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COMPETITION, COMPETITIVENESS AND DEVELOPMENT: LESSONS FROM DEVELOPING COUNTRIES

CONCLUSIONS

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Conclusions

COMPETITION, COMPETITIVENESS AND DEVELOPMENT: RE-STATING THE CASE

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Throughout this book, it has been argued that competition laws and policies in their various forms can be used as a tool for enhancing competitiveness and development. The book offers a number of suggestions to developing countries on how to maximize the benefits stemming from well-implemented competition laws and policies. Based on a selection of country case studies, ranging from larger more advanced developing countries such as Brazil, Peru, Republic of Korea, Thailand and South Africa, to least developed countries (Nepal, United Republic of Tanzania, and Zambia), this book offers clear arguments about the development-related aspects of competition and the pre-requisite institutional environment necessary for effective competition policy implementation.

In this concluding chapter we summarize some of the major findings and point out some challenges facing developing countries in adopting and implementing competition laws and policies.

That all countries, including developing countries and LDCs, are adversely affected by anticompetitive practices is unquestionable. Similarly, there is a widespread belief that the creation of competitive markets empowers the poor, provides them with employment opportunities, and increases their access to cheaper and better quality products. Competition policy is therefore an important institutional pillar for a thriving market economy wherein competitive pressures hone production efficiency and stimulate product and process innovation fundamental to international competitiveness and economic growth.

While recognizing that globalization and liberalization of goods and services markets had the potential to improve national welfare, the studies included in the book show that market failures, especially in developing countries, can pose major challenges to their competitiveness. As governments increasingly become cognisant of the fact that international markets are characterised by imperfect competition rather than the ideal competition of liberal economic theory, the role of competition law and policy becomes fundamental in ensuring a “level playing field”. In such a complex and dynamic economic environment, competition, competitiveness and overall economic performance are closely intertwined.

Competition policy and economic performance

A major contribution of the book is to fill some of the gaps in the existing literature of *ex-post* studies quantifying the effects of competition policies in developing and least developed countries. As the various chapters suggest, competition, competitiveness, and development are intrinsically linked. This is not merely a conceptually attractive theoretical proposition but also a basis for clear policy recommendations.

For instance, as the analysis of the Tanzanian experience clearly showed, various aspects of competition policy played an important role in spurring international competitiveness. The evidence provided by firm-level performance indicators (such as investment, productivity and export performance) suggests a robust positive relationship between government measures aiming to stimulate competition and protect consumers against anti-competitive practices. As international competitiveness depends on a country's ability to consolidate, upgrade and diversify its productive capacity, a well-implemented competition policy may act as a crucial ingredient in a successful development strategy.

Moreover, as several contributors have convincingly argued (the Korean experience is a *locus classicus* in this regard), in the long run full confrontation with competition has been essential to ensuring the continuing development of industries, at all stages of development. In order for protected industries to gain significant economies of scale and become globally competitive in the true sense of the term, "infant industry" protection should be applied selectively, made conditional upon meeting performance standards, transparent, time-limited, involve minimum discrimination, and, above all, be constantly reviewed. It has to be also recognised that providing protection to the domestic sector, particularly to infant industries, is the second best option. For instance, Amsden and Singh (1994) shows that even in Korea, a typical example for the infant industry argument, there existed more competition than is often thought, and not all of the growth was due to government protection and subsidies. Moreover, the chapter by Yun in this book convincingly argues that although increased monopoly rent may boost up productivity growth on the short term, it may hinder economic development in the long run, and that the latter effect is prevalent.

Further, it is not only the degree of competition that matters, but also the nature of competition that stimulates growth. As developing nations implement structural reforms designed to stimulate economic growth through greater reliance on the market system, concerns regarding competition policy naturally arise. These nations have a unique opportunity to create new conceptions of competition policy designed to promote the competitive process and foster development.

Several contributors (see in particular the chapters by Hartzenberg and Lipimile) have shown that enterprise development has been successfully transformed into a major "public interest" policy objective with the introduction and enforcement of competition laws in South Africa and Zambia. Such policies not only complemented the existing development-related policies, but also specifically benefit SMEs and increase the competitive edge of larger firms. A large body of literature suggests that SMEs from developing countries face significant constraints. In particular, SMEs are most likely to face imperfect financial markets where transaction costs preclude their growth. Thus, given these market imperfections, SMEs may require public funding to achieve socially desirable goals. An effective competition policy focused on enterprise development in a dynamic market may also encourage innovative behaviour, given the knowledge that innovation encourages technological advance and technological advance stimulates economic growth and the competitiveness of firms. Large firms with market power may be able to realize advantages of firm size, and their market power may stimulate R&D investment, but the potential source of innovation and rapid adaptation to market changes provided by SMEs should not be neglected.

Competition policy and sound institutional environment

One central argument in the current development debate is that good governance has become the key variable in explaining the economic performance of successful developing countries over the last few decades. As part of good governance and institution building, an increasing number of developing and least developed countries have adopted competition policies at national level, as part of a coherent set of policies to create comparative advantage and internationally competitive industries. As the contributors to this book tried to demonstrate, there are various mechanisms through which competition policy can positively impact on a number of key macro- and micro-economic ingredients for competitiveness and development. In short, competition policy is needed by all countries, but it should be accompanied by the right pre-conditions and measures.

Good governance of regulatory agencies is also a major factor that can improve sector performance. For instance, the empirical evidence included in this volume based on the Brazilian experience suggested a positive relationship between the level of independence of Brazilian regulatory agencies and the performance and effectiveness of their respective regulated sectors. Similarly, one of the most important lessons from the reform implemented in the electric energy sector in Peru, during the last decade, is that the success of a process of competition promotion does not depend exclusively of the individual performance of the competition agency, the sectoral regulator or the privatization agency. In the case of the Peruvian electric market, the book shows that the benefits of competition promotion through competition policies and privatization (for example in terms of lower prices of generation) could have been offset by incoherent policies. The contributors of the book also argue the importance of a cautious policy on the adoption of exemptions and exceptions. Exemptions for state-owned enterprises and exceptions provided for regulated private companies have certain justification, but proved to be costly to the economy when effective regulatory regimes are not yet in place (see for instance the chapter on Thailand). The impact of these exemptions and exceptions vary, depending on the scope and scale of the alleged restrictive practices and the nature of players in the market.

However, several contributors cautioned that merely adopting a competition law is no panacea. Instead, what really makes a key contribution to competitiveness and development is properly implemented competition policies. Moreover, favouring a competitive environment in other economic sectors through other policies that are directly or indirectly linked to competition policy, (e.g. establishing production standards, defined property rights, consumer protection agencies, efficient institutional frameworks with adequate human, technical and financial resources) would also have a 'multiplier effect' on the overall benefits expected from competition policy implementation. As Michal Gal argued, any successful unfolding of these processes will depend on the "ecology of antitrust". If not part of a well-coordinated set of legal and economic institutions, the impact of competition policy on productive capacities and in favour of more competitive economies is likely to remain minimal. The existence of large informal activities (in some developing countries the informal sector is thought to account for as much as 60% of their GDP), the lack of well defined property rights, limited environmental, safety and health standards, underdeveloped consumer protection institutions and laws, limited capability to verify and check standards, lack of technical expertise and experience, may all limit the potential benefits stemming from an effective competition policy implementation.

This points out that policy-makers in developing countries face the challenging task of designing appropriate competition policies that will bring about economic development in these countries. As discussed earlier in this book (see for instance the chapters by Gal, Adhikari, and Nkikomborirak), there are several characteristics in developing countries that certainly can make the task of competition policy design and implementation difficult. For instance, while market entry and access are the key elements of market economies that many developing countries are currently striving to achieve, in practice, in most developing countries the "invisible hand" of the market does not always operate very smoothly and indeed the instance of market failures are rather frequent.

The theoretical explanation for market failure in developing countries is that the high transaction costs and asymmetric information in these countries limit economic efficiency. Competition authorities should therefore perform two most important functions: eliminating *private* and *governmental* barriers to entry.

When dealing with *private barriers to entry*, the authority must have sufficient economic expertise to assess the business practices of dominant firms in order to challenge only those practices that impede the competitive process by erecting artificial barriers to entry. In addition, as several contributors suggested, to ensure that these benefits are materialized, competition authorities should be insulated from the rent-seeking activities of business and political interest groups. The task of identifying and challenging the entry-deterring business practices of dominant firms requires sophisticated and discerning competition authorities that can distinguish between pro and anticompetitive business practices, implement a workable definition of dominance, count on efficient procedures for examining defences of challenged business practices, and apply suitable penalties or other remedies to eliminate the use of practices deemed anticompetitive. Developing countries need to improve the system of data collection and reporting on the competition matters e.g. concentration, determination of market power, investment behaviour of the producing firms, and other possible measures of competition and encouragement and facilitating training in disciplines necessary for the competition policy implementation such as competition law, economics that has strong emphasis on competition aspects and the related fields. However, conditions prevailing in most developing countries and uncertainties regarding existing rules make this objective extremely problematic. For instance, the process of determining dominance, as the case of Thailand suggests, is complex, controversial, and critical to effective competition policy implementation. Without clearly defined, simple operational rules, competition authorities can hardly discourage dominant firms from using anti-competitive practices (e.g. exclusive dealing arrangements, refusal to deal, predation, exclusive access to essential facilities, mergers aimed at increasing market power) designed to deter entry and stifle competition. Furthermore, as the case study of Nepal has shown, given limited financial and technical capabilities many developing countries can hardly afford to establish new institutions manned by required expertise and institute a well-functioning competition policy without appropriate technical cooperation. Hence, the need to provide technical and financial assistance to developing countries engaged in the design and implementation of national competition legislation cannot be stressed enough.

Not only private barriers but also governmental barriers can impose major restrictions to competition and competitiveness. A competition authority may identify and amend public policies, rules, and laws that restrict competition. The competition authority should therefore be a senior partner in developing countries that are attempting to reform their economic systems and incorporate more market-oriented reforms. Privatisation and deregulation strategies, as well as trade reform plans (to name just a few) should include key inputs and guidance from competition authorities. Ultimately, the success of the reform process will also depend of the combination of competition policies, privatization and regulatory policies and of the internal consistency and coherence between them. Given these reasons, the competition authority's role is broader and even more fundamental than that normally associated with competition authorities in developed countries.

The competition authority also could play an important role in eliminating or reducing other barriers to entry. Given the conditions that characterize most developing countries, natural barriers to entry significantly deter competition. Through competition advocacy, an active competition authority could coordinate with other state agencies in promoting more favourable business conditions. For instance, Baumol

(1992) suggests adopting public policies that encourage the exchange of technology, including incentives for licensing, and signal a clear commitment not to penalize technological joint ventures in order to promote inter-firm cooperation in producing and disseminating technology. However, effectively tackling natural barriers to entry is a difficult challenge (particularly in many developing countries with shallow financial sectors, limited educational and training opportunities, and limited technological capacities) and having too high expectations from competition authorities in these areas would be unrealistic.

Directions for further research

So far we have seen that a clear understanding of the sources of the market failure is a useful step in trying to design an effective competition policy that could enhance the competitiveness of developing countries. In practice, a well functioning competition policy needs to be linked with other rules and regulations in a particular economy. It is important to understand how competition, and competition law and policies work in different economic and institutional settings. This means that one needs to look at both general and specific settings in which competition policy needs to operate. This was precisely the major attempt throughout all chapters included in this volume, be they qualitative or quantitative in their methodological approach. By locating the firm at the centre of the analysis, the country cases included in the book tried to build bridges between general analyses on the benefits of competition policy and microeconomic studies, two approaches that are all too often disconnected.

Given the complexity of the task at hand, some caveats are in order. Some of the effects of competition are not easily measurable, or there may be little available empirical evidence thereon, while some evidence may be inconclusive or ambiguous. Furthermore, it may be difficult to isolate the effects of more competition from other domestic reforms. For instance, liberalization and the elimination of distortions within an economy do not automatically lead to growth in the absence of the supply capabilities to take advantage of new opportunities, and the prevalence of competition is only one factor determining countries' growth rates. It should also be mentioned that the findings of the chapters discussed above often do not take into account all adjustment losses, which one may reasonably suppose to occur in countries where competition policies are adopted as part of a broader reform process.

One way in which some of these shortcomings have been dealt with in the book, was to adopt complementary methodologies. Qualitative analyses look at the more general pre-conditions that competition policy needs in order to fulfil its objectives. Quantitative methods take a narrower approach and investigate the impact of specific features of competition and competition policy on several economic variables, thus making the overall argument more convincing. The quantitative chapters suggest that when well-implemented competition policies fulfil their objectives (such as lower prices and higher quality for consumers, and enhanced efficiency across all sectors) competition authorities will have acquired their own "legitimacy by results".

Even if quantitative tools do not give us precisely measurable data, they provide the confidence that making the necessary political and economic reforms related to the introduction and enforcement of competition law and policy will necessarily improve the developments prospects of developing countries and LDCs.

Despite these difficulties, the main argument coming across the country cases included in this volume is that competition policies implemented in a coherent manner, not only with regard to their own objectives but also vis-à-vis the broad development objectives at national level, usually lead to better policy decisions and efficient use of society's resources. The chapters included in the volume therefore offer important insights about the benefits of competition policy for competitiveness of developing and least-developed countries. It is likely that the above estimates understate the benefits of reform, as several mechanisms through which competition contributes to improved welfare (e.g. qualitative assessments in terms of better service quality or pressures to innovate) are not taken into account.

For more general conclusions regarding application of competition policy for developing economies, it would be important to directly test other hypotheses found in the literature, such as the optimal competition theory. Similarly, it would be interesting to further investigate the linkages between increased competition, corporate governance and social corporate responsibility in developing countries. Additional research may also shed light on specific developing countries and economic sectors where scale economies are significant and where the blind pursuit of a policy designed to provide for 'maximum competition' will merely lead to low capacity utilisation and will diminish both economic growth and international competitiveness. For these and other reasons not fully explored in this book, policymakers should conceive appropriate tailor-made competition policies that take into account the specificities of developing countries.

Competition policy and development: a stake in the future

While some aspects related to the design and implementation of competition policy may still deserve further investigation, the discussion in the previous chapters brought out one clear conclusion: mainstreaming a certain degree of competition into a successful policy framework is fundamentally pro-development. Ensuring that competition policy contributes to enhancing the development prospects of developing and least developed countries has been a longstanding preoccupation in UNCTAD (Brusick and Cernat 2004). Over almost four decades, UNCTAD's work in this area proved that the case for national competition policies can hardly be overstated. As noted in the introduction to this volume, Adam Smith clearly understood the significance of competition and market entry over 200 years ago. This widely held notion remained perennial in economic thinking and there is now widespread recognition of the need to adopt national competition policies, both for reasons of equity and on grounds of economic efficiency. Joseph Stiglitz, the 2001 Nobel Prize winner, makes the argument forcefully:

"Strong competition policy is not just a luxury to be enjoyed by rich countries, but a real necessity for those striving to create democratic market economies." (Stiglitz, 2001)

Therefore, the economic rationale for competition policy remains of paramount importance. This is particularly so for those developing and least developed countries moving towards market-oriented reforms. Several specific reasons call for adoption of competition law sooner rather than later. Firstly, the adoption of liberalisation policies, the rise in privatisations, and the fact that most privatised entities in the utilities sector are natural monopolies underscore the importance of a solid competition regime to elicit the most favourable efficiency and welfare effects of liberalisation and privatisation. In some cases, privatisation and deregulation have taken place with scant regard for, and often in the absence of legal and institutional frameworks for competition policy. In a period of extensive deregulation, the adoption of competition law and policy represents a complementary measure that would "bring the state back" in ways that support and reinforce recent market-oriented reforms, while limiting the scope for unnecessary regulation. During such an adjustment process, one challenge ahead is to infuse competition principles with sound economic analysis that reflect the special characteristics in which firms and policy-makers operate when "rebuilding the ship at sea".

Secondly, the recent proliferation of massive international mergers, the existence of international cartels and their potentially negative impact on consumers (Evenett, 2003) puts forward a case for competition policy to equip developing countries with the tools to deal with the increased market power of multinational companies and their anti-competitive practices. Such evidence suggests that, once the "deep waters" of government-imposed trade barriers are gradually removed, the "mountain peaks" of trade-related private anti-competitive practices become even more apparent.

Even though national competition policies may be poorly equipped to deal with such potential negative external influences, the importance of domestic competition policies stems also from the differential impact that domestic and competition from abroad may have during adjustment periods. In certain cases, competition among domestic firms may have a relatively more beneficial effect than foreign competition, not only because it increases rivalry with known competitors but also because it provides a 'level playing field' among similar competitors and a gradual exposure to competitive forces, before engaging in full-fledged competition on world markets.

Although national competitiveness means different things to different people, it basically involves building public-private partnerships for the purpose of promoting exports and economic development. As several contributors argued in this book, a development-friendly competition policy is best suited to promote competitiveness, while maintaining the right balance between the interests of all stakeholders. In this regard, the experiences of the countries included in this book contain key elements for the design and implementation of tailor-made competition policies in developing countries and LDCs.

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