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Foreign Direct Investment in a Globalizing Economy: The Role of Competition Policy

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I. Introduction[1]

Accelerated growth and its subsequent increases in consumer welfare and reduction of poverty are two goals in the mind of any government. Private sector development contributes to achieve them in two ways: First, it enhances competitive forces and competitiveness, which produce growth and jobs. Second, it allows governments to have greater fiscal space needed for spending in social sectors and infrastructure, which are fundamental to sustain growth in the long-run. Foreign direct investment (FDI) – and multinational corporations (MNCs) as the main conduits through which FDI takes place – [illegible] are primary vehicles for private sector-led growth.

From a development perspective, the economic case commonly made for encouraging FDI into a country is well known: FDI brings to a host country not only capital, productive facilities, and technology, but also employment, new job skills, management expertise, export markets, and tax revenues. For developing countries, there are some other practical reasons for encouraging FDI. In many countries, fiscal deficits have limited the ability of governments to impose further taxes or borrow from capital markets to finance development. This has in turn generated pressures to downsize the public sector, privatize state-owned enterprises, and deregulate markets. Moreover, poor infrastructure facilities and inefficient domestic markets have wore away the relative competitive position of firms in export markets, and limited the general consumer welfare.[2] Countries in this position have no choice but to take full advantage of FDI to overcome these limitations in development.[3] But this

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[1] Paper prepared for the Expert Meeting on Competition Laws and Policies: Identification of Common Grounds in the ESCWA Region, Abu Dhabi, September 17-19, 2001. This paper benefits from useful comments provided by Frank Sader and Warrick Smith. The opinions and views are the author's and do not reflect the views and policies of the World Bank and FIAS.

[2] See, Private Sector Development in Low-Income Countries (1995).

[3] In a recent paper, Klein, Aaron and Hadjimichael (2001) consider the case for attracting FDI into developing countries and their positive impacts on development. In the authors' view MNCs are larger and more productive than domestic firms in developing countries, and thus they tend to produce higher quality goods and services and export relatively more. By relying on FDI, countries can import and imitate such larger, more productive firms and stimulate productivity, technical and organizational

endowment requires of both policy-makers and business leaders first to have a clear understanding of the changes that have occurred in the last decade in the pattern of FDI flows, developed and developing alike. More concretely, the globalization of FDI and the resulting increase in international and domestic competition in product and service markets.

To approach these issues and design policies, governments should realize three facts: One, that the potential FDI inflows to a country are strongly influenced by both the business enabling environment and, in particular, the level of competition as well as the institutions designed to protect the competitive process. Two, where competitive incentives are inadequate, the performance of multinational corporations (MNCs) is weaker, and energies can be diverted to lobbying, anti-competitive practices, and other rent-seeking behavior that can undermine the expected benefits of FDI on the host country's economic development. Three, to foster competition, countries should pursue policies that offer MNCs security of market entry and exit, exposure to effective competition on an even playing field, and non-discrimination vis-à-vis domestic investors for their transactions.

Notwithstanding the trend of rapidly growing FDI inflows, many developing countries have not been able to effectively attract foreign investment. Despite the rapid concentration of FDI in a handful locations, many developing countries still approach FDI suspiciously, and treat it in a discretionary and discriminatory fashion. Likewise some countries still remain doubtful as to whether open policies toward more competition in the domestic markets (including that coming from MNCs)are appropriate for their economic system or stage of development. Especially in the Middle East and North Africa, many countries are at the cross-road of this discussion and may run the risk of being left behind.

Relevant to this discussion are the following questions:

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improvements throughout the economy. Countries can use MNC practices to accelerate the development of local small and medium-sized firms. Overtime, as productivity improvements spread in the economy, incomes progressively become more equal to the rest of the world, and the corresponding increase in tax revenues aids governments to supply public goods and social safety nets required to sustain growth.

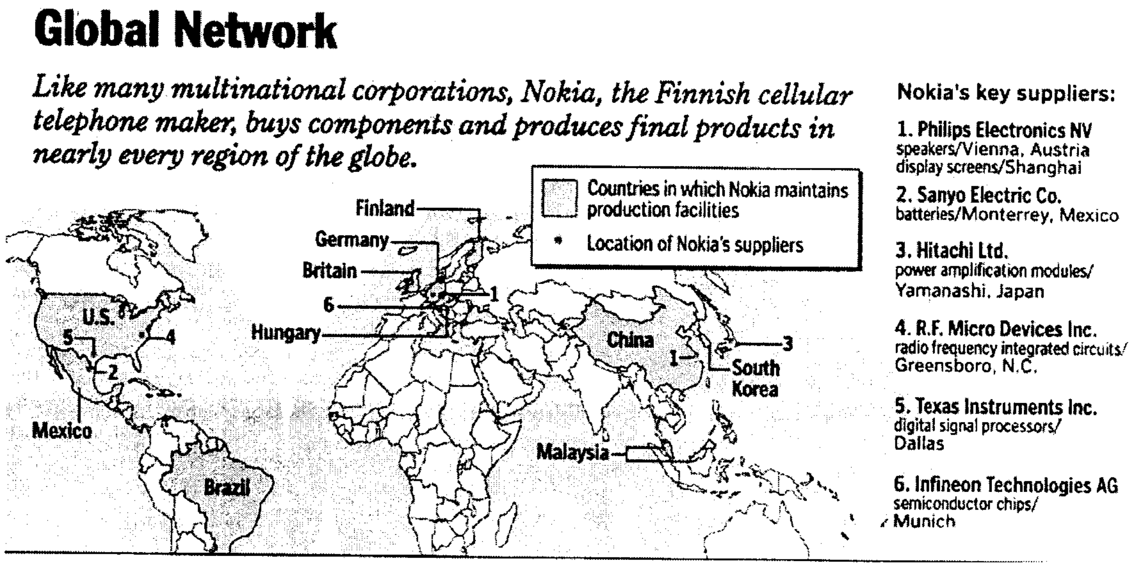
- Are competitive markets likely to attract the type of FDI required to enhance economic growth, international competitiveness and consumer welfare?
- How governments' approaches to competition policy affect the quality of FDI inflows and the benefits these flows bring into countries?
- What is the role of competition policy, including the enforcement of a competition law, in promoting an enabling climate for FDI?
- Are the potential costs of improper competition law enforcement, misuse of bureaucratic power, or regulatory capture not likely to outweigh the potential benefits?
- When and how should competition policy and law be sequenced among the range of policies which governments need to attract FDI?

This paper intends to address these questions by offering a framework to understand the linkages between two complicated and sometimes controversial policy areas: FDI and competition policies.

II. Competition and the Quality of FDI

The globalization of FDI is being shaped by two inter-related forces: country framework policies and corporate strategies. Country policies (such as reduction of tariffs, elimination of non-tariff barriers and quantitative restrictions to trade, and opening of key sectors, privatization, and lifting of controls to foreign investment) have made countries more open to trade and investment, representing a major change in the way FDI is applied and approached. Before globalization, FDI was basically a substitute strategy for trade under the import-substitution regimes that prevailed in developing countries for decades (and still persist in some). In a segmented world due to trade and investment barriers, the main goal for MNCs was to have presence in each domestic market, not to integrate production processes. A MNC decided to locate independent production facilities in a country as an alternative to export due to existing protection from imports to gain either access to inputs for production (i.e., natural resources, raw materials, inexpensive labor), or to markets for output (typically large and protected markets).

Today the shift toward liberalization of trade and investment policies worldwide has naturally resulted in substantial changes in MNC strategies. Pursuing the penetration of global markets, MNCs have adopted integrated strategies that, based on greater specialization and geographical dispersion of interdependent production facilities and supply activities, have aimed to maximize their competitive advantage through economies of scale. The following chart on Nokia provides a good example.



Source: Washington Post, July 18, 2001

This integration of FDI has led to a growing multiplicity of linkages which is reflected in a rise in intra-firm trade across national boundaries, between foreign affiliates and parent companies. MNCs trade more goods through foreign subsidiaries than they export from their home countries. In fact, of all world trade, intra-firm trade among MNCs accounts for about one third, and MNC exports to non-affiliated firms accounts for another third. Thus only one third of world exports does not directly involve MNCs (Mallampally and Sauvant, 1999).

Within this new context, competition in product and service markets have increased dramatically. To the point that competition both international and domestic is an increasingly determining factor in the location of FDI. Production in protected and inefficient environments is a strategy of the past which has no prospects of success in today's globalized markets. First-class MNCs simply cannot afford isolation from the

rest of the world even if they operate in large domestic markets. Thus, FDI that constitutes part of the global production strategy of a MNC is the kind of FDI that contributes to sustained productivity and growth in a country.

As successful MNCs have become increasingly used to operating and growing under competitive forces, countries have begun competing against each other in a new race to attract FDI. A very different one from the recent past indeed. In the past countries lured MNCs with privileges such as protection from imports, monopoly grants, tax concessions and other types of preferential treatment. Today, as markets have become more integrated, MNCs look beyond a specific country. Countries that are succeeding in attracting FDI are rather concentrating efforts on the creation of firms connected to world markets. This requires of countries to provide flexible conditions for the production and delivery of goods to international markets (i.e., access to services, inputs and logistics) at the least cost possible.

Domestic competition is fundamental to initiate or improve the complex web of global supply chains through which trade and investment are channeled today. To foster domestic competition, countries – particularly those with small and underdeveloped markets such as the Middle East and North Africa – should pursue policies that offer firms security of market entry and exit, exposure to effective competition on an even playing field, and non-discrimination vis-à-vis domestic investors for their transactions.

III. Domestic Competition and Attraction of FDI

The degree of domestic competition in product and service markets is often an overlooked but increasingly determining factor in attracting FDI flows to a country. Competition plays a powerful role in stimulating the growth of private sector opportunities, including those for FDI.

- First, it forces firms to reduce production costs and introduce new technologies and products, resulting in a more efficient allocation of resources;

- Second, it provides an important source of market discipline for incumbent firms, particularly in countries with highly concentrated or vertically integrated industrial structures as is not unusual in developing countries.
- Third, it promotes the entry of new participants or the restructuring of the existing ones, creating new jobs and expanding business opportunities.

These elements of the competitive process can be correlated to FDI inflows. Developing countries with average inflows of $18 billion in 1983-87, received nearly $200 billion by 2000, a more than a ten-time increase.[4] Most of this FDI (72%) was concentrated in the regions with the highest growth prospects, notably, Latin America, East Asia, and China. Middle East and North African countries have had limited success, attracting only around $6 billion (see table below). Nearly 75% of total FDI flows has gone to the countries that are the most aggressive in the region to liberalize their trade regimes and open their economies to private investment: Egypt, Tunisia, Morocco and Lebanon, with Jordan on the rise.

Middle East and North Africa FDI Inflows, 1995-2000 (US$ millions)

	1995	1996	1997	1998	1999	2000
Developing Countries	107,000	131,700	172,680	176,800	185,400	207,619
Mena Region	5,328	3,465	10,448	8,901	2,183	6,013
Egypt	600	640	890	1,100	1,500	1,613
Jordan	13	16	360	310	150	543
Lebanon	35	80	150	200	250	851
Tunisia	378	351	366	670	368	500
Morocco	335	357	1079	329	847	1,400

Source: *World Investment Report 2000,* UNCTAD

Nonetheless, analyses by FIAS of the investment pattern in the region reveal that markets are still small and heavily dominated by state-owned enterprises.[5] The size and composition of the private sector (mainly small and micro-enterprises) is smaller that in other developing countries, making business opportunities in the region less profitable. In Egypt, Tunisia, Morocco and Lebanon, the share of private sector participation is on average below 65% of GDP, compared with 80% in Brazil or 84% in Hungary. FDI plays a much lesser role. In general, FDI's share in GDP is on

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[4] UNCTAD, World Investment Report (2001).

[5] FIAS reports on FDI in Lebanon, Egypt, Jordan and Tunisia.

average below 3%. Successful small economies such as Chile or Malaysia attract FDI of 5% GDP (see table below).[6]

The importance of FDI Flows to Less Developed Countries, 1999

FDI > 5% of GNP	FDI 3%-5% of GNP		FDI 1%-3% GNP		
Angola	Albania	Hungary	Azerbaijan	Kazakhstan	Philippines
Cambodia	Bolivia	Jamaica	Botswana	Latvia	Romania
Czech Republic	Chile	Laos	Bulgaria	***Lebanon***	Slovak Republic
Malaysia	China	Mozambique	Cameroon	Lesotho	Slovenia
Trinidad and Tobago	Colombia	Nicaragua	Dominican Republic	Macedonia	Thailand
Vietnam	Costa Rica	Papua New Guinea	***Egypt***	México	***Tunisia***
	Ecuador	Peru	Gabon	***Morocco***	Uganda
	Estonia	Poland	The Gambia	***Oman***	Uruguay
	Ghana	Tanzania	Guinea	Namibia	Venezuela
			Honduras	Nigeria	Zambia
			Indonesia	Paraguay	

Source: 2001 World Development Indicators

All this suggests that despite progress made over the recent years, investment is still hindered by a number of government-driven impediments, which result in higher costs for business, and therefore not competitive products in international markets. Domestic competition, and the capacity of domestic firms to respond to external competition, has been limited by incomplete price liberalization, administrative restrictions to FDI, special monopoly concessions to local firms, and slow progress in privatization, especially with respect to infrastructure services, where the region has the lowest rate of private sector participation.

In looking into the causes of this poor performance, assessments of the recent crises in South East Asia, Russia or Turkey reveal that the close relationship between governments, the financial sector and enterprises, often involving conflicts of interest, and weak or non-existent policy incentives and institutional safeguards for competition became a negative factor in attracting FDI. This setting created barriers to the entry of private sector firms, and isolated incumbent firms from competitive pressures to innovate, reduce costs, and seek new markets. In absence of competitive incentives concentration in product and service markets gave rise to market power, resulting in inferior and overpriced products and fewer choices to the detriment of consumers, including MNCs. Likewise, ownership concentration enabled a few firms

[6] For detailed assessments of private sector development in the Middle East and North Africa, see Fawzy and Galal (1999).

or family groups to engage in rent-seeking behavior and wield political influence to shape policy in their favor through various barriers to entry and preferential treatment. Because of this, broad participation in the economy became limited.

Under these circumstances, a type of FDI certainly flew to these markets where firms had artificial monopolistic advantages as to ensure them – with minimal investment and value-added capacity – supra-competitive profits, while remaining inefficient due to the limited competitive challenges they faced. But FDI of this nature only encouraged a pattern of short-term inward-looking development that left these countries vulnerable to crisis and unduly cross-subsidized foreign firms and consumers. The lessons from these crises show that, by contrast, firms are more likely to grow and remain competitive when trade expands and investments can be made easily. The growth process then begin to entrench itself, with FDI fueling improvements in the business conditions, and improving conditions spurring additional FDI. However, for this process to occur in developing countries, changes are necessary in government measures that affect industry competitiveness and firm behavior (including that of MNCs) that lessens market competition.

These changes can be significantly advanced through an adequate integration of competition policy into a country's broad-based investment policies including: (i) an interface with other government-driven measures affecting competition in local and international markets such as barriers to entry and exit; creation of even playing fields through elimination of differential tax and regulatory treatment to FDI; and (ii) the open and expeditious application of simple regulations (competition law) against business practices that reduce the degree of competition such as price-fixing, abuses of dominant position and exclusionary or discriminatory practices.

IV. Pro-FDI Approaches to Competition Policy

Competition policy, including the enforcement of a competition law, enters the picture in the context of FDI insofar as: (i) government barriers to FDI impede entry, and (ii) business practices by incumbent firms promote exclusion from entry and discrimination in the market. Both elements may affect the level, composition and form of FDI. In practice, when MNCs are evaluating their decision to enter a country,

competition policy matters if (i) their entry is made difficult by protection policies in favor of existing or incumbent firms; and (ii) they are subject to biased scrutiny and review by government authorities when entry has the potential to impact negatively the existing market structure.

Despite the general trend towards the liberalization of FDI flows worldwide (including the adoption of standards of non-discrimination, national treatment and most-favored treatment for FDI), it is still difficult to identify a country that does not restrict FDI in some way. Governments are not always liberal at the sectoral level. It is not rare to find that governments offer protection to existing (local) companies in priority sectors, sometimes for strategic reasons (i.e., trade, environment, employment, etc.) and/or under political pressures. Traditional government barriers to entry against FDI include exclusive rights, ownership limits, technical standards, export or local content requirements, licensing regimes, and public procurement practices. Furthermore, there frequently exist administrative obstacles. These obstacles are not necessarily included in laws or regulations but reflect current practices, both by governments or the private sector, and can take various forms, notably the granting of exclusive rights to local firms (i.e., licensing for distribution services).

Moreover, in some countries where reforms are still incomplete, horizontal agreements (price fixing, cartels or market allocation schemes, bid rigging, refusing to deal and other abuses of incumbent position) have made the presence of MNCs difficult. Vertical restraints (including resale price maintenance, exclusive dealing or distribution, tied sales, reciprocity agreements, territorial restrictions on dealers and distributors, refuses to deal etc) have also been found to create barriers to entry to potential foreign entrants. MNCs have failed to enter in some markets (notably Japan, UK, Indonesia) because they have been unable to contract with domestic distributors or have encountered significant difficulties in establishing their own independent distribution networks. These restraints restrict the ability of MNCs to reach the costumers, limiting market access. To overcome such barriers, MNCs have been forced to use more expensive and less efficient options such as joint venture agreements with an established domestic competitors or acquisition of such

competitor.[7] These various restrictions can affect investors and impact FDI location decisions. A lack of competition law (or a lax enforcement of it) against market discrimination or exclusion can become a barrier to FDI in a country. The next box provides an illustration of this point.

Asia Lags in Protection from Cartels

Some years ago, two senior directors of Hutchison Whampoa were negotiating with another company. Hoping to help his boss out, the junior of the two scribbled down a suggestion. Why not, said the note, remind them of Hong Kong's open market? The senior director glanced at the message, jotted down a reply and passed it back. "Bull," he had added; "Hong Kong was built on cartels, and don't ever forget it."

What is most striking about this anecdote - as recalled by the younger director - is that almost every business leader in Asia has one like it. That Asia's investors and consumers suffer from producers who abuse their market power has long been known. This makes it all the more regrettable that governments are only now starting to fight back.

Despite this burst of activity, most Asian governments still give a low priority to anti-trust. Hong Kong and Singapore, the region's two most developed markets outside Japan, still do not have a law against cartels. In Asia, the temptation for producers to play foul may be even greater than in Europe or the United States because economic power tends to be concentrated in fewer hands. In Southeast Asia, for instance, most business is still controlled by a small number of ethnic-Chinese tycoons, who cultivate close ties to governments and to each other.

In South Korea, despite a recent breath of entrepreneurial fresh air, giant family-owned conglomerates still dominate the market. Nor does Asia have consumer lobbies to match those in Western countries, although a middle class of wiser and more-demanding shoppers is starting to appear, especially in more developed markets. In Hong Kong, for instance, a consumer body (financed mostly by the Government) tries to keep an eye on suspicious industries, ranging from text books to chickens.

Hong Kong recently passed two industry-specific ordinances, one for telecommunications and one for broadcasting. Almost immediately, the newly empowered telecoms ombudsman blew the whistle on a simultaneous price increase by mobile-phone operators. But such a sectoral approach would fall short when abuse occurs across industries.

In Asia, where the biggest companies are not focused on one industry but sprawl across many, only comprehensive competition laws are likely to do the trick.

Source: The Economist, January 21, 2001

Another reason why foreign investors have to deal increasingly with competition policies is that, by virtue of their size and scale, MNCs are often accused of exerting power in an exploitative fashion and modify the market structure of the host economy. They are thus likely to attract the attention of authorities who would review their investment projects and business practices. While some of the effects attributed to

[7] The Kodak-Fuji Film case before the WTO is an example of these restrictions. Kodak's claim was that its ability to compete in the Japanese market was restricted because of exclusive dealing arrangements among the four largest wholesale firms used by Fuji in distributing its films. For a detailed account of these practices, see Noland (1999)

MNCs are efficient and pro-consumer even if there are negative consequences for local firms due to superior economies of scale or product differentiation, others are plain negative for overall economic efficiency and consumer welfare (anti-competitive conduct). Policy-makers need to distinguish these clearly and base their judgment on best practice as high transaction costs could become a potential barrier to otherwise legitimate FDI transactions. A rational way of analyzing the impact of FDI on competition would be by understanding the two modes of entry of FDI: Greenfield and mergers & acquisitions (M&As).

Concerning the first mode of entry , most empirical studies have revealed that greenfield FDI initially increases the number of competitors in the host country market and hence increases the competitive pressure on existing companies. However, these pro-competitive effects of FDI may be mitigated in the medium run by MNCs' capacity to outweigh local competition through the introduction of larger scale and more capital-intensive technology, production of more differentiated products, and/or foreclosure competition, or through raising barriers to entry. Practices of this type may include:predatory/discriminatory transfer pricing between MNC and subsidiaries to avoid tariffs or taxes; export sales of subsidiaries or licensees; restrictions on subsidiary sales with a view of maintaining power over prices; export cartels; discriminatory pricing among regions and customers; unreasonable refusals to deal; as well as anticompetitive use of intellectual property rights.

In some other industries where production or technology requires a large initial investment and costs are sunk (cannot be recovered after being incurred), such as highly capital intensive (i.e., steel, oil, soft drinks, technology) competition is not necessarily associated with the number of competitors in the market. FDI largely concentrates in these markets, as they seek to achieve economies of scale. If such economies of scale characterize the industry and the market size is small, then the market may only support a limited number of firms. Problems of competition, then are associated with the degree of entry. If barriers to entry are low, then incumbent oligopoly firms may be disciplined to keep their costs continuously low in order to survive. On the other hand, when there are significant barriers to entry by way of

impediments to importation of competing products or to investment, market dominance would enable firms to increase price.

The second, and most common, form of entry into the host economy is through M&As. The recent UNCTAD's 2000 World Investment Report (Cross-border mergers and Acquisitions and Development) indicates that as much as two thirds of FDI to developing countries have taken the form of M&As. In recently liberalized environments, M&As provide effective, quick and inexpensive means to revitalize distressed corporate sectors in need of consolidation and restructuring to face domestic and international competition. M&As also provide inexpensive means for import distribution, development of economies of scale, and technology transfer to develop new products. Many M&As seek the fuller use of resources such as a firm that has developed expertise in the marketing of one consumer product may believe that it could use its expertise to market other consumer products, or an enterprise that has developed a new technology may seek new applications for that technology.

Despite these potential benefits, from a competition policy perspective, M&As have been subject of an additional concern in developing countries. As M&As often reduce the number of participants, policy-makers worry about the possible monopolization of markets and imposition of market conditions, particularly by MNCs, frequently the main players behind M&As. However, review of case records in selected countries reveals that most M&As pose little or no threat to competition. Still a minority of M&As may seriously harm competition by significantly increasing the probability of exercising market power. Thus prospects for increased scrutiny under competition laws of M&As involving MNCs are becoming progressively stronger. This can be a cause of concern for MNCs as will be following explained. [8]

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[8] One concrete recent example of such a negative impact can be found in Brazil where Colgate Palmolive acquired a dominant share in the local health care manufacturer Kolynos (leading it to control about 80 percent of the toothpaste market). Rival Procter & Gamble requested the competition authority to review the transaction. In light of unclear and complex regulations for M&A scrutiny, Procter & Gamble expressed to the Brazilian authorities the likelihood to reconsider its medium to long term investments and possibly to close its subsidiary operations in Brazil. Other examples where the entry of foreign company have raised competition issues include Coke-Pepsi (Venezuela), Volkswagen-Skoda (Poland), Budweiser, Brahma and Antarctica, Mahle-Metal Leve (Brazil), Kimberly Clark (Mexico, Costa Rica), Chaebol restructuring (Korea), IBRA conglomerate restructuring (Indonesia), Cable industry (Thailand).

V. Implications for the Design and Implementation of Competition Law

The previous sections presented a framework to understand a series of linkages between FDI, MNCs and their potential positive and negative impacts on different aspects of the competitive process. Governments should make efforts to ensure that FDI always yields beneficial results to the host country. Safeguards to the competitive process embodied in a competition law are necessary complements to FDI that countries should be use for further development and expansion of the investment framework. In a world where multinational companies have grown accustomed to operate with competition laws the absence of a competition law or the tolerance of private anti-competitive practices by governments can act as a barrier to entry for new foreign entrants.

Since 1990, over 50 developing countries have enacted or are in the process of enacting or revising existing competition laws, including virtually all of the countries in Latin America, Eastern Europe and South East Asia. In the Middle East and North Africa region, countries have yet to adopt competition law. Work is under preparation in Morocco, Jordan, Egypt and Tunisia. In light of these efforts, MNCs must begin to take new competition laws into account when planning transactions that possibly affect competition conditions in the host country.[9]

In designing and implementing competition laws, countries need to understand the implications that such laws can have in the plans of MNCs doing business in host countries. Two major concerns are the enactment of poorly conceived laws, and their improper application. When investing in a country, MNCs may be discouraged if the procedures followed by the authorities do not comply with international best practice or are unnecessary complicated. Therefore, MNCs expect :

- Predictable and transparent rules. Although there does not exist one unique approach, it is important that the authorities adopt clear and well-defined rules. Complying with competition regulations might be a time-consuming and

[9] According to a recent survey conducted by White & Case, multinational firm transactions can be subject of review under the competition laws of jurisdictions worldwide, ranging from U.S. and E.U. to India, Costa Rica or the Kyrgyz Republic.

cumbersome process for foreign investors, especially in countries where several agencies are involved and coordination and information are lacking. In general, scrutiny raises questions of process and substantive standards. Although this concern applies to developed and developing economies alike, it is more worrisome in the latter countries.[10]

- Capacity to make and enforce decisions. Competition laws need to be properly designed and adapted to the needs and capacity of the host economy. In the past few years, difficulties have emerged when developing countries have tried to apply regulatory frameworks based on mature economies (i.e., OECD countries). Most developing countries do not have the administrative and institutional capacity or capability to implement the same rules and enforce them properly over time. There seem to be several underlying problems, namely: (i) lack of expertise; (ii) misuse of discretion, including risks of political or industry capture and corruption; and (iii) poor enforcement capacity (both at the government and the judiciary), which often results in increases in the cost of doing business.

The following box provides a set of good practices for the design and implementation of competition laws, which could be compatible with the governments' goals of attracting FDI and ensuring that the gains from it are not precluded by private arrangements and abuses of market power, including those of MNCs.

[10] In Korea, monitoring of M&A activity by the Korea Fair Trade Commission for example, has been primarily limited to pre-notification filings and complying with the statutory requirements of calculating the market dominant position of merging firms. Of the 158 mergers notified to KFTC by the 30 largest chaebols during the first 11 months of 1998, 156 mergers were approved without any objection. The other two were approved subject to certain restrictions. The high level of approvals has been subjected to criticism that the criteria used by the KFTC for the selection and disposition of cases is not standard and well known.

Competition Law: A Basic Toolkit

Objective

The principal objective of competition law should be to maintain and encourage competition as a vehicle to promote economic efficiency and maximize consumer welfare. The focal point of competition law should be the actual and, or potential business conduct of firms in a given market and not on the absolute or relative size of firms. The implication of this is that competition law needs to focus not only on the business conduct of firms but also on the business environment in which the firms operate. The latter results in examining the impact of various other government economic policies.

Scope of Competition Law

Competition law should be of general application to all sectors of the economy and to both government and private sector firms engaged in commercial economic activity. No exemptions from the law should be provided to firms/industries unless based on sound economic principles. The inclusion of state enterprises in the purview of competition law is particularly important in the case of transition market economies pursuing privatization processes. Competition law generally contains conduct and structural provisions relating to business activity.

The Conduct Provisions

The conduct provisions of competition law primarily relate to:

- Horizontal agreements between firms to fix prices, engage in bid-rigging, restrict output and/or market shares, allocate geographic markets and, or customers.
- Abuse of market position by large dominant firms.
- Vertical restraints between suppliers and distributors such as resale price maintenance, exclusive dealing and geographic market restriction.

Economic theory suggests no valid efficiency or consumer welfare reasons for horizontal agreements between firms limiting price and/or output competition. There is virtual unanimous agreement among economists and lawyers in different jurisdictions that these agreements should be strictly prohibited and per se illegal, and to deter such behavior, they ought to be subject to heavy penalties and fines. While relative large firm size in a market should in and of it-self not be illegal, the abuse of a dominant market position by these firms which substantially lessens competition needs to be prevented. In this context, a distinction should be drawn between a firm maintaining its dominance through superior competitive performance such as being a more efficient low cost producer, providing products of higher quality and better customer service, and anti-competitive practices aimed at entrenching its market position such as preemptive purchase/control of vital input sources or distribution facilities and predatory pricing. Given that there may not always be a clear demarcation point between which types of business practices may or may not be abusive/anti-competitive, a rule of reason approach is often advocated.

The Structural Provisions

The primary structural provisions of competition law relate to mergers, acquisitions and joint-ventures. Of these, the principal competitive concerns lie in the area of horizontal as against vertical/conglomerate mergers and acquisitions. Two views regarding horizontal mergers and acquisitions are prevalent. One view is that when such transactions significantly reduce the number of independent firms and increase concentration in the market, substantial lessening or prevention of competition may occur. The other viewpoint is that these transactions are generally motivated by the pursuit of efficiency and substantial lessening of competition can only occur if there are barriers to entry/new competition. The focal point of competition policy should therefore be on reducing or eliminating these barriers. Notwithstanding which viewpoint is held, a cost-benefit approach in implementing merger policy is advisable. Since mergers, acquisitions, joint-ventures, specialization

and rationalization agreements can irreversibly alter the structure of industry, prior notification and approval of such business arrangements is recommended. However, to avoid unnecessary regulatory burden being imposed on firms, only the largest transactions or proposals should be screened. The extensive restructuring and privatization of state enterprises in transition market economies suggests that the appropriate implementation of these structural provisions of competition law is of particular importance.

Administration and Enforcement of Competition Law

In some jurisdictions such as Canada and the United States, a mix of criminal and civil/administrative legal procedures have been employed in the administration and enforcement of competition law whereas in other jurisdictions (primarily Europe) reliance is placed solely on administrative legal procedures. The courts/administrative tribunals in most transition market economies are not likely to have the necessary expertise in competition related matters. Consideration may need to be given to the creation of a specialized administrative body, department or tribunal comprised of members with backgrounds in law, economics, finance, and various fields of industry and business to enforce competition law.

Competition Advocacy

The agency specialized in competition law matters should also be vested with a statutory role of participating, formulating and commenting on government economic and regulatory policies impacting on competition in the market place. By having a competition advocacy role, the agency can counter or at least minimize the adverse effects of rent-seeking behavior prevalent in most countries but, particularly in developing and transition market economies. Given the limited administrative capacity and relevant enforcement experience in this field, this role has been viewed as being most important if not the sole function of a competition policy agency. It is argued that a competition advocacy can also reduce the possibility of misapplying the specific provisions of competition law which could induce further distortions into the economy.

Source: A Framework for the Design and Implementation of Competition Law and Policy (2000).

VI. Concluding Remarks

The creation and expansion of competitive markets and business opportunities are the most important tasks to attract FDI. Competition policy has important implications for attracting FDI. Therefore, to what extent should it be integrated into countries' broad-based investment policies? This paper has identified two aspects of competition policy in which governments have a role to play .

- Open and non-discriminatory investment policies. The most effective policy for the creation of competitive markets and the reduction of market power of incumbent forms is not cumbersome, discretionary and high transaction cost control mechanisms, but rather efforts to reduce government-based impediments to entry, operation and exit of firms. Removal of both entry barriers to FDI and special treatment to FDI, domestic deregulation, tax reform, and measures for private participation in infrastructure can provide a strong competitive stimulus to

simultaneously create opportunities for expanded FDI and increase the likely benefits of that FDI for host economy.

- Effective application of competition law. Equally harmful as government impediments to FDI is the issue of anticompetitive business practices. Agreements between domestic firms or individual abuse of market power to restrict access of new firms (MNCs or local) and entrench the positions of domestic firms or industries can affect the investment decision of a MNC. Although open and non-discriminatory policies towards trade and FDI are the most effective instruments to prevent these practices, the enactment of a competition law offers a safeguard to protect competition and ensure a level playing field . To this extent, misguided design and erroneous application of competition laws can affect the disposition of FDI. Best practices suggest that foreign investors are looking for transparent, simple, low transaction costs procedures through which they can identify the issues at stake in the host country. A concern appreciated in other developing countries trying to apply competition law is the continued reliance on administrative remedies to try to fix transitory monopoly problems created by past policies, or promote different goals than efficiency and consumer welfare. Thus, competition law review in developing countries should be useful in ensuring that FDI results in benefits to the host market insofar as it is designed and implemented sensibly, and having regard to the capabilities and priorities of the country in question.

Countries in the process of adopting competition policies – as is the case of Middle East and North African countries – can benefit from the experience of other countries in this area, be they other developing and transition market economies (such as Peru or Poland) or industrialized countries (such as the United States, Australia, Germany or Canada) . Through bilateral and multilateral cooperation involving such agencies as the UNCTAD, OECD, and The World Bank (FIAS), it is possible to facilitate the process of designing and implementing appropriate competition policies and laws.

While each country may need to adopt competition legislation and institutions suited to its particular circumstances, taking into account such factors as the stage of

economic development, domestic capacity, industrial market structure, and legal-economic framework, the principles outlined here will hopefully remain applicable.

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