The State of Competition and Competition Policy in Emerging Markets: International and Development Dimensions

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Executive Summary

This paper examines the role of competition policy in emerging markets from a developmental and international perspective. Its purpose is to brief developing countries on the complex range of analytical empirical and policy issues connected with the subject. The paper notes at the outset the increased importance of competition policy at the international level as a consequence of its inclusion in the WTO's work program at the recent Doha Ministerial meeting. Nevertheless, it is emphasized here that apart from this international dimension, competition and competition policy are important for developing countries in their own right. The present paper builds on the author's previous work in this area (Singh and Dhumale, 1999, 2000; Singh 2001a, 2001b) and extends it in a number of directions including specifically the analysis of:

(1) the relationship between competition, competition policy and development at the national level;

(2) the important implications of the recent new conceptual advances in the theory of industrial organisation for competition policy for developed and developing countries;

(3) the impact of market power exercised by industrial country firms on developing countries, including a more complete examination of the effects of the current cross-border international merger wave;

In addition, the paper also examines, from a developing country perspective, the implications of proposals for establishing an international competition authority to monitor anti-competitive behaviour by large multinationals. The desirability of such an authority, and if so, what form it should take to address the concerns and particular needs of developing countries are considered.

The paper therefore, examines the virtues and limitations of both national and international (including multilateral, pluerilateral and bilateral) competition policies. The analysis is divided into four broad sections. The main points and conclusions under each section are summarised below.

IA State Of Competition And Competition Policy In Developing Countries

This section considers the state of competition and that of competition policy in emerging markets and examines the relationship between these variables and economic development. The main conclusions of the section can be summarised as follows:

IA.1 There is a widespread presumption among economists that emerging markets suffer from a poor competitive environment because of the various distortions created by government support for industries and its restrictions on entry and exit of industrial firms for social purposes (such as preventing unemployment). Indeed, the structuralist theories of the Asian financial crisis that emanated from the IMF and other orthodox economists, blamed the crisis precisely on a poor competitive environment in the crisis-effected countries. There is some support for this hypothesis in static measures of concentration for countries such as Korea, Brazil and India. However, evidence based on dynamic measures of the intensity of competition suggests that this impression is misconceived. Two kinds of dynamic measures are examined in this study – one based on time-series analysis of profitability and its persistence and the other based on the entry, exit and turnover of firms. The results of both types of studies suggest that leading emerging markets are faced with as much, if not more, intense competition than their counterparts in advanced countries. Persistency coefficients in leading advanced countries are found to be generally lower for emerging as compared to mature markets. Similarly, births, deaths and turnover of firms in the few emerging markets where this analysis has been done, indicate that in all relevant dimensions developing country firms are faced with as intense competition as their advanced country counterparts. Other kinds of evidence relating to efficiency and size distribution of firms are also reviewed.

IA.2 According to the data provided by UNCTAD, the end of 1980s, only 16 developing countries had adopted competition laws. During the 1990s, often under-prodding from international financial institutions, competition laws were passed in 50 countries. As it takes about 10 years from the passage of legislation to effectively implement such laws, most developing countries in fact, have not had a competition policy regime. The reasons for this phenomenon and its implications are examined in the text of the paper.

IB. Competition, Competition Policy and Economic Development

IB.1 There would not appear to be any obvious relationship between competition policy and the intensity competition in an economy. This is suggested by the fact that many developing countries have been able to maintain considerable rivalry and competition in their economies, despite the absence of formal competition policies.

IB.2 The relationship between competition policy and economic development is controversial both in economic theory and in relation to empirical evidence. Economic orthodoxy posits monotonic positive relationship between the two variables and therefore, suggests that greater the intensity of competitions the better the economic performance. Modern economic analysis reviewed in this paper indicates that this may be true only in highly abstract and unrealistic models, which do not apply to the real world. Theory suggests that maximum competition is not necessarily the optimal degree of competition, defined as the kind of competition that would maximise an economy's long term productivity growth. There may be too much competition just as there may be too little. Economic theory provides strong grounds for the view that a combination of co-operation (for example, governmental co-ordination of investment activities) and competition is likely to be superior to a regime of maximum competition.

The theoretical arguments are illustrated with empirical evidence from East Asian including China as well as other countries where "co-operation" through for example, governmental intervention has not been successful.

II. Competition Policies In Developed And Developing Countries: Analytical And Empirical Considerations.

This section of the paper makes the following main points.

II.1 Notwithstanding the facts that there is considerable competition in leading developing countries, it is argued here that today they do need a competition policy. This is for two reasons:

(a) Market oriented reforms (e.g., privatisation and deregulation) which many developing countries have undertaken during the last decade raise the spectra of government monopolies being replace by private monopolies.

(b) A gigantic international merger movement which is characterised by unprecedented cross-border mergers.

II.2 The nature of this merger activity as well as its implication for developing countries, is examined in some detail. Some important conclusions are as follows:

(i) There is little evidence to indicate that the present international mergers will enhance global economic efficiency. Rather these are likely to reduce the contestability of international markets.

(ii) Even with competition policies, developing countries may not be able to adequately forestall anti-competitive behaviour by large multinationals.

(iii) Cross-border mergers as well as mergers which take place outside developing countries have important implications for competitions and survival of large firms in developing countries. Such firms which have often been the spear heads of technological change in many developing countries are particularly vulnerable to the even larger multinationals being created by the merger movement.

II.3 What is the appropriate competition policy for developing countries? For this purpose, the paper examines both the new developments in the theory of industrial organisation as well as competition policies in leading advanced countries. The main conclusions are as follows:

(i) No single competition policy - "one size fits all" - would be appropriate for developing countries. Countries at different level of development and governance capacities require different types of competition policies.

(ii) The competition policies that are currently being followed in the US and the European Union are particularly unsuitable for developing countries. These do not also conform to the new advances in the theory of industrial organisation.

(iii) A good role model for many developing countries, which have effective governance structures and are industrially relatively advanced is that of the Japanese competition policy during the period 1950-73. Japan was more like a NIC during this period that also saw extraordinarily fast economic growth.

(iv) A central analytical point here is that for a developing country the main objective of competition policy cannot simply be static efficiency and short term consumer welfare as has traditionally been the case in the US. In order to increase long term economic growth, developing countries need high rates of investment, which in turn requires sufficient profits to maintain and enhance the private sector's propensity to invest. Therefore, as noted earlier, a competition policy, which calls for maximum competition, will not be useful for developing countries. It may adversely affect the animal spirits of the private sector (for example, through reduced profits).

III. Multilateral Competition Policy

The previous two sections have considered essentially national competition policies in the new international context of liberalisation and globalisation. This section of the paper examines pros and cons of a multilateral competition policy for developing countries.

III.1 The following arguments for such a policy are reviewed.

(a) A multilateral policy will make it possible for small developing countries to be able to resist the anti-competitive effects of international mergers.

(b) Similar arguments apply to the case of international cartels.

(c) It is suggested that the anti-competitive effect of the TRIPs agreement can be combated by a multilateral competition policy.

However, the paper finds none of these arguments to be convincing. In addition to the reasons suggested earlier, for countries at different levels of development to have different competition policies, a multilateral treaty would have additional harmful consequences for developing countries. Such a treaty is likely to involve also a multilateral agreement on investment, including national treatment. It is argued that neither of these would be helpful to developing countries

IV. International Competition Authority

The paper puts forward a proposal for an International Competition Authority in order to control anti-competitive conduct of the world's largest multinationals (above a certain threshold of size) as well as to control their propensity to grow by take-overs and mergers. In order to maintain contestability and efficiency of international markets it is proposed that the large multinationals should only be allowed to take over another company if they sell of a subsidiary of similar value. Thus they are not stopped from growing provided they expand their size by green-field investment. Neither are they stopped from taking over other firms provided they are able to sell off equal value subsidiaries, i.e. they cannot grow by mergers or take-overs. The paper argues that these institutional arrangements would both be more efficient as well as more equitable compared with the present situation.

V. This section outlines the policy proposals that follow from the previous analysis. Its central point is to suggest that the current work at the WTO on the development dimension of competition policy is most unsatisfactory. It is couched in terms of WTO concepts of market access, national treatment, most favoured nation treatment, etc. The terms and language of this discourse need to be entirely changed if the development dimension is to have its due recognition. This means that the Working Group on Competition Policy at the WTO should give more attention to the overall developmental goals set out in the Preamble to the WTO Agreements than to its procedural rules. The ultimate aim of the WTO is surely not to promote market access and free trade for its own sake, but to achieve economic development.