth and development is through quantitative analysis using statistical tools. This would allow us to see changes in GDP *per capita* or corporate productivity and competitiveness in relation to the implementation of competition policy. But, as mentioned previously in the introduction, it is not only difficult and complex to undertake primary analysis which proves the relationship between competition policy variables and macroeconomic growth and development, but the exercise is also beyond the scope of this chapter. Thus, in this chapter, I begin on the theoretical and empirical basis that concludes the positive correlation between competition variables and economic growth and development. From this point of view, it is possible to provide indirect proof of competition policy's positive effect on economic development just by showing that competition policy implementation generated great competition. On the other hand, since it is somewhat easy to estimate consumer and social welfare improvements through actual examples, many of my arguments will depend on this aspect. In the following pages, I will try to show that competition policy has provided a microfoundation for continuous economic development by dividing competition policy categories into monopoly regulation, cartel regulation and competition advocacy (regulatory reforms). I will also show how efficiency and welfare have increased through law enforcement.[13]

3.1. Market regulations on monopoly and oligopoly, competition promotion through cartel regulations and social welfare improvement

3.1.1. Increase in economic efficiency through regulations on monopoly and oligopoly

3.1.1.1. Regulations on monopoly and oligopoly in Korea

Korean monopoly regulation has consisted largely of identification and disclosure of market-dominating corporations and restrictions on abuses of market dominance. This system was first adopted when the MRFTA was enacted in 1981 and was used until 1999. It was a system unique to the Korean economy. The KFTC designated market participants with certain dominant characteristics each year and imposed *ex post facto* regulations on abuses of market status. But it has been noted that these measures are not sufficient to reform monopoly or oligopoly structures at their core since it focuses on enforcement of law after the violation has occurred. To make market structure more pro-competitive, the KTFC established and enforced the reform policies targeting the market structure. In the 1999 Amendment to the MRFTA, the designation system for market dominant enterprises was abolished. Now, market dominance is determined on a case-by-case basis.

The M&A control system is a typical means of competition policy aimed at prevention of monopolization. The KFTC reviewed 5,506 cases for M&A in total from 1981 to 2000. Among them, corrective measures were ordered in only 13 cases where the KFTC recognized competition restraints and injunctions were ordered in only four of those 13. Observing that nine out of 13 corrective measures were ordered after the financial crisis, we can say that the M&A regulation policy has been more active since then.[14]

3.1.1.2. Reducing market concentration[15]

Due to growing free trade and investment as well as 20 years of competition policy implementation, the Korean market structure is gradually becoming more pro-competitive.[16] As we can see in Table 1, the industrial concentration ratios in the mining and manufacturing sectors have gone down generally since enforcement of the MRFTA. The index shows that concentration was temporarily intensified between 1997 and 1998 because the economic crisis in 1997 reduced the number of corporations and business activities. In 1999, however, the index is even better than before the crisis. Since the number of businesses has decreased compared to that before the economic crisis, this can be translated to mean that competition structure has greatly improved in the Korean market.

Table 1. Trends of average industrial concentration ratios in mining and manufacturing

Year	1980	1990	1995	1997	1998	1999
CR^3 (%)	62.4	52.8	47.8	48.6	50.0	45.4

Table 2. Number of industries according to concentration ratio class (No., %)

Concentration Ratio (CR_3) Class	**1980**	**1990**	**1995**	**1997**	**1998**	**1999**
Under 0.20	18 (4.3)	89 (15.0)	91 (15.2)	88 (14.7)	87 (14.7)	92 (19.0)
~ under 0.50	133 (32.1)	214 (36.1)	259 (43.3)	268 (44.7)	258 (43.6)	222 (45.8)
~ under 0.70	93 (22.5)	107 (18.0)	111 (18.6)	102 (17.0)	92 (15.5)	65 (13.4)
~ under 0.90	85 (20.5)	84 (14.2)	69 (11.5)	67 (11.2)	79 (13.3)	55 (11.3)
Over 0.90	85 (20.5)	99 (16.7)	68 (11.4)	74 (12.4)	76 (12.8)	51 (10.5)

Table 2 divides the industrial concentration ratio into several classes and shows the number of industries and their gravity in each class. According to this, industrial concentration in mining and manufacturing has generally improved since 1980. Looking at the table, we can see that there is a tendency for industrial gravity to decrease in classes with high concentration and to increase in classes with low concentration.

3.1.1.3. Empirical studies on efficiency enhancement effects of monopoly regulations

(i) Decreased loss of social welfare

Economic logic would conclude that prices in monopolies are likely to be higher than in the competitive market. In monopolistic and oligopolistic situations, corporations can easily raise prices using market dominance. In addition, since the producers are few and corporate consensus can easily be reached, the possibility of explicitly or implicitly raising prices or preventing their reduction is greater. This being the case, the possible loss in social welfare is also greater than in a competitive market as less production results in higher consumer prices. In addition, long-term negative effects can result because there is little competition to stimulate technological innovation (which confers dynamic efficiency).

Jeon (2002) has reached conclusions worth pointing out through his statistical analysis of the social cost effects of Korean monopolistic and oligopolistic structures formed during past government-led rapid economic growth. According to the study on social welfare loss in 22 manufacturing industries from 1981 to 1998, the loss in 1995 was estimated to be 12.5 billion won (3.31 per cent of the GDP), which is considerably higher compared to the same index for the US or other developed countries. However, if we look at changes in the annual size of social welfare loss, it was 8.45 per cent of GDP in 1981 whereas it was 7.07 per cent in 1985, 4.87 per cent in 1990, 3.31 per cent in 1995 and reached 3.36 per cent in 1998. That clearly shows the decrease in welfare loss caused by the monopolist market structure. The decreasing tendency can partly be explained by other factors such as free trade, but most of all it can be regarded as the result of the government's adoption and implementation of competition policy since the early 1980s that steadily improved domestic anti-competitive markets and induced competition. In conclusion, it can be said that monopoly regulations have contributed greatly to the steady increase in economic welfare in Korea through improved market structure.[17]

(ii) Improved consumer welfare and the regulation of market dominance

Kim and Moon (1999) used the Lerner Index[18] to estimate how designation of market dominant enterprises has contributed to competition and consumer welfare. They selected nine items that had dominating parties in the market during the 6 to 12-year period from 1981 to 1997, and chose representative corporations for each. They calculated the Lerner Indexes before and after designation as monopolistic enterprises.

Lerner Indexes before designation seemed to be higher than those after designation for all nine products. This means that, though actual showings of monopoly regulations by the MRFTA were insignificant,[19] the fact that corporations are subject to *ex post facto* regulations once pointed out as monopolistic enterprises, has actually contributed to weakening the monopoly and to making the market more competitive by producing indirect regulating effects. The decrease in excess profit of monopolistic corporations means an increase in consumer welfare and causes efficient production that in turn makes a contribution to the continuous economic development.

3.1.2. Pulling the market economy development through cartel regulations

3.1.2.1. Harm from the cartels

Cartels comprising monopolistic corporations or business associations are the activity in which corporations collectively decide prices or supply sizes that should be decided independently. Cartels are the most important target of the antitrust policy since they are often so powerful that they can impede the operation of the market principles. Cartels provide excess profits for the participants, but on the social level, they bring inefficiency and social welfare loss. Thus, it is an essential task for development of the national economy to prevent cartelization. This will directly increase consumer benefit and, furthermore, enable the rise in dynamic economic efficiency by preventing the establishment of the monopolistic structure and by recovering market competition. Particularly in Korea, it has been critical to curb cartels because a considerable number of legalized cartels existed as remnants of the days when rapid growth and collaborative activities were widespread due to the monopolistic market structure.

3.1.2.2. Restriction on cartels and its economic effects

The KFTC has put a lot of effort into investigating cartels and the intensity of law enforcement has significantly increased since the mid-1990s. First of all, though the KFTC holds the power to authorize cartels that are planned to rationalize the industry or to overcome the economic slump, this has not happened. If we look at the corrective measures imposed on cartels by monopolistic corporations, except for the corrective measures on prohibited activities of business associations, there were 215 cases that the KFTC imposed more than corrective orders (including surcharges and prosecution) and 44 corrective recommendations since the 1981 enforcement of the MRFTA up to 2001. Since 1988 when the surcharges for cartels were first adopted, 314.4 billion won in total were imposed, about 93 per cent of this since 1998. If we add the 155 warnings, 374 cartels identified in total. This shows how widespread cartels were among corporations in Korea. To look at it differently, we can assess that the KFTC had a positive influence on the national economy as it succeeded in regulating cartels to a considerable degree by enforcement of antitrust policies. The continuous rise in numbers of disclosed cases and the increases in sanctions since the 1990s appear to be having preventive effects on cartels. Meanwhile, to regulate effectively cartels that are operating in very shrewd and covert ways, the KFTC adopted the Leniency Program for those who cooperate with the investigation by offering evidence. In addition, starting from 2002, the reward system of up to 20 million won was introduced for third-party reports on cartel activities.

Below are examples of typical cartels to demonstrate how cartel regulations had practical impacts on consumer economic welfare.

a. Correction of student uniform manufacturers' cartel (May 2001)

Three major student uniform manufacturers with around a 50 per cent share of the market collaborated to fix consumer prices for student uniforms. In this cartel case, the KFTC took strong measures that included an injunction order, an imposition of 11.5 billion won surcharges in total and they reported the case to the prosecutor's office. The estimated annual reduction of consumer burden by the disclosure of this cartel is about 60 billion won.[20] The case is a good example of how cartels can have negative effects on consumer welfare and how antitrust policies correct the distortion of resource allocation and increase consumer welfare by preventing and disclosing cartel activities.

b. Correction of bid riggings for public construction projects

The KFTC imposed strict sanctions by investigating three public construction projects bidding cases, one on the Baekje bridge construction in 1994, another on rolling stock purchase in 1996 and the other on the West-Coast Expressway construction in 1999. This worked as an impetus to end this long-lived practice of the industry. Also since 1998, it reinforced the supervision of public constructions by building and managing a permanent information collection system on public biddings. Consequently, competition is taking root in those public constructions that have a total value of 20–30 trillion won each year. Also, retrenchment of the annual government budget is estimated at around 4 trillion won as the average contract-awarding rate decreased from 87 per cent in 1997 to 75 per cent in the mid-2000s. This shows how cartels aggravate burdens and reduce efficiency in the economy.

c. Correction of the international cartel of graphite electrodes (March 2002)

On March 20, 2002, the KFTC decided to impose a surcharge of 11.2 billion won (US$ 8,532 thousand) on six graphite electrode manufacturers from the US, Germany and Japan which participated in an international cartel of graphite electrodes. The six companies comprised approximately 80 per cent of the worldwide market share of graphite electrodes. The participants held meetings in London and Tokyo to fix prices and allocate markets among themselves during the 1992–1998 period. Korea is 100 per cent dependent on imports for graphite electrodes, and during the 1992–1998 period, the import price increased by 48.9 per cent. In contrast, the price of imports from non-cartel members only rose by 9.1 per cent during the 1992–1997 period. The damages incurred from the cartel were estimated at about US$ 139 million.

This case is significant in the sense that it was the first case of the MRFTA being applied to an anti-competitive action committed by foreign companies located outside Korean territory. The decision demonstrates the KFTC's determination to apply competition laws when Korean companies and consumers are subject to damages due to anti-competitive actions committed by foreign companies. The decision will also serve as a strong deterrent against international cartels that heavily affect the developing countries. Korea is the first Asian country to join the worldwide efforts in controlling and rooting out international cartels. The case has a strong implication for the developing countries as well. This is because the developing countries have long suffered damages by international cartels and only advanced economies such as the US, EU and Canada had made efforts to sanction such cartels.

As we've seen from the examples above, cartels do immense economic harm to consumers by setting higher prices than the normal prices with competition. Thus, preventing cartels and insuring market competition have direct effects that increase consumer benefit. In this sense it is worthwhile to estimate the size of economic benefit to consumers due to the KFTC's achievements in repealing cartels in Korea. For convenience' sake, let's assume that 10 per cent of the total sales amount is the extent of consumer damage[21] caused by cartels and that the KFTC's surcharges amount to 1 per cent of total sales of the relevant market during the period when the cartel existed (average one year). Until 2001, the surcharges the KFTC imposed on cartels add up to 314.4 billion won, so while cartels existed, the total sales of the market is 31.44 trillion won. With this we can estimate around 3 trillion won as additional burdens on consumers by the cartels. So if it is assumed that cartels would have lasted for one extra year on average if they had not been revealed, that amount (3 trillion won) has returned for the benefit of consumers through cartel regulations by the KFTC. The numerical value of this estimate is much lower than the actual effects considering that the KFTC imposed surcharges on only 84 cases among the 374 cases where the KFTC imposed measures stronger than warnings until 2001. Still, if we take into consideration that 93 per cent of the surcharges have been imposed in the last 4 years since 1998, it sounds more reasonable to estimate consumer benefit at 3 trillion won, which is gained by the KFTC's regulations on cartels during the period.

3.2. Regulatory reforms and increase of economic efficiency and welfare

3.2.1. Regulatory reforms and competition advocacy of the competition authorities

The competition advocacy role refers to all those activities of competition authorities that advise and influence government statute revisions and regulations in order to promote a more competitive industrial structure and corporate behaviour by creating a pro-competition environment. In developing countries such as Korea where a competition culture is not established, competition advocacy is regarded as an indispensable element in antitrust policies. This is because getting rid of anti-competitive institutions and practices that had become widespread during the government-led economic management era is the core task necessary to complete the transition to a market economy and to prepare for steady economic development.

Regulatory reform is one of the fundamental functions of the competition authorities and the most important means of competition advocacy. The purpose of regulatory reform is to promote market competition, technological innovation and creative activities of corporations and to raise economic efficiency by reforming anti-competitive government regulations.[22] Regulations often act as an artificial barrier that blocks entry. Thus, deregulation aims to put pressure on existing corporations to raise competitiveness by improving productivity and innovating technologies. In addition, it has positive effects on consumer welfare in that it promotes development of new goods or services, broadens the consumer's options and influences price and quality. Regulatory reform, as described above, has common effects and purposes with antitrust policy because it also has a positive influence on long-term economic growth and development.

3.2.2. The KFTC's efforts in regulatory reforms and accomplishments

Ever since the enactment of the MRFTA, the KFTC has contributed to promote economic development by preventing the diffusion of public restrictions on market competition, i.e. anti-competitive government regulations, and by expanding the arena of the market economy while steadily assuming the competition advocacy role inside the government. It has stopped the formation of anti-competitive regulations using the Prior Statute Consultation System and achieved considerable abolitions of existing regulations and practices as a leader of the deregulating operation at government level. Meanwhile, the Omnibus Cartel Repeal Act was one of the accomplishments of the competition advocacy in the dimension of regulatory reform.

3.2.2.1. Prevention of anti-competitive regulations

To prevent anti-competitive regulations in advance, Article 63 of the MRFTA prescribes prior consultation with the KFTC when government bodies plan to establish or revise anti-competitive legislations or impose administrative measures of a similar nature. This is a competition advocacy system quite unique to Korea. The system was adopted at the time of the MRFTA enactment in 1981 and has had considerable achievements in preventing new adoptions of anti-competitive regulations or policies. During the consultation process, the KFTC mainly deals with market entry restrictions, price maintenance, restrictions on business territories, cartel activities, awarding monopolist rights of import and prohibited activities of business associations and suggests its opinions with regards to the issues. From 1991 to 2001, the total number of consultations was 3,654. The KFTC recommended removal or revision in 654 cases, which is 12.4 per cent of the total and in 581 cases (72 per cent of the total number of recommendations), its opinions were accepted. In particular, as the KFTC's independence and status strengthened, its acceptance by other authorities increased.

3.2.2.2. Reforms in the existing government regulations

Meanwhile, the KFTC recognized regulatory reforms as the main responsibility of the competition authorities from early on and has been leading government efforts to reform various anti-competitive statutes and policies since its establishment. In 1987, it spearheaded the use of the term "deregulation" and began to pursue regulatory reforms actively to reinforce competitiveness in each industry. It was then that the KFTC performed deregulations in 18 industries selected after industrial research. Coming into the 1990s, it took the lead in government efforts to reform regulations, participating in the Economic and Administration Deregulation Committee (1993) and in the Economic Administration Regulatory Reform Committee (1996).

The KFTC was in complete charge of economic regulatory reforms, operating the Economic Regulatory Reform Committee from 1997 to 1998. During this period the Economic Regulatory Reform Committee selected 11 core sectors, such as information and telecommunication, industrial location and factory construction, distribution, transport, construction and so on, that have great influence on the national economy yet are burdened with many regulations. It completely reformed the relevant regulations such as market entry barriers, price regulations or business activities regulations. During that period of regulatory reform, the KFTC was regarded as having been a success as a neutral third party overcoming protests from vested interest groups. Most of all, under critical monitoring by the IMF, successful reforms contributed much to the Korean economy as it developed into a pro-competitive market economy.

Since regulatory reform works were integrated into the Regulatory Reform Committee in 1998, the KFTC Chairman has participated in the Committee as a member and steadily influenced the regulatory reform process to reflect the competition policy perspective. Since then, the KFTC has been pursuing regulatory reforms by way of preparing improvement plans on anti-competitive regulations and presenting them to the Regulatory Reform Committee.

3.2.2.3. Examples of regulatory reforms and their economic effects

(i) Examples of regulatory reforms led by the KFTC

(a). Abolition of service fee regulations in certified professions

The legislation and enactment of the Omnibus Cartel Repeal Act[23] in early 1999 is noted as one of the most unique and remarkable achievements among the KFTC's regulatory reforms. Due to the Act, 20 different cartels were eliminated or improved, causing immediate modifications of price, production quantity and division of sales areas. These cartels had been granted government authorization. The reforms eliminated price fixing for service fees in nine certified professions such as lawyers and accountants. Since the Act took effect, the KFTC has reported the variations in fees for those professional services on a regular basis to assist consumers in making a rational choice of service. According to reported figures, the elimination of price regulations has generated greater variation between the maximum and minimum fees. This variation can be attributed to price differentiation according to the quality of service. Initially, levels of service rates in some certified professions rose, but in the second year of service rate liberalization, average service rates began to decrease or stabilize. Service fees for patent lawyers, for example, rose until the second half of 2000. However, according to research conducted in December 2001 on fees in professions concerned with patent applications, fees dropped 10.2 per cent since the latter half of 2000. In the case of lawyers' fees, rates have been dropping steadily since the market was liberalized. From 4.56 million won in the second half of 1999, the total average of lawyer's fees dropped to 4.35 million won in the first half of 2000, 4.07 million won in late 2001 and 3.85 million won as the annual average for 2001. Fees for certified accountants have also fallen steadily since fee regulations were abolished. Auditing service fees dropped an average 9.9 per cent between 1998 and the second half of 2001. Analysis suggests that these changes are the effects of price competition and new optimal prices being reached in the market. It is also evidence that effective competition is taking root within the certified professions with the expansion of consumer information that is provided through frequent investigation of changes in service fees.

(b). Relaxation of entry and price regulation in the telecommunication market

Since 1990, in consultation with the relevant government bodies, the KFTC had been trying to make the telecommunications market more competitive by deregulating market entry and price control. Consequently, in the Korean telecommunications industry since the late 1990s, competition has increased in each service sector as new corporations enter the market. In 1998, the KFTC induced active competition among companies by changing the billing system of telephone charges from the authorization to the report system. This change had positive effects on both telephone rates and quality of service. General telecommunications rates decreased steadily since 1995 resulting in more than 50 per cent cuts in long-distance and international rates. Taking into account the influence the telecommunications industry exerts on the overall increase of industrial competitiveness, the economic effects of regulatory reforms in this sector are regarded as very important.

(c). Abolition of entry regulations on gas station and beer brewery market

The KFTC abolished market-entry barriers on gas stations in consultation with the Ministry of Commerce, Industry and Energy in 1995, and they started competing on price and services. Before this, every station had more or less the same price and the numbers of stations were so few that consumers were not well catered for. Similarly, in August 2001, in consultation with the Ministry of Finance and Economy, the

KFTC deregulated controls that prescribed brewery facilities above a certain size. As a result, small brewers are now able to sell their beer and consumers have greater choice, making competition in the beer market more intense.

(ii) Analysis of the economic effect of regulatory reforms

As previously mentioned, it is not too difficult to estimate how regulatory reforms would facilitate economic activity and have positive influences on various economic growth indices, in theory. However, empirical analysis on the economic effects of regulation or deregulation is rare. Thus, I will refer to the research data on the effects on the Korean economy's macro-variants of the successful regulatory reforms since 1998 to support the argument of this article.

Ha (1999) investigated the benefits of the government's main regulatory reform measures in 1998, classifying their effects into three areas: increase in employment, reduction of public burdens and curtailment of the government cost. The measures analysed here are the reform policies on 324 main regulations that 30 different government bodies were in charge of. In numbers, it amounted to 4.1 per cent of the total 7,841 regulation adjustment cases in 1998. According to estimations, the main regulatory reform measures were expected to create a maximum of roughly one million job opportunities from 1999 to 2003, equivalent to 4.9 per cent of the 1997 population in terms of economic activity. During the same period, the opportunity and actual cost to be paid by the private sector to uphold the regulations were to be reduced by 18,600 billion won, about 4.4 per cent of 1997 total GDP. If the amount of cost reduction were to be used for economic activities, it would make a great contribution to the development of the Korean economy. However, this analysis has certain limitations in that it started with the pre-condition that all the decisions on regulatory reforms at that point would be executed efficiently without failure.

In addition, this study tried to analyse regulatory reform's macroeconomic effects with regard to five service industries, electricity, telecommunications, construction, distribution and transport, that play important parts in the national economy. As a result, if regulatory reforms in the five industries are successful, labour and capital productivity will increase by 4.3 per cent and 4.8 per cent, respectively, in the general Korean economy. Particularly in the telecommunications industry, labour productivity is estimated to increase by 15 per cent. With the fall of cost in the target industries of the study as well as in other industries, producer price will also decrease by 2.21 per cent. As we look at the general effect of all the impacts caused by regulatory reforms, in 10 years, actual GDP increase is estimated to be 8.57 per cent. This amounts to a 0.64 per cent rise in annual growth rate and indicates that, in Korea, regulatory reforms have very extensive effects on economic growth and development.

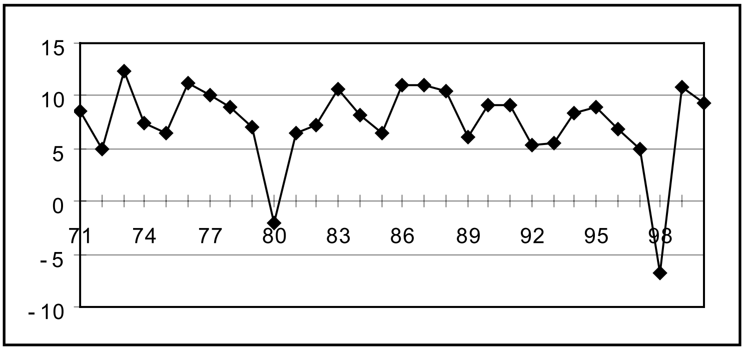
4. Conclusion

In the 1960s and 1970s, Korea promoted a government-led export-oriented growth strategy that distributed resources directly through protection and regulation resulting in remarkably rapid growth that surprised the world. In this period, however, the market economy was distorted and the resulting monopolistic market and structural inefficiency started to disturb the economy. To respond to these problems, antitrust policy was adopted in 1981. Since then, the KFTC has tried to diffuse competition principles into the economy and it has achieved some positive results. The Korean government and corporations, however, refused to face the necessity to restructure based on the principles of the market economy and, consequently, Korea had to undergo a harsh time in restructuring the economy after the 1997 financial crisis. As a result of the aforementioned efforts, Korea quickly overcame the crisis and is recovering economic vitality.

As we have seen, Korean antitrust policies have achieved certain accomplishments in introducing the competition principles into the economy and promoting competition by monopoly regulation, cartel repeal and competition advocacy that is manifested as regulatory reforms. As a consequence, they have made significant contributions to improve social welfare and develop the economy steadily. In particular, technological innovation and increase in productivity coming from competition and regulatory reform aided the growth of the Korean economy by improving economic efficiency. These are substantially different from the growth effects that arise from increases in production factors or in demand. Increases in these factors do not guarantee continuous economic growth. However, policies that provide a microeconomic environment where corporations can freely compete with one another enable the economy to grow steadily by improving productivity and increasing economic efficiency. In this respect, the impact of the antitrust policy on Korean economic growth and development is remarkable.

Korean competition policies have evolved to the present intertwined with the process of rapid economic growth that adopted the market economy system to overcome domestic structural problems as a response to changes in the external environment. Graph 1 shows the shift in Korea's annual GDP growth rate for 30 years since the 1970s. This shows that while Korea continued to maintain over 10 per cent growth every year on the whole, it had two clearly critical periods. The first is 1980, when the government adopted the MRFTA as it changed the economic policy fundamentals to attach importance to the market. The second period began with the financial crisis at the end of 1997. The government admitted that the causes of the crisis were the structural defects resulting from the immature market system. It executed extensive restructuring measures and spread the principles of the market economy. Enforcement of antitrust policies and laws was also greatly emphasized.

Graph 1. Changes in annual GDP growth rate.



As we've observed so far, Korea has constantly pursued reforms to reinforce the market system and antitrust policies each time it faced a crisis without taking a step backwards. Therefore, it can be said that the antitrust policy provided a means of recovering from economic depression in a short period of time and served as a driving force in continuing the path of high economic growth and development.

Nevertheless, many developing and less developed countries are worried that adopting antitrust policies will not be conducive to the country's economic development. Considering the Korean experience, however, for a country to develop steadily, it is advantageous in the long run to rely on the principles of competition from the early stages of economic development based on a strong belief in market efficiency. Developing countries should not argue that countries like Korea have succeeded in developing their economies without antitrust policies. However, it should be noted that the global economic environment today is changing so much compared with the past. With the stabilization of the WTO system, government protection can no longer be tolerated under the GATT system. Progress in liberalization of trade and investment and globalization of the corporations also intensify the trend that world markets are integrating into the one "level playing field". At an early stage of economic development, government intervention seems to be inevitable to a certain degree and it is not mandatory for developing or less developed countries to be equipped with the same level of antitrust policy system as that of the developed countries. It should be noted, however, that competition policies successfully took root in Korea because they evolved while trying to meet the needs of the economic situation of Korea. What is most important is that, in the long run, the earlier the adoption of antitrust policies the better, and it is imperative that the policies be constantly expanded and reinforced for countries to achieve continuous economic development.

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Notes

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1 The Seoul Competition Forum 2002 (2002.11.6).

2 Economic development refers to the process of economic progress that improves the quality of life of the people, as the domestic potential reveals itself gradually. Narrowly defined, it could mean an increase in the GDP or the GDP *per capita*, i.e. a quantitative increase in people's economic ability. However, it can be also broadly defined as an overall improvement in the quality of life.

3 Art. 1 in the Korean MRFTA describes its purpose as "… to promote fair and free competition, to encourage creative enterprising activities, to protect consumers and to strive for balanced development of the national economy by preventing any abuse of market-dominating position by enterprises and any excessive concentration of economic power, and regulating unreasonable joint acts and unfair trade practices".

4 Porter's empirical analysis (Porter, 2000) is a unique example which had remarkable results. In his research presentation in the World Competitiveness Report, Professor Michael Porter proved the strong positive correlation between the effectiveness of antitrust policy and national GDP *per capita* regardless of the country's stage of development. He used regression analysis on the relationship between many microeconomic variants and economic development.

5 We can think about the number of times that the competition authority enforced the law, the amount of surcharges, the number of personnel and the size of the budget as the

variants that could indicate the intensity of antitrust policies. However, these are not enough. Dutz and Hayri (1999) attempted inter-state transaction analysis using the numerical value of responses from entrepreneurs as the variant indicating the effectiveness of antitrust policy. This shows the difficulty of finding objective variants. In Porter's analysis mentioned in footnote 3 (Porter, 2000), this method was used to measure the effectiveness of antitrust policy.

6 In the early 1960s when supply was short, monopolist and oligopolist companies that produced flour, sugar and cement derived excessive profits by adjusting prices three to four times higher than official prices and evading taxes as they took advantage of the chronic supply shortage.

7 GDP growth rate in 1980 is recorded as being -2.1 per cent.

8 First established as an office inside the Economic Planning Board with the personnel of 75 at the time of the MRFTA legislation, the KFTC has grown steadily and its authority has been reinforced through several subsequent law amendments. In 1990, the KFTC was re-established as an independent administrative organization under a commission system (221 staff members). The power to enforce the MRFTA was transferred from the Minister of Finance and Economy to the KFTC chairman. Regional offices were also opened at this period. In 1995 at the dissolution of the Economic Planning Board, the KFTC became a totally independent administrative body. In 1996, it was elevated to Ministry status and its role was once again reinforced (381 staff).

9 Control system on debt guarantees was introduced in the 3rd revision of the MRFTA in 1992. It was limited to less than 200 per cent of owned capital in 1992 to be re-adjusted to 100 per cent during the 5th revision in 1996. The problem of debt guarantees among *chaebol* affiliates was resolved belatedly after the practice was completely banned with the help of the IMF, along with the economic crisis.

10 In 1998, the KFTC eliminated all mutual debt guarantees among *chaebol* affiliates with assets or sales totalling 34 trillion won or more and banned the practice in order to prevent the possibility of collective insolvency among affiliates. In addition, it focused on disclosing insider trading among affiliates and imposed surcharges of over 3000 billion won to promote the establishment of independent management in each affiliated company.

11 General prohibition of cartels and surcharge imposition were adopted at the revision in 1986, still 62 per cent of all correction orders (128 out of 204) on cartels till 2001 and 93 per cent of the total amount of the surcharges (3,144 billion won) were imposed after the crisis. On prohibited activities of corporate organizations, too, corrections orders, which had been under 20 cases annually increased to be more than 70 cases since 1998. Imposition of the surcharges once rare is becoming more frequent. Meanwhile, looking at the general trend of the MRFTA enforcement – though in the early stages it was weak - we can see that it was reinforced since the early 1990s and it is increasingly so after the economic crisis in 1997. Since the beginning of the 1990s, correction measures, surcharge imposition and reports increased dramatically and since 1998, especially, correction orders and surcharges have multiplied. Before the economic crisis the maximum annual correction measures and total amount of surcharges were, respectively, 250 cases and 162 billion won in 1996. In 1998, however, correction measures have more than doubled to 533 cases and surcharges amounted to 1350 billion won. In 2001, the biggest amount in surcharges was imposed (2,234 billion won).

(In 2002, the amount was down to 1,632 billion won.)

12 Moody's upgraded Korea's international credit rating by two steps (Baa2 ? A3) last March and Fitch did the same in June (BBB+ ? A).

13 I will not deal with the effects of the economic power concentration control on *chaebols* that the KFTC has been implementing since 1987. There is divergence on its effectiveness and influences. In principle, it is more desirable to let the market deal with the inefficiency problems of the *chaebol* system than to have government intervention. In reality, however, as the financial system, management market and capital market are not mature enough, government intervention is necessary for the time being to improve the management structure and behaviour of *chaebols*. It is hard to say that the economic power concentration control system in the MRFTA, which is represented by total shareholding and loan security regulations and prohibitions of mutual shareholding, would be the policy that raises corporate efficiency in a direct manner. However, the important point is that if insider trading among affiliates or cross-support exists, it will lower the national economic competitiveness and increase the possibility that the whole Korean economy will suffer a mortal blow in times of crisis. In this respect, policies on *chaebols*, such as prohibition of mutual loan security, total (shareholding) regulations and investigation on insider trading have the effect of stabilizing the economy and raising the long-term potential for growth by contributing to stop the *chaebols'* irrational expansionist administration from worsening. To support this argument we can look at the current situation. Recently, the tendency to have independent administration in *chaebol*) affiliates is gaining ground as giving debt security is abolished and unfair insider trading is suppressed.

14 It would be difficult to say that the KFTC's M&A regulations had an impact on monopoly prevention by looking at the KFTC performance in the past 20 years. However, it can be said that certain contributions were made by saving the social costs of monopoly since the mere existence of preliminary structural regulations such as M&A reviews have the effect of preventing M&A attempts that could bring monopolization.

15 That the worsening industrial concentration will have negative effects on social welfare and effectiveness is similarly explained by the empirical example mentioned below.

16 Of course, there are many factors other than antitrust policy that can be identified as a determinant of market structure. Still, it is reasonable to think that antitrust policy is the factor that has the most direct influence on the market structure because it has as its primary goal, promotion of competition through the market structure reform.

17 Competition influences economic development in quantitative terms, i.e. economic growth can be classified in two ways. First is the static effect. This refers to the effect of price nearing marginal production cost as the market approaches full competition. The production and consumption is likely to meet at a level where social welfare is maximized. Second is the dynamic effect. Here, competition increases economic wealth steadily by inducing industrial technology innovation and ensuring the survival of only the most efficient corporations. Thus, the effect of improving social welfare refers to the former explanation. It means that market structure reform and the resulting competition will, in a static sense, decrease the social cost caused by the monopolistic structure and expand the economic wealth.

18 The Lerner Index is the most conventional means to estimate the monopolist power and social welfare effect. It shows how far price is fixed from marginal production cost. Lerner Index ranges from 0 to 1. The higher the index the stronger monopoly is and the lower the index the closer to full competition.

19 Between 1981 and 2000, the KFTC took 3013 corrective measures in total regarding MRFTA violations. But only 23 cases were concerned with the abuse of market dominance. During the same period, the amount of the imposed surcharges on market dominance was around 35 billion won which accounted for only 0.6 per cent of the total surcharges

(Sung and Shin, 2001).

20 A market survey, after the correction measures were imposed, showed that the prices for winter uniforms have decreased from 175,000 won to 145,000 won for the three major cartel participants and from 155,000 won to 125, 000 won for other SMEs. In the case of summer uniforms, the price decreased from 50,000 won to 40,000 won. According to this survey, we can calculate the annual benefit transfer effect for consumers by the dissolution of the cartel. Adding benefits for both winter (30,000*1.5 million students = 450 billion won) and summer uniforms (10,000*1.5 million students = 150 billion won), the total reaches 600 billion won.

21 When estimating the size of the surcharges on cartels in the US, generally 10 per cent of the total sales amount is regarded as the industry's unjust profit surplus by forming a cartel. In addition, actual consumer damage is believed to be even bigger considering the consumers who give up purchasing at all upon price increase. Thus, here the size of consumer damage is at 10 per cent of the total sales amount, but the actual size is likely to be considerably higher than that.

22 Anti-competitive regulations refer to regulations that hinder competition by direct government intervention on variants such as number of suppliers, products, price of service and production scale that should be decided by market functions. They include various authorization/permission systems, certificate systems, price regulations and regulations on business areas. Those regulations dispersed in the overall industry weaken the constitution of individual corporations and cause social inefficiency and a decrease in consumer welfare by giving rise to high costs, low production phenomenon in the general industry. They also encourage corruption since privileges and interests are incorporated into the regulations.

23 The official title is "Act on Regulating Undue Concerted Activities Exempt from the Application of the Monopoly Regulation and MRFTA" (No. 5815, promulgated Feb. 5th, 1999).