Promoting competition for long-term development

Liberalization and integration, both with the rest of the region and with the rest of the world, are having strong effects on Asia's firms and their ability to contribute to national development objectives. As competitive forces become stronger, so do some incentives for anticompetitive behavior. Competition policy can both help markets deliver the benefits of competition to consumers and support sustainable economic growth. But there may be tensions between what is good for short-term, allocative efficiency and what is good for long-term, dynamic efficiency. Countries in developing Asia are exploring ways to balance competing concerns, as competition policy moves up the reform agenda in the region.

Introduction

Across developing Asia, countries are striving to achieve or maintain high rates of economic growth and employment. Crucial to reaching these goals is competition in product and factor markets, which leads to greater choice, lower prices, and increased production efficiency, and which ultimately contributes to a country's growth and development. As Ahn (2002, p. 5) notes, "Competition has pervasive and long-lasting effects on firm performance by affecting economic actors' incentive structure by encouraging their innovative activities, and by selecting more efficient ones from less efficient ones over time."[1] Given the importance of firms as the drivers of growth and employment, promoting competition is immediately relevant to the Asia-Pacific region as it adopts open market-oriented policy regimes.

In the past two decades, many countries in the region have adopted market-based reforms and reduced government intervention in their economies in response to heightened competition resulting from regional and global integration. Trade barriers have been lowered, foreign investment encouraged, exchange rate pegs removed, protection of domestic industries withdrawn, and government enterprises privatized. These changes reflect confidence that open-market forces will strengthen firm-level productivity and competitiveness, and will contribute more to growth and development than a closed, centralized orientation would.

As a result, policies to promote competition have climbed up the domestic and trade agenda in Asia, just as they have in the rest of the world. However, Asian countries have been slow to adopt and implement comprehensive competition policies, reflecting a debate between the pros (who point to efficiency gains from greater competition,

lower prices, etc.) and the antis (who are concerned about compromising industrial policy, cost of enforcement, etc).

This part of *Asian Development Outlook 2005* reviews recent developments in competition policy and the interactions among competition, policy, and economic development in Asia, with an eye toward distilling lessons for the future. It reviews the relationship between competition policy and other important policies—such as industrial, trade, and foreign direct investment (FDI) policies. To draw some general principles for developing Asia, this part assesses competition and policy regimes in general and in six developing Asian countries in particular, some with competition laws, some without, in the context of general economic trends, industrial concentration structures, and policy reforms.[2]

One of the major arguments of this part of *Asian Development Outlook 2005* is that competition policy is complementary to other policies. Consequently, liberalization and privatization policies cannot be expected to automatically contribute to economic growth if competition policy and institutional infrastructure are lacking. The domestic benefits of effective competition policy also merit attention, regardless of its consideration in multilateral trade negotiations. And in a dynamic context, finding a balance between promoting short-term competition and preserving long-term incentives for innovation and invention is a critical challenge for sustaining growth and development.

Benefits of competition

Economic theory suggests that prices and quantities in a competitive market will equilibrate to levels that generate efficient outcomes at a given point of time, i.e., attaining static efficiency, if there are no government interventions, asymmetries of information, impediments to the entry and exit of firms, or anticompetitive practices by firms. In this situation, the price that consumers pay for a good will equal the incremental (or marginal) costs of the firm that produced the last unit of the good.[3] Competition is then beneficial because it gives to consumers wider choice and provides sellers with stronger incentives to minimize costs, so eliminating waste. Competition increases the likelihood that cost savings resulting from efficiency gains will be passed on to a firm's customers, who may be either final consumers or other firms (in which case costs of those firms are also lowered). Ample empirical evidence supports these arguments.

Thus, the importance of competition for achieving a higher rate of innovation and adoption of new technologies over time is critical for sustaining Asia's rapid growth. Yet competition is not automatic, and is not the same as *laissez faire*.[4]

> In fact, there are reasons for believing that less mature markets tend to be more, rather than less, vulnerable to anticompetitive practices than the markets of developed countries. The reasons include: (a) high "natural" entry barriers due to inadequate business infrastructure, including distribution channels, and (sometimes) intrusive regulatory regimes; (b) asymmetries of information in both product and credit markets; and (c) a greater proportion of local (non-tradable) markets" (Anderson and Jenny 2005).

While perfect competition is a fundamental assumption in any market economy, there is little mention in most economic texts about how perfect competition can be achieved. Early economists such as Adam Smith and Alfred Marshall emphasized the benefits of free entry to, and exit from, industries. This refers to the dynamic form of competition. For the greatest efficiency gains to accrue to the economy, new and efficient firms must be able to enter the market with relative ease, while forcing old and less-efficient firms to upgrade or exit. Competition for profits forces existing firms to seek greater efficiency in resource allocation to boost productivity and lower costs. Inefficient firms are forced out, and their resources reallocated to new or more efficient firms. Firms need to constantly innovate and adapt quickly to the changing environment, thus creating dynamic efficiency (UNCTAD 2004).

Freedom of entry and exit is therefore a crucial condition for maximizing the efficiency benefits of competitive markets. It should be noted that the lower production costs boost the competitiveness of the country's exporters in foreign markets. However, the industrial structure most efficient for static resource allocation is not necessarily the most efficient for dynamic efficiency. Some temporary market power after a new invention or innovation is introduced may be necessary to provide firms with the incentive to undertake such inventions or innovations. This will require consistency and coherence among industrial, trade, investment, competition, and intellectual property regimes.

Economic efficiency is an important, but by no means the only, goal of most countries. Fortunately, competition also serves to diffuse socioeconomic power, broadening participation in economic, social, and political advances while ensuring opportunities for new entrepreneurs. Moreover, it can facilitate realization of the benefits for the domestic economy of integrating into international trade and investment patterns.

In a context of market distortions and restraints to competition

Competitive forces work best in the presence of markets that are free from distortions. However, a perfectly competitive environment rarely exists in all sectors of an economy, so the full benefits of competition do not often materialize. Competition is usually not intense and not equal for reasons of special interests, big government, and citizens' weak economic understanding (Lewis 2004). When markets are not competitive, whether due to policy-induced distortions, technological characteristics, or anticompetitive behavior on the part of market participants, an economy may miss many potential benefits for its citizens. Furthermore, government deregulation efforts that are intended to benefit consumers do not always work as planned.

The most obvious form of noncompetitive behavior is the case of a monopoly, where the price and quantity of production that maximize profit for the monopoly are higher and lower, respectively, than those that would yield the most welfare for society. Similarly, cartelization and collusion by firms, which also raise prices above marginal costs and may limit choices available to consumers or end-user industries, result in market outcomes where the sum of producer and consumer welfare falls below the level attained with static efficiency. Consequently, measures to enforce policies that encourage firms to compete (or discourage or prevent firms from resisting rivalry) can improve the allocation of resources by making market outcomes move toward the statically efficient outcome.[5] Thus, the benefits from competition are not limited to keeping prices at marginal cost for the benefit of consumers, as in static efficiency, but also create a conducive environment for new businesses to enter and grow while at the same time compelling existing firms to continuously improve and perform better.[6] It is important to note that cartels can be local, national, or international.

Given the importance of competition in contributing to economic efficiency in both its static and dynamic aspects, policies to promote competition remain of considerable interest to developing countries in both the domestic and international contexts. The existence of atypical production cost or consumer preference structures in certain economic sectors can also cause tension between promotion of competition and the realization of dynamic efficiency goals. Arguments to limit competition often stress the expected value of letting some firms achieve a large scale of operations. In principle, firm size is said to be important for corporate "competitiveness" under conditions of:

- economies of scale (where larger production runs are associated with lower average costs of production);
- when firms need to attain a certain minimum scale to successfully innovate or imitate, or to raise funds in capital markets; or
- when "learning-by-doing" is faster in larger firms.

When firms have pronounced economies of scale, it is possible that enforcing competition law so as to maximize rivalry between firms is not necessarily a good idea, because there then exists a trade-off between competition policy and efficiency. An example of this is a natural

monopoly—i.e., a situation where, due to overwhelming economies of scale, a market is most efficiently served by a single supplier. This applies often in the case of utilities, usually leading to a regulatory framework to prevent abuse of dominance.

Related to cartelization and monopolization is abuse of dominant position, which consists of both structural dominance of a relevant market as well as harmful conduct (e.g., predatory pricing) within that context. Concepts of what constitutes a dominant position (in terms of both market share and insulation from competitive market forces), a relevant market (on the basis of geography or similarity of products), or harmful conduct are often subject to debate, leading to a "rule of reason" approach in trying to determine wrongdoing.

Excess capacity may also draw attention as it can trigger price wars. Mergers and acquisitions can result in vertical market restraints—contractual arrangements linking firms at different levels of the market, such as exclusive dealing, exclusive territories, tied selling, or resale price maintenance (Box 3.1). Governments could, therefore, be justified in taking an active role in managing investment decisions by firms in high-growth or targeted industries (Singh 2002, p. 19). This argument calls into question whether a maximum degree of competition is optimal and suggests that *increasing economic growth requires a mix of cooperation and competition by firms.*

Another example that has received much attention in recent literature and policy debates relates to industries where network externalities are pervasive.[7] In the presence of such externalities, the maximum amount that consumers are willing to pay for a good or service depends, in part, on the number of other consumers who also purchase the item in question. Much of the discussion of network externalities takes place within the context of markets where firms have advanced technologies (Box 3.2), such as in the market for computer software. However, many communication and infrastructure services that are important for economic development exhibit network externalities. Such services include telephones, railways, and water-supply systems (Laffont and Tirole 2000).

Although the analysis of market outcomes in the presence of these externalities can be complex, one theme that does emerge from much of the literature is that *there are instances where consumers will prefer that a smaller number of goods (and possibly a single good) be available in the marketplace*. If a small number of firms supply a product to a large number of consumers, the positive externalities generated for consumers (resulting from the fact that each product they consume is also consumed by many others) may

Box 3.1 Tied sales: Whiskey and beer

Prior to liberalization of production, all liquor in Thailand was produced under concession by the Government. Each liquor-producing facility was government owned. In 2000, the Government decided to sell its aging factories to the Sura Maharas/Sura Thip group (later known as the Sang Som group), which has monopolized the domestic liquor industry since the late 1990s.

Though the whiskey market was supposed to be fully liberalized, licensing conditions remained stringent, with requirements for minimum capacity, minimum registered capital, land, and distance from natural waterways that effectively closed the industry to potential entrants. Hence, the monopoly continued.

In 1994, the Sura Maharas/Sura Thip group entered the beer market, which at that time was dominated by Singha beer. In an attempt to gain a foothold in this market, the Sura Maharas/Sura Thip group tied the sale of its Chang (Elephant) Brand beer to the sale of its white liquors that were in great demand. Retailers were often obliged to sell the excess supply of beer below cost, while raising liquor prices to make up for lost revenue. This practice brought positive results to the group, as Chang beer's market share rose from zero in 1994 to 75% in 2004.

In trying to expand into the bottled water market, the Sang Som group used the same approach—tied sale and dumping. As a result, many small local manufacturers have had to close down. Although authorized to do so, the competition authority has not yet effectively addressed the situation.

Source: Nikomborirak (2005).

Box 3.2 Korea: The broadband Internet market

In July 1998, Thrunet, Korea's third-largest Internet service provider (ISP) in terms of number of subscribers, first launched broadband Internet services. Hanaro Telecom, the second-largest ISP, followed in April 1999, and Korea Telecom (KT) the largest ISP, in December 1999. Korean ISPs generally provide broadband Internet services through digital subscriber line (DSL) or asymmetric DSL (ADSL) and cable modem. ADSL is brought to users via copper telephone lines or optical fiber, while cable modem uses the hybrid fiber coaxial (HFC) network.

During the industry's early stages, most subscribers were cable modem users since this was the predominant service offered by ISPs. However, after KT's entry into the market, the number of ADSL users surpassed that of cable modem users. As of December 2003, ADSL users accounted for 59.5% of the broadband market, cable modem users 34.8%, and local area network (LAN) users 5.6% (Internet Statistics Information System 2004).

KT provides ADSL services to its Internet users via its existing copper telephone lines and does not own any HFC network. For its part, Hanaro Telecom provides ADSL services through optical fiber networks that it had to build, and cable modem services mainly by leasing the HFC network of Powercomm, a firm spun off from Korea Electric. Most of the other ISPs also lease Powercomm's HFC network. Meanwhile, Powercomm is restricted under its basic telecommunications service license to provide broadband Internet services to end-users. Besides Powercomm, which owns the largest HFC network in Korea, there are more than 100 local cable television companies that can lease out their own HFC networks. The existence of this infrastructure, which was encouraged by the Korean Government through the availability of low-interest loans, contributed to the fast growth of Korea's broadband Internet market.

In placing priority on developing the broadband Internet market, the Government did not favor any ISP. In fact, the Government encouraged competition by relaxing its entry policy for ISPs. By classifying broadband Internet services as value-added telecommunications services, existing basic telecommunications service providers were allowed to provide Internet services without requiring additional permits or licenses. New entrants, meanwhile, only had to file a simple report. As a result, more than 75 ISPs have entered the market, making broadband Internet access available at competitive prices (about W30,000–43,000 per month, equivalent to \$25–35). This allowed existing dial-up Internet service users to easily switch to broadband Internet services.

By balancing the technical advantages of network infrastructure with the efficiency advantages of competition, Korea has achieved one of the highest rates of broadband penetration at competitive prices.

Source: Chang and Jung (2005).

outweigh the effect of higher prices that might follow from a high degree of market concentration. Put simply, there may be times when consumers prefer concentrated markets with a small number of firms because of the network externalities that larger output levels can create.

Moreover, firms in such industries may adopt pricing strategies that deliberately take into account the impact of the current number of customers on the future demand for their products. Many potential customers may only be willing to buy a product once the number of existing customers exceeds some critical level that generates sufficient externalities. In that case, firms will have an incentive to keep prices lower at present than they would in the absence of network externalities, in order to raise their customer base to that critical level. Network externalities therefore benefit current consumers both directly and through the effects of stronger than usual disincentives for firms to raise prices. Both theoretical and empirical analyses have shown that firms in industries with network externalities often adopt complex pricing strategies that typically involve substantial price discrimination across customers.

The above arguments can provide an efficiency-based rationale for not taking steps to maximize rivalry between firms in particular (limited) circumstances. Put another way, in certain sectors with observable and identifiable technological characteristics, maximizing rivalry among firms may harm the interests of both consumers and producers. Nonetheless, this does

not imply that there is no role for competition policy in these markets; rather, it means that *competition policy must be applied in ways that take account of the technological characteristics of such markets*—as indeed competition authorities increasingly do. Recent contributions highlight the importance of appropriately tailored competition rules in network industries, due precisely to concerns over the market power that can be created or entrenched through network effects (see, e.g., Church and Ware 1998).

Competition policy regimes

Once one allows for the possibility that private firms can create barriers to entry or foreclose entry to a market by new firms, then improving dynamic economic performance may well require enforcement of policies to promote or ensure competition.

Objectives

Competition policy is concerned both with private anticompetitive practices and with government measures or instruments that affect the state of competition in markets. For example, trade barriers, barriers to FDI, and licensing requirements (among others) can influence the extent of competitive pressures in markets and so are often seen as appropriate concerns of competition policy.

Barriers to trade and FDI, as well as stringent licensing and registration requirements, can influence the extent of competitive pressures in markets and so are seen as legitimate concerns of competition policy. Thus, as Peter Lloyd has put it: “Policies relating to the liberalization of international trade, reduction in restrictions on foreign direct investment, privatization, deregulation and the protection of intellectual property rights are all relevant to the promotion of competition in markets” (Lloyd 2001).

Not all countries are driven by the same objectives when adopting competition policies. Some countries adopt competition policies to protect market processes and grant equal rights for firms to engage in commerce. This generally involves the removal or prevention of restraints on competition to enhance consumers’ freedom of choice and to give firms freedom to trade and to access markets. Other countries impose competition laws aimed at securing economic efficiency improvements, both static and dynamic. This implies that the economy’s resources are allocated to the activity that provides the highest value; that production is done at minimum possible cost; and that innovation and technological progress allow the expansion of the economy’s feasible production set.

Thus, *competition policy is usually aimed at enhancing consumers’ freedom of choice and firms’ freedom to trade and to access markets, balancing short-term (static) efficiency improvements with long-term, dynamic efficiency and development*. This is illustrated in five of the six countries studied (endnote 2), which already have the relevant legislation in place and explicitly identified the objectives for their competition laws.

The People’s Republic of China (PRC), India, Korea, Thailand, and Viet Nam all mentioned free competition, or the protection or promotion of effective competition, as the main objective of their competition laws (Table 3.1).

For the PRC, the objectives of its competition law are to safeguard the healthy development of a socialist market economy, encourage and protect fair competition, stop acts of unfair competition, and defend the lawful rights and interests of producers and consumers.[8] India’s Competition Act states in its preamble the objectives of preventing practices that have an adverse effect on competition, promoting and sustaining competition in markets, protecting the interests of consumers, and ensuring freedom of trade carried on by other participants in markets, while keeping in view the economic development of the country.[9]

The stated purpose of Korea’s competition act is to promote fair and free competition, encourage creative enterprising activities, protect consumers, and strive for balanced development of the national economy by preventing the abuse of market-dominating positions by enterprises and the excessive concentration of economic

Table 3.1 Competition policy regimes

	PRC	India	Korea	Malaysia	Thailand	Viet Nam
Competition policy objectives						
	To safeguard the healthy development of the socialist market economy, encourage and protect fair competition, stop acts of unfair competition, and defend the lawful rights and interests of operators and consumers	To prevent practices that have an adverse effect on competition, promote and sustain competition in markets, protect the interests of consumers, and ensure freedom of trade carried on by other participants in markets, while keeping in view the economic development of the country	To promote fair and free competition, encourage creative enterprising activities, protect consumers, and strive for balanced development of the national economy by preventing the abuse of market-dominating positions by enterprises and the excessive concentration of economic power, and by regulating undue collaborative acts and unfair trade practices	Growth with equity (general development objective)	To promote fair and free trade within a competitive environment, and to prevent business structures from creating monopolies and conducting unfair trade practices	To create and promote an equitable and nondiscriminatory competition environment and to foster fair business competition
Competition legislation						
	1980 Regulations Concerning Development and Protection of Competition; 1993 Anti-Unfair Competition Law; Other regional/sectoral regulations; 1998 Price Law; Anti-Monopoly Law (draft)	Monopolies and Restrictive Trade Practices Act 1969 (MRTP Act); Competition Act 2002	Monopoly Regulation and Fair Trade Act 1980; Other sectoral regulations; Omnibus Cartel Repeal Act 1999	No national competition law; Sectoral regulations	Price Control and Anti-Monopoly Act 1979; Trade Competition Act 1999; Goods and Services Price Control Act 1999	Price Regulation 1992; Commercial Law 1997; Ordinance on Prices 2002; Competition Law 2004
Competition policy history						
	No competition policy until late 1970s	MRTP Act was part of the command-and-control laws, rules, regulations, and executive orders adopted after independence in 1947; with the adoption of free-market principles came the recognition of the need for an effective competition regime, hence the new Competition Act	Series of unsuccessful attempts to introduce competition law since 1964	Since independence, sectoral regulations imposed	Competition law in place since 1979	Initially, only price control measures were put in place

Source: Compiled by Asian Development Bank staff.

power, and by regulating undue collaborative acts and unfair trade practices.[10] Similarly, Thailand's competition act aims to promote fair and free trade with a competitive environment, and to prevent business structures from creating monopolies and conducting unfair trade practices.[11] Viet Nam's competition law was approved by its National Assembly in November 2004. The main objectives of the law are to regulate unhealthy competitive practices and practices in restraint of competition.

To date, Malaysia has not passed any economy-wide competition legislation. Since independence, it has relied on sectoral regulations to enforce competition in markets.

Thus, the objectives of competition law are not confined to include static efficiency considerations and, in many cases, extend to include dynamic economic performance. Moreover, competition law is only a subset of a nation's competition policies and should not be confused with other policies that affect the intensity of competition in a nation's markets. The governments of most of the countries studied have envisaged their competition laws as supportive of their national development objectives. Each one consequently views the prevalence of competition as contributory to the country's economic development.

Is competition policy necessary or appropriate for developing countries? For the full benefits of competition-induced efficiency to be realized, well-functioning input markets (especially those for capital and labor) play a critical role. Unlike industrial countries, many developing economies do not have well-functioning factor markets—such as stock exchanges and bond markets—and have often been unable to create institutions that support the operation of markets, such as bankruptcy codes, efficient contract enforcement, and the like (Laffont 1998). These "missing markets" and "missing institutions" alter the optimal degree of competition in an economy and, therefore, have implications for the vigor and manner with which competition policy should be enforced. These considerations are especially important when efforts to achieve dynamic efficiency drive policy making.

The competition laws of PRC, India, and Viet Nam, for instance, do not have specific provisions against monopolies. However, the PRC's competition act does have a provision preventing monopolies from forcing others to buy their goods. It also has a couple of provisions relating to the protection of intellectual property. In a similar vein, Viet Nam's competition law subjects monopolies, even if they are state owned, to the same prohibitions as private enterprises holding dominant market positions in the same sectors. Prohibitions include selling below cost, fixing prices, restricting production or distribution, and bundling unrelated obligations into a contract, among others. India's Competition Law does not directly ban cartelization, but prohibits collusive behavior among firms that adversely affects competition.

In comparison, the competition law of Thailand expressly forbids the creation of monopolies and devotes a full chapter to specifying antimonopoly and anticompetitive provisions. Korea's competition law is also unambiguous in its intent to promote competition in monopolistic or oligopolistic markets by regulating abusive market-dominating behavior and by controlling mergers.

Instruments

In many countries, the anticompetitive effects of government measures are addressed through the instrument of competition advocacy activities. This involves the conduct of activities by competition authorities related to the promotion of a competitive market environment through nonenforcement mechanisms, such as by establishing close relationships with other government agencies to influence their activities in pro-competitive ways and by increasing public awareness of the benefits of competition (ICN 2002).

The potential contribution of competition advocacy activities to national economic performance has been discussed extensively at the International Competition Network, at the Organisation for Economic Co-operation and Development (OECD), and in the World Trade Organization (WTO) Working Group on the Interaction between Trade and Competition Policy. An overview of the different types of competition advocacy is provided in Box 3.3.

Notwithstanding the importance attached to competition advocacy in both national competition regimes and in the work on competition

Box 3.3 Importance of competition advocacy

The growing importance attached to competition advocacy is described by Anderson and Jenny (2002).

> Apart from the potential benefits for developing countries of appropriate competition law enforcement activities, discussions in the WTO Working Group on the Interaction between Trade and Competition Policy and other fora such as the OECD Global Forum on Competition Policy have called attention to the importance of so-called competition advocacy activities. These may include public education activities, studies and research undertaken to document the need for market-opening measures, formal appearances before legislative committees or other government bodies in public proceedings, or "behind-the-scenes" lobbying within government. These, it has been suggested in the Working Group, may be among the most useful and high payoff activities undertaken by agency staff (p. 7).

Anderson and Jenny go on to discuss the particularly strong link between competition advocacy and regulation:

> The importance of competition advocacy activities arises partly in relation to regulation. Of course, in both developed and developing economies, regulation can and often does serve valid public purposes. For example, it is well-established that regulation can be an efficient response to market failures such as imperfect information, the existence of a natural monopoly (a situation in which a market is most efficiently supplied by a single firm) and other such problems. Nonetheless, it is important to recognize that, notwithstanding its avowed aims, regulation often thwarts rather than promotes efficiency and economic welfare. This is likely to be the case, for example, where it imposes restrictions on entry, exit and/or pricing in non-natural monopoly industries. In fact, experience in both developed and developing countries shows that, in many cases, rather than having regulation imposed on them for the public benefit, incumbent firms have often sought regulation for their own benefit, for the purpose of limiting entry into the industry and helping them to enjoy higher prices for their products. … In the light of this, efforts to remove inefficient regulatory restrictions and related interventions can be central to the establishment of healthy market economies in developing and transition economies (p. 7).

Source: Anderson and Jenny (2002).

policy in international organizations, another instrument—namely competition law and its enforcement—is at the center of competition policy in many countries.

Competition law refers to the set of rules and disciplines maintained by governments relating either to agreements between firms that restrict competition, or to the abuse of a dominant position (including attempts to create a dominant position through mergers) (Hoekman and Holmes 1999). UNCTAD (2002) provides a list of firms' actions that may fall within the purview of competition law, five of which figure prominently in most laws:

- Measures relating to agreements between firms in the same market to restrain competition. These can include provisions banning cartels as well as provisions allowing cartels under certain circumstances.
- Measures relating to attempts by a large incumbent firm to independently exercise market power (sometimes referred to as abuse of dominant position).
- Measures relating to firms that, acting collectively but in the absence of an explicit agreement between them, attempt to exercise market power. These are sometimes referred to as measures against collective dominance.
- Measures relating to attempts by a firm or firms to drive one or more of their rivals out of a market. A law prohibiting predatory pricing is an example of such a measure.
- Measures relating to collaboration between firms for the purposes of research, development, testing, marketing, and distribution of products.

This list of five instruments is not supposed to be exhaustive, nor is it meant to suggest that each element is given the same weight or referred to in the same terms in each country with a functioning competition law.

While it is important to know what issues

competition law covers, it is just as essential to stress that the following government interventions fall outside competition law:

- most consumer protection laws, such as those relating to faulty products, warrantees, and misleading advertising;
- unfair trade laws, such as laws on anti-dumping and countervailing duties, and measures to protect national industries against surges in imports;
- government policies toward the registration of new businesses and taxation and corporate governance oversight of existing businesses; and
- most trade and FDI policies. (Note, however, that policies toward mergers and acquisitions fall within the scope of competition law.)

Despite the distinction between what falls within and beyond the scope of competition law, competition laws (in those jurisdictions that have them) do not cover all economic sectors. Some sectors—often including those involving state-owned firms—are exempted by law from the disciplines of competition. Other firms that engage in anticompetitive practices at the behest of the government are also often exempt from competition law. In addition, many competition laws include provisions that allow the government or an independent agency to grant exemptions to firms or sectors after the competition law has been enacted.

An important point is that competition law and advocacy are not entirely separate spheres—in many countries, advocacy activities are explicitly authorized by relevant national legislation. The Competition Law of India, for example, contains specific provisions relating to competition advocacy activities.

> The Competition Act extends the mandate of the Competition Commission of India beyond merely enforcing the law. Under the advocacy provisions of the act, the commission will be able to participate in the formulation of the country's economic policies and in the review of laws related to competition. The provisions allow the central government to refer existing or proposed laws to the commission for an assessment of their effects on competition. The commission must respond to such a request within 60 days. The commission will therefore be assuming the role of competition advocate, acting proactively to bring about government policies that lower barriers to entry, promote deregulation and trade liberalization, and enhance competition in the marketplace.
>
> The Competition Act seeks to bring about a direct relationship between competition advocacy and competition law enforcement. One of the main objectives of competition advocacy is to foster conditions that will lead to a more competitive market structure and business behavior, thus avoiding the need for intervention and enforcement by the Competition Commission of India (Chakravarthy 2005).

The mix of competition policy instruments used, and the manner in which they are employed, will depend on a country's broader development objectives, its historical and institutional background, and the international context.

Consistency with other development objectives

During economic transition or reforms, the benefits of an open market economy cannot be fully realized unless restrictions on competition are removed. Sectors with characteristics of natural monopolies, such as utilities and telecommunications, need to be subjected to competition law or regulation to prevent abuse of firms' dominant positions. Price liberalization that is not accompanied by competition policy can lead to price increases if monopolistic structures are allowed to remain. Trade and investment liberalization may bring in more market players, but those agents can abuse their dominant positions if no competition policy is in place. Competition authorities can watch out for practices such as market-sharing agreements, predatory pricing, and cartelization, which

allow the benefits of liberalization to accrue to firms instead of to consumers. Without adequate competition, such issues can be difficult to resolve (Box 3.4).

Several objections about the use of competition policies have been raised, e.g., competition policy does not allow state authorities adequate discretion in relation to other development policies, particularly trade or industrial policies; its effective contribution to economic efficiency is relatively small; and it gives too much weight to efficiency relative to other societal goals such as environmental protection, income distribution, etc.

Thus, one argument often proposed that restricting competition can enhance dynamic efficiency is that in the case of young industries, firms may need to finance growth and reducing rivalry will result in higher prices that, in turn, can generate the internal funds to attain this goal.

A variant of this argument was advanced by Amsden and Singh (1994) as practiced in Japan. They observed that:

> In general, whether competition was promoted or restricted [in Japan] depended on the industry and its life cycle: in young industries, during the developmental phase, the government discouraged competition; when the industries became technologically mature, competition was allowed to flourish. Later, when industries are in competitive decline, the government again discourages competition and attempts to bring about an orderly rationalisation of the industry (p. 945).[12]

Restraining competition to bolster investment in a developing country setting is not necessarily more effective and less costly than offering firms an investment subsidy or tax credit, or taking measures that encourage banks to lend to firms. Reducing rivalry has the effect of increasing prices paid by customers. In contrast, an investment subsidy or tax credit that stimulated investment by the same amount as the reduced rivalry would not have the same adverse effect on customers' welfare. The investment subsidy or tax credit would, though, have implications for the government's budget, highlighting the importance of initial country conditions.

A related possible trade-off between competition policy and dynamic efficiency occurs when firms need to attain a certain size to compete effectively in world markets. Some advocates of industrial policy argue that domestic firms "need" profits to finance foreign expansion. If true, this might imply that the enforcement of competition laws related to cartels and merger review should place greater weight on export competitiveness than on domestic customers' welfare.

While monopoly profits could in theory have a beneficial effect by providing a source of funding for the investment necessary for a firm to compete internationally, several criticisms of this argument can be made.

First, capital markets are a more efficient source of funds for investment abroad than monopoly profits derived from domestic consumers. Tapping capital markets through either bonds or equities also increases discipline on the firm's investment decisions by imposing obligations, controls, and incentives on the shareholders and managers of firms. In contrast, when a firm has access to monopoly profits, it has less incentive to invest rationally and efficiently either at home or abroad.

Second, if monopoly profits are necessary to fund a foreign investment, then in effect the investment is only viable because of a cross-subsidy from domestic consumers. The overall effect on the domestic economy would consequently be negative as the investment would in reality be financed by a tax on domestic consumers to subsidize competition in export markets.

Third, a firm may seek to expand externally following a domestic merger and, as a consequence, the merger raises monopoly issues in one product market. If the firm produces more than that one product, rather than blocking the whole merger it would be more appropriate to apply competition remedies to the specific domestic market power abuse (Ireland 2003).

Finally, the assumption that larger domestic firms have greater export competitiveness is questionable, especially when the creation of those larger domestic firms results in a substantial reduction in the degree of rivalry between incumbent firms. Intense competition in the domestic market can build discipline that leads to success abroad. Firms that have to compete

Box 3.4 Competition in the Malaysian services sector

The following cases highlight some competition issues in the Malaysian services sector.

Malaysia Airlines vs AirAsia

Prior to 2002, Malaysia Airlines System Berhad (MAS) was virtually a monopoly operator in Malaysia's domestic airline market. With the entry of AirAsia, the market became more competitive. MAS responded by introducing a new pricing scheme (Super Saver Scheme) which offered a 50% discount for 10 seats in every flight, even though, in July 2001, the Government had allowed MAS to raise fares by 52%. AirAsia in turn countered MAS' pricing strategy in September 2002 by offering lower fares. Despite MAS' plea for intervention by the Ministry of Transport to resolve the price war, the Government maintained that the competition between the two firms is healthy. This case highlights an important impact of market entry on competition in a Malaysian service industry.

The Pangkor-Lumut Ferry Case

Two firms—Pangkor-Lumut Express Feri and Pan Silver Ferry—provide ferry services between Lumut and the island of Pangkor. A price war started between them in January 2003, and the adult round-trip ticket price plunged from RM10 in December 2002 to RM1 in July 2003, stabilizing later at around RM4. On 20 October 2003, the companies increased the ticket price from RM4 to RM10, generating a public outcry. In what seemed an angry response, the ferry operators suspended the sale of monthly passes to frequent users. The public viewed the price increase as an outcome of collusion between the two operators to avert the adverse consequences of a protracted price war. Both firms claimed that they incurred losses amounting to about RM10,000 a month during the price war.

The Government's response to the problem has been limited. Following the public's complaints in October 2003, the Perak state government attempted to negotiate a reduction of the ticket price (RM7 was considered reasonable), though without success. It then referred the problem to the Ministry of Transport. Under the Merchant Shipping Ordinance, however, tariffs for merchant and passenger ships with less than a registered gross weight of 40 tons are not regulated. The Government is currently planning to amend the law to enable them to undertake regulatory oversight in such matters. For the time being, the Ministry of Transport has resorted to direct negotiations with the concerned parties in an attempt to maintain reasonable fare levels.

This case highlights that a government's lack of regulatory oversight could lead to anticompetitive conduct, and raises interesting issues about the potential links between regulation and competition. The price increases in October 2003 were apparently an outcome of an exercise of market power by two colluding firms. A competition law prohibiting collusion would have been able to deal with this problem.

The Haulage Industry Case

The haulage industry was liberalized in 1997 to increase its efficiency. The number of haulage firms increased from five that year to about 60 in 2003. However, by 2003 the Container Hauliers Association of Malaysia (CHAM) had only six firms, including the original five. Slightly more than half of the new entrants (about 30 firms) had formed or joined another association, the Association of Malaysian Haulers (AMH).

Following the continued entry of more new firms into the industry, a price war broke out in the industry around 2000. By 2003, container haulage rates had fallen by between 20% and 40%. In an effort to stem the drop in rates, the two industry associations agreed to stop giving rebates to their customers from 1 January 2004. As of late 2004, the Commercial Vehicle Licensing Board, the industry regulator, had not made any comment on these initiatives even though it sets price ceilings for the industry.

In this case, entry liberalization for the haulage industry clearly precipitated a price war, which industry associations attempted, together, to end (aided by the fact that the market share of the six CHAM members in container haulage is about 55%). It is too early to tell whether the industry associations' efforts will work, especially given the large number of firms involved. Furthermore, the continued practice by some firms of renting out their hauler permits to other companies, and the illegal trucking of empty containers, can continue to undermine the industry's resolve to coordinate prices.

This case illustrates that tariff regulation can compromise competition in an industry. When market conditions change in such a way that an equilibrium price lower than the regulated tariff level prevails, firms may collude to maintain prices at the regulated level by agreeing not to wage price wars. When this occurs, the regulated tariff acts as a benchmark for a collusive price level. Worse, since the regulated tariff level is set by the Government, the industry associations' acts of explicit collusion may escape any legal sanction even if they are clearly anticompetitive. Competition policy could help to resolve such cases. Perhaps even more important, regulation may need to be scaled back to allow competition itself to resolve such problems by allowing more entrants into the market.

Source: Lee (2005).

domestically know how to cut costs, operate efficiently, attract customers, and fight for market share. This discipline gives them an advantage when expanding into foreign markets.

Some argue that, for firms to reach the appropriate size, state action is called for, essentially to create or foster "national champions." These state actions may include forced mergers and acquisitions, or state-encouraged mergers and acquisitions by private firms. Even in this case there is an issue as to what should be the appropriate competition law enforcement regime for national champions after they have been formed.

An important feature of policies employed to create national champions is that they can involve discrimination against foreign firms. The discrimination can be de jure, for example, when foreign firms are simply banned from acquiring or merging with domestic firms in certain sectors. Also, a foreign firm's proposal to buy or to merge with a domestic firm may be reviewed under a different and potentially more stringent procedure than when two domestic firms decide to form a single combination. Alternatively, the discrimination could be de facto, for example, when merger review procedures are implemented in such a way that proposed combinations involving domestic firms are treated differently than those involving at least one foreign firm.

Industrial policy, competition, and competition policy

Concepts

A recurring concern in the debate over the efficacy of competition law in developing countries is that its enforcement may compromise important industrial policy goals, creating an inherent tension between the two. However, the characterization of industrial policy in the literature is considerably less precise than that of competition law, and can be a source of considerable confusion in discussions on development policy.

No single accepted definition of industrial policy exists, but a persistent theme is that industrial policy in developing countries is intended to facilitate a structural transformation of their economies. As Ajit Singh (2002) puts it, the crucial importance of industrial policy is to achieve structural changes required for development. Likewise, structural change in favor of industry has been viewed as a prerequisite for developing countries' modernization and growth, and developing countries' industrial policies were aimed to speed up the industrialization process to achieve levels of industrial development that were comparable with those in Europe and North America (Dervis and Page 1984).

The ultimate objectives of industrial policy are generally taken to be faster national economic growth and economic development, while the intermediate objectives are to expand the output of those sectors with high value added or the potential for considerable growth of value added. Not every industry targeted needs to be identified as high value added or having prospects for fast growth. Furthermore, nothing in principle prevents a nonindustrial sector—such as services or agriculture—from being so identified.

> After all, industrial policies are supposed to have been confined to the trashbin of history in modern and modernizing economies, along with other outmoded policies like central planning and trade protection. The reality is that industrial policies have run rampant during the last two decades—and nowhere more so than in those economies that have steadfastly adopted the agenda of orthodox reform. If this fact has escaped attention, it is only because the preferential policies in question have privileged *exports* and *foreign investment*—the two fetishes of the Washington Consensus era—and because their advocates have called them strategies of "outward orientation" and other similar sounding names instead of industrial policies. Anytime a government consciously favors some economic activities over others, it is conducting industrial policy. And by this standard, the recent past has seen more than its share of industrial policies (Rodrik 2004, pp. 28–29).

As with competition policy, there appears to be no accepted set of instruments that are always considered to be part of industrial policy. Several characterizations of industrial policy instruments can be found in the literature. In his analysis of East Asian industrialization, Wade

(1990) differentiates between sectoral and functional industrial policy instruments. He defines sectoral industrial policy instruments as those aimed at directing resources into selected industries so as to give producers in those industries a competitive advantage. In contrast, he defines functional policy instruments as those that affect either economy-wide factors (such as the supply of engineers or the price of energy) or in principle alter in the same manner firms' or investors' incentives, irrespective of the industry or sector in which they operate. An example of a functional instrument of industrial policy would be an economy-wide investment subsidy or tax credit.

Pangestu (2002) presents perhaps the most exhaustive categorization of the instruments of industrial policy—external, product, and factor market interventions. External market interventions, aimed at protecting domestic industries from imports, include import tariffs, quotas, local content requirements, and export promotion measures. Product market interventions, intended to foster competition in domestic markets, include competition policy (to ensure fair competition between domestic and foreign players) and domestic market-entry regulations. Factor market interventions, often designed to influence the operations of foreign affiliates so that the host country realizes a net benefit from FDI, include policies such as performance requirements and restrictions on FDI.

Pangestu's characterization of the instruments of industrial policy is of interest for several reasons. First, her characterization highlights how the enforcement of competition law is *one* of the large number of policy instruments associated with industrial policy. This is important because it implies that the preponderance of industrial policy instruments falls outside the domain of competition law. Second, Pangestu presumes the goal of competition policy here is to promote rivalry and not to restrain it, as Tilton (1996) had suggested. This hints at divergent views as to the contribution to economic development of rivalry between firms. Third, the fact that she feels the need to list so many policy instruments to accurately characterize the term industrial policy suggests that the term is so wide-ranging as to be of little more than descriptive value.

Tilton (1996) identified two types of industrial policy instrument in his analysis of postwar Japanese economic performance. The first instrument, which is similar to Wade's sectoral policy instruments, is described below:

> The principal way industrial policy functions here is by allocating resources to favoured sectors. It can do so through policies that directly provide resources to industries, such as tax breaks, loans, subsidies, and import protection. More important, however, have been policies to reduce competition between firms. … Industrial policy may also support industry by providing or helping to circulate information about market or technological opportunities (pp. 2–3).

He adds:

> A second form of industrial policy, strategic trade policy, seeks to appropriate the benefits of strategic industrial sectors by promoting them at home and helping them gain a larger share of world markets (p. 3).[13]

For the purposes of this chapter, Tilton's characterization of industrial policy is important because it highlights the fact that some competition policy and trade policy instruments are also seen by some as *industrial policy* instruments.

> Overall, then, … government did play a variety of roles in the successful Japanese industries. However, these roles were very different from what is closely associated with Japan, and they were not the Japanese policies that have been the most widely emulated. Not only was there little of the intervention in competition associated with the received government model; in some successful industries, such as automobiles, the industry actually spurned government's efforts to suppress competition (Porter et al. 2000, p. 31).

In light of these findings, it would be misleading to argue that there is an intellectual consensus behind the proposition that limiting rivalry promoted Japanese economic development. Moreover, in a contribution to the WTO Working Group on the Interaction between Trade and

Competition Policy in 2001, *Japan itself argued that intrafirm rivalry has previously played and continues to play an essential role in Japan's development*:

> While it has been commented that Japan's postwar economic development was achieved by subordinating competition policy to industrial policy … much of Japan's economic dynamism has in fact been rooted in the robust market mechanisms created through competition among firms. Industrial policy and competition policy coordinated mutually and developed an environment that allowed companies to engage in free and fair competition. The introduction of competition policy early in Japan's economic reconstruction, as well as the subsequent evolution of this in response to economic development, was a great factor in Japan's rapid economic growth in the past. Even today, it is those sectors where competition has been intensive - the automobile industry, for example - which tend to have the greatest international competitiveness (Japan 2001, p. 2).

The Japanese experience is not unique. In Korea, it also appears that the costs of creating such a cadre of large firms have become increasingly evident over time. It is said that these large firms used their market power at home to frustrate entry by rivals, to raise prices, and to resist the enactment and enforcement of competition laws that could have put a stop to these adverse outcomes. These points have been made with some force in a submission by Korea to the WTO Working Group on the Interaction between Trade and Competition Policy in 2001, noting that:

> Korea's experience demonstrates that it is better to introduce a competition regime at the initial stage of economic growth, when monopolies have not yet gained political and economic power. Despite their merits of achieving economy of scale, large monopolies, if left unchecked, are very likely to engage in excessive facility investments, cause price hikes resulting from their inefficient operations, and hinder opportunities for new entrants. This eventually necessitates the introduction and enforcement of competition policy to remove anti-competitive elements in the market under the political and social pressure stemming from the rising public discontent against the unbalanced distribution of wealth (Korea 2001, p. 3).

In addition,

> With the progressive liberalization of world trade, developing countries can no longer resort to the export-oriented economic growth policy through the protection of domestic industries. Therefore, competition policy should be put into operation from the early stage of economic development to respond proactively and promptly to the rapidly changing economic conditions at home and abroad. Greater competition will ensure that unrestrained interaction of competitive forces will yield the best allocation of economic resources, thereby helping promising small and medium enterprises to grow on market-driven foundations and form a healthy industrial platform (Korea 2001, pp. 3–4).

The widespread use of industrial policies in developing Asia highlights the importance of examining their interaction with competition and competition policy. This is illustrated in Box 3.5.

People's Republic of China

Ever since the start of its open-door policy in the late 1970s, the PRC has persistently pursued industrial policies by, for example, identifying and providing preferential treatment to what have been termed sunrise industries. Industrial policy objectives are embedded in various policies covering the fields of FDI, science and technology, education, land use, and taxation policies, among others. According to Jiang (2002, p. 49), the central Government published more than 80 detailed industrial policies from 1978 to 1997, pertaining to virtually every government department and industry. Jiang divided them into the following three categories: those designed to reform the industrial landscape, those with interventionist measures, and those intended to support or restrict industries and enterprises.

Box 3.5 The colored television cartel in the People's Republic of China

After engaging in several rounds of price wars in the late 1990s, top managers of nine TV manufacturers in the People's Republic of China, which reportedly account for more than 80% of the market, held a summit in June 2000 and agreed to form an alliance. The top TV producer, Changhong, did not join the alliance. The alliance agreement covers: research and development cooperation in digital technology standards and new products; joint efforts in promoting exports; and, most notably, setting minimum prices for TVs sold domestically.

The State Development and Planning Commission (SDPC, now State Development and Reform Commission) publicly announced that the agreement was in breach of the 1998 Price Law, and that the alliance was a monopoly in disguise. However, a high-ranking official from the Ministry of Information Industry, which supervises the TV sector, supported the alliance, stating that it embodied the healthy development of the industry via self-protection, self-discipline, and voluntary cooperation.

After meeting with the nine producers, SDPC and the Ministry of Information Industry jointly declared in August 2000 that while there was nothing wrong with discussing long-term issues via dialogue, setting minimum prices violated the 1998 Price Law. No formal action has been taken by the alliance, but one of its members has been pricing TVs lower than the floor price set by the alliance.

Source: Lin (2005).

He argues that the PRC's industrial policies have undergone three stages of development in relation to their interaction with competition:

- From the late 1970s to the mid-1980s, they promoted competition by encouraging entry of new firms, particularly in nonstate sectors, introducing competition among existing enterprises and relaxing price controls.
- From the mid-1980s to the mid-1990s, they limited competition by restraining establishment of new small and medium enterprises, restricting competition between rural and state-owned enterprises (SOEs), and providing preferential treatment to large SOEs.
- Since the mid-1990s, they have promoted and limited competition in concert, by promoting competition in monopolistic industries, on the one hand, and instituting measures to rescue SOEs that were facing difficulties, on the other.

Until the mid-1990s, policy makers regarded industrial policies as the cure to many economic problems and the key to long-term economic development. Whenever a shortage or surplus occurred in the marketplace, or excessive competition existed (as manifested in, for example, price wars or a large number of loss-making enterprises), the public expected the Government to step in with proper industrial policies.

During the first stage of economic reform (late 1970s to mid-1980s), a primary goal of the Government was to improve firms' performance by introducing competition (relaxing price controls, removing entry barriers, and so on). Such measures were generally successful. From the late 1970s until the mid-1990s, market mechanisms were only regarded as supplementary to central planning. As competition intensified, new small-scale entrants (mostly nonstate owned) began to crowd out large SOEs. Toward the latter part of this period, the Government introduced new industrial policies to protect SOEs from increasing competition. The second stage in Jiang's analysis corresponds to such a correction period. After a period of consolidation, industrial activities consequently slowed down, and a new round of industrial policies was introduced to restimulate industrial production.

In October 1992, the Government decided to replace its traditional central planning approach (supplemented by markets) with one aimed at establishing a "socialist market economy." Gradually, market mechanisms began to be accepted as another, perhaps better, solution to economic problems. The Government still uses industrial policies, but they are no longer regarded as a panacea for the country's economic ills.

Throughout the 1990s, the central Government continued to encourage large-scale enterprises. Taking its cue from Korea, it regarded the establishment of large conglomerates as the most important means of achieving

economies of scale to be able to compete with multinational enterprises both in the domestic and international markets. Merger and acquisition (M&A) activities were regarded as effective vehicles to absorb and transform loss-making SOEs. In 1991 and 1997, a national team of 120 large enterprise groups from industries considered of strategic importance was selected. To enhance competitiveness, the Government granted special treatment to these national champions, including tariff protection, special rights to engage in international trade, requirements for potential foreign investors to transfer technology to these selected firms, and favorable terms on loans from state-owned banks.

In spite of the adverse effects of the 1997–98 Asian financial crisis, particularly on Korea, the PRC Government still considers setting up large-scale domestic enterprises as a top priority. Unsurprisingly, a large number of large-scale mergers or acquisitions that took place in recent years were government managed. For example, in a government-ordered merger in 2002, the Civil Aviation Administration of China pushed nine domestic airlines directly under its supervision to form three super groups: China National Aviation and China Southwest became subsidiaries of Air China; Yunnan Airlines and China Northwest became subsidiaries of China Eastern; and China Northern and Xinjiang Airlines became subsidiaries of China Southern. Under the administrative transfer technique, these three "super groups" secured the assets of the regional carriers for free.

As far as competition in its domestic markets is concerned then, PRC industrial policies have shifted toward encouraging interfirm rivalry. This has been accomplished without compromising another stated government goal: that of building a cadre of large firms able to withstand competition on world markets. Moreover, to the extent that enhancing competition in the domestic markets is a prerequisite to having firms perform well on global markets, PRC industrial policies toward rivalry in domestic markets could well have underpinned the exporting prowess of this select group of firms.

India

Somewhat similar to the PRC, since the early 1950s India has had a planned strategy for its economic development. The Industries (Development and Regulation) Act, 1951 (IDR Act) empowered the state to channel the direction of private investment through the extensive use of industrial licensing. Entry into industries, capacity expansions, and choice of product mix and technology were effectively subject to state control. The intention was to reallocate resources from production of consumer goods and into the production of machine tools and capital goods. Only small-scale industry was exempted from licensing to encourage labor-intensive consumer goods production in rural areas. By the late 1960s, policies to protect the small-scale sector against competition from the large-scale sector were in place.

Additional Indian legislation, particularly the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) and the Foreign Exchange Regulation Act, 1973 put in place more barriers to entry. The Industrial Disputes Act, 1947 controlled firm closures and labor retrenchment, effectively creating barriers to exit. At the same time, the public sector was made responsible for the development of infrastructure and was given control over key sectors such as defense and defense equipment, iron and steel, energy, power, transportation, and telecommunications. Central government departments and public sector enterprises were mandated to accord price and purchase preferences to the public sector.

In 1991, India's industrial policies underwent a substantial change. The Industrial Policy, 1991 liberalized FDI, foreign technology agreements, and compulsory industrial licensing. Licensing in all but 18 industries was abolished, and an additional 12 industries were subsequently delicensed. Only industries relating to strategic or environmental concerns remained subject to licensing. In the same manner, the monopoly of public sector industries was abolished, save for industries dominated by security and strategic concerns, such as defense equipment, railway transport, and atomic energy and nuclear minerals. These measures catalyzed competition in industrial manufacturing and services. However, a number of commodities remained subject to price and quantity controls, such as sugar, fertilizers, pharmaceuticals, and cement. As a result, even in some industries with a private sector presence, market conditions and outcomes are not truly competitive.

Korea

Accounts of Korean economic development show that the Government, differentiating between domestic and foreign competition, undertook steps to promote the development of large firms that could compete on international markets while at the same time encouraging fierce competition between these firms. These measures are thought to have secured the benefits of large firm size without the costs associated with diminished competition. In recent years, however, this argument has fallen out of favor.

Rodrik (1995) summarized Alice Amsden's (1989) thesis on Korea's economic development since World War II as an incentive system based on an effective balance between carrots and sticks. The Government adopted measures such as trade protection, selective credit subsidies, export subsidies, export targets (for individual firms), public ownership of the banking sector, and price controls aimed at acquiring technological capacity and building world-class industries. At the same time, it set stringent performance standards in exchange for the subsidies and protection. Penalties (such as rationalization) were imposed on poorly performing firms, and rewards (such as subsidized credit) were offered to firms fulfilling government targets. This kept the system free of the rent seeking that has proliferated in other regimes. Amsden and Singh (1994), in describing the implications of this apparent mix of policies, contend that the Government encouraged big business through licensing and subsidized credit, but ensured that no collusion existed between big businesses by allocating subsidies only in exchange for adherence to strict performance standards.

High and growing concentration ratios appear to be the result of these policies. Smith (2000) reported a trend of growing *chaebol* market power from 1970 up to the mid-1980s. From 1977 to 1994, the 30 largest *chaebol* accounted for between 32% and 40% of total national output. In 1994, total sales by the top five *chaebol* were 49% of national income. Amsden (1989) showed that in 1982, only about 18% of 2,260 commodities, or 30% of all shipments, were produced under competitive conditions. The result was an industrial structure different from one that a market economy would have produced. Large, diversified business groups, which were less subject to the discipline of the market than to the discipline of managerial hierarchies, dominated the economy (Smith 2000).

Over time, the costs of creating such a cadre of large firms became increasingly evident, as these large firms used their market power at home to frustrate entry by rivals, to raise prices, and to resist the enactment and enforcement of competition policies that could have put a stop to these practices. Early efforts to introduce competition laws in the country were easily thwarted by lobbying from the corporate sector, as the monopolies had already gained political and economic power. Although some were able to achieve economies of scale, the monopolies, if left unchecked, were more likely to over-invest, over-diversify, and over-price due to their inefficient operations. The Government takes the view that the 1997 financial crisis and the problems now besetting the *chaebol* are somehow caused by the lack of a competitive economic environment in the past decades. To correct the situation, the Government is exerting extra effort to establish a more competitive market structure through stricter implementation of competition and related laws. However, it is facing difficulties in the process as vested interests resist change. This experience highlights the importance of having faith in the benefits of competition from an early stage of economic growth and of incorporating competition policy based on the functioning of markets into the basic framework of economic policy (Korea 2001).

For policy makers convinced of the need for industrial policies to groom internationally competitive firms or national champions, one implication of the Korean experience is that mitigating the adverse domestic side effects of such a policy will require measures, such as the enforcement of competition law, that stimulate or ensure rivalry between these firms. The Korean and PRC experiences both suggest that policies to create large national firms ought to be complemented by measures to ensure continued rivalry in domestic markets.

Malaysia

In Malaysia, growth with equity has always been the primary economic objective. Race

riots in 1969 prompted the Government to adopt an interventionist long-term development policy—the National Economic Policy—aimed at reducing poverty and redistributing wealth among the different ethnic groups. Over time, the objective of wealth redistribution received greater attention than poverty reduction. Specific ownership targets were set for commerce and industry. Outright purchases, licensing, quotas, and government procurement regulations were implemented to meet these ownership targets for the *bumiputra* community. Large SOEs and state development corporations were also established to accumulate corporate assets on behalf of that community.

In the agriculture sector, several marketing boards were established under the National Economic Policy to reform distribution networks. The Government believed that persistent poverty in the agriculture and fishery sectors was due to the exploitative behavior of rural traders with monopolist or monopsonist positions. The exclusionary nature of government policies to redistribute wealth reduced, to a certain extent, the degree of competition in some sectors, such as government procurement.

The Government also employed industrial policy to further develop its economic sectors. Policy measures included: (i) trade-related instruments such as import tariffs, import licensing, export promotion or processing zones, and export-related equity or ownership incentives (Box 3.6); (ii) industry promotion instruments such as pioneer status, investment tax allowance, research and development (R&D)-related tax incentives, and local content programs; (iii) national champion-type investments such as Proton (the national automobile project, see Box 3.7); (iv) factor market-related instruments such as foreign labor policy, priority sector lending guidelines, and provision of industrial areas; and (v) regulatory interventions in domestic markets such as licensing, price ceilings, government procurement, moral suasion on mergers, and market liberalization.

In general, export-oriented industrial policies and factor market-related instruments appear to have had a neutral impact on competition in Malaysia's domestic market. In contrast, import substitution strategies have raised issues related to market access, as for instance, in the automotive sector. The national champion-type investments that are supported by these strategies tended to reduce competition.

Eventually the Government realized that the painful trade-offs accompanying redistributive policies could be softened by economic growth propelled by the FDI-driven export sector. This approach resulted in the adoption of pro-growth policies, such as market liberalization in both tradable and nontradable sectors that increased the degree of competition in affected markets. However, in anticipation of greater competition from foreign firms, the Government also took steps to consolidate various industries (most notably banking) via mergers, to partially offset the competitive impact of liberalization.

Thailand

Thailand's industrial policy focuses mainly on promoting companies that employ advanced technology, invest in R&D activities, provide training programs, utilize available domestic resources (including labor), and promote industrial linkages. Firms with such qualifications are likely to receive incentives from the Board of Investment.

However, many state rules and regulations pose barriers to entry to certain industries. Manufacturing industries that display high market concentration usually receive state protection in various forms, including high tariffs and surcharges imposed on competing imported products, stringent licensing conditions making new entry difficult, or a change in the excise tax regime that benefits the incumbent monopoly.

Certain laws or cabinet decisions also grant exclusive rights to SOEs to provide services to the public. For example, until recently the law granted a statutory monopoly in the ownership and operation of all telecommunications services to state enterprises. Private participation was subject to build-transfer-operate agreements, whereby private operators built the networks and then transferred ownership of the networks to the state enterprises in exchange for exclusive rights to operate the networks for a specified period of time. Under such an arrangement, the private concessionaires could not claim any assets and were subject to operating conditions

Box 3.6 Malaysia: The steel industry case

Malaysia focused on steel production as part of its heavy industrialization program in the early 1980s. The two largest steel projects in Malaysia are Perwaja (producing billets) and Megasteel (producing hot- and cold-rolled coils). After investing more than RM10 billion in Perwaja, the Government sold the then loss-making firm to a private company, Maju Group. Megasteel, in contrast, has always been a privately owned plant, with a market capitalization of more than RM2.4 billion.

Both investments are protected from foreign competition via import duties and permits (administered by the Ministry of International Trade and Industry) and price regulation (set by the Ministry of Domestic Trade and Consumer Affairs [MDTCA]). Rising demand for steel scrap (the basic raw material for making steel products) abroad since early 2003 reduced the availability of this input for domestic production.

As a result, steel supply for domestic consumption declined and steel prices increased sharply. Domestic consumers of steel products such as the construction industry were severely affected. Concomitantly, both Perwaja and Megasteel reported significant improvements in their financial performance.

To alleviate the shortage, the Government undertook the following measures: suspending for 6 months import restrictions on steel billets and bars, and exempting raw materials from import duties; restricting steel exports; and directing MDTCA to introduce an automatic pricing mechanism for domestic steel billets and bars to provide incentives for steel production for domestic consumption.

These events illustrate the complex interaction among industrial policy, competition, and trade. In this case, the implementation of industrial policy (in the steel industry) via trade policy (import permits and duties) and regulation (price controls) resulted in adverse impacts on other sectors (such as construction). The temporary solution of liberalizing imports clearly increased competition between local and foreign steel producers. Meanwhile, there is no indication that the Government considers restricting exports as a temporary option, and may aim to keep this restriction in place even after the automatic pricing mechanism comes into effect.

Source: Lee (2005).

set by the state enterprises, some of which restricted competition. With the enactment of the Telecommunications Act in 2002, the statutory monopoly is now void.

Similarly, the state-owned metropolitan and interprovincial bus operators hold exclusive rights to provide services on main routes. But unlike telecommunications, the monopoly is granted by the executive—i.e., through a cabinet decision—rather than through legislation. Again, private operators can only operate under concessions from the state enterprise and therefore must pay a royalty fee that can either be a fixed fee or a profit-sharing scheme.

Viet Nam

Industrialization and modernization have for a long time been strategic development objectives for Viet Nam. Although there has been a significant shift in development priorities at the central level, there is still a strong emphasis on the adoption of government-led industrialization policies, similar to those previously applied in Japan or Korea. This has an important implication for competition policy in Viet Nam, since for many years competition was limited and special preference given to SOEs was quite persistent. The objectives of self-sufficiency and self-reliance remain dominant forces in the Government's choice of policies, particularly in the promotion of certain key industries where the state takes a lead role.

In response to increasing competition from foreigners in domestic and international markets, the Government has adopted a policy of promoting conglomerates. General corporations (GCs) have been established to take control of SOEs with the aim of strengthening accumulation of capital and increasing competitiveness, abolishing the administrative dependence of SOEs on the relevant ministry or local administrative authority, leveling the playing field for central and local SOEs, and strengthening the management of SOEs. In effect, each GC will perform the role of management team for a group of SOEs.

A GC allocates capital from the Government

Box 3.7 Malaysia: The EON and Proton Edar case

Cars produced by the national car company, Proton, which was established in 1983, used to be distributed domestically by EON and Proton Edar. EON was established in 1984 as the sole distributor of the national car (the Proton Saga). The Government was a major shareholder in both Proton and EON. The government strategy was to separate manufacturing from distribution. Proton Edar was established in 1985 and became a wholly owned subsidiary of Proton in 2000, subsequently distributing other Proton models previously distributed by EON. In the same year, the 10-year distribution agreement between Proton and EON ended. This set the stage for the intensification of rivalry between Proton Edar and EON in distributing Proton cars.

Problems arose with the launching of a new Proton car—Gen.2—in February 2003. Proton chose initially to distribute Gen.2 solely through Proton Edar, with EON sourcing its supply of Gen.2 from Proton Edar. (Proton also argued that EON should restrict itself to selling a single brand in a single showroom, referring to EON's practice of selling Audi and Chevrolet cars as well as those of Proton).

Anticompetitive conduct is fairly obvious in this case, as there was severe conflict of interest due to Proton's ownership of Proton Edar. It is in Proton's commercial interest to favor its own subsidiary over EON. This is manifest in Proton's decision to compel EON to source its new product from its rival Proton Edar. Proton's insistence on a single brand in a single showroom distribution policy is also akin to market foreclosure to reduce interbrand competition in the car market.

The Government did not intervene in the initial stages of these controversies. However, as the disagreement became more public and acrimonious, it finally asked each party to present their case in February 2004. This eventually led to their signing a 5-year dealership agreement in March that year.

The dealership agreement signed may contain elements that would normally come under competition policy scrutiny. One such clause is the requirement that EON allocate 70% of its servicing capacity to Proton cars. This may be construed as the use of market power by the supplier firm (Proton) to force a buyer firm (EON) to limit the latter's ancillary services to other competing suppliers. This is an important issue given the importance of ancillary services to the actual sale of the primary product (cars) in this case.

Industrial policy can also restrict competition via the promotion of strong vertically integrated structures. In the Proton case, this took the form of car production and distribution. The absence of a competition law exacerbated these vertical restraint problems. If such a law had existed and if Proton had been found guilty of anticompetitive conduct, it could have been forced to divest its distribution subsidiary. The Government currently regulates these companies via its substantial shareholdings, but without them, these companies would be difficult to regulate without competition law.

Source: Lee (2005).

to its SOE members, who have full autonomy in using these resources for their business activities. GCs, however, can adjust the allocation of funds to ensure the smooth operation of the whole group. GCs also determine how the markets are divided among their members, effectively limiting competition from nonmembers. They impose price ceilings for imports and floor prices for exports. As a result, some GCs, such as Viet Nam Airlines and Viet Nam Post and Telecommunications, act as monopolies, which allows them to earn large profits. As the GCs significantly limit competition in certain sectors, the Government is now considering privatizing them and encouraging competition.

Complementarity with industrial policies

For present purposes, the issue is not whether governments should or should not promote national champions. Nor is the issue whether M&A activity actually attains the efficiencies and cost reductions envisaged, a matter that has been debated extensively in the literature on industrial organization. Rather, the question is whether, in order to promote national champions, governments need, or are well-advised, to relax the enforcement of competition law. In most cases the relevant market is wider than the national market and hence an accurate competition assessment, i.e., one based on the wider market, would not identify a competition problem.

Furthermore, to the extent that creating national champions substantially increases concentration in a domestic market, there may actually be a stronger reason for enforcing competition law than would otherwise be the case. Small economies have all the more reason to apply competition rules more vigorously in the import and distribution sectors. Doing this would ease any adverse domestic implications from national champions.

The purpose here is *not* to undertake an evaluation of industrial policy per se, but rather only to examine the competition implications involved. The experience of these six Asian nations does not show that restricting interfirm rivalry is a common and consistent component of national industrial policies. In fact, some countries' industrial policies have taken no steps to alter interfirm rivalry between domestic firms, though other countries' policies at times have done this. None of this is to say that industrial policy has been ineffective, nor that domestic firms have not been shielded somewhat from rivalry from abroad, although even the latter protection has been diminishing over time.

A (remarkably) broad range of scholarly analysis of East Asian experience—and in particular the Korean experience—suggests that industrial policy measures to create national champions should be complemented with state measures to promote vigorous competition within the country in question.

In the instances where policies to curtail domestic interfirm rivalry were employed in Asia, they were principally directed toward a small number of declining industries or markets with over-capacity—not to infant industries. *The tension between the objectives of competition law (promoting rivalry) and industrial policy (promoting the growth industries of tomorrow) is more apparent than real.*

In an attempt to support other development objectives, sectors with dominant SOEs are often exempted from the disciplines of competition law. The railways in India, for instance, continue to be a state-owned monopoly with administered prices and very limited competition despite the existence of competition law. Similarly, Viet Nam's competition law expressly indicates that the state will continue to control SOEs operating in declared state monopoly sectors and will dictate production and prices for these enterprises. In other countries too, firms engaged in anticompetitive practices at the behest of the government are often exempt from competition law. In addition, many competition laws include provisions that allow the government or an independent agency to grant exemptions to firms or sectors after the competition law has been enacted.

It should be noted that the greater the extent of any sectoral or general exemptions from a national law banning hard core cartels, the smaller the overall benefits of adopting such a provision. Moreover, such exemptions may have a "beggar-thy-neighbor" aspect to them as is likely to be the case in certain international transportation sectors. In particular, government-inspired or government-tolerated cartels are rife in ocean liner shipping conferences, involving cooperative working arrangements as well as agreements to set prices.

The state offers another form of encouragement to private international cartels. Many nations, such as India, appear to have taken the view that their own firms can cartelize markets, provided that those markets are abroad. In fact, numerous jurisdictions have explicitly exempted *export cartels* from their domestic competition laws—essentially providing legal privileges and immunities to their own nation's firms that are members of export cartels.

Initially, such export cartel exemptions were supposedly justified on the grounds that small exporters could join together to share costs of marketing their products abroad. If these cartel exemptions were specifically to aid small firms, then one might have expected the relevant legislation to be confined to these firms. Invariably, it has not been. In recent years some nations have repealed such exemptions—in part, perhaps, because they fear that if their firms adopt the habit of cartelizing foreign markets then there is a greater risk that the same firms will attempt to cartelize the home market too.

Sectoral policies, regulation, and deregulation

Regulation is a type of intervention in sectors with market failure where the existence of competition law is insufficient to correct the market

failure. In such cases, government regulation of firms may increase welfare. To clarify:

> Sometimes, however, Government regulations—and the rules of self-regulatory bodies—block competition. This may be for very good reason. For example, *laissez faire* cannot be guaranteed to deliver food safety, so there is clearly a need for basic food safety regulation. In a sense this stops unsafe food from competing with safe food. But regulation should not block competition and its good incentive properties more than is necessary to achieve public interest goals. Indeed competition is generally helpful in advancing, rather than at odds with, those goals (Vickers 2003, p. 5).

Unfortunately, regulation in practice often differs considerably from the regulation that would be optimal in theory, and sometimes makes market inefficiencies worse. Thus, regulatory policies sometimes conflict with competition objectives (Box 3.8). Restrictions imposed by government agencies on licensing of new firms, for instance, hamper competition and reduce consumer welfare. Imposing uncommon norms and standards, as well as prohibiting foreign ownership in certain industries are other examples of entry restrictions that inhibit competition. Other regulatory barriers to competition may take the form of public subsidies or monopoly rights. The costs of administering regulations may exceed the benefits, even where they are properly applied. Meanwhile, exempting specific industries from competition laws or favoring certain firms in public procurement can also affect the market operation of competing industries or firms.

In view of the potential conflict between regulation and competition, many developing countries have begun to implement regulatory reforms that serve public interests better and support competition more. These reforms have included privatization efforts by governments, as well as removal of market entry restrictions, in order to broaden the scope for markets to allocate resources. Deregulation is aimed at reducing market distortions caused by government intervention. Introducing competition into previously

Box 3.8 The cable television monopoly in Thailand

Cable television service became a monopoly in Thailand in February 1998 as the two incumbent operators merged to form the United Broadcasting Corporation (UBC). The operators argued that they needed to consolidate operations in light of the sharp depreciation of the baht resulting from the financial crisis. Against public sentiment, the Mass Communication Organization of Thailand (MCOT), the government organization authorized to issue broadcasting licenses, approved the merger. According to the terms granted by MCOT, UBC was to offer two packages, silver and gold. The subscription application forms, however, did not offer the option of a silver package.

In May 1999, UBC raised the monthly fee for its gold package, the subscription plan with the most channels, by over 20%, claiming that this was necessary to recover losses incurred from adding new channels. A consumer group filed a complaint with the competition authority, alleging that the cable operator had abused its monopoly by charging excessive prices.

An expert subcommittee, which was assigned to investigate the case, failed to establish whether the price was excessive. But the subcommittee found that UBC had abused its dominance, limiting consumer choice by failing to offer the lower-priced silver package, which had fewer channels. Customers were thus forced to take the gold package, in clear violation of UBC's licensing conditions.

While the Trade Competition Committee concurred that the cable operator was a monopoly, it decided to refer the case to MCOT, which was responsible for monitoring compliance with the licensing agreement and for approving tariffs. Although the tariff was therefore not revised, public pressure prevented further price hikes that were pending at the time. However, a few months later, MCOT approved a price increase. Both gold and silver packages are now available to subscribers, but the package has been altered such that certain licensed channels have been withdrawn from the silver package.

Source: Nikomborirak (2005).

regulated industries has significantly strengthened the efficiency of firms and improved economic performance over time. Interfirm rivalry provides incentives for efficiency-enhancing restructuring. In general in Asia, deregulation and privatization have increased economic efficiency and raised public welfare.

Greater competition between firms resulting from deregulation can encourage managers and capitalists to focus on improving their enterprises' performance so as to maximize profits or at least to stave off threat of bankruptcy, takeover, or other loss of control. Indeed, *more intense competition in product markets tends to intensify the pressure on firms to lower costs.* Competition agencies should thus be involved in governments' regulatory reform efforts, playing the roles of competition advocate, consumer protector, and regulatory police to ensure that complementarities between competition and regulation are maximized. However, competition authorities and regulatory agencies are not substitutes, i.e., one cannot just replace the other. Both should coexist and work together to protect consumer welfare.

Competition policy in the context of regional and global integration

As globalization proceeds, attention has increasingly turned to the cross-border implications of anticompetitive practices. At the international level, contestability of markets in a foreign country requires either freedom of trade or the establishment of an affiliate in a foreign country and national treatment in order to compete on equal terms with domestic producers.

Trade liberalization

Is a liberal trade policy a complete substitute for competition policy? Or must trade reform be complemented by measures to tackle anticompetitive practices? Which types of anticompetitive practices, if any, have followed trade reforms in Asian economies? To what extent have the benefits of trade reform been eroded by lack of attention to competition policy principles? And to what extent has the removal of government impediments to trade (tariffs, quotas, etc.) been replaced by private anticompetitive practices?

Economic theory suggests that trade liberalization will increase national welfare in a competitive domestic market. The liberalization of trade allows producers to venture into world markets, bringing them export opportunities that allow them to increase output and reduce costs through economies of scale. In addition, because there are more players in export markets, competition among them is likely to be stiffer, forcing producers to increase production efficiency, adopt better marketing techniques, and impose stricter quality control measures on their production techniques. As a result, domestic as well as foreign consumers benefit from lower-priced and higher-quality products.

Similarly, import tariffs are perhaps the most common tool that governments of developing countries use to protect domestic industries and limit competition from outside. Reducing import barriers exposes local producers of tradable goods and services to competition from imports, thereby increasing pressure to raise productivity and keep costs down.

These arguments form the basis for assuming that, for small open economies, trade liberalization provides a market structure that encourages competitive industries and prevents monopolistic behavior. However, there is less consensus on whether it will bring about an increase in national welfare when the domestic market is not competitive. Trade liberalization by itself is usually not enough to keep competition at an optimal level in all economic sectors. In addition, while trade barriers have generally been reduced in many countries, they still exist and new forms, such as contingent protection and antidumping regulations, have sometimes been adopted to replace those that have been removed.

That *the intended benefits of trade reform may not be realized without active enforcement of competition law* is a source of complementarity between competition policy and long-term economic performance. The concern here is

that reductions in official trade barriers will be replaced by anticompetitive private practices, the latter counteracting the price-reducing effects of trade reforms. For example, lower import tariffs may merely result in higher profit margins for monopolistic (or oligopolistic) importers, with fewer benefits reaching consumers and the broader economy. To the extent that reductions in the prices of imported machinery and other capital equipment bolster investment and enhance dynamic economic performance, then measures to discipline private anticompetitive practices may be required for reductions in trade barriers on these durable goods to translate into higher growth. *The enforcement of competition law, therefore, reinforces the effectiveness of cuts in trade barriers on growth-enhancing imports.*

In the 1980s and the early to mid-1990s there were a number of trade disputes between the United States (US) and Japan concerning the openness of the latter's markets. Some firms trying to export to Japan claimed that they faced a thicket of private anticompetitive measures. This issue is, therefore, not new in Asia. What is interesting is that non-Japanese Asian economies have begun to see that more open borders do not necessarily result in increased market access opportunities for their exporters or in lower prices for their purchasers.

While an open trade policy would be supportive of competition policy objectives, it is not necessarily a guarantee of competition. Government policies may pose a threat to the attainment of competition objectives, particularly if they give rise to restraints and distortions in trade practices and in the market. All trade policies should therefore comply with an established framework of competition principles. An effective competition policy that ensures that trade policies fall within these contours is in the interests of both consumers and free and fair trade (Government of India 2000).

It can also be the case that instead of engendering competition, trade liberalization results in anticompetitive practices. This can happen either when international cartels simply expand their markets with trade liberalization, or when domestic and foreign firms collude to set prices or market shares. When this occurs, the potential benefits of trade liberalization do not accrue to consumers since government trade barriers are simply replaced with private anticompetitive barriers imposed by suppliers.

It should be stressed that, while international pressure can help, competition from imports is a less robust determinant of beneficial restructuring than competition in domestic markets. This suggests that measures to promote rivalry among domestic firms tend to have a more consistent effect on restructuring—and on dynamic economic performance—than trade liberalization. Therefore, it would be imprudent to rely solely on lowering trade barriers in order to discipline entrenched market power and to provide strong incentives to firms to keep costs under control.

With increasingly open economies, some large producers may undertake steps to protect their markets, including such anticompetitive actions as the establishment of cartels, abuse of dominant position, and abuse of intellectual property rights. Meanwhile, local suppliers could effectively shut out imports in the domestic market through exclusive arrangements with local retailers. The existence of an effective competition policy would ensure that such anticompetitive practices could be challenged and stopped if proven to violate competition principles. An effective competition policy, put in place, can allow trade liberalization to deliver its full potential benefits.

Thus, while bilateral, regional, and multilateral trade agreements have changed the shape of Asia's international trade and competition, competition policy has an important role to play in the domestic market.

India

Until the 1970s, the broad objectives of India's trade policy were across-the-board import substitution and the protection of domestic industry. In addition to the fact that certain key raw materials were produced in the public sector, many commodities were subject to price and quantity controls. Industries providing important commodities (such as edible oils, sugar, fertilizers, pharmaceuticals, aluminum, cement, steel, coal, and petroleum products) were subject to price and quantity controls to varying degrees. This implied that, even in sectors where there was a private sector presence, conditions and outcomes were

not competitive. A complex system of excise and corporate taxes further distorted incentives.

Reforms since 1991 have centered on licensing and tariffs. To meet its WTO commitments, India has abolished its quantitative restriction regime. Tariffs are also being reduced in a phased manner from levels that were among the highest in the world. The Government reduced the average applied tariff rate from 125% in 1990/91 to 35% in 1997/98 and to 20% in 2001/02, with the peak rate declining from 335% in 1990/91 to 40% in 1999/2000 and to 35% in 2001/02. In addition, India bound about 3,300—or nearly 70%—of its 4,700 tariff lines. Of these, 99% were bound at rates of 40% or lower, with the applied rates much lower than the binding rates for most products (Mehta 2003). Nontariff barriers were phased out. These reform measures infused and enhanced competition in the market (Kumar 2003, Mehta 2003).

Korea

As another active participant in successive General Agreement on Tariffs and Trade (GATT)/WTO negotiations on trade, the Korean Government has also made efforts to liberalize trade, especially since the 1980s. In the aftermath of the 1997–98 financial crisis, it redoubled its efforts. The simple average bound tariff rate was reduced from 24.4% in 1997 to 18.5% in 2000, while the applied tariff rate fell from 13.4% to about 8.8%. In the context of its postcrisis agreement with the International Monetary Fund and its Uruguay round commitments, the Government removed quantitative restrictions on the eight remaining items subject to balance-of-payments protection as of 1 January 2001. The import diversification system, implemented in 1978 to restrict imports from Japan (and criticized as constituting an unfair trade practice), was abolished in June 1999. Export subsidies and imprecise import-licensing and certification procedures that allegedly distorted international trade have also been discarded (Lee et al. 2004).

In the case of Korea, where the domestic market is not always large enough to realize economies of scale, and where various trade protection measures have distorted the market and prevented domestic companies from operating in an efficient manner, trade liberalization is likely to have a "rationalization effect" by making inefficient firms exit. The remaining firms would then be more likely to benefit from economies of scale. *The Korean case illustrates that trade liberalization does not automatically lead to a more competitive domestic market, and that the best outcomes are achieved when liberalization is accompanied by measures to increase competition in the domestic market.*

Malaysia

In Malaysia, where competition concerns are addressed through sectoral regulations, some strains between industrial policy, trade liberalization, and competition pressures have become apparent. Box 3.9 gives an example of such strains.

Thailand

Thailand is an open economy, with the value of trade (exports plus imports) representing approximately 108% of GDP in 2001. However, Thailand still maintains high tariffs compared with other ASEAN countries. The country's average applied tariff rate is 38.2% for agricultural products and 13.9% for manufactured goods.

Under the Common Effective Preferential Tariff scheme—the mechanism by which the ASEAN Free Trade Area (AFTA) was established—tariff rates have been significantly lowered. On 1 January 2003, tariffs on all products were reduced to 0–5%, with the exception of those placed on the scheme's temporary exclusion list, sensitive list (mainly agricultural products), and general exceptions list (mainly products relating to national security, culture, and health). Thailand appears to have the smallest number of items on these lists. In addition, AFTA has a very liberal rule-of-origin regime: to be eligible for preferential tariff rates, products need to contain only 40% local content, a threshold that applies to all products. In effect, this means that many Thai industries are now facing increasingly strong competition from neighboring countries.

The contribution of imports to competition is evident in a study of trade practices in 12 manufacturing industries by Nikomborirak et al. (2002). The authors found that two product markets that were subject to low import tariffs—batteries and light bulbs—did not experience any restrictive business practices even when the

Box 3.9 Malaysia: AFTA commitments and the national car industry

The Malaysian national car company, Proton, was established in 1983 as a key component of the country's heavy industrialization program. From the outset, the Government "tilted" the playing field by exempting Proton from import duties on completely knocked-down (CKD) kits.

As a result, Proton could sell its cars at 20–30% less than comparable cars produced by other assemblers in the country. By the 1990s, Proton had become the dominant car producer in the Malaysian market.

About 75% of passenger vehicle sales are controlled by two firms—Proton with 45% and Perodua with 30%. This dominance was, however, threatened by Malaysia's commitment under the ASEAN Free Trade Area agreement to reduce import duties to 20% by 2005 and to 0–5% by 2008.

Implementing these trade liberalization commitments is expected to seriously affect Proton's (and Perodua's) competitiveness. To neutralize the committed reduction in import duties, the Government raised excise duties on passenger cars twice, the first from 1 January 2004, and the second 1 year later. The import duty on CKD passenger cars from ASEAN countries was reduced from 42–80%, to 25% by 2004, then to 0% by 2005; excise duty was increased from 55%, to 60–100%, then to 90–250%.

For completely built-up units from ASEAN countries, the import duty was reduced from 140–300% to 70–190%, then to 20%; excise duty was increased from 0% to 60–100%, then to 90–250%.

The box table presents a hypothetical computation of the effects of these changes for a local car relative to a foreign CKD car. The effect of the countervailing increase in excise tax is to increase the price of the local car, thereby reducing its price competitiveness relative to the base case.

In contrast, the reduction in import duties lowers foreign car prices slightly, as the excise tax increase somewhat neutralizes the downward impact. However, without any increase in excise taxes, consumers would pay substantially less for foreign cars.

This illustrates how the impact of trade liberalization (e.g., via import duty reduction) can be neutralized by a government through the use of domestic policies (e.g., excise tax) to support industrial policy.

In Malaysia's case, this strategy is probably an interim strategy aimed at buying some time for restructuring the national industry. The prime minister has, in fact, stated that local automotive companies will have to depend less on government protection.

Sources: Lee (2005); Asian Development Bank staff.

Box table Impact on prices of passenger cars (with ≤1800cc Engines), RM

	Local	ASEAN completely knocked-down
Pre-January 2004		
Base price	40,000	40,000
Excise tax (55%)	22,000	22,000
Excise tax rebate	-11,000	0
Import duty (42%)	0	16,800
On-the-road price	51,000	78,800
Post-January 2004		
Case 1: Increase in excise tax, reduction in import duty		
Base price	40,000	40,000
Excise tax (60%)	24,000	24,000
Excise tax rebate	-12,000	0
Import duty (25%)	0	10,000
On-the-road price	52,000	74,000
Case 2: No increase in excise tax, reduction in import duty		
Base price	40,000	40,000
Excise tax (55%)	22,000	22,000
Excise tax rebate	-11,000	0
Import duty (25%)	0	10,000
On-the-road price	51,000	72,000
Post-January 2005		
Case 1: Increase in excise tax, reduction in import duty		
Base price	40,000	40,000
Excise tax (90%)	36,000	36,000
Excise tax rebate	-18,000	0
Import duty (0%)	0	0
On-the-road price	58,000	76,000
Case 2: No increase in excise tax, reduction in import duty		
Base price	40,000	40,000
Excise tax (55%)	22,000	22,000
Excise tax rebate	-11,000	0
Import duty (0%)	0	0
On-the-road price	51,000	62,000

market was highly concentrated. In contrast, markets that were protected by high tariffs, such as alcoholic beverages (whiskey and beer) and motorcycles, and those in which goods are not easily traded, such as cement and cellular phone services, experienced competition problems.

As well as being a member of AFTA, Thailand is engaged in the negotiation of bilateral free trade agreements (FTAs) with several countries. It has signed trade and investment framework agreements with Bahrain, PRC, and India, as well as with industrial countries such as US, Japan, and Australia. The country is beginning to feel the impact of these FTAs: the first "early harvest" provisions under the agreement with the PRC required tariffs on most fruit and vegetables to be eliminated by 1 October 2003, leading to an instantaneous influx of fresh food products to Thailand from the PRC. Thailand's FTA with Australia was signed on 5 July 2004. It is believed to have exposed the local automobile market to stiff competition from that country—a production base for large cars—since it came into effect in January 2005.

The Thai services sector appears to be eluding trade liberalization at the bilateral level. Except for the bilateral agreement with the US, which is expected to cover services, there is no clear indication that FTAs will lead to a progressive opening up of the services sector to competition. There are concerns, however, that selective trade liberalization, particularly in certain service sectors, will lead to higher market concentration.

Under the proposed FTA with the US, the entry of large US multinationals could lead, in the longer run, to US domination of Thailand's markets in the absence of competition from other, non-US, multinational operators. For example, if Thailand accedes to the US request to open up the express delivery market to US companies only, global operators such as TNT and DHL will not be allowed to compete, and the domestic market could end up being dominated by a few large American operators, such as Federal Express and Courier.

Thailand has not liberalized any of its service markets in the absence of commitments in its bilateral and multilateral agreements to do so, so empirical evidence on the impact of service liberalization is lacking. Nevertheless, a study by Nikomborirak (2004) indicates that the entry of foreign banks such as ABN Amro, United Overseas Bank, United Bank of Singapore, and Standard Chartered Bank since the crisis, enabled through acquisitions of ailing Thai banks, appears to have broken the domestic banking cartel, bringing about a remarkable improvement in service. Customers now enjoy longer banking hours, more diversified financial services as a result of customer segmentation, and credit card services that are free of annual fees (TFRC 2003).

Bilateral FTAs that involve Thailand and a developed country must contain competition policy provisions to satisfy the GATT requirement that such agreements cover "substantially all trade" (Article XXIV). So far, Australia is the only developed country to sign an FTA with Thailand. The competition policy provisions in the agreement are relatively weak in that they focus mainly on voluntary cooperation between the competition authorities of the two countries.

The FTA between Thailand and the US is likely to contain more advanced commitments on the implementation of domestic competition law. Very briefly, the competition policy chapter in the Singapore–US FTA, on which the Thailand–US agreement is likely to be modeled, requires each party to (i) maintain measures to proscribe anticompetitive conduct, (ii) prohibit SOEs from engaging in restrictive trade practices or abusing their monopoly position unless granted an exception on efficiency grounds, and (iii) ensure that SOEs act solely in accordance with commercial considerations in the sale and purchase of goods or services.

Viet Nam

Over the last two decades, Viet Nam has moved toward a more open, transparent, and enabling trade regime. Rights to trade have been expanded and granted in virtually all sectors of the economy, regardless of ownership. However, the trade regime is still characterized by price controls and quantitative restrictions, which were placed even on imports of goods that were not produced domestically, such as refined oil, fertilizer, steel, cement, and paper.

Most of these protectionist measures created barriers to entry and led to high concentration in affected sectors. Domestic prices for these

commodities are often higher than in international markets and neighboring countries. Consequently, firms operating in protected industries reap huge profits but remain inefficient in their operations. While the overall level of protection has been steadily declining as a result of the Government's commitments to its bilateral trading partners, the consequences of protection remain visible.

Import tariffs are also widely used. While the average rate seems to be moderate, the dispersion remains quite high. Manufacturing is still highly protected, even if the effective rate of protection has significantly declined.

At the same time, the Government has adopted export-related measures to counter the effects of its import-substitution and protection policies. These include export promotion schemes, duty drawbacks, tax and duty exemptions, access to preferential credit, and a performance-based rewards system. The dual-policy trade regime makes Viet Nam an interesting case: an economy that has achieved an outstanding export performance despite a highly protected trade regime. The country's trade-to-GDP ratio is about 100%, and export growth has remained at about 20% a year for a decade.

These protective measures discouraged foreign competitors from venturing into the domestic market; the impact on domestic competition is, however, less clear. In some cases, such as for rice, easing export quotas increased the number of small private traders that buy paddy from farmers and sell processed rice to exporting companies. Competition toughened among rice traders, and paddy farmers obtained better prices. However, in most other sectors where quotas were removed in 2000, there has been little noticeable impact on domestic competition, as the number of firms has more or less remained the same.

In Viet Nam, the motivations for protection have not always been clear. Price and quantitative controls were formerly placed even on imported goods and commodities not produced in Viet Nam at the time, such as refined oils, fertilizers, some kinds of steel, cement, and even paper. Quantitative restrictions now apply only to petroleum and sugar, but 5 years ago they were placed on over a dozen commodities. Petroleum is still on the list because the Government considers it a strategic commodity that it needs to supply smoothly and monopolistically (Government of Viet Nam 2002). Sugar is on the list because of a government program initiated in 1994 to build a sugar industry capable of ensuring self-sufficiency in supply. The program failed, owing to the inefficiency of the sugar mills (Dapice 2003). Nevertheless, the Government retained quantitative quotas on sugar imports in order to protect the mills from foreign competition and support farmers who relied on the mills to take their sugarcane. Motorcycles and cement were on the list until recently because the Government wanted to support these infant industries.

The incidence of protection across industries is mixed, but its impact on competition is clear: most protectionist measures have created barriers to entry and led to high concentration in the affected sectors. Domestic prices for commodities in protected sectors are generally higher than those in international markets as well as in neighboring countries. For example, in 1999 1 ton of cement cost $29 in Korea, $39 in Singapore, and $46 in Thailand, but $73 in Viet Nam (CIE 1999). Firms operating in protected industries tend to earn huge profits, but their capacity to meet the challenges of deepening integration and increasing competition is in doubt. Honda, for example, reportedly accrued large profits even during the Asian crisis because of its protected position in the market. Most heavily protected industries, such as cement and motorcycles, appear to be uncompetitive (CIEM 2002). The overall level of protection has been declining gradually but steadily, but the consequences of protection are still visible.

The average tariff rate in Viet Nam seems moderate, but dispersion remains high, suggesting that the distortionary impact of tariffs is significant (Table 3.2). The average import-weighted tariff for all commodities was nearly 21% in 1997, falling slightly to 19.6% in 2003. However dispersion as measured by the coefficient of variation was as high as 130.7% in 2003. Manufacturing remains the most protected sector in the economy even though the effective rate of protection fell significantly from 121% in 1997 to 46% in 2003 (Athukorala 2004).

Aware of the negative effects that import substitution and protection policies may have

Table 3.2 Viet Nam: Nominal and effective rates of protection, 1997 and 2003 (%)

	1997		2003	
	Nominal	Effective	Nominal	Effective
Weighted average				
Agriculture	8.12	7.74	12.74	14.70
Mining	9.42	6.05	3.63	0.03
Manufacturing	30.63	121.47	30.30	46.26
All traded goods sectors	20.95	72.22	19.60	27.07
Simple average	23.32	59.54	20.34	26.35
Coefficient of variation	133.81	156.01	102.51	130.65

Sources: Athukorala (2004); Technical Group (1999).

on other sections of the economy, especially exporters, the Government has often introduced countermeasures or neutralizing measures in the form of export promotion initiatives, duty drawbacks, exemptions from some domestic taxes and fees, preferential credit, and, recently, a performance-based rewards system. In 2001, for example, with exports slowing due to weaker demand in international markets, the Government adopted a series of export promotion measures aimed at encouraging firms to expand their exports and find new partners and markets. A value-added tax (VAT) rebate and exemption scheme for exporters and a program of awards for improved export performance were also implemented. Before the export quota on rice was eased and subsequently abolished in 1997, a special fund was set up to support those who bought and exported rice under government orders. A study of the textile and garment sector shows that, although the official tariffs were quite high (at 31% in 1997 and 28% in 2002 for textiles, and 42% in 1997 and 49% in 2002 for wearing apparel), most companies in the sector are exempt from import duties.[14]

To what extent have these external market interventions affected competition in Viet Nam? One thing is clear: they have reduced foreign competition in the domestic market. What is less clear is their impact on domestic competition. In some cases, the removal of protection has led to significant improvements in competition, evidenced by an increase in new entries and a fall in prices and profits per unit. The abolition of the quota on rice exports and the decision to allow private firms to export the commodity in 1998, for example, led to the emergence of numerous small private rice traders who bought paddy from farmers and sold processed rice to exporting companies. Competition in the rice market may have been very tough for these rice traders, but growers obtained better prices. The difference between the export price of rice in Viet Nam and Thailand narrowed significantly due to these measures (Vu 2001). But in other cases the impact of the removal of protection is not so clear. There is a danger that some monopolies will simply change from being government owned to being privately owned or having mixed ownership. Most quotas were removed in 2000, but competition in some sectors shows little sign of change if one looks at the number of firms or price indicators.

People's Republic of China

Of particular interest in the PRC is the prevalence of *local protectionism*. For historical reasons, local governments have had a strong incentive to protect local enterprises from competition from other regions. This has contributed to the duplication of investments and to excess capacity in some industries, and thus the PRC's low degree of industrial concentration.

Local protectionism has taken such forms as imposing taxes on commodities made in other provinces, banning exports to other regions of locally made raw materials that are of high quality or in short supply,[15] or even preventing law enforcement officers from dealing with local firms that counterfeit the brands of other regions (Lin 2001). With the move toward fiscal decentralization since 1978, local governments have

had a strong incentive to shield local firms and protect their tax base. The desire to guarantee local employment is another economic as well as political incentive for local government officials. Throughout the 1990s, local governments competed to attract FDI, even adopting protective measures that would ensure the profitability of locally based foreign firms (Box 3.10).

Local protectionism leads to market fragmentation and thus to low regional specialization. The eight-firm concentration ratios reported in Table 3.3 are consistent with widespread local protectionism in the PRC. Although the degree of concentration has generally increased since 1995, very few industries have a concentration ratio above 50%, and for most the ratio is below 20%.

The central Government has long been trying to prohibit regional protectionism. This was the intention of Article 6 of the State Council's Provisional Regulations Concerning Development and Protection of the Socialist Competition Mechanism, issued as early as 1980. Enforcement of these regulations has, however, been poor.

Trade-related exemptions

In many countries, export cartels are outside the scope of competition law. In India, for example, an exception to the provisions on anticompetitive agreements protects the right of any person to export goods or services from India. Many countries regard export cartels as competition-restricting, but nevertheless exempt them from competition law because they do not affect competition in the domestic market. A further justification for their exemption is that countries do not wish to shackle their export efforts for fear of disturbing their trade balance or balance of payments.

Between them, Evenett, Levenstein, and Suslow (2001) and OECD (2003a) identified 15 countries whose competition laws explicitly or implicitly exclude export cartels. Meanwhile, the proponents of export cartels argue that they are a lawful way of realizing cost-reducing and output-enhancing efficiencies (OECD 2003b). However, exemption of export cartels goes against the concept of free competition, as the circumstances

Box 3.10 Local protectionism and competition in the People's Republic of China: The car industry

Shanghai and Hubei provinces are two leading car-manufacturing areas in the PRC. In 1984, Germany's Volkswagen set up a joint venture with a consortium led by Shanghai Automotive Industry Corporation to produce Santana passenger cars. In 1992, Automobiles Citroën of France and Dong Feng Motor Corporation entered into a joint-venture agreement to establish the Dong Feng Citroën Automobile Company in Wuhan, the capital of Hubei, to produce and sell Fukang cars in the PRC.

In mid-1998, Shanghai municipal government imposed local regulations to protect its Santana sedans. It also added extra licensing fees and sales taxes on consumers buying non-Shanghai made cars, adding some CNY80,000 (about $9,600) to the already high price of domestic cars. As a result, in the first half of 1999, only 24 Fukang cars were sold in Shanghai, compared with 6,400 Santanas.

Hubei swiftly retaliated, levying taxes on consumers purchasing cars other than the locally made Fukang. Taxes included irrigation construction fees (which had been abolished long ago by the central Government) and a CNY70,000 ($8,400) levy for "helping SOEs overcome their losses." This increased the selling price of the Shanghai-made Santanas to CNY326,000 ($39,000) in Wuhan, nearly double their usual price of CNY172,000 ($20,700).

Regulations imposed by Shanghai and Hubei provinces have prevailed despite a 1990 directive from the State Council banning restrictions on interprovincial trade. With more than 120 carmakers nationwide, nearly every locality that boasts of a car-making plant applies restrictions to outside manufacturers to keep its own champions afloat.

Unable to enforce the ban among competing localities, the central Government decided to take under its protection the country's three leading indigenous carmakers—Shanghai Automotive Industry Corporation, Dong Feng Motor Corporation, and First Automotive Works based in Jilin province. In January 2000, Shanghai scrapped its protective licensing fees and opened its market to outside manufacturers.

This strongly suggests that local protectionism can be just as bad for consumers and efficiency as international protectionism.

Source: Lin (2005).

Table 3.3 PRC: Eight-firm concentration ratios in selected manufacturing industries, 1995 and 2000 (%)

Industry	1995	2000
Food processing	5.3	7.5
Food production	9.9	13.1
Beverage production	8.6	20.4
Tobacco processing	33.0	54.0
Textiles	2.8	6.6
Garments and other fiber products	3.8	9.3
Leather, furs, and related products	2.9	—
Timber and straw products	5.7	—
Furniture manufacturing	5.4	—
Papermaking and paper products	5.3	10.9
Printing and recorded medium products	5.1	—
Educational and sporting products	8.1	—
Petroleum processing and coking	44.9	82.8
Chemical materials and products	11.3	7.9
Pharmaceutical products	11.8	28.8
Chemical fibers	37.6	13.8
Rubber products	18.3	36.4
Plastic products	3.6	6.0
Nonmetal mineral products	2.4	6.1
Ferrous metals	30.2	39.5
Nonferrous metals	13.3	10.3
Metal products	4.6	9.5
Ordinary machinery	6.5	9.9
Equipment for special purposes	6.2	11.7
Transport equipment	20.9	28.9
Electrical equipment and machinery	8.8	30.8
Electronic and telecoms equipment	14.7	23.1

— = not available.

Source: China Statistics Press (1997, 2002).

relating to a soda ash cartel operating in India make clear (Box 3.11).

As mentioned in the box, India's new Competition Act has extraterritorial reach. The jurisdiction of the competition authority extends to restrictive trade practices employed by enterprises outside India that have the effect of preventing, distorting, or restricting competition in India, or that give rise to restrictive trade practices in the country. On the provisions relating to extraterritorial jurisdiction in the MRTP Act, the Supreme Court of India ruled that the MRTP Commission would obtain jurisdiction only after goods had been imported and a restrictive trade practice had been found to have taken place.

In Korea, in 2002 the Korea Fair Trade Commission (KFTC) took the unprecedented step of applying Korean antitrust law extraterritorially to six foreign manufacturers of graphite electrodes and imposed fines on the manufacturers for price fixing. The following year the KFTC concluded a large-scale investigation into an alleged international cartel by six foreign vitamin manufacturers, again levying fines. Later that year, it introduced a system of notification of foreign-to-foreign mergers. This series of moves to regulate behavior that has taken place outside the domestic jurisdiction reflects a growing concern about the economic impact of such behavior on the domestic market.

The KFTC's investigation into the vitamin cartel was greatly aided by the findings of competition authorities in other countries such as Canada, Japan, and US. Bilateral cooperation with these countries to disband the vitamin cartel helped the KFTC gain valuable experience in regulating international cartels. However, not all cases are so straightforward.

As far as anticompetitive practices are concerned, trade liberalization is a double-edged sword. The country studies highlight cases where reforms have led to foreign firms undermining domestic anticompetitive practices, lowering prices toward costs. However, the very lowering of trade barriers also enables foreign firms to more profitably engage in anticompetitive acts in Asian economies. Without the threat of competition law-related sanctions, cross-border traders and their domestic rivals will be tempted to replace lower government barriers to trade with agreements to keep prices high. Competition law and its effective enforcement thus play an important role in maximizing the benefits of trade liberalization.

As markets integrate, international anticompetitive practices—especially those associated with abuses of dominant position and international cartelization—have received more attention in Asian policy circles. Although Asian enforcement experience against foreign anticompetitive practices is mixed, such enforcement would not have been possible without a competition law in the first place. The latter is a prerequisite for enforcement and for nurturing international cooperation to tackle these price-raising acts.

At the international level, in 1980 the United Nations' General Assembly adopted a "Set of Multilaterally Agreed Equitable Principles and

Box 3.11 Export cartels in India: The case of a soda ash cartel

In September 1996, American Natural Soda Ash Corporation (ANSAC), an export trading company comprising six American producers of soda ash, attempted to ship a consignment of soda ash to India. ANSAC is registered under the Webb–Pomerene Act, US legislation that exempts associations of American firms engaged in export trade from the country's antitrust laws so long as they do not restrain any US competitor of the association. The Alkali Manufacturers Association of India (AMAI), whose members included all major Indian producers of soda ash, filed a complaint against ANSAC before the Monopolies and Restrictive Trade Practices (MRTP) Commission alleging cartelization. The commission imposed an interim injunction on ANSAC restraining it from exporting soda ash to India as a cartel, while making it clear that the companies could continue to do so individually. Quoting from the ANSAC membership agreement, the commission held that ANSAC was prima facie a cartel. It found that it was carrying out part of its trade practices in India, giving the commission extraterritorial jurisdiction under Section 14 of the MRTP Act, even though the cartel itself was formed outside India (MRTP Commission 1997).

ANSAC then lodged an appeal with India's Supreme Court, which eventually overturned the commission's orders. The court held that the wording of the MRTP Act did not give the commission extraterritorial powers. It stated that the commission could take action only if it could prove that an anticompetitive agreement involved an Indian party, and even then only after the goods had been imported into India (Supreme Court 2002). Thus the commission could not take action against ANSAC or prevent the import of soda ash into the country.

The verdict of the Supreme Court was announced while the new competition bill was pending in the Indian Parliament. With the court's ruling in mind, the bill was amended to allow the Competition Commission of India to grant a temporary injunction restraining any party from importing goods if it could be established that such imports would contravene the substantive provisions of the law.

Source: Chakravarthy (2005).

Rules for the Control of Restrictive Business Practices" (the "UN Set"). The 1995 Osaka Action Agenda of the Asia-Pacific Economic Cooperation forum (APEC) included competition policy as one of 15 policy areas to be developed by member countries, noting that:

> APEC economies will enhance the competitive environment in the Asia-Pacific region by introducing or maintaining effective and adequate competition policy and/or laws and associated enforcement policies, ensuring the transparency of the above and promoting cooperation among the APEC economies, thereby maximizing, inter alia, the efficient operation of markets, competition among producers and consumer benefits (Asia-Pacific Economic Cooperation 1995).

This was reinforced by a collective action plan and individual action plans in the area of competition policy, and in 1999 by the APEC Principles to Enhance Competition and Regulatory Reform.

In July 2004, the General Council of WTO decided that three of the four Doha round Singapore issues (competition policy, investment, and government procurement, but not trade facilitation) would not be included in the Doha round negotiations, and that developing countries needed more capacity building and institution building in these areas first. However, given the importance of competition in ensuring economic efficiency in both its static and dynamic aspects, competition policy remains of considerable interest to developing countries in both the domestic and international contexts, as evidenced by the number of developing country representatives and their active participation in the discussions.

Indeed, in the context of multilateral negotiations, "developed country protectionism … is bad not only for developing country producers and consumers everywhere but also for developed country credibility in global negotiations to remove trade barriers. What is needed is more globalization, not less" (Vickers 2003, p. 8).

Foreign direct investment

Another related Singapore issue, and another source of complementarity between competition law and dynamic economic performance, is investment. In particular, appropriate enforcement of competition law both enhances the attractiveness of an economy as a location for foreign investment and is important for maximizing the benefits that flow from such investment.[16]

Various questions arise. Would the enactment and enforcement of competition policy also deter some FDI? Is such policy necessary to ensure that foreign direct investors do not engage in anticompetitive acts, including driving out local firms? Do cross-border mergers and acquisitions, which many Asian countries have experienced on a sizable scale for the first time in recent years, pose a particular problem in this regard? Developing countries have long considered cross-border anticompetitive practices a major concern, resulting in the formulation (and updating every 5 years) of the UN Set at UNCTAD.

Overall, FDI inflows can contribute significantly to development, especially if they are of the greenfield type. This is because such investments have a greater potential for knowledge inflow than mergers and acquisitions. In addition, they generally increase the number of players in the market, thereby increasing competition. However, even greenfield FDI can lead to predatory pricing and abuses of dominant positions.

Thus, while most developing countries have already opened their doors to foreign investors, governments are well aware that there is no guarantee that the potential benefits of FDI will automatically accrue to the host economies.[17] This is partly because FDI does not always result in a more competitive market structure. FDI, in the form of cross-border M&A activity in particular, may lead to concentration and market dominance in certain industries. Since such activity often merely results in an increase in the stake of foreign investors in existing domestic firms, it may not increase the number of market players. In such an event, the dominant firm could have price-setting abilities and would likely enjoy higher profit margins.

Alternatively, affiliates of different multinational corporations (MNCs) could set up competing businesses in a developing host country. If the parent MNCs in the home country or countries merge their operations, the affiliates in the host country are likely to eventually merge as well, possibly creating a dominant firm, or worse, a monopoly. It could very well be the case that the merger eliminates competition in the host country but not in the MNCs' home country (or countries).

Competition policy should, therefore, operate in concert with FDI liberalization. A typical relevant provision in competition laws is the ban on any merger, acquisition, or takeover that will allow the newly merged entity a dominant position in the market or prevent competitors from gaining access to a market. To complicate matters, avoiding these consequences entails the adoption of effective competition policy in both the home and host countries.

Generally, MNCs are attracted to locations with competition policies already in place. This is because the *existence of a competition policy indicates some commitment by the government to ensure a level playing field among investors, whether domestic or foreign*. In addition, the presence of an effective competition policy reduces the uncertainty faced by prospective foreign investors in terms of when and how the authorities might implement a new policy.

Thus, government policy on FDI must be consistent with the objectives of competition policy in order for developing countries to gain the full benefits of FDI. Governments generally avoid trying to attract foreign investors by granting anticompetitive concessions, such as monopoly rights to particular markets or industries, because it is likely that the overall impact on the economy will turn out to be negative in the long run.

The following brief review of the six countries highlights the diversity of their experiences with respect to the impact of FDI on competition in their domestic economies.

People's Republic of China

In the PRC, since an open-door policy was adopted in the late 1970s, inward FDI has been a major driving force for increased competition. The emergence of foreign-invested companies greatly changed the landscape of competition in almost all industries. However, entry of foreign investors

is far from free. They are subject to numerous government regulations. Every new project involving foreign investment must be approved either by the concerned provincial and/or regional government or by the Ministry of Commerce (formerly the Ministry of Foreign Trade and Economic Cooperation), depending on the size of the investment.

The Government (or governments) also sets requirements on modes of foreign entry. Prior to the mid-1990s, formation of joint ventures was the main FDI mode of entry, driven by the Government's desire for local partners to learn about and adopt advanced foreign technologies. In addition, the Government used local content requirements in an attempt to foster backward linkages from FDI (via vertical technology transfer to local suppliers). Only with the PRC's WTO accession in January 2002 were wholly foreign-owned enterprises allowed.

FDI in the PRC has generally affected industrial structures through two channels. First, increased competition from foreign companies that are often equipped with superior technology and management drives out inefficient local firms from the market, leading to a higher degree of industrial concentration. Second, foreign firms often merge with or acquire top domestic enterprises in relevant markets. Foreign enterprises have thus become dominant players in such industries as automobiles, cellular phone production, household chemical products (e.g., detergents and skin care products), and soft drinks. These developments have sown concern that foreign enterprises might soon dominate most industries, and domestic firms may be driven out of business (Box 3.12).

As a result of the varying experiences of domestic firms under the control of foreign investors, the Government has issued regulations to monitor FDI-related M&A activity. An M&A notification/evaluation system was set up in March 2003, aimed at promoting and regulating foreign investment and introducing advanced technology and management experience from abroad, improving the utilization of foreign investment, rationalizing the allocation of resources, ensuring employment, and safeguarding fair competition and national economic security. The regulation also stipulates that mergers and acquisitions must not create excessive concentration, eliminate or hinder competition,

Box 3.12 People's Republic of China: Possible motivations for foreign direct investment

Zhonghua, manufactured by the Shanghai Toothpaste Factory (STF), has been the top toothpaste brand in the PRC for decades. In 1993, STF gave Unilever the sole right to manufacture, market, and sell the Zhonghua brand in the PRC. The agreement has an unlimited term, subject to trademark renewal every 10 years, provided that total production volume in the last year of the decade is higher than that of the first year.

In 2002, STF wanted to take the brand back because it felt that Zhonghua was not receiving enough exposure from Unilever. Unilever countered that it had spent a lot on Zhonghua's brand development, with the brand accounting for 53% of its annual advertising and promotion budget in its "oral" category. In addition, Zhonghua's production had reached 40,000 tons in 2003 compared with 35,000 tons in 1993. Unilever had also given Zhonghua new packaging and had launched many promotion campaigns that had boosted sales. However, STF claimed that Unilever managed to increase sales only toward the end of the first decade. STF is thus determined to take back the Zhonghua brand to protect its name and its history, just as in 2000 it had taken back the Maxam brand leased to Unilever.

Another multinational, Procter & Gamble (P&G), had previously been accused of "freezing" a local brand. In 1994, P&G set up a joint venture with the Beijing Second Daily Cosmetic Factory, taking a 35% share of its detergent brand, Panda. At that time, Panda was among the top three selling detergent brands in the PRC. In September 2000, the factory bought back its brand. But by that time, Panda had already lost its position in the market, with production dropping from 60,000 tons to 4,000 tons in 6 years. Meanwhile, P&G's detergent brand, Tide, had become a household name.

Some observers feel that in the above two cases, FDI was driven by the domestic brand-freezing motive so as to promote the multinational's own brands.

Source: Lin (2005).

disturb social and economic order, or harm public interests.[18]

Foreign investments involved in the merger or acquisition of a domestic enterprise are required to notify the Ministry of Commerce and the State Administration of Industry and Commerce if: (i) the turnover of a party to the merger or acquisition in the domestic market in the current year exceeds CNY1.5 billion; (ii) the foreign investors have merged with or acquired 10 domestic enterprises in the relevant industry within 1 year; (iii) the market share of a party to the merger or acquisition in the domestic market is 20%; or (iv) the market share of a party to the merger or acquisition in the domestic market will reach 25% as a result of the transaction. Since the regulations apply only to foreign firms, there is widespread concern among foreign investors that future anti-monopoly legislation may not be applied equally to foreign and domestic firms.

India

In line with its 1991 economic reforms, the Government adopted a liberal policy toward FDI, which involved:

- expanding the list of industries open to FDI and limiting the negative list of industries to those that need to be regulated for security or environmental reasons;
- expanding the list of industries subject to automatic approval of FDI;

Box 3.13 Impact of mergers and acquisitions in India

The following cases highlight the increased concentration resulting from mergers and acquisitions in India.

The consumer goods industry

Since 1913, Unilever has generally opted for mergers and acquisitions as a means of establishing its business presence in India. Initially, Unilever took over several companies engaged in the trade of soaps and consolidated them. A subsidiary of Unilever, Hindustan Lever Limited (HLL) followed the same strategy in efforts to expand its activities and strengthen its market presence. Prior to 1991, HLL acquired a number of small enterprises that had run into financial difficulties. These acquisitions expanded HLL's activities and allowed it to diversify into, among other things, garments and marine products.

Following the Government's 1991 liberalization policies, HLL sought to restructure its diversified product range and strengthen its market presence by engaging in further mergers and acquisitions. Tea, ice cream, frozen foods, coffee, and detergents were among the products it added to its portfolio in the last decade. As a result, the market share of HLL and its associates has steadily increased (Box table).

The soda industry

Consumer goods are generally sensitive to changes in market networks and brand loyalties. As a result, multinational enterprises tend to exploit the established marketing and distribution networks as well as brand loyalties of their acquired enterprises. A case in point is Coca-Cola, which reentered the Indian market (which it had left in 1977) in 1993 by acquiring Parle, at that time the largest player in the Indian soda market. Parle already had several well-established brands and boasted of a nationwide network of bottling and marketing facilities. This gave Coca-Cola an advantage over its rival Pepsi. Pepsi had entered the country in 1988, but was still struggling with a 25% share compared with market leader Parle's 60%. In acquiring Parle, Coca-Cola profitably used Parle's bottling and marketing network, besides taking advantage of Parle's popular brand presence in sodas. Following Coca-Cola's success, Pepsi acquired Duke, a smaller soda manufacturer, in its efforts to build its market share. Today, Coca-Cola and Pepsi dominate the soda market in India, with their respective shares believed to be 50% and 48%.

Source: Chakravarthy (2005).

Box table Market share of HLL or its associates, 1992/93 and 1997/98

Product	1992/93	1997/98
Ice cream	0.0	74.06
Sauces, ketchups, jams	0.0	63.54
Dental hygiene products	11.20	41.56
Soaps	19.66	26.01
Synthetic detergents	33.12	46.72
Vanaspati	0.85	13.90

- removing the 40% limit on foreign ownership except for a short list of sectors subject to caps;
- granting national treatment to companies with more than 40% foreign ownership; and
- gradually dismantling performance requirements.

These reforms significantly promoted competition in the domestic economy, as the reduced restrictions encouraged the entry of FDI. The result has been a steady rise in FDI inflows from only $75 million in 1991 to $4.3 billion in 2003.

In addition, the Government stopped merger surveillance and regulation in 1991, when the MRTP Act was amended to exclude M&A supervision. This caused a significant rise in cross-border M&A activity, with the average annual number of mergers and acquisitions increasing from fewer than five before 1991 to 51 between 1992 and 2003.

Despite the proliferation of M&A activity between April 1999 and January 2004, the concentration indexes of most of the affected industries show little change. In a few specific cases, however, mergers and acquisitions involving MNCs have resulted in some concentration (Box 3.13).

Korea

As did the governments of the PRC and India, the Korean Government gradually liberalized the services sector from the 1980s to the mid-1990s. After the Asian financial crisis, however, the Government undertook more dramatic liberalization measures and aggressive solicitation of foreign investment. Ceilings on foreign equity ownership in the stock market were eliminated, cross-border mergers and acquisitions were allowed, and foreign land ownership was fully liberalized. As a result, FDI increased substantially. However, as in India, M&A activity seems to have had a tightening effect on market concentration, illustrating that FDI does not automatically lead to more competition in the market (Box 3.14).

Box 3.14 The vegetable seed industry in Korea

In 1998, there were 48 major vegetable seed-producing companies in Korea. Hungnong was the top Korean firm in the vegetable seeds market, with a market share of 32%. Choong Ang ranked second with a market share of about 13%. After the Asian financial crisis, three of the top five firms—Hungnong, Choong Ang, and Seoul Seed Co.—were acquired by foreign multinationals.

Seminis Vegetable Seeds Inc., headquartered in California, US, acquired Hungnong and Choong Ang. Hungnong remains a separate entity from Seminis, specializing in particular products for a particular region, and the prior management remains in full control of its operations. Choong Ang has also remained a separate establishment, but since it was Hungnong's strongest competitor, Seminis had difficulty coordinating their operations. Seminis resolved the problem by adopting a market-sharing mechanism, where each firm would specialize in different products. In products where both firms lack competitiveness, Seminis would resort to importing. In August 1999, Seminis invested $10 million to establish Seminis Asia Corporation. This firm would be the research and retailing arm, but would also act as the Asian headquarters, coordinating between Seminis and its subsidiaries in Korea.

Even after the acquisition, Hungnong remains the top firm, with its market share remaining unchanged and still below the benchmark 50% set by the Monopoly Regulation and Fair Trade Act to determine market dominant firms. Taken together, Hungnong and Choong Ang's joint market share comes to 45%. Although the two firms remain separate entities, Seminis has control over both, and their product portfolios have been restructured with the result that they can no longer be considered competitors. In July 1999, the Korea Fair Trade Commission investigated Hungnong, which had prohibited its retail outlets from selling below a consumer price limit it had set for "Hungnong Chilli," under threat of supply disruption. This illustrates that although Seminis and its subsidiaries have not technically breached the 50% market share benchmark, they have established an effective dominance in the vegetable seed market, with price-setting abilities in certain product lines.

Source: Chang and Jung (2005).

The case of the Korean seed industry illustrates that *market share is an inefficient measure of market dominance*. Other indicators such as the ability to restrict prices and supply should be considered as well. While investment policy alone may have a limited role in promoting competition, it can be supplemented by trade liberalization policy (such as reduced import tariffs to encourage more importing, and thus, more competition), together with effective implementation of competition policy (e.g., M&A regulation) to ensure increased competition in the domestic economy.

Malaysia

FDI has also been an important source of capital in Malaysia's development, where it continues to be regarded in a positive light in manufacturing, partly because most manufacturing FDI is related to export activities. It provides capital, imports technology, generates employment, and earns foreign exchange. FDI in the services sector also confers such benefits. However, when FDI in services competes with home-grown small businesses, such investments are perceived to incur social costs as they tend to drive out small businesses (Box 3.15).

Meanwhile, mergers and acquisitions involving foreign interests are encouraged, but are required to secure approval from the Foreign Investment Committee in the Prime Minister's Department if they exceed equity thresholds set by the Government. The limit on foreign equity participation limits the amount of resources that domestic firms can source from foreign investors to compete in the market. FDI that is export oriented, however, used to be exempt from this requirement. In addition, the Government relaxed limits on foreign equity participation in private enterprises after the Asian financial crisis. Although there is a dearth of studies on the impact of mergers and acquisitions in Malaysia, *relaxing foreign equity participation requirements is generally expected to contribute to increased competition in the domestic economy.*

Thailand

In the small, open, economy of Thailand, foreign trade and investment—and thus foreign suppliers and service providers—have played a major role in its development. The most important law governing foreign-controlled businesses in Thailand is the Foreign Business Act of 1999. The act identifies a negative list of sectors where foreign ownership is prohibited or limited. Businesses listed in category 1 are absolutely prohibited to foreigners[19] unless there is an exception contained in a special law or treaty.

Box 3.15 The hypermarket case in Malaysia

Since the establishment of the first hypermarket by Makro in Malaysia in 1993, the sector has grown rapidly. Today, there are some 22 hypermarkets in Klang Valley. Most of the well-established international hypermarkets such as Carrefour (France), Tesco (United Kingdom), Giant (Hong Kong, China), and Makro (Netherlands) are foreign owned. There have been significant concerns on the part of the Government, however, that hypermarkets compete with and can displace small neighborhood retail (sundry) shops.

Thus, more stringent guidelines have been imposed over time on hypermarkets. These include a higher population density precondition, local product display requirements, a stricter definition of hypermarkets (from 8,000 square meters to 5,000 square meters), preliminary "impact on sundry shops" surveys within a 3.5-kilometer radius, and limitation on operating hours (no 24-hour businesses). In addition, a 5-year freeze on the establishment of foreign-owned hypermarkets in Klang Valley, Penang, and Johor Bahru came into effect on 20 April 2004. The Ministry of Domestic Trade and Consumer Affairs provided no reason for this decision.

The ban will clearly reduce the flow of FDI into the hypermarket sector. It could also delay restructuring of the retail trade sector that could have enhanced local upstream-downstream linkages as well as improve productivity levels. The differing treatment for foreign-owned and locally owned hypermarkets also raises market access and competition issues in the sector. The consistency of such policies with the country's commitment under the World Trade Organization's General Agreement on Trade in Services remains unclear.

Source: Lee (2005).

These include the mass media, as well as rice, animal husbandry, and other resource-based businesses. Those in category 2 are businesses that concern national security or safety, or are involved with local art, culture, handicrafts, or natural resources and the environment. Foreigners are not permitted to start new businesses listed in this category unless they obtain special permission from the minister with the approval of the cabinet.

Category 3 contains businesses that the Government believes are not yet competitive and are thus vulnerable to foreign competition. These include mining, salt farming, forestry, fishery, professional services, and all services unless specified in the ministerial regulations. Similar to category 2, foreigners may obtain special permission to operate businesses listed under this category, but from the Director General and the Foreign Business Committee. To obtain a license, applicants must be able to convince the relevant local authorities that local firms cannot competently conduct the particular investment project.

Based on the list of businesses prohibited to foreigners, manufacturing is generally open to foreign investment, bar a few businesses concerned with national security, small and medium enterprises, and the environment. The services sector, however, remains relatively closed as in Malaysia, since category 3 includes "other categories of service business except those prescribed in the ministerial regulations."

In addition, sector-specific legislation may impose even more stringent conditions for foreign participation. For example, the Telecommunications Act 2001 limits the foreign equity share of a facility-based operator to only 25%. The resulting relatively closed service sector contributes to inefficiencies, which, in turn, impose costs on manufacturing.

While the entry of foreign companies generally promotes greater competition that benefits consumers, in a few cases, it has had the opposite effect, such as the case of the cement industry in Thailand (Box 3.16).

Viet Nam

Viet Nam's policy toward FDI has become more liberal and open in recent years, but restrictions still exist that effectively limit competition. On the surface, these measures appear to limit only foreign competition. In reality, they serve to protect all incumbents from both foreign and domestic competitors. The restrictions take the following forms.

Restricted sectors and forms of operation. Currently, FDI is not allowed to operate in certain sectors. In telecommunications and media, for example, only business cooperation contracts are permitted. In other sectors like oil and gas, air transportation and airport construction, forestation and tourism, foreign firms can only operate in joint ventures with at least one local partner. Until 2004, foreign firms were not allowed to be part of listed companies.

Performance-based requirements. FDI in Viet Nam is also subject to local content, export share, and legal capital requirements. Foreign partners are required to contribute at least 30% of total capital in any joint-venture arrangement. Meanwhile, local content requirements are perhaps the most complicated regulation on FDI. Motorbike manufacturers, for instance, are required to achieve a local content ratio of 5–10% by the second year of operation, which should eventually reach 60% in 5–6 years. Tax rates imposed are also based on these performance indicators. Export performance requirements, on the other hand, are now limited to only 14 items and enforcement is questionable.

Regulations in the financial and land markets. Foreign firms have traditionally had limited or no rights to possess land in Viet Nam. Recently, the Government extended land use rights to overseas Vietnamese (many of whom are foreign investors) and it is currently considering legislation enabling land use rights to be mortgaged with offshore banks. Small and medium enterprises and the private sector still have limited access to credit compared with big SOEs and foreign firms, due to complicated collateral requirements.

Foreign direct investment and competition policy

We have seen that, *in recent years all of the six countries studied have generally been open to FDI. However, this has not always resulted in increased competition in their domestic markets.* This is because other government regulations and policies have created barriers to the development

Box 3.16 Impact of FDI on competition in cement and retailing in Thailand

Cement was one of the industries worst hit by the 1997–98 Asian financial crisis as the local construction industry came to a halt with the collapse of the finance and real estate markets. A few firms were taken over by foreign companies. In 2001, the second-largest market player, which was already majority owned by a foreign cement supplier, made a bid for the third-largest and locally owned cement company, which was then in the middle of a debt-restructuring process. Analysts of many securities houses predicted that the merger would lead to collusion and, hence, an increase in cement prices.

Retail is another sector that was attractive to foreign investors after the crisis. Multinational corporations such as Tesco (United Kingdom), Carrefour and Casino (France), and Royal Ahold (Netherlands) now own most discount stores in Thailand. This is because the Foreign Business Act of 1997 allows wholly foreign-owned retail stores that meet a total minimum capital requirement of B100 million.

While these foreign retail companies compete vigorously among themselves and with local retail and department stores to offer consumers lower prices, their extremely aggressive business culture has caused tremendous friction with local suppliers. A 2001 study by Thailand Development Research Institute confirmed that positive benefits accrued to consumers from competition in the retail industry, but acknowledged concerns over unfair trade practices.

Because of their size, these companies can heavily squeeze local suppliers' margins by imposing conditions such as mandatory enrollment in price promotion schemes and preferential treatment for house brand products, as well as collection of various service fees. Although these practices do not necessarily reflect anticompetitive practices, they can be seen as unfair trade practices. The Thai Trade Competition Commission has published a Retail Industry Code of Ethics in response to suppliers' complaints, but the code does not seem to provide small suppliers with effective protection against unfair trade practices.

Sources: Nikomborirak (2005); Poapongsakorn et al. (2001).

of free competition. In the PRC and Viet Nam, for example, local content requirements are used to encourage backward linkages. This provides a constraint for FDI firms trying to obtain their inputs from the best possible source, and compels them to use local suppliers instead. Thus, even with FDI liberalization, increased competition is not guaranteed, as in some cases other regulations effectively limit the inflow of FDI.

In India, Korea, Malaysia, and Thailand, protection of small-scale firms prevents entry by large firms in certain sectors and industries. As a result, some service industries such as retailing have remained uncompetitive in spite of FDI liberalization. In Korea, retail stores larger than 1,000 square meters need approval by the local government advisory board, but these boards generally have strong connections with existing retailers, who lobby against the big retailers. In Malaysia, as noted above, more stringent conditions were initially imposed on foreign-owned hypermarkets in efforts to protect small local retail stores. Eventually a 5-year ban on the establishment of new foreign-owned hypermarkets was enforced. This contributed to continued inefficiencies in the domestic retail industry.

Just as in trade reform, FDI in Asia has both undermined and created anticompetitive practices. Gross generalizations about FDI's effects are not warranted in this regard. Often, foreign investors come with better technologies and management practices, so assessing the advantages and disadvantages of cross-border mergers and acquisitions requires a careful evaluation of the efficiency effects as well as any potential price-increasing effects.

Effectively enforced competition law discourages the wrong sort of FDI without placing inordinate burdens on efficiency-enhancing foreign investments. However, poorly or arbitrarily enforced competition law can deter overseas investors. Moreover, there is a role for competition advocacy to ensure that the inducements offered and requirements placed on foreign investors do not seriously distort competition in Asian markets. In a competitive environment without distortions, FDI can contribute substantially to growth and development.

Issues for implementation

Recent empirical research has confirmed that barriers to entry are substantially higher in developing economies than in industrial nations (Djankov et al. 2002, De Soto 2000). If reforms cannot be introduced to effectively lower these barriers—perhaps because in some situations poor governance practices cannot be eliminated in any realistic time frame—then dynamic efficiency may actually be best served by competition policy measures that prevent incumbent firms from setting higher prices for customers over the longer term.

In many developing countries, the benefits of competition policy have yet to emerge visibly, because enforcement has been hampered by lack of resources, reliable data, or sufficient information about production costs, market shares, and consumer behavior. In Thailand for example, the Trade Competition Commission has not yet determined the criteria for threshold market share that will both define a "dominant" business and determine a postmerger level of market concentration that would trigger mandatory premerger notification. As a result, all practices that should be classified as abuse of dominance and all mergers that may foreclose future competition are currently exempt.

Even so, in many areas of Asia competition authorities have played an important role in the formulation of liberalization, privatization, and deregulation policies, ensuring that the objectives of those policies induce growth.

The manner in which competition policy is implemented and enforced has important implications for its effects on macroeconomic performance and on the poor. Competition issues may be handled through sectoral regulations, as in Malaysia, or through economy-wide legislation, as in the other five countries discussed. The agency delegated to enforce competition policy may be independent or may answer to a particular ministry. It may be centralized or decentralized. Development of a culture of competition may be left to the competition authority or it may be undertaken through other means, such as via the educational system. Enforcement of competition law may depend primarily on administrative decisions or on recourse to the judicial system.

As economies open up, governments have to make the transition from a protectionist, regulatory regime to a new emphasis on efficiency and innovation. This may require a focus on microeconomic, or second generation, reforms. Governments need to ensure more effective R&D and other support schemes, better physical infrastructure, legal reform, improved education, and administrative reform.

Initial conditions

The diversity of the six countries studied has influenced their implementation and enforcement experiences. Table 3.4 highlights their diversity while Table 3.5 illustrates some of the key aspects of their implementation experiences.

The PRC's human capital base is comparatively strong, with near universal literacy, segments of technical excellence, and R&D strengths for innovation. Its foreign trade and investment have expanded rapidly. In contrast, its commercial institutions have historically been weak, and the country scores poorly in international comparisons of corruption and protection of property rights. But institutional quality is improving quickly, and physical infrastructure is being upgraded rapidly, facilitating the entry of firms.

India's human capital base has pockets of international excellence alongside quite high levels of illiteracy. Until recently, its inward-looking strategy meant that it was unable to exploit its human capital strengths in the global economy. Its commercial environment is broadly predictable, and the legal system cumbersome but independent. It also has the highest level of decentralized economic policy making among the six countries. The 1991 reforms and their aftermath have begun to transform the commercial environment, but the unfinished reform agenda is long and complex.

Korea's development strategy has been underpinned by exceptional strength in certain areas. It reached OECD levels of educational achievement and R&D expenditures at comparatively low levels of per capita income. Its infrastructure and institutional quality are good. External factors—

Table 3.4 Comparative statistics

	PRC	India	Korea	Malaysia	Thailand	Viet Nam
General economic indicators						
GDP, 2003 ($ billion)	1,410	599	605	103	143	39
GDP per capita, PPP, 2003 ($)	4,995	2,909	17,908	9,696	7,580	2,490
GDP per capita, average annual growth (2000–2003) (%)	7.4	3.8	4.8	2.3	4.0	5.7
Openness						
(Exports+Imports)/GDP, 2003 (%)[a]	65.0	31.8	73.8	204.8	122.3	115.0
Export growth, 1990–2003, (%)[b]	18.0	11.2	9.3	11.3	10.3	13.2
Average tariff rate, 2002[c]	12.4	28.0	4.9	5.2	10.5	15.0
Index of Economic Freedom, 2005[d]	3.5	3.5	2.6	3.0	3.0	3.8
Trade Policy Index, 2005[e]	4.0	5.0	3.0	3.0	3.0	5.0
Human capital						
Years of education, 2000[f]	5.7	4.8	10.5	7.9	6.1	3.8
Tertiary enrollment as % of age group, 2002[g]	13.0	11.0	82.0	27.0	37.0	10.0
Number of Internet users as % of total population, 2002	4.6	1.6	55.2	32.0	7.8	1.8
Public spending on education as % of GDP, 2001[h]	2.2	4.1	3.6	7.9	5.0	2.8
Physical infrastructure[i]	46	55	29	31	34	77
Institutional quality and risk						
Corruption (Corruption Perceptions Index, 2004)[j]	3.4 (71)	2.8 (90)	4.5 (47)	5.0 (39)	3.6 (64)	2.6 (102)
Property rights index, 2005[e]	4.0	3.0	2.0	3.0	3.0	5.0
Bureaucratic quality (Public Institutions Index, 2004)[k]	4.39 (55)	4.45 (53)	4.81 (41)	5.06 (38)	4.71 (45)	3.66 (82)

PPP = purchasing power parity.

Notes: [a] Data for Viet Nam are for 2002. [b] Data for Viet Nam are for 1997–2002. [c] Average import tariff (MFN) for manufactured goods, ores, and metals. Data for PRC, India, and Thailand refer to 2001. [d] Index of Economic Freedom ranges from 0 (mostly free) to 5 (highly restricted). [e] This is a composite from the Index of Economic Freedom. The index ranges from 0 (very good) to 5 (very poor). [f] Average years of schooling of population aged 25 and over. Data for Viet Nam refer to 1990. [g] Tertiary enrollments (regardless of age) as a percentage of the 20–22 age group. Data for PRC and India refer to 2001. [h] Data for the PRC are for 1998, India for 2000, and Viet Nam for 1997. [i] Growth Competitive Index, 2004, ranking of 104 countries, 1 is the best. [j] The index ranges from 10 (highly clean) to 0 (highly corrupt) for 146 countries. The highest is 9.7 and the lowest 1.5. Numbers in parentheses are the country rankings. [k] The public institutions index is based on survey data and ranges from 2.47 to 6.59 across 104 countries. The higher the index, the higher the quality. Numbers in parentheses are the country rankings.

Sources: Barro and Lee (2000); Miles et al. (2005); Porter et al. (2004); Transparency International (2005); UNCTAD (2005); World Bank (2005).

aspiring to membership of international organizations and the Asian crisis—have been important factors in its policy reforms.

Malaysia emerges as a country with comparatively high institutional quality, excellent physical infrastructure, and large public investments in education, much of it designed to redress past ethnic imbalances. It has had the most consistent commercial policy environment of the six. Nevertheless, there are concerns that the independence of its legal system may have weakened over the past two decades, there has been a persistent loss of high-level non-*bumiputra* human capital, and it faces competition from below (especially the PRC) and from above (the Asian newly industrializing economies).

Thailand scores well on most indicators, with the principal exception of human capital. In consequence, during the 1990s, as real wages began to rise quickly in the wake of rapid economic growth, it experienced difficulty in managing the transition out of labor-intensive activities. It has become progressively more open in its trade and FDI policies. Historically, its legal

and commercial institutions were not strong, but physical infrastructure is generally good.

The principal challenges in Viet Nam still relate to establishing the infrastructure that underpins a market-based economy since property rights, the legal system, financial intermediation, and physical infrastructure are all poorly developed. Illiteracy levels are low, but so too is the pool of internationally experienced entrepreneurs. Many small and household enterprises operate in an insecure commercial environment, while SOE reform lags. The quality of the physical and commercial infrastructure shows pronounced regional differences.

In their competition regimes, it is useful to divide the six countries into three groups. The first comprises those with historically very restrictive regimes, which have opened up during the past quarter century, namely PRC, India, and Viet Nam. The second covers those that have traditionally been reasonably open, and become progressively more so—Malaysia and Thailand. Finally is the special case of Korea, which was initially highly selective in its opening up, and which has become progressively more open to competition over time. None of the sample countries has become less open toward competition.

In some cases, it is possible to date the promotion of greater competition as part of a package of major general reforms. In Korea, there was gradual liberalization from the late 1980s, with major reforms in the late 1990s in the wake of the economic crisis. In the PRC, the reform process began in 1978, strengthened in the late 1980s, and further consolidated in 2002 on accession to WTO. In India, 1991 is regarded as the key reform year. In Viet Nam, it was the late 1980s *doi moi* reforms, with further liberalization around 2000. In contrast, Thailand, and particularly Malaysia, have always been quite open to competition, and over time have become progressively more so. In neither of these have there been major swings in the policy pendulum.

A range of internal and external factors was operational. These factors include a recognition that outward-oriented economies grow more quickly, and that it is possible to achieve national objectives in an open economy context. Competitive liberalizations—keeping up with one's neighbors—have been another factor. Foreign pressures, including a desire to join international agencies, have often contributed. Conversely, the demise of an international benefactor (the former Soviet Union) was a major trigger in Viet Nam's reforms.

Competition policy enforcement may differ between regions. Three of the six countries (PRC, India, Malaysia) feature quite high levels of decentralized economic policy making. (Local protectionism in the PRC was highlighted above.) Thailand has been pursuing a policy of industrial decentralization for some time, with implications for competition at local levels. In all but Malaysia, economic authority is being progressively devolved away from the center at varying degrees and speeds. In addition, there are large interindustry differences in protection, and thus competition, in all six countries. SOEs frequently receive preferential treatment, especially in PRC, India, and Viet Nam.

In some cases, such as Viet Nam, many of the broader problems associated with the business environment were barely addressed in the first round of reforms: red tape, corruption, insecure property rights, an ill-defined legal environment, poor physical infrastructure, limited financial development, and the huge, inefficient, and privileged SOE sector. The reforms have been a "positive-sum game," since growth has accelerated. But there have been losers too, notably among the bureaucrats who dispensed power and patronage, the SOEs sheltered from competition, and the labor unions in cosseted (especially state-owned) industries.

In Korea, too, there seems to have been ambivalence about recent reforms in sections of the bureaucracy that are reluctant to relinquish control. To overcome this attitude, reformers have proposed the establishment of "free economic zones," where liberalization (particularly of labor markets) can proceed more quickly than elsewhere, highlighting the importance of competition in factor markets. It is unlikely that Korea could achieve its current objective of becoming an economic hub for Northeast Asia unless these reforms are introduced and implemented successfully.

Korea undertook its major liberalizations after it had become democratic, but in any case it

appears that external factors were a major trigger for reform. Two factors in particular stand out. One was the Government's desire to join international organizations (GATT then OECD), membership of which required reform. The second was the Asian financial crisis when, in spite of intense nationalist sentiment, the Government felt it had no choice but to open up the economy.

Promotion of competition can also play an important role during the recovery of crisis-hit economies. With weak consumer demand, tight government budgets, and investment that has been reduced by lowered confidence, exports are critical in the immediate recovery period. Crucial to the competitiveness of exports is the efficiency gains from competition. The 1997–98 Asian crisis also served as a reminder that restrictions on competition may appear compatible with an open trade and FDI regime, while mounting tensions may remain hidden.

Competition is central to the process of globalization. Competition benefits the economy since domestic factors of production are able to maximize their returns, subject to the institutional constraints they face. Competition is also presumed to constitute a spur to better economic policy, to the extent that the option of "exit" for investors exerts a policy discipline on governments. In most cases, potential tension between industrial policy and promotion of competition is handled by ensuring competition in the domestic market, but not necessarily with equal treatment for foreign rivals.

Openness to the international economy varies significantly among the six countries (Table 3.4 above). All have become more open to trade since 1990, as indicated by both trade reforms and rising export-to-GDP ratios. This ratio has increased by more than 50% in three of the countries (PRC, India, and Thailand) and substantially in the others. Malaysia and Thailand were among a very small group of developing economies classified by Sachs and Warner (1995) as "always open." Both exhibit very high trade orientation, quite low average tariffs, modest inter-industry tariff dispersion, and limited incidence of nontariff barriers. Qualitative indicators support this conclusion. Korea now has fairly low average tariff rates. Notwithstanding recent reforms, PRC, India, and Viet Nam still have relatively high tariffs, and a higher incidence of nontariff barriers than the other three countries. The more protected an economy is, the more limited competition is, reducing allocative efficiency.

Among the six, Korea's trade and investment regime has arguably been the most unusual. From the early 1960s, it achieved very rapid export-led growth in the context of (until recently) very restrictive policies toward imports (except those required by export-oriented firms) and FDI. Its industrial policy resulted in tremendous achievements but also high costs. In addition to tariff reform and a reduced incidence of nontariff barriers, Korea's reforms in the 1990s included a reduction in the number of subsidy programs, as well as customs simplification. A desire to join both GATT/WTO and OECD, and the imperative to reform in the wake of the 1997–98 crisis, drove much of the liberalization.

Viet Nam's reengagement with the international economy is of fairly recent origin. Typical of a late reformer, its official trade regime remains opaque and poorly documented. Only quite recently was a formal tariff schedule released. It still retains very high levels of protection (several hundred percent) for its automotive, sugar, and garment industries. Much protection is firm-specific in nature, tailored to the needs of inefficient SOEs. Viet Nam aspires to WTO membership soon, which constitutes a powerful incentive to continue and broaden the reform process.

Political commitment to promoting competition and to ensuring the independence of the competition authority plays a large role in effective implementation. In the case of Thailand, intense lobbying has caused delays in the adoption of a threshold market share to define a dominant position. The country's Trade Competition Commission also suffers from human resource and capacity constraints, funding limitations, lack of protection of confidentiality, and limited public awareness and support.

When enforcement is handled through administrative decisions in a decentralized manner, the potential exists for inconsistent enforcement across locations. In the PRC, local State Development and Reform Commission branches have had some success in breaking price agreements among suppliers, such as among nine travel

agencies collectively setting minimum package prices for trips to Southeast Asia. However, stronger coordination of the network of local implementation/enforcement agencies may be necessary to deal with (or stave off) instances of local protectionism.

Several key points emerge from this survey of approaches to, and experiences with, implementing competition policy. Notwithstanding their diversity, almost all developing Asian economies have adopted progressively more open policies toward competition during the past decade or two, and this trend seems set to continue. This more open posture has been accompanied by the adoption of more liberal trade and FDI regimes, a process that has had profound implications for the promotion of competition. These changes have been so rapid in some cases that the policy and institutional framework has been unable to keep pace.

A major challenge for policy makers is keeping up with a rapidly changing international commercial environment. As with FDI, for an economy to reap the full benefits of competition, the quality of incentives, institutions, and infrastructure matters more than before. In transitional economies, the first round of reforms typically focuses on macroeconomic stabilization and partial trade liberalization, while other, microeconomic, components essential for competition typically lag.

Effects on government finances

The effect on a government's budget of implementing and enforcing competition policy is, in principle, ambiguous. On the one hand, outlays are necessary to create and sustain a competition enforcement agency. On the other, greater competition brings benefits. For example, the vigorous enforcement of a bid-rigging law (a form of cartel law) can result in savings for government purchasers who otherwise might find themselves the target of suppliers' conspiracies. In many developing countries, the size of government purchases is now so large that only small reductions in the amount of bid rigging on state contracts would more than cover the likely costs of cartel enforcement. This is particularly noteworthy since as much as a quarter of documented competition law-enforcement actions in developing economies involve bid rigging against state purchasers (Clarke and Evenett 2003). The PRC, for one, has reported several enforcement actions of this type in recent years.

Table 3.6 provides some evidence of the magnitudes involved. The table reports data for seven developing economies that have competition enforcement agencies. It gives the savings to each respective national government if stronger cartel enforcement deterred bid rigging *in just 1%* of the value of state contracts. Those savings (reported in the second and third columns of the table) are compared to the current outlays on the national competition enforcement agency (in the last two columns of the table).

For countries with large government expenditures, such as India, a 1% reduction in bid rigging on state contracts would save the national treasury a sum equivalent to over 16,900% of the cost of its competition enforcement agency! This means that India could increase the expenditures on this agency 100-fold and still come out ahead—so long as the additional expenditures ensured that bid rigging on state contracts fell by at least 1%. In short, government expenditures in most developing countries are large enough that *the savings on government purchases that result from less bid rigging are likely to easily offset any additional outlays needed to rigorously enforce national cartel laws.*[20]

More generally, data on the magnitude of national imports and government consumption expenditures can be employed to gauge the likelihood that investing in cartel enforcement will be beneficial for developing countries. Table 3.7 includes data on 26 developing countries for which there is no record in OECD documentation of active cartel enforcement in the 1990s. The purpose of Table 3.7 is to estimate the minimum percentage reduction in cartelization on different purchases that would have to follow from a $10 million investment in cartel enforcement for this outlay to at least pay for itself.[21]

In the case of a nation's imports, assuming

Table 3.5 Implementation arrangements: Competition laws

PRC	India	Korea	Malaysia	Thailand	Viet Nam
Regulatory agencies					
State Administration of Industry and Commerce (SAIC)	Monopolies and Restrictive Trade Practices (MRTP) Commission	Korea Fair Trade Commission (KFTC)	Various regulatory agencies	Trade Competition Commission (TCC)	Local governments and their departments of prices and finance for price regulation
Quality of competition institutions					
Uneven	Generally good for MRTP Act, but unproven for Competition Act	Generally good; more improvement after Asian financial crisis	Generally high	Generally good but vulnerable to political influence	Weak for the price laws
Implementation problems					
Heavy reliance on administrative channels, rather than on judicial system	No explicit definitions nor mention of certain offending trade practices in MRTP Act	Overly expansive power granted to KFTC, sometimes leading to conflict with its antitrust mandate	Uneven applicability of laws across sectors; some sectors regulated, others not	Failure to pass implementing rules and regulations, so too many exemptions and exceptions	Commercial Law 1997 too broad, with no assigned enforcement agency
Lack of public awareness about laws; some producers think collective price-setting behavior is lawful	MRTP Act did not cover extraterritorial jurisdiction and merger control	KFTC has discretion over imposition of administrative surcharges, and is sometimes criticized for lack of prior resort to the judiciary	Laws vague, needing publication of supplemental clarifying documents	Law broad and vague, leaving much discretion in administration; lack of transparency in implementation	Laws vague, needing publication of supplemental clarifying documents
Anti-Unfair Competition Law of 1993 neither outlaws price cartels nor defines predatory pricing				Composition of TCC vulnerable to political influence and lobbying	
Implementation successes					
Campaign against anticompetitive practices by public utilities yielded a large number of bid-rigging cases	Extraterritorial jurisdiction and merger control subsequently incorporated in Competition Act	Law amended to inhibit concentration of economic power among *chaebol* and their affiliates		Increased awareness by small enterprises as regards unfair trade practices	Administrative fines and remedies imposed for confirmed violations of price laws
Campaign against sector monopoly and regional blockades implemented		Promoted deregulation and privatization of SOEs			
To ensure uniform enforcement, administrative explanations issued for local SAIC branches		Antimonopoly policy has reduced industrial concentration ratio and prices			

Source: Compiled by Asian Development Bank staff.

Table 3.6 Estimated savings to governments through a 1% reduction in bid rigging of government contracts

Country	Conservative estimate of reduction in government spending in 2000, ($ million)		Budget of competition authority in 2000, ($ million)	Ratio of estimated savings to cost of competition agency	
	15% price reduction	20% price reduction		15% price reduction	20% price reduction
India	122.0	162.6	0.7	169.4	225.9
Kenya	4.9	6.5	0.2	20.2	26.9
Pakistan	20.3	27.1	0.3	61.6	82.9
South Africa	34.9	46.5	7.7	4.5	6.0
Sri Lanka	5.1	6.8	0.1	50.9	67.9
Tanzania	1.5	2.0	0.2	9.5	12.6
Zambia	0.5	0.7	0.2	2.7	3.6

Source: Data on central government spending and on the budget of the competition enforcement agency taken from Consumer Unity & Trust Society (2003).

very conservatively that cartels raise prices by 15%, this amounts to calculating what reduction in the percentage of cartelized imports is needed to generate savings of $10 million. For these 26 countries, the mean reduction in cartelization on imports necessary to justify an investment of this magnitude was 1.25%. For 12 of these countries, the reduction of cartelization needed on imports was less than 1%.

The reduction in bid rigging and overcharges necessary to justify increased outlays on competition law enforcement is small. This finding alone suggests that the net impact on a national treasury of adopting a competition law is likely to be positive, in stark contrast to the fears about the implementation costs of adopting multilateral rules on the "behind-the-border issues" in the world trading system. These direct benefits for the government budget and for customers more widely are in addition to the positive impact on macroeconomic performance (and consequently on tax revenues) of greater rivalry between firms.

Toward a competitive future

The discussions above have highlighted the importance of promoting competition. They have also indicated that many other issues are involved in consideration of competition.

> The rich countries have … learned the hard way about monopolistic and oligopolistic behavior, predatory pricing, price fixing, insider trading, accounting conflicts of interest, perverse incentives from stock options, import tariffs, producer subsidies, government ownership of business, property rights, land use policies, and many other matters affecting the intensity and fairness of competition. These are the ways special interests gain favoritism. The so-called Washington Consensus about good economic policy in developing countries is hopelessly superficial about the importance and complexity of achieving intense and fair competition. To become rich, poor countries have to deal with these issues (Lewis 2004, p. 296).

To the extent that the enforcement of competition policy prevents or discourages incumbent firms from taking steps to foreclose entry by potential rivals, then such enforcement will strengthen the incentives of the potential rivals to invest in innovation. This is because these potential competitors will expect it to be easier to enter the market and so will have greater confidence that their investments in innovation will pay off.

Competition, innovation, and intellectual property

Innovation itself is a result of market interactions and the fact that even firms that are not currently

Table 3.7 Reduction in imports or government spending needed to justify $10 million for enforcement of competition law

Developing country[a]	Reduction in cartelization required, 2001 (%)[b]		
	Imports	Government consumption expenditures	Imports plus government consumption expenditures
Algeria	0.58	0.95	0.36
Cameroon	3.06	7.98	2.21
Costa Rica	1.06	3.28	0.80
Côte d'Ivoire	2.28	8.12	1.78
Ecuador	1.25	4.27	0.97
Egypt, Arab Rep.	0.35	0.77	0.24
Ghana	2.05	9.30	1.68
Guatemala	1.34	7.16	1.13
India	0.10	0.15	0.06
Indonesia	0.16	0.71	0.13
Iran, Islamic Rep.	0.23	0.42	0.15
Jordan	1.24	3.61	0.92
Kenya	2.05	6.92	1.58
Lebanon	1.09	2.50	0.76
Malaysia	0.09	0.72	0.08
Mauritius	2.71	13.09	2.25
Morocco	0.63	1.25	0.42
Pakistan	0.61	1.13	0.40
Philippines	0.20	0.76	0.16
Senegal	4.41	16.50	3.48
Syrian Arab Rep.	1.38	3.32	0.98
Thailand	0.11	0.71	0.09
Tunisia	0.80	2.80	0.62
Turkey	0.16	0.39	0.12
Venezuela	0.35	0.77	0.24
Zimbabwe	4.09	4.40	2.12
Mean	1.25	3.92	0.91
Minimum	0.09	0.15	0.06
Maximum	4.41	16.50	3.48

[a] Where there is no record to date of active cartel enforcement. [b] To justify spending $10 million on the enforcement of competition law, given a 15% price increase on cartelized products.

Notes: The assumptions underlying these calculations are very conservative. For instance, a 15% price increase due to cartelization is at the lower end of estimates of the price impact of cartels (see, for example, the case studies in Levenstein and Suslow 2001). Moreover, the $10 million price tag for the enforcement of national competition law is in excess of what the South African Government spends each year on the enforcement of all of its competition laws, not just cartel law. The South African experience is pertinent as South Africa is widely regarded as having an effectively enforced set of competition laws.

Source: World Bank 2004 (for underlying data on imports and government consumption expenditures).

competing with each other in existing product markets may be competitors in markets for future innovations. Competition in such markets (and hence the incentive for innovation) can be undermined by mergers or other (potentially) anticompetitive practices. Antitrust law promotes innovation and economic growth by combating restraints on competitive activity. Firms are more likely to innovate if they face strong competition. By deterring anticompetitive practices, antitrust law ensures that consumers have access to a wide variety of goods and services at competitive prices. More generally, *preserving the ability of innovative firms to enter a market may well be contingent on the appropriate enforcement of various competition laws.*

On the whole, innovation and productivity improvement are likely to be promoted rather than impeded by interfirm rivalry. Nonetheless, identifiable situations can arise in which—given the technologies available to firms in an industry—the maximization of the number of competitors in a market may lead to inefficient outcomes. According to the thinking of leading scholars in the field of industrial organization (see, e.g., Carlton and Perloff 2000), such situations by no means call for the wholesale rejection of competition policy as a tool of economic governance; rather, they call for appropriate tailoring of the application of such policy to take account of relevant technological and other considerations.

Competition policy promotes innovation and economic growth by limiting, if not removing, constraints on open markets and free competition. As noted earlier, firms are less likely to develop new and better products if other firms do not pose any threat of encroachment to their share of the market or if they are constrained from entering new markets. This means that the more stringent competition is among firms, the stronger the incentive to innovate. By preventing restrictive business practices, competition policy guarantees the availability of a large selection of goods, services, and processes at competitive prices.

Similarly, the protection of intellectual property is a spur to innovation in today's economy. Firms and individuals normally invest resources and effort to fashion a unique or better product, process, or service with the expectation of earning a reasonable return on their

investment. If there is no possibility of this, then no profit-maximizing agent will make the investment. Intellectual property rights (IPRs) are vital for fostering innovation and growth in an economy. These rights provide the motivation for research and development leading to new products, services, and production processes.

Firms have an incentive to develop new and better products when the prospect of free riding by other firms is minimized. In general, the objective of IPRs is to compensate the innovator for his or her creative efforts, not to put the interests of the individual innovator over and above the interests of consumers. IPRs are usually granted to ensure that appropriate protection is provided to the innovator. Unlike physical property rights however, IPRs are often limited in scope and coverage. At the outset, consumers will be faced with higher prices as the initial innovator reaps the profits of the innovation. However, by justly rewarding the initial innovator, development of similar and related products will be encouraged, ultimately resulting in lower prices for consumers. This is the rationale for granting protection to intellectual property owners—so that the process of innovation becomes sustained over time. This helps drive the growth and development of an economy. By promoting innovation, IPRs also serve to benefit the public and increase consumer welfare.

Intellectual property law preserves the incentives for innovation. Firms are more likely to innovate if they are protected against free riding. Innovation benefits consumers through the development of new and improved goods and services, and spurs economic growth. The aim is not to promote the individual innovator's welfare, but to ensure a sufficient reward for the innovator to elicit his or her creative or inventive effort while not delaying follow-on innovation and not leading to unnecessarily long periods of high prices for consumers. In order to strike a balance between under- and overprotecting innovators' efforts, IPRs differ from, and are usually less absolute than, "normal" property rights.

Protection granted to intellectual property owners include patents, trademarks and service marks, and copyrights. A patent usually covers new inventions or improvements on an existing product. It is a form of recognition by the government that the inventor has the exclusive use and benefit of the invention. A patent may grant the inventor the right to exclude others from making, using, offering for sale, or selling the invention.

A trademark or service mark is a distinctive symbol, device, word, or name attached to a product to indicate that it is sourced from a particular firm or individual. It is a mark used to distinguish the product from the products of other firms or individuals. A trademark is an identifier for a good, while a service mark is for a service. Trademark and service mark rights are granted to prevent other firms or individuals from using substantially similar marks to take advantage of the reputation of the owner of the trademark or service mark and confuse consumers into buying similar products. They do not, however, preclude other firms and individuals from producing or selling similar goods or services provided that the trademark or service mark is different.

A copyright is a form of protection granted by governments to authors of original works, including literary, musical, dramatic or artistic works, films, sound recordings, broadcasts, and other matters, whether published or unpublished. It gives the copyright owner the exclusive right to prepare derivative works, to reproduce the copyrighted work or portions of it, to display or perform the copyrighted work in public, and to distribute copies or recordings of the copyrighted work. These rights may be sold or transferred to other parties. The copyright protects the work in the specific form it was created, but not the idea, subject matter, theme, or concept expressed in the work.

Thus, IPRs are often limited in duration (patents, copyright), strictly limited in scope (copyright, trademark), not protected against parallel creation by others (copyright, know-how), or lose their value once they become public (know-how).

As discussed above, competition policy instruments include competition advocacy and all measures available to governments that affect competition in markets. In the application of intellectual property policy, competition policy may play a positive role. Among intellectual property instruments available to governments

are patent scope, which establishes the extent to which an innovator has property rights over related innovations, and patent duration, which establishes the length of time the innovator has exclusive rights over his or her own innovation. Governments thus have the ability to ensure that competition concerns are incorporated into the implementation of intellectual property policy.

For example, in the PRC's 1993 Anti-Unfair Competition Law, Article 5 offers protection against trademark infringement. It prohibits not only the forgery of trademarks and certificates of quality and origin, but also the use of similar brand identification—brand names, packaging, or designs—that would be likely to confuse the consumer. A fine of 100–300% of the value of the illegal gains may be imposed for breaches of the law. Criminal sanctions may also be imposed. Article 10 protects trade secrets, which are defined as technical and operational information that is not known to the public; that is capable of bringing economic benefits to the owners of the rights; that has practical applicability; and that the owners of the rights have taken measures to keep secret. The law imposes a fine of CNY10,000–200,000 on those who obtain such secrets illegally, or who know or should know that a trade secret was obtained illegally but nevertheless agree to distribute such knowledge to a third party.

Intellectual property rights and competition policy

Intellectual property rights and competition policy are complementary since both seek to promote innovation and enhance consumer welfare. They are also complementary ways of attaining allocative efficiency in a market economy. Like IPRs, competition can inspire innovation. Competition drives firms to introduce new or improved products, services, or processes in order to survive in the marketplace, capture a larger share of the market, or simply increase profits.

The desire to gain control of a particular market segment can also encourage firms to develop new products to satisfy consumers' unmet needs. Thus, free enterprise and open markets serve to benefit the public and increase consumer welfare through innovation, as well as through keeping prices low.

Several intellectual property practices clearly have a competition dimension. Some of the more common ones are described below: [22]

- Pooling and cross-licensing arrangements—owners of IPRs license their rights to one another and split royalty fees. This may result in cartel-like behavior on the part of the pool members.
- Exclusive territories—the licensor agrees not to license any other licensee in a particular area. This grants licensees monopolies to serve particular territories, but restricts them from expanding into other localities.
- Grantbacks—the licensee is required to license back to the licensor improvements made by the licensee on the licensor's intellectual property. To some extent, this is tantamount to exclusivity between the licensor and licensee, and excludes others from profiting from the intellectual property.
- Acquisitions of IPRs—outright purchases of IPRs or of firms owning IPRs. Similar to other asset acquisitions, this could allow a firm to have monopoly power over a market or to obtain a dominant market position.
- Exclusive dealing—an auxiliary agreement is attached to the granting of a license, which prohibits the licensee from selling, distributing, using, or licensing a competing technology. This denies rivals the opportunity to use the licensee as an outlet for their products or processes.
- Reach-through royalties—the licensor requires that royalties be based on the product's total sales, irrespective of whether the licensor's technology was used in each stage of the production process. This effectively presents an all-or-nothing choice to the licensee, and provides a disincentive to use other or similar technology in some stages of the production process.
- Tying arrangements—the licensed technology has a variable input related to usage that can only be sourced from the licensor. This allows the licensor to earn a profit both on the licensed technology and on the licensed complementary input. An illustration is home

printers sold at low prices, but for which the consumable input, the toner, is sold at high prices.

- Compulsory licensing—legal intervention to restrict the monopoly rights of existing patent holders. This grants certain firms the license to use, sell, or distribute a patented technology to make it more available to a larger number of users. Compulsory licenses are often granted in cases of national emergency, such as during the anthrax attacks after the events of 11 September 2001 in the US, when many manufacturers were granted compulsory licenses in order to make the anthrax vaccine more readily available.
- Vertical price restrictions—the licensor determines the price at which the licensee must sell the licensed products. This effectively limits competition among licensees, as the licensor restricts the price at which the product can be sold.

From a short-run perspective, there appears to be some tension between the goals of IPRs and competition policy. The apparent conflict arises because intellectual property laws give the innovator the right to exclude others from exploiting the innovation. This may lead to market power, and even monopoly as defined under existing competition legislation. Thus, intellectual property law, in seeking to protect property rights, limits competition to a certain extent. Meanwhile, competition policy is generally driven by the assumption that the removal of barriers to free competition is the best way to maximize consumer welfare.

However, competition and IPRs are not essentially in conflict. IPRs, while providing some form of statutory monopoly, generally do not provide market power of such a significant degree as to cause concern to competition authorities. This is because the scope of a particular IPR is often smaller than the relevant market, so that the opportunity to create similar products to compete with the protected one still exists.

The apparent short-run tension between competition and IPRs also contrasts with a longer-term view. *IPRs generally strengthen competition in the economy over the long run, by providing incentives for the development of new products and production processes.* In recognizing that technological progress contributes to social welfare, the apparent conflict between IPRs and competition policy is resolved. Since the long-run goals of competition policy and IPRs are mutually reinforcing, governments are increasingly willing to restrict competition temporarily at present, so that competition in new products and processes can be attained in the future.

The above issues illustrate how competition policy can be associated with the implementation of IPRs. While there is some complementarity in the goals of intellectual property policy and competition policy, the interface between them may be difficult to manage. This is because IPRs can limit competition in the short run, resulting in a trade-off between the immediate benefits from increased competition and the future benefits from subsequent innovations. Therefore, governments need to balance policies on intellectual property and competition to ensure that consumer welfare is maximized and that policies support economic growth. Policy makers face the challenge of coordinating the instruments of intellectual property policy and competition policy to efficiently allocate resources toward the development of new and better goods, services, and processes.

Policy makers have striven to maintain the balance between intellectual property policy and competition policy by using various pre- and post-patent grant mechanisms. Pregrant measures typically include limiting the scope and duration of patents. This is because overly broad patent grants, interpretations, or applications of IPRs may unduly limit competition. Many agree that some form of protection for the innovator's investment is justified to encourage future innovation. Too much protection, however, may unintentionally result in just the opposite. This is because procedures that are too complicated or too stringent would actually serve to discourage prospective pioneers from innovating similar products and follow-on innovators from developing the next generation of products.

It is therefore imperative for governments to ensure that protection granted to intellectual property holders will still allow current and future innovators to build new and improved products or processes from the existing patented products

or processes. By contrast, postgrant measures typically include allowing compulsory licenses and exemptions on specific uses of the patent, especially for patents related to health issues.

Apparent conflict arises because IPRs give an innovator the right to exclude others from exploiting the innovation, which may lead to market power and even monopoly as defined under competition law. Intellectual property law seeks to protect property rights, and in so doing, limits competition. Competition policy may therefore play a positive role in forming intellectual property law, especially through competition advocacy with the policy makers formulating intellectual property law. Competition policy expertise should prove useful in helping decide on issues like the correct scope and duration to be awarded under intellectual property law.

Competition law, meanwhile, has generally reflected the premise that consumer welfare is best served by removing impediments to competition. However, this short-run view of some competition authorities has been replaced by a longer-run view, which acknowledges that *technological progress contributes at least as much to social welfare as does the elimination of allocative inefficiencies from noncompetitive prices. There is now growing willingness to restrict competition today in order to promote competition in new products and processes tomorrow.*

Patent and competition policy are complementary instruments for rewarding the innovator most efficiently: patent scope by preventing imitation and antitrust by affecting price through constraints on contracts for transferring technology. Patent scope and competition policy are distinct instruments for affecting the incentives to research and to transfer technologies: one sets the “threat points” or the opportunity cost of entering into the licensing agreement (e.g., whether or not a rival can introduce an imitation) and the other establishes the feasible set of legal licensing contracts. Consequently, intellectual property law and antitrust law are complementary since both seek to promote innovation and enhance consumer welfare, and are complementary ways of achieving efficiency in a market economy.

Despite sharing important goals, IPR and competition policies are not purely complementary and managing the interface between them is difficult. A completely legitimate use of IPR can restrict competition, at least in the short run, thereby producing a trade-off between the benefits of increased competition and the gains from further innovation. A typical challenge facing policy makers is to coordinate patent instruments (patent scope and duration) and competition instruments (contractual restrictions) so as to achieve an efficient allocation of resources directed toward the development and use of new products and processes. Thus:

> A country’s optimal patent policy is found by equating the sum of the extra deadweight loss that results from strengthening the IPR protection granted to domestic firms and the extra consumer surplus loss that results from expanding the fraction of goods that are subject to monopoly pricing with the benefits that flow from providing greater incentives for innovation to firms worldwide. A country’s optimal IPR protection depends on the policies set by its trading partner, because the strength of foreign patent rights affects the responsiveness of global innovation to a change in a country’s own patent policies (Grossman and Lai 2004).

Summary and conclusions

From reviewing the experiences of six diverse Asian countries in regard to competition policy, lessons emerge that may benefit other developing countries. Countries with different initial conditions of competition and at different stages of reforms or integration with global trade and investment flows may follow different paths to reaping the gains from competition. However, the globalizing economic environment imposes a form of discipline on domestic economic activity, creating pressure for promoting the sort of efficiency improvements that competition can bring.

Greater competition in product markets can lead to lower prices, greater choice, and increased production efficiency, ultimately contributing to

a country's growth and development. Restrictions to competition must generally therefore be removed to enable markets to deliver the benefits of competition to consumers and to support sustainable economic growth. At the same time, the greatest degree of competition possible may not be optimal, and increasing economic growth requires a policy mix promoting both cooperation and competition, balancing short-term (static) efficiency improvements with long-term, dynamic efficiency and development.

We have seen that competition policy is concerned with both private anticompetitive practices and government measures or instruments that affect the state of competition in markets. Competition policy is usually aimed at enhancing consumers' freedom of choice and firms' freedom to trade and access markets. There are some instances where consumers will prefer that a smaller number of goods (and possibly a single good) be available in the marketplace. There are also some instances where production may be most efficiently pursued by a small number of producers (possibly just one). Competition policy must be applied in ways that take account of the technological characteristics of such markets.

Most of the countries studied have envisaged their competition laws as supportive of their national development objectives. The prevalence of competition is consequently viewed as contributory to the countries' economic development. Tension between the objectives of competition policy and industrial policy is more apparent than real. To the extent that creating national champions substantially increases concentration in a domestic market, there may actually be a stronger case for implementing competition policy than otherwise. Japan itself has argued that intrafirm rivalry has previously played and continues to play an essential role in its development.

Most measures to protect domestic industries or firms create barriers to entry and can lead to high concentration in affected sectors. At the subnational level, local protectionism leads to market fragmentation and thus to low regional specialization. Competition law can reinforce the effectiveness of cuts in trade barriers on growth-enhancing imports. The trend toward greater openness and globalization is likely to continue, with competition playing a key role in enhancing the international competitiveness of a country's firms. In turn, growing firms will contribute to the country's growth and employment. Thus, participating in international organizations such as WTO or OECD is an effective way to bring the pressures of international competition to bear on promoting competition in domestic markets.

During economic transition or reforms, the benefits of an open market economy cannot be fully realized unless restrictions on competition are removed. This has been reflected recently in India (where competition policy has been revised and expanded), Viet Nam (where a new competition policy was adopted in late 2004), and the PRC (which has firm plans to develop and implement a new competition policy). Opening markets is not enough by itself for countries to begin reaping the benefits of competition. Firms will still find incentives to engage in anticompetitive practices. Thus, the intended benefits of trade reform may not be realized without active enforcement of competition law. The Korean case illustrates that trade liberalization does not automatically lead to a more competitive domestic market, and that the best outcomes are achieved when liberalization is accompanied by measures to increase competition in the domestic market. This experience highlights the importance of having faith in the benefits of competition from an early stage of economic growth and of incorporating competition policy into the broader economic policy framework.

In recent years all of the six countries studied have generally been open to FDI. This has been true longer in Malaysia and Thailand in particular. It has not always resulted in increased competition in their domestic markets. However, for foreign investors the existence of a competition policy indicates some commitment by the government to ensure a level playing field among domestic and foreign investors. And relaxing foreign participation requirements can be generally expected to contribute to increasing competition in the domestic economy.

Competition policy is affordable. In most countries it will more than pay for itself. The saving on government purchases, which results from less bid rigging alone, is likely to easily

offset any additional outlays needed to rigorously enforce national cartel laws. Even greater may be the increase in tax revenues resulting from greater competition-induced growth. At the same time, implementation of competition policy serves to reinforce consumer rights and the competition culture that help ensure that the benefits of competition are realized.

Development of a "competition culture" can, in turn, ensure that competition is strengthened. In most developing countries, the interests of consumers are poorly represented and are much weaker than those of producers. Organizing and promoting consumers' rights create a potent force for ensuring the promotion of competition. In this regard, it can be crucial that the authority charged with promoting and enforcing competition has independence from ministries or other agencies representing producers or producer groups.

Competition can help create a prosperous future. Preserving the ability of innovative firms to enter a market may well be contingent on the appropriate enforcement of competition laws. IPRs generally strengthen competition in an economy over the long run by providing incentives for the development of new products and production processes. Such technological progress will likely contribute at least as much to social welfare in the long run as the elimination of allocative inefficiencies resulting from noncompetitive prices will in the short run.

With regional and global integration accelerating, the pressures of international competition and their context have become increasingly palpable. However, as we have seen, competition policy is important in its own right for domestic reasons, and does not have to be considered jointly with the rest of the Doha round's Singapore issues. Regardless of whether multilateral rules on competition policy are negotiated under WTO, each country should strive to develop and implement its own competition policy.

Drawing on lessons from the experience of Japan and Korea, developing countries in the Asia-Pacific region should start early and take a long-term view in implementing competition policy. Most have completed their first round (macroeconomic) reforms, which play a key role in setting a framework for greater competition. Late reformers, such as Viet Nam, still face challenges from the first round of reforms but are acting to ensure that restraints to competition will pose minimal hindrance to future development. The benefits of competition will flow more freely from the strengthening of property rights, development of a credible legal and judicial system, trade and FDI liberalization (informed by competition policy), and infrastructure expansion.

The complementarity of competition and competition policy with industrial, trade, and FDI policies highlights the need for active competition advocacy. Too often, the advocacy functions of competition authorities are neglected at the expense of enforcement of competition law, only to create the need for even greater enforcement as other legislation is enacted without consideration of the implications for competition.

The general conclusion is that competition confers net benefits on an economy. Productivity rises, choice expands, and some (generally the bulk) of the increased benefits are appropriated by domestic consumers and factors of production. These benefits appear to be especially important in connecting the country to the global economy and ensuring the international competitiveness of its firms as the country develops. At the same time, the discipline of participating in a globalizing economy reinforces the importance of competition. Of particular relevance is the fact that, while many countries are moving to implement or strengthen their competition policies, none appears to be moving toward repealing them.

Endnotes

[1] For a review of his evidence in support of this claim, see Table 1.1 and Section IV.1 of Ahn (2002).

[2] The countries were selected for the variety of their conditions and experiences with competition and competition policy. Country studies were prepared by Ping Lin (Lingnan University); S. Chakravarthy; Seung-Wha Chang (Seoul National University) and Youngjin Jung (Woo, Yoon, Kang, Jeong & Han); Cassey Lee (University of Malaya); Deunden Nikomborirak (Thailand Development Research Institute); and Vu Quoc Huy (Institute of Economics). They were studied in greater detail as part of an Asian Development Bank regional technical assistance study (Brooks and Evenett 2005, forthcoming).

[3] The concept of efficiency has both static and dynamic aspects. *Static* efficiency refers to maximization of the benefits of voluntary exchange at a *given point in time*; that is, maximizing the sum of producer and consumer surpluses in a given market at a point in time. *Dynamic* efficiency refers to the maximization of the sum of such surpluses *over time*. The latter takes account, in particular, of the impact of technical progress, innovation, and investments of various types.

[4] As Vickers (2003) notes, "questions about the *desirability* of competition – whether it directs incentives positively – should not be confused with questions about its *inevitability*. There is no inconsistency in regarding competition as beneficial but vulnerable to being undermined – for example by cartel activity. … in short, being pro-competition is by no means the same as being pro-*laissez faire*. … Hence the importance of public policies to safeguard and promote competitive incentives. In a sense, the competition policy is judicious regulation to bring out the best in *laissez faire*. A competitive market is generally a far better regulator than any regulator can hope to be" (p. 3).

[5] This rather theoretical discussion is based on some rather strong assumptions. In the context of a developing country, these assumptions may well not hold and the same actions which increase efficiency and welfare in an optimal situation may be inferior to "second-best" solutions. However, since second-best solutions require a level of detailed analysis beyond the capabilities of many developing countries (and possibly many industrial countries as well), promoting competition will generally be preferable to alternatives.

[6] Cartels figure prominently in relation to bid rigging in government procurement processes, and thus their deterrence can also improve the efficiency of government.

[7] See White (2000), for an accessible economic analysis of such externalities and the implications for regulatory and competition policy.

[8] Article 1, 1993 Anti-Unfair Competition Law, available: http://www.globalcompetitionforum.org/regions/asia/China/ch_unf1.pdf.

[9] The Competition Act, 2002 (No. 12 of 2003), available: http://dca.nic.in/competition_act2002.pdf.

[10] Article 1, Monopoly Regulation and Fair Trade Act, available: http://ftc.go.kr/data/hwp/monopoly.doc.

[11] Competition Act 1999, available: http://www.globalcompetitionforum.org/regions/asia/Bangkok/Bankok%20Act.pdf.

[12] Amsden and Singh (1994) cite Okimoto (1990) in support of this claim.

[13] Strategic trade policy involves setting up national trade policies—such as tariffs—to enable a domestic sector to reap greater economies of scale from the protected home market or to enable the sector to expand output and lower costs through learning-by-doing effects. Both of these result in lower production costs enabling a nation's exports to, in theory, expand export sales. In addition to expanding the output of the domestic industry, proponents of strategic trade policy note that it can result in profits being effectively "shifted" from foreign firms to domestic firms.

[14] A survey of 150 textile and garment enterprises conducted by the Institute of Economics shows that, although the sector relies heavily on imported inputs, its import tax commitments are very low (Institute of Economics 2000). In 1999, imported materials accounted for 66% of total materials purchased. By 2000 this share had increased to 77%. However, 58% of these imports were totally exempt from tax in 1999, and the rest were subject to low tax commitments. As a whole, the tax rate for the sample was barely 1%.

[15] Watson et al. (1989) cite the "wool war" and the "silk war" of the mid-1980s as examples of local governments trying to keep raw materials within their locality to favor local manufacturers.

[16] These arguments are developed, for example, in UNCTAD 1997 and in other references cited therein.

[17] For a more complete discussion of FDI in developing Asia, see ADB (2004), Part 3 "Foreign Direct Investment in Developing Asia" or Brooks and Hill (2004).

[18] Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, available: http://www.helplinelaw.com/law/china/merger-acquisition/index.php.

[19] A "foreigner" refers to a natural person who is not of Thai nationality or a juristic entity, (i) which is established under foreign law, (ii) in which half or more of its capital is owned by foreigners even if the company is incorporated under Thai law, or (iii) in which half or more of the value of the total capital is being invested by foreigners even if more than half the capital is owned by Thai nationals. (The third requirement is effectively a bar on the use of Thai nationals as nominees.)

[20] See Clarke and Evenett (2003) and Evenett (2003, part III) for a more general discussion of the costs and benefits of enforcing national anticartel laws. The available empirical estimates suggest that the reduction in overcharges incurred in jurisdictions with active cartel enforcement regimes from *only one* major international cartel in the 1990s would have gone a long way to pay for the entire state outlays of Brazil, Mexico, and several European Union member states on their respective competition law enforcement regimes.

[21] The $10 million figure is almost certainly larger than the outlays necessary to implement a cartel law in a small or middle-sized developing economy.

[22] This subsection draws heavily on Tom (1998).

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