From monopoly to rivalry: policies to realize the competitive potential of transnational corporations

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Generally, national competition and antitrust policies should not be specifically addressed to transnational corporations (TNCs). Market imperfections and monopolistic conduct can be associated with both national and transnational firms. To the extent, however, that the presence of TNCs is strongly correlated with imperfect markets, competition policies may need a transnational corporation-specific focus. Similarly, in so far as market failures generate barriers that particularly affect domestic firms, compensating interventions (even if neutral in approach) would be non-neutral in impact.

Introduction

This article examines the role of competition policies in markets where the presence of transnational corporations (TNCs) is significant. The literature on TNCs shows that such firms are associated with imperfect forms of market structure. But it is not clear whether TNCs are just attracted to markets that are naturally concentrated or whether they have an independent role in increasing market concentration and lowering the intensity of competition. That TNCs are attracted to markets that would naturally be concentrated stands to reason. Their specific advantage *vis-à-vis* national firms are in scarce managerial, technological, financial and organizational endowments. The fact that relatively few firms command those assets explains why markets populated by TNCs tend to be concentrated. Still, concentration may be reinforced by TNCs' anti-competitive behaviour, such as predatory and other entry-deterrent conduct.

If, from an industrial organization perspective, the most relevant fact regarding TNCs is an association with imperfect markets, then stimulating competition would be the core policy measure to maximize the welfare gains from the presence of TNCs in domestic markets. Competition policy

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should be a non-discriminatory tool. Both national and transnational firms need to be induced to compete and overcome existing barriers. Entry of TNCs, in particular, should not be blocked. Countries need access to their special endowments. Yet, as incumbents, TNCs should not be protected either. If they are to make the most productive use of their endowments and dissipate their rents within a country, they must operate in a competitive environment. Thus the importance of neutrality (national treatment).

The economic importance of an active competition policy is clear. A growing body of case studies indicates that competition is the prime motivation for managers to cut waste, improve technical parameters of production and allocate resources efficiently. Sectoral evidence shows in addition that it is a compelling force for firms to restructure outdated operations, introduce new product lines and search for new markets at home and abroad. Assuring a competitive environment is thus the most effective means to stimulate modernization and structural change.[1] The need for and the benefits of competition are not dependent on the nature of asset ownership in the domestic economy. Public as well as private enterprises that face competition allocate and use resources more efficiently, just as national and transnational corporations do.[2]

Competition should not be regarded, however, as a sufficient condition for TNCs and domestic firms to behave in ways that bring the greatest welfare gains to the country. It is a most effective force for modernizing the industrial sector in the presence of an entrepreneurial class actively engaged in industrial activity, and able to mobilize resources in response to market opportunities or threats. It functions as a policy tool when national and transnational producers can be attracted to the domestic market. Firms must have access to industrial endowments such as skilled human resources, basic physical infrastructure, supplier networks, industrial maintenance and services. If the market is not structurally competitive, in the sense that only a few have the incentive or the

[1] Note that there may be desirable barriers to competition if increased competition lowers aggregate economic welfare. First, certain externalities may require restricting competition on static efficiency grounds. It is well known that the competitive exploitation of commonly held resources leads to suboptimal outcomes (the "problem of the commons"). Second, by reducing economic profits, competition may be "excessive", in the sense of not providing sufficient incentives for firm growth and technical change. Third, in economies in which firms and individuals face large differences in initial endowments, competition might exacerbate problems of distributive justice. For simplicity, those issues will be ignored here.

[2] Domberger and Piggot (1986) concluded that ". . . opening up a market to competition is crucial in promoting improved economic performance" (p. 150). The authors further noted that ". . . liberalization without ownership transfer will generate substantial improvements in productive efficiency" (p. 152).

ability to enter (that is, when both potential and actual competition is intrinsically weak), competition policy can become an ineffective instrument.

This article is organized as follows. After this introduction, the following section identifies major barriers to competition, while the subsequent section discusses the policies required to overcome them. A summary of the general approach to competition policy concludes the article.

Barriers to competition

Background

Most markets in both industrial and developing countries can be described as imperfectly competitive. One would expect that larger and more dynamic markets, or those populated by informed consumers, tend to be more competitive. More producers are attracted to them and more is demanded from them. Conversely, adverse welfare effects of imperfect competition are particularly significant in developing countries, where markets are thinner, factor endowments far more limited and an industrial culture lacking. In that perspective, the greatest potential for welfare gains from an improved competitive environment is in industrializing countries, where emerging and fast-growing markets may breed intense rivalry among firms, both transnational and national, depending on the competition policy regime.

Yet in those markets, rivalry has been historically constrained by numerous barriers to competition. Some are natural, of which the most important are economies of scale and financial-market imperfections. National firms tend to be at a particular disadvantage in overcoming both.[3] Other barriers are strategic in nature and emanate from firm conduct. Though both national and transnational firms are known to resort to them, TNCs are generally in a better position to both erect and surmount such barriers. Finally, there is a set of barriers that are policy-generated: promotional instruments, protective mechanisms and regulatory regimes. Sometimes, those policies protect national firms from the competition of TNCs. More often, they serve to shelter incumbents, national and foreign, from entrants. Combined, those barriers are reflected in high levels of market concentration (table 1).

[3] Other natural entry barriers would be associated with a post-entry absolute advantage (related, for example, to the proprietary or closely held nature of technology used by incumbents) or a pre-entry asymmetry (for example, incumbents may have lower production costs due to acquired experience or may command greater consumer loyalty). A special type of asymmetry is related to capital-market imperfections. Generally, entrants are perceived by investors as posing a greater risk and, therefore, they face higher capital costs than established firms.

Table 1. Market concentration in selected countries

Country	Year	Average of four-firm concentration ratio	Number of industries[a]
Argentina	1984	43	72
Brazil	1980	51	119
Chile	1979	50	41
India	1984	46[b]	n.a.
Indonesia	1985	56	119
Mexico	1980	48	166
Pakistan	1985	68[c]	n.a.
Turkey	1976	67	125
United States	1972	40	323

Source: For Argentina, Chile, Mexico and Turkey, World Bank,1988a; for Brazil, Willmore, 1988; for Indonesia, India and Pakistan, World Bank data.

[a] To compare concentration ratios among countries requires using statistics with the same level of disaggregation (the same number of industries). Despite similar four-firm concentration ratios, the degree of industrial concentration in Argentina, for example, appears to be much larger than in the United States as the Argentine data refer to 172 industries and the United States, data to 323 industries.

[b] Weighted by value of output for 1983/1984.

[c] Average for the spinning, weaving, polyester yarn, polyester fibre, fertilizers, automotive products, bicycles and tractors.

In developing countries, an inordinate proportion of barriers to competition are related to the policy regime. Rents (monopoly profits) can be extracted because dominant firms, both national and foreign, are protected by government policy. The origin of many of those protective regimes was attempts to spur industrial development, by regulating, promoting, protecting or creating capacity in specific business activities. In many cases, policies designed initially to provide temporary support for infant firms and industries hardened into policies protecting mature industries from both domestic and international competition. As a result, competitive markets did not develop. In the early stages of industrial development, competition was

not perceived as critical to development goals. Moreover, regulatory controls, promotional instruments and trade restrictions, by raising the profitability of the industrial sector, had a significant impact in stimulating the entry of new firms, national and transnational.

In some countries, as the industrial sector matured, Governments increased domestic firms' exposure to competitive forces. In most others, however, protective barriers solidified, stifling entry and preventing the emergence of new areas of comparative advantage. Efficiency losses grew, overshadowing the short-term gains achieved through a growing industrial base. The examples that follow illustrate the regulatory and incentive barriers most commonly found in industrializing countries. Sometimes they were originally designed to improve the relative position of national firms or even create a national entrepreneurial class. After a few years, their position consolidated to the detriment of newcomers that were often not awarded similar benefits. In other cases, the policy-generated "first-mover" advantages were created for both TNCs and national firms. Yet, the greater ability of the former to deter competitors strategically while absorbing fiscal and other transfers created entrenched, monopolistic positions. Even other TNCs were unable to dislodge them. In all cases, such open-ended regulatory, promotional and protective instruments became antithetical to the objectives for which they were originally created.

Regulatory controls

Possibly the most pervasive regulatory instrument in industrializing countries is capacity licensing and other market-reservation policies. Through such licensing, many Governments attempt to control the total amount of domestic capacity, as well as its allocation. Licensing is used to promote priority industries, decentralize plant location to less developed regions and conserve resources by balancing domestic supply and demand. Yet it precludes potential competition by regulating entry, encourages entry-deterrence by incumbents and reduces actual competition by constraining supply. Licensing was often used in the past to control the entry or expansion of TNCs into specific segments or the maximum share of ownership in their local ventures, though incumbents (of foreign origin) were generally subject to more lenient rules. Sometimes licensing simply constituted a barrier protecting any incumbent—national or transnational firm—against all potential entrants, irrespective of their national origin.

For example, capacity licensing in India used to function as a significant (often binding) barrier to entry and growth outside the small-scale sector. The system was geared against newcomers, with a stronger bias against TNCs (which often were forbidden to enter specific industries, even under joint venture agreements). Incumbents filed applications for additional capacity to pre-empt entry or expansion of competitors. Firms accumulated licences to ensure a pipeline of potential projects. With licensed capacity fixed according to projections of domestic demand, unused licenses resulted in excess demand. Incumbent producers were able to reap high rents from poor-quality goods in markets protected from domestic and import competition. In Pakistan, licensing has been used to avoid excess capacity and reduce market concentration. But it has also protected incumbents while deterring growth by preventing producers from reaching a minimum efficient scale of production.[4]

Regulatory constraints often go beyond capacity licensing. In Mexico, extensive bureaucratic requirements significantly raised the cost of doing business. Lengthy procedures were needed not only to open or expand industrial-firm capacity, but also to import inputs, price goods or close an enterprise. Those procedures caused particular problems for small and medium-sized producers, since large national and transnational firms had specialized departments to deal with those requirements. While those transaction costs are difficult to measure, they were not insignificant. They could account for 5 per cent of a firm's operating costs, and opening a business could require up to 420 person-days. More important, by disproportionately affecting smaller firms, they stifled an important source of domestic competitive pressure in a country in which imports were tightly regulated, to the benefit of dominant producers, TNCs and otherwise.

Investment incentives

Capital-market imperfections in developing countries are important natural barriers to entry, particularly for national firms, which have relatively less access to credit. Governments attempt to help national producers overcome that barrier by lowering investment costs through fiscal and credit

[4] In the cotton-spinning industry, for example, optimal scales are in the range of 25,000 spindles per mill. The average size in Pakistan is 15,000, because it has been easier to obtain licenses for units of 12,500 spindles than for larger ones. In the cement industry, average domestic plant size is 450,000 tons per year, whereas efficient scales are in the order of 900,000 tons per year. At the same time, with the small size of Pakistan's domestic market, the policy of fragmenting output has not prevented the degree of market concentration from remaining fairly high in several industrial subsectors.

incentives. In many instances, the motivation for such incentives is the perceived need to attract TNCs, on the presumption that, in the absence of such incentives, they would be lured away to other locations. Incentive regimes often grant privileges to TNCs over national firms (a situation commonly observed in least developed countries that perceive themselves in a weak bargaining position). In attempting to either support national producers or attract TNCs, the net effects of such incentives tend to be quite harmful. They generate heavy fiscal burdens, bias the choice of policy instruments and particularly, after their prolonged use, come to favour incumbents in highly concentrated industries, while fostering anticompetitive practices. In Argentina, for example, the incentive system allowed established firms to obtain unit cost advantages of up to 41 per cent, which helped them consolidate their market position. Entrants, competing for scarce fiscal resources, were at a disadvantage relative to well-informed incumbents that had already demonstrated an ability to fulfil domestic demand requirements.[5] The system's bias in favour of capital-intensive techniques and low-value-added activities in which Argentina had no obvious comparative advantage, and its emphasis on mature and declining industries, deterred investment in new industrial segments and slowed industrial restructuring.[6]

Directed credit for industry is another policy instrument that often reinforces the position of incumbents. In many industrializing countries those firms absorb a significant proportion of development-bank lending, which generally is the sole or major source of term-finance to industry. In Mexico, for example, 70 per cent of all development banks' preferred credit to industry in 1987 was allocated to 10 firms. In Brazil in 1987, 25 firms commanded 50 per cent of credit approvals of the National Economic and Social Development Bank system. Such high levels of concentration of scarce investment resources have crowded out potential entrants and deterred competition.

These examples do not undermine the rationale for certain types of incentives. For instance, both national and transnational firms might profit from phased and closely coordinated investment along the value-added chain, with incentives functioning as a signalling device. Similarly, directed credit may be

[5] About 80 per cent of promoted investments were for large dominant firms. Nearly all promoted investments in cement, paper paste, fertilizer, plastics and resins, were undertaken by one of the top eight firms in the industry (World Bank, 1988a, chapter II).

[6] Simulation results showed the subsidy per unit of value-added rising from 39 per cent to 82 per cent as capital intensity increased from 10 per cent to 85 per cent. The unit subsidy went up from 63 per cent to 75 per cent as the value-added share of the production value fell from 75 per cent to 48 per cent (World Bank, 1988a).

required if national firms are to be able to enter markets. If those incentives are time-bound and awarded against specific and pre-agreed performance targets, they might be indeed economically justifiable on an *ex-post facto* basis.

Public-sector procurement

The government procurement process in many countries has traditionally been an area characterized by opaque rules, asymmetric information, preferential treatment for domestic firms and collusion among preferred suppliers. In Argentina, for example, bidding and evaluation procedures were not sufficiently transparent to ensure that the most competitive bidder was awarded the contract. The system stimulated collusion, agreements on market sharing, price rigging and other non-competitive strategies. Most firms considered profitability on government contracts superior to that which otherwise prevailed in the domestic market. Although TNCs (and importers) in Argentina were precluded from bidding, in a number of other countries they are not. Just as national producers, they tend over time to accommodate to the "rules of the game", colluding by "taking turns", fixing prices, lobbying for "targeted" contracts, while ensuring that outsiders are not allowed in.

Pricing policies

Price and distribution controls are used in many developing countries as a means of allocating goods on a priority basis and minimizing the impact of short-term supply shortfalls. Yet, as shown in the Brazilian and other cases, by institutionalizing the frequency and method of price setting, controls not only tend to preclude price competition, but induce explicit and tacit collusion among firms, both when price controls are in effect and after they are eliminated.[7] Control of industrial prices, in particular, tends to be established on the basis of a cost-plus methodology, where the "standard" cost structure is given by the leading firms in an industry, which are often TNCs. When controls are severe, the industry "fringe", composed of national producers, is penalized. When they are loose, TNCs and other market leaders earn Ricardian rents.

To put these country examples in perspective, it should be stressed that, historically, the focus of industrial policy has been to promote industrial growth, sometimes by strengthening the role of national firms, at other times by stimulating investment from TNCs (when targeting a specific industry—such as automotive—or a specific activity—such as exports). In that sense,

[7] See Frischtak, 1980.

regulatory controls and promotional systems should not be measured by the yardstick of ensuring mobility and competition. None the less, by decreasing the risk and bolstering profits in the manufacturing sector, such policies initially promote entry and, by attracting new economic agents, make markets denser and more competitive.

Over time, however, entry-inducing rents are appropriated by the new incumbents. This is partly a function of growing disparities in information available to incumbents and entrants. Entrants generally lack knowledge of promotional and regulatory instruments, as well as access to the officials who manage discretionary regulations and incentives. In turn, government officials not only have more information on established producers, but often assume a protective attitude towards incumbents—having, after all, attracted and nurtured them with implicit guarantees of minimum profitability. The pro-incumbent bias—generally favouring established TNCs and national firms—is also a reflection of certain criteria adopted by many regulatory and promotional agencies for screening industrial projects. Fiscal and financial incentives, for example, are often denied to entrants on the presumption that demand growth could be balanced by incumbents and that excess capacity by new entrants would destabilize markets and waste resources. Progressively, the gains initially attained by an activist policy are overtaken by the costs of an increasingly rigid and uncompetitive economy.

Barriers to import competition

Protection against import penetration is the other major policy-generated barrier to competitors operating in domestic markets.[8] Although numerous countries (including Argentina, Indonesia, Mexico, Morocco, Nigeria, Thailand and Turkey) have lowered protection on imports of manufactured goods as part of their efforts at structural reform, trade restrictions still are pervasive in most developing and developed countries (table 2).[9]

[8] Those restrictions take the form of tariff barriers, quantitative import constraints and a myriad of rules and regulations that constrain the flow of imports. While GATT limits the use of quantitative restrictions and tariffs, more sophisticated import restrictions like regulations concerning physical import procedures and administrative delays often hinder and prevent imports as effectively. Furthermore, production subsidies that artificially lower the price of import-competing products also function as barriers to import competition.

[9] As noted by the World Bank (1988c, p. 16), "manufacturing has seen a resurgence of protectionism, especially in the guise of NTBs, such as Voluntary Export Restraints (VERs) and quotas. Between 1981 and 1986 the proportion of imports from North America and the European Community (EC) affected by NTBs rose by more than 20 percent. Trade between industrial and developing countries is increasingly affected by NTBs. Roughly 20 percent of developing countries exports were directly covered by such measures in 1986."

Table 2. Import protection in selected countries

Country	Year	Unweighted average tariff rate[a]	Non-tariff barriers[b]	
			Percentage of imports	Percentage of country production
Argentina	1988	27.7	n.a.	18.0
Brazil	1988	37.4	n.a.	41.0
Colombia	1988	56.9	n.a.	84.6
India	1988	118.0[c]	75.0[d]	
Indonesia	1988	23.0[c]	5.0[e]	34.8[e]
Japan	1987	3.5[k]	36.9	n.a.
Madagascar	1988	46.0	0.0[f]	0.0
Mexico	1988	4.3[g]	n.a.	23.2
Morocco	1986	35.1	14.0	n.a.
Nigeria	1988	32.0		
Pakistan	1988	102.0	31.0	n.a.
Philippines	1988	28.0		
Venezuela	1987	34.1	n.a.	48.0
Yugoslavia	1987	12.0	29.9[h]	36.0[i]
Turkey	1988	53.7[c]	6.0	n.a.
United States	1987	3.9[k]	16.8	n.a.
European Community[j]	1987	4.2[k]	29.8	n.a.

Source: World Bank data; Laird and Yeats, 1987, 1988.

[a] Tariffs include surcharges. In view of the widespread practice of granting exemptions from duties, effective tariffs are generally lower than the official rates reported here.

[b] Non-tariff barriers include quantitative restrictions (including prohibitions, quotas and restrictive licensing), minimum pricing, anti-dumping and countervailing duties, tariff quotas and state or importing-agency monopoly of imports.

[c] Average for all products.

[d] Percentage of domestic value-added.

[e] Figures are as of December 1987 and are expected to drop to 15 per cent for import coverage and 30 per cent for production coverage in 1988.

[f] All import restrictions were removed in January 1988.

[g] The production-weighted average is 11 per cent.

[h] A further 57 per cent is covered by a quota that is semi-automatic depending upon foreign exchange availability.

[i] Expected to fall to 31 per cent in 1988.

[j] Based on external trade.

[k] Those rates are trade-weighted most-favoured-nation average tariffs for all products. Although the average rates appear low, they are high in some sectors. Tariffs on clothing and footwear, for example, are respectively 19.9 per cent and 22.5 per cent in the European Community, 15.0 per cent and 14.2 per cent in Japan and 20.3 per cent and 11.7 per cent in the United States.

Historically, national firms took advantage of those barriers to penetrate segments that were previously dominated by imports, while TNC entry was motivated by the need to "jump" the newly erected trade barriers. Yet, the very shelter provided to incumbents allowed for slow growth in productivity, thus prolonging the need for protection and promotion. That further tilted the regime in favour of incumbents. The inefficiency effects of trade restrictions were not observed only among national firms. Foreign affiliates also accommodated to the lax competitive environment, as generally there are no universal standards of productivity and quality by which such affiliates abide.

Import restrictions not only constitute a barrier to competition, but also act as a brake to structural change in developing economies. Protection is often most extensive in industries that have benefited from it for the longest periods, even when such industries are dominated by TNCs with access to the latest technology and with highly productive plants in more competitive economies. The infant-industry argument is in that sense turned upside down. Relief from import competition is provided for the more mature and declining subsectors, while new or innovative activities are penalized, discouraging producers from entering areas of emerging comparative advantage. Similarly, protection is being awarded to mature incumbents while entry and operation of newcomers, often dependent on access to imported capital goods and intermediates, is either precluded or discouraged. Indonesia's tire and downstream aluminium industries illustrate that point. The first tire producer began manufacturing 50 years ago, while the second one began 30 years later. Their survival was assured by an import ban that kept domestic prices 20 to 50 per cent above international levels. In industries using aluminium, the level of protection was directly correlated with the age of the firm. Certainly, neither the level of protection in the tire industry nor the structure in aluminium metal fabrication could be justified on infant-industry grounds.[10]

It should be noted that, behind high trade barriers, financial and economic incentives are not aligned. The prospects of scarcity rents often result in excess entry, an insufficient degree of intra-industry specialization and fragmentation of production. The oligopolistic reaction of TNCs, in

[10] Until recently the structure of protection in Argentina has had similar features. Tariff protection was particularly high for traditional industries such as textiles and apparel, but below average in electrical machinery and scientific instruments. Similarly, the industries most heavily protected by non-tariff barriers were food products and textiles, 60 per cent and 49 per cent, respectively (World Bank, 1988a, chapter I).

particular, accentuates that phenomenon.[11] Although import restrictions generate severe resource-allocation distortions, trade reform should not be approached as a *deus ex machina* solution. The intensity of import competition and the reaction of producers to a more open trade regime depend first on the credibility of trade-policy reform. Before producers adjust their technological and market behaviour, they need to perceive that the Government is bound by an irrevocable commitment (for instance, membership in GATT), or has a reputation for implementing announced policies systematically.

The effectiveness of trade reform also can be limited through "tariff privatization". Most end-users do not buy directly from foreign producers, but from local distributors, which are often linked to dominant firms in the domestic market. In many cases, those are affiliates of TNCs. Trade is intrafirm in nature, and the price effects of liberalization may be quite small. Thus, even if imports relieve supply constraints, the impact of import competition may be diminished by the specific organizational arrangements that link foreign sellers and domestic buyers. For example, Argentina's dominant steel producer, Somisa, was the dominant importer for many years. It was able to shield itself from import competition and reap substantial rents by controlling the volume of imported steel.[12] Similar problems have been observed in other countries, such as Hungary (World Bank, 1986, chapter III) and Chile (de Melo and Urata, 1986), where collusion between domestic producers and foreign trading companies served as a powerful barrier against competing imports.

Import penetration is not necessarily or immediately translated into an effective competitive force for an additional reason. The organization of foreign trading, domestic wholesale and retailing can form an invisible barrier to import competition. Non-tradeable services—marketing, product repair and maintenance, product adaptation and other engineering services—are critical in enabling imports to penetrate domestic markets. Difficulties in entering Japanese markets, for example, often have been associated with various regulations and organizational barriers against foreign entry or foreign business partnerships in the commercial sector. Finally, import liberalization may open up new possibilities for international suppliers to behave

[11] See Knickerbocker, 1973.

[12] This resembles closely the prevailing arrangement in Indonesia, where the Government has granted exclusive import rights for all raw materials and semifinished inputs to P. T. Krakatau Steel, which dominates the steel industry with 65 per cent of crude steel capacity and an even larger proportion in flat products.

strategically, reducing developing-country benefits. Dumping and overpricing are two forms of behaviour that have attracted attention. Both are generally associated with negative welfare effects that at least partially offset the gains from a more open trade environment.

Barriers to export rivalry

Exports markets are an arena in which firms, national and transnational, compete intensely. In the case of TNCs, trade is often intrafirm, export markets regionally segmented and allocated among affiliates. Despite those factors, competition for export opportunities tends to be significant. Globalization of operations and search for cost-minimizing transaction patterns are forcing TNCs to become increasingly aggressive in export markets, while allowing foreign affiliates greater flexibility in conducting their business operations.

The importance of export competition for performance is well documented.[13] Developing an internationally competitive product typically requires firms to improve quality and design, as well as to invest in efficient export-oriented production lines. That applies to TNCs and national firms alike, though the latter are at a disadvantage when it comes to identifying suitable markets and setting up distribution channels. Many of those activities are, in any case, resource-intensive and subject to increasing returns to scale. This explains the association between export propensity and size. One would therefore expect that foreign affiliates would be especially well positioned to penetrate the international market. Yet, just as with national firms, the willingness of TNCs to export depends on the structure of economic incentives and the relative profitability of domestic and international markets.

Two dimensions of the policy regime particularly affect the relative profitability of export markets. One is the exchange rate. An overvalued and

[13] A detailed study of the behaviour of exporting firms from the Republic of Korea concluded that there is "a tremendous efficacy of export activity as a means of acquiring industrial competence: [through it] Korean firms have enjoyed costless access to a tremendous range of information, diffused through them in various ways from the buyers of their exports. The minor innovations that have resulted have been significant in increasing production efficiency, changing product designs, upgrading quality and improving management practices. Exporting thus appears to offer a direct means of improving productivity . . ." (Westphal, Rhee and Pursell, 1981, p. 77; see also Rhee, Ross-Larson and Pursell, 1984, chapter 4). Similarly, a study of Brazilian manufacturing firms established that the probability of firms engaging in technological activities (defined as import of technology, research and development and process rationalization through engineering efforts) generally increases with exports and decreases with the extent of import protection (Braga and Willmore, 1988).

unstable exchange rate is a major barrier to export rivalry. It lowers profits and deters firms from making the commitment needed to become significant exporters.[14] Equally important is the level of competition in domestic markets. All barriers to domestic competition function as export barriers by increasing the relative profitability of domestic sales. Thus the importance of removing those barriers and introducing a balanced and effective mix of competition policies—the subject of discussion in the following section.

Competition policies

Rationale

Competition is a potentially powerful tool of industrial policy. To use it effectively, entry should be stimulated and market rivalry promoted. The basic aim of national competition policy is to ensure that firms, whatever their national origin, operate in competitive environments. Informed consumers, growth-oriented national firms and TNCs are the agents of an effective competition policy. Transnational corporations, in particular, can be a principal instrument in view of their ability to enter markets that are already oligopolized. Although it might be argued that it would be easier to attract TNCs to, or to elicit competitive conduct in, markets dominated by national firms, on account of the "mutual forbearance" hypothesis, globalization and multi-polarity are forcing TNCs to compete with fewer restraints. At the same time, emerging TNCs from newly industrializing economies do not recognize old rules of behaviour, and pursue opportunities aggressively. The potential for using TNCs as an instrument of competition policies is growing.

Domestic competition policy

Competition policy is an instrument that might have been unavailable in the early stages of industrial development, but it is more effective than Government controls and incentive systems in the presence of functioning markets and dynamic actors, both national and transnational. The first step in promoting domestic competition is to remove policies that deter mobility and interfirm rivalry, especially the following:

- *Capacity licensing.* Those systems have often served as barriers to entry and growth. The creation of capacity should not be denied on

[14] There is strong evidence from individual case studies linking real exchange rates and export-supply response. One such example comes from Morocco's exports of leather garments, which fell dramatically between 1982 and 1986 (its share in the world market dropped from 2.8 per cent to 0.2 percent during the period) as its real exchange rate appreciated significantly relative to its competitors (India, Pakistan, the Republic of Korea).

the basis of nationality (except, possibly, for national security considerations); in particular, the entry of TNCs in stable oligopolies led by national producers or other TNCs should not be discouraged to the extent that this leads to more efficient market outcomes. On the contrary, in markets in which national firms hold a quasi-monopolistic position or TNCs are dominant, entry of a newcomer TNC might be the most effective means of overcoming entrenched positions.

- *Investment incentives and sectoral programmes.* Governments should phase out financial subsidies and drastically reduce the extended periods for which fiscal incentives are awarded (they sometimes extend up to 15 years), which generally confer significant and undue cost advantages to dominant incumbents. Often those are TNCs that see their market position reinforced through government policy. To function as a coordinating device, fiscal and financial incentives do not need to be in place for extended periods (say, beyond three to five years). Automatic and transparent screening would also lessen the incumbent bias of incentive systems, since major producers normally enjoy preferential access under discretionary systems. To reduce the transfer of rents to selected industries, Governments should phase out sectoral programmes and remove entry-restricting provisions that usually accompany them.

- *Anticompetitive public-sector procurement practices.* More transparent, equitable procurement systems would increase competition in government markets. Information on the volume and composition of public purchases should be diffused widely among actual and potential suppliers. Bids should be publicized well in advance of their public openings, with specifications that are clear, precise and complete. Newcomers should be encouraged and TNCs not deterred, both to increase competition and to move away from single-sourcing. That is particularly critical when dominant or monopoly suppliers have cornered government procurement markets. In those circumstances, attracting TNCs to government markets may be the only short-term remedy to break the stranglehold of cartelized or collusive arrangements. Over the medium term, it is important to promote the development of national suppliers so they can equally challenge incumbents in government markets. The acquisition of technological and related capabilities would be facilitated if Governments introduced a procurement budget structured on a multi-year basis. Performance

goals need to be announced well in advance so that firms have enough time to generate the needed capacity.

- *Price controls.* There is no rationale for controlling prices in competitive sectors (except, of course, if goods are to be allocated by some alternative mechanism, such as rationing coupons). In uncompetitive markets, prices do not necessarily reflect relative scarcities. Growing levels of market efficiency will be attained as barriers to competition are removed, including price controls themselves (as argued in the previous section). A comprehensive competition policy, including the introduction of an effective antitrust mechanism, is required in highly oligopolized economies that have grown accustomed to price controls. As prices are fully liberalized, rivalry needs to be stimulated by lowering trade barriers, attracting newcomers to markets while curbing monopolistic conduct (see below). As noted, in concentrated and stable oligopolies, TNC entry may be the most effective instrument of competition policy for markets to generate efficiency prices.

Potential competition from transnational corporations

So far, this article has emphasized the importance of removing policy-generated barriers to competition and using TNCs to inject rivalry in markets. How effective can that strategy be? After all, TNCs are associated with and/or causally connected to concentrated markets. In fact, the direction of causality is unclear. Once TNCs penetrate a market, it can become more or less concentrated, while competition can become more or less intense. It depends, first, on the mode of entry, if *de novo* or by acquisition of an incumbent. Second, it depends on the nature of competition prior to the TNC entry. If the market was previously dominated by a few firms, penetration by a TNC tends to introduce significant turbulence, even if entry was by acquisition. The degree of rivalry in the first period is bound to increase. Whether producers reach an accommodation or display a Bertrand type of behaviour (that is, compete aggressively) in the second period depends on numerous circumstances, including how concentrated the market becomes post-entry (which affects the probability of concerted action), as well as the incumbents' and entrants' previous interactions in other markets.

If, on the other hand, the market presents *ex ante* competitive characteristics, entry by a TNC with differential access to specialized and scarce resources could have the effect of lowering the degree of rivalry. Still, the net result could be welfare-improving if the efficiency gains from the appli-

cation of superior technology or management dominates the deadweight loss from monopolistic behaviour (expressed in higher prices and lower output). This will depend on the kind of environment in which the TNC operates. Dominant firms, national or transnational, have to be challenged to improve their performance. Thus the importance of economic incentives and institutional mechanisms that increase the ability of newcomers to overcome natural and strategic barriers, and maximize market rivalry.

If imperfect competition is the result of large natural barriers to entry, competition policy should be focused on their root causes. It may involve increasing the supply of physical and social infrastructural services; establishing a regulatory framework to facilitate leasing arrangements for durable goods (in so far as the sunk costs associated with fixed investment constitute a binding entry barrier); and undertaking financial sector reforms to address scarcity of credit. The experience of some East Asian countries suggests that a judicious use of selected directed credit to small and medium-sized firms may offset the power of incumbency and help domestic producers overcome barriers to entry that would otherwise limit competition. Attracting TNCs as entrants may, in addition, require targeting them with relevant information regarding the conduct of business in the host country.

Costly fiscal (and financial) incentives should not be used as a means of attracting newcomers in order to spur competition. If the fiscal regime is an undue burden on entry (or firms' operations), its reform should take precedence over ad hoc (and often unsustainable) tax breaks. Similarly, if the tax regime is biased in favour of incumbents or certain dominant producers, that should not justify offsetting tax breaks or exceptions. For example, deductions that favour TNC-dominated and advertising-intensive business activities should be phased out, so that the traditionally stronger position of TNCs in markets for differentiated goods is not further enhanced by that feature of the policy regime. The alternative would be to build into the tax system further countervailing deductions that might ultimately exacerbate its implied deadweight losses.

High levels of concentration generally increase the probability of collusive and other forms of non-competitive behaviour, while the shelter provided to incumbents by entry barriers sanctions such behaviour. Strategic barriers to competition that result from excessive concentration should not be dealt with by encouraging fragmentation or deterring amalgamation. In some industries moderate or even high degrees of concentration may be needed for firms to operate at the production frontier and

exploit available economies of scale and scope. In that sense, mergers should not be blocked, as they can be essential for rationalizing an industry. Mergers should be discouraged only when there is a significant probability that the merged company would have the market power to deter entry, engage in unfair trade practices and push prices above competitive levels. Some guidelines could be established, for example, prohibiting firms to merge if their combined market shares exceed a certain prescribed level. Those guidelines should be equally applicable to national and transnational producers.

Competition policy should, none the less, have an active antitrust dimension.[15] A policy towards highly concentrated industries should be pursued on the grounds that competition in specific industries is closely related to the number of firms and the distribution of market shares, and that a highly skewed firm-size distribution is an indication that imperfect forms of competition prevail. Mergers should be controlled on an *ex ante* basis and, in limited cases, demonopolization may actually be required. In any case, it is particularly critical to ensure that entry remains at all times a credible threat to the market position of incumbents.

Lowering barriers to entry and deterring extreme forms of concentration are structural dimensions of a competition policy. Controlling predatory, collusive, entry-deterring and other forms of anticompetitive conduct are its behavioural counterpart. Predatory conduct, particularly with the intent to gain and maintain monopolistic market positions and deter entry, should be forestalled by appropriate legislation and enforcement, in view of its adverse economic impact. The same applies to price fixing and other forms of cartelized conduct.[16] The role of government would be to set a legal and regulatory framework that establishes the limits for acceptable market conduct so as to

[15] See Boner and Krueger, 1991.

[16] "Predatory" behaviour should be the object of restraint and penalty whenever two conditions are present. First, the actions of the "aggressor" firm are selective, that is, they entail targeting one or a few competitors. Uniform actions such as across-the-board price cuts or broad-scale advertising campaigns are not harmful to competition. Second, differential market shares between the "aggressor firm" and its targets are sufficiently high that selective actions are necessarily anticompetitive. A large mismatch in market shares between producers normally does not permit effective competition. The reason is that dominant firms, in addition to having access to resources that are unavailable to smaller competitors, work under different sets of incentives. Equal gains in market shares translate into proportionately larger profits for the former. The outcome of a market game where the dominant producer uses selective actions against smaller competitors tends to be biased against the latter, and should be restrained by regulatory or judicial means (Shephard, 1986).

curb effectively anticompetitive behaviour. Again, the policy should be neutral in approach, treating both national and transnational firms on an equal basis.

Import competition policy

Moderate to strong competition from imports is an important means of improving the allocation of resources and their use. It is also an effective way of curbing the exercise of market power, particularly when production technology calls for scales typical of natural monopolies or when a few dominant producers are entrenched and protected by high entry barriers. The effectiveness of trade reform would depend on the presence of economic agents capable of establishing a multiplicity of conduits with the international market, so as to preclude the exercise of monopoly power by dominant vertically integrated producers and/or wholesalers.

To address potential tariff privatization,[17] entry should be encouraged. It may be the most effective means of sustaining trade reform while deterring monopolistic conduct of local importers. Yet entry of new distributors, irrespective of their knowledge of the domestic market, will be a weak counterpoint against vertically integrated firms. It may be necessary for them to associate with TNCs, for the latters' comparative advantage lie, *inter alia*, in being "plugged into" the international market. From that perspective, TNC entry is also an important instrument of import competition policy.

Export rivalry policy

As domestic markets become more competitive and less profitable, producers are stimulated to enter or substantially expand their commitments to international markets. The role of a supportive export policy is to ensure free trade (at least for exporters) as import liberalization is introduced, as well as to provide the marketing, finance and infrastructure needed to compete in export markets. Import and domestic competition help narrow the profitability differential between domestic and export sales. They enable pro-export arrangements to tip the balance in favour of the international market.

[17] If domestic producers can effectively control the distribution of imports, they may be able to avoid adjustment and continue enjoying the benefits of protection. Domestic consumers do not usually buy directly from foreign producers but from wholesale firms. If dominant domestic producers control these wholesalers, they can shield themselves from import competition by controlling the volume of imports and not passing on tariff reductions to consumers.

The experience of successful East Asian economies (particularly Hong Kong, the Republic of Korea and Singapore) is instructive regarding how exporters were put on an equal footing with their international competitors. A long-term, stable and credible commitment to achieving high rates of export growth was critical to their performance, as was an aggressively competitive exchange rate policy.[18] Often, the export-expansion drive was spearheaded by TNCs (as in the case of Singapore). Non-discriminatory treatment towards those firms, in the context of a well articulated policy ensuring that producers are subject to the rivalry of export markets, has been most effective in maximizing the economic gains of their presence.

A number of key institutional mechanisms helped.[19] First, free-trade status was granted to all activities that generated export value added, initially through duty exemption or duty drawback systems (in the Republic of Korea and Singapore). That mechanism was then broadened to include smaller, indirect exporters (subcontractors and suppliers of parts, components and raw materials), and was incorporated in other institutional arrangements (such as free-trade zones). Free-trade status was most important to TNCs, in so far as their production processes are closely integrated in the international division of labour, requiring access to imported inputs through intrafirm flows.

Second, financial markets supported exporters by ensuring them automatic access to credit. Financing arrangements were modernized and a number of financial innovations introduced. Those included undisrupted and speedy rediscount by central banks, preshipment export finance, automatic loan disbursement and liquidation mechanisms tied to import and export bill negotiations, domestic letter of credit systems, export credit insurance mechanisms and post-shipment finance arrangements.

Finally, the effectiveness of those instruments was based not only on their innovative design, but also on the principles that guided their use. As already stressed, automaticity and expediency have been the key means of minimizing administrative uncertainty and accelerating exporters' response time. Also important has been the equal treatment of all activities that gener-

[18] In the Republic of Korea, credibility was promoted through the Government's adherence to long-term trade objectives and policies; by setting export-target systems; by negotiating and diligently pursuing specific targets; and by establishing an appropriate forum ("trade promotion" meetings) to discuss these and other export-related matters with the management of exporting firms (World Bank, 1987)

[19] For a detailed analysis, see Rhee, 1985.

ate export value added, whether originating in national or transnational firms. The prevention of abuse, the simplification of administrative procedures and the decentralization of authority to either public or private agencies (commercial banks, export associations) routinized and gave impetus to export activities.

Policy conclusions

Many developing countries are paying increasing attention to the importance of competition policies, and are reforming their regimes in the direction of a more open and competitive environment. This article suggests that competition policies, universal in principle, would be most effective by taking into account the potential of TNCs to both stimulate rivalry and dampen competition. The design of such policies would, to a significant degree, influence their behaviour in one direction or the other.

What should be, then, the general approach to competition policy?

- First, policy-generated barriers to competition should be removed. The regime should be neutral, in the sense of not favouring one TNC over another, national firms over transnational ones or vice versa, or incumbents over entrants. Policy arrangements that start off as temporary are often perpetuated, usually to the detriment of entrants and weaker agents. That lesson is one of the central themes of this article.

- Second, the presence of strategic barriers to competition requires Governments to inspect their origins to assess if remedial or preventive action is required. If barriers are related to structural features of markets, only preventive action may be advisable (such as instituting mechanisms for merger review, so that market concentration does not increase further). If, on the other hand, they are a product of monopolistic conduct, they can be more directly constrained at moderate costs. That applies both to individual conduct (such as predation) and collective action (such as price fixing). In either case, the higher the strategic barriers and the more entrenched the incumbents, the greater the potential usefulness of TNCs as an instrument of competition policy, due to their ability to surmount such barriers.

- Finally, market failures giving rise to significant natural barriers to competition should be the object of attention if Governments have the means to address such failures effectively. The shallowness of credit markets, for example, affects the mobility of national firms

disproportionately, whereas a weak human resource base or a limited supply of infrastructural services can function to deter entry of both national and transnational firms. Governments might thus want to focus on building up institutional, human resource and physical infrastructure as a means of alleviating specific market imperfections. The development of financial markets and instruments, a strong commitment to education and training, and an investment programme assuring the supply of critical infrastructural services (such as telecommunications and power supply) would constitute some of the dimensions of such an affirmative regime. ■

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