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OECD Global Forum on Competition

CHALLENGES/OBSTACLES FACED BY COMPETITION AUTHORITIES IN ACHIEVING GREATER ECONOMIC DEVELOPMENT THROUGH THE PROMOTION OF COMPETITION

Contribution from the United States

-- Session II --

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**CHALLENGES/OBSTACLES FACED BY COMPETITION AUTHORITIES IN ACHIEVING
GREATER ECONOMIC DEVELOPMENT THROUGH THE PROMOTION OF COMPETITION**

**THE ROLE OF RESEARCH IN THE DESIGN AND IMPLEMENTATION
OF COMPETITION POLICY**

Executive Summary

1. Experience in a number of jurisdictions has shown that research can play an important role in improving the design of competition policy systems and the implementation of competition policy programs. In the period leading to the adoption of a competition policy system, research concerning the jurisdiction's initial conditions can assist in diagnosing barriers to competition and selecting a set of substantive legal commands and institutions that are most likely to promote the attainment of competition policy objectives. Once a competition policy system is established, a research program can inform the competition agency's judgment about how to apply its resources and, particularly in carrying out advocacy

2. Barriers to Competition

5. Barriers to competition take a number of forms in most countries.⁴ This section provides a summary of significant barriers to competition as a way to provide a frame of reference for considering, in later sections of the paper, how research can facilitate the development of pro-competition policies that increase economic growth. The discussion includes selected citations to and illustrations of modern research that has assisted in documenting the existence of specific barriers to competition and understanding their cost.

2.1 *Conduct of Private Parties*

6. Private entities, acting alone or in concert, can take a number of measures to suppress competition. These measures fall generally into one of two categories: *collusionary* behaviour by which rival firms agree to pursue a common course in setting output, prices, quality, or other terms of trade, and *exclusionary* behaviour, by which a firm, acting alone or in concert with others, seeks to deny a rival access to the market entirely or to some input necessary to compete effectively.⁵ A horizontal price-fixing cartel is the best-known example of conduct with anticompetitive collusionary effects, whereas an abuse of dominance – say, for example, the adoption by a dominant firm of exclusive dealing contracts that deny a rival access to downstream distribution channels without offsetting efficiency justifications – is one illustration of conduct with anticompetitive exclusionary effects.

7. With some variation, the competition laws of most jurisdictions condemn both forms of anticompetitive conduct.⁶ The principle concern of this paper is the pursuit of research activities that give priority to addressing the most serious restraints upon competition. As suggested below, collusion by direct rivals and government-imposed barriers to entry and expansion ordinarily will supply an appropriate starting point.

2.1.1 *Contributions of Research to Understanding Private Anticompetitive Conduct: The Case of Supplier or Purchaser Cartels*

8. Research has played a major role in increasing the understanding in a wide range of economic settings of how cartels operate and how they adversely affect economic performance.⁷ Modern research has provided informative insights about how cartels, old and new, have solved problems of organization, coordination, and internal discipline and about the actual economic effects of cartels.⁸ Another line of research has examined, at the national level, how specific forms of producer coordination take place within individual commercial sectors.⁹

2.1.2 *Links between Policies to Challenge Private and Public Restraints*

9. Relatively few competition policy systems limit themselves to the treatment of purely private behaviour. Most systems contain provisions that give the national competition agency, either through law enforcement or through various forms of advocacy, authority to oppose actions by public instrumentalities that reduce competition.¹⁰ The dual approach of addressing public and private restrictions on competition is widely recognized today as essential to effective policy making.¹¹ Effective enforcement against private anticompetitive conduct creates incentives for private economic actors to persuade the state to take measures that the law forbids private parties to undertake. A competition system that focuses solely on private misconduct runs a serious risk of channelling impulses to suppress rivalry toward eliciting public intervention and, in doing so, solves only half of the problem of competitive restraints.¹²

2.2 *Conduct of Public Bodies*

10. Government authorities adopt a number of policies that establish barriers to competition. Competitive distortions introduced by public intervention take the following forms.

2.2.1 *Policies that Directly Restrain Competition*

11. The most commonly discussed measures by which public intervention limits competition consist of *direct*

- *Consumer Protection.* Broad prohibitions upon advertising and related forms of marketing practices can deny entrepreneurs useful means to publicize their products and expand their client base.
- *Bankruptcy Law*

entities were exempt from privatization. This exemption placed a premium on the ability of the natural monopoly law drafting group to devise (and gain acceptance for) a working definition of "natural monopoly" that properly limits the activities subject to natural monopoly oversight. This problem had two dimensions. The first was to identify industry sectors that today have natural monopoly traits and to provide a mechanism for adjustment that takes account of changes in technology and competitive circumstances. The second was to address the conglomerate, integrated structure of firms that engage in natural monopoly activities.

27. During the era of central planning, the absence of strong markets for intermediate inputs and the government's desire to use firms as engines of social policy caused state-owned enterprises to pursue self-sufficiency. Thus, the state pipeline company owned not only natural gas pipelines, compressor stations, and scheduling facilities, but also owned the housing in which its workers live, the retail stores in which they shopped, the construction company that serviced the pipeline and other purchasers of building services, and the farms that produced the food consumed by the pipeline company's employees.

28. Ministries responsible for specific economic sectors in Ukraine had a strong interest in seeing that the concept of "natural monopoly" was defined and interpreted broadly, to increase the number of sectors exempt from privatization and to prevent the privatization of business entities that are affiliated by the natural monopoly firm but do not perform functions that could be called natural monopoly activities. A narrow definition of natural monopoly, and the de-conglomeratization of firms holding natural monopoly assets, promised to reduce significantly the ministries' base of economic and political power.

3.2 *Countervailing Interests: Potential Sources of Support for Competition Reforms*

29. In most countries, it is possible to identify potential sources of support for reforms that will increase reliance on market mechanisms to govern the economy. When engaged in the process of pursuing competition policy reforms, such groups can provide an important counterweight to the opposition interests identified above.

3.2.1 *Incumbent Firms that Suffer from Monopoly Overcharges*

30. It may be possible to identify industry groups whose opportunities for growth suffer from the absence of competition. One group of candidates consists of firms whose costs increase because they purchase inputs at supracompetitive prices set by a cartel or a dominant firm. Suppose that a domestic producer of decorative flowers exports its output in competition with growers located in other countries. The domestic producer can suffer a serious competitive disadvantage, and will lose sales, if it must purchase transportation services from a single-firm monopolist or a cartel.²³

31. Another group of enterprises that might support pro-competition reforms consists of service providers who do not buy inputs from a cartel or a monopolist but whose operations nonetheless depend on the prices charged and quality of service provided by the cartel or monopolist. Consider the example of hotel owners whose facilities serve foreign tourists. The hotels may lose customers if the government dedicates all domestic air transport service to a single state-owned enterprise that charges monopoly prices for domestic service to tourism destinations. A lack of price competition for the domestic leg of the tourist's journey may result in a cost for the entire tour package that leads the tourist to consider other destinations. It could be the case that economic and social policies designed to sustain employment or revenues for one sector (the domestic airline industry) deny the country the opportunity to realize still greater growth in employment and GDP by stifling growth in another sector (hotel and related tourism services).

3.2.2 *Government Authorities with a Stake in Promoting Economic Growth*

32. Some ministries of government might perceive how policies that suppress competition can diminish opportunities for economic growth. We can turn again to the examples mentioned above. The agriculture or foreign commerce ministries might be willing to oppose the transport ministry if greater competition in the transport sector would reduce the cost of exporting agricultural goods and increase export sales. The ministry responsible for tourism might oppose the transport ministry if adding a second domestic air carrier would depress domestic airline fares and attract more tourists to destinations within the country.

3.2.3 *Socially Disadvantaged Groups*

33. Complex regulatory regimes that increase the cost and difficulty of forming a new business enterprise fall particularly heavily on impoverished individuals or groups.²⁴ Competition policies that reduce artificial entry barriers can facilitate small business development and give previously excluded individuals new economic opportunities. Eliminating artificial regulatory barriers also can induce informal operators to participate in the formal sector. This gives the operators the protections available to formal sector participants (e.g., recourse to legal process, such as to enforce contracts) and gives the state the benefit of tax payments that informal operators do not provide.

3.2.4 *Consumer Organizations*

34. In a number of countries, consumer organizations are a valuable source of political support for pro-competition reforms. By publicizing the costs of policies that suppress business rivalry and informing the public about the benefits of competition, consumer organizations provide a vehicle for overcoming the collective action problems associated with accomplishing economic reforms.

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with academics, consumers, government officials, legal practitioners, and business managers. The case

avoid problems that sometimes arise when transition economy laws are modelled too closely upon off-the-rack variants of statutes or institutions developed in older market economies.³³

4.2 *Demonstrating the Costs of Policies that Restrict Competition*

44. Research can play a valuable role in the reform process by identifying and measuring the costs of private behaviour and public policies that suppress competition. Confronting defenders of the status quo

In many instances, the costs of regulation fall upon a large, diffuse body of actors, each of whom would realize comparatively small gains from regulatory reform and who collectively would incur substantial costs in forming a coalition to pursue reform. The combination of highly focused benefits and widely dispersed costs creates a substantial obstacle to reform.

49. Despite the power of regulatory restrictions on competition to endure, public policy in the United States since the mid-1970s has featured important episodes of pro-consumer regulatory reform. Regulatory structures that shielded incumbent service providers from competition have toppled or undergone dramatic retrenchment in the commercial airline, electric power, trucking, railroad, and telecommunications sectors. What once might have seemed to be immutable controls on entry and pricing gave way to liberalized regimes that rely heavily on competition as the means for governing economic activity.

50. Researchers played an important part in understanding the timing of these deregulatory measures and in fostering an intellectual environment supportive of reform. One contribution was to identify the costs of existing regulatory controls and to underscore the feasibility of reforms. Experience with airline deregulation provides an important example. By the mid-1970s, several empirical studies had shown that intrastate airline routes in California and Texas had much lower fares than interstate routes of comparable distance and showed that intrastate carriers operated profitably and safely.³⁸ Such studies provided crucial intellectual support later in the decade for efforts to abandon limits on entry and pricing for domestic carriers.³⁹

jurisdictions. The essential point is that, without a strong research base that is developed internally or derived from external sources, it will be difficult for the competition agency to make sound judgments about how to deploy its resources for enforcement or advocacy.⁴³

55. Performing case studies can help a competition agency, particularly new authorities, achieve important methodological and substantive objectives. Performing studies can enrich the agency's understanding of market phenomena that it must analyze and address in applying its enforcement powers. Case studies also serve important methodological ends. A study can be seen as an opportunity for the agency's staff to develop skills that are instrumental in investigating possible violations of the law and building cases.

56. Collaboration between the agency and foreign advisors can be effective elements of the agency's training program. In performing case studies, the agency's professional staff can acquire familiarity with the analytical tools and information-gathering methodologies that will be needed to enforce the competition law.⁴⁴ Case studies, in turn, can provide valuable material for devising training programs that use hypothetical examples and role-playing exercises based on economic circumstances true to the experience of new competition authorities.⁴⁵

5.2 *An Indigenous Intellectual Infrastructure*

57. Successful competition policy systems rely heavily on collateral institutions to develop technical skills and perform studies that are the essential foundations of good research.⁴⁶ The intellectual infrastructure that supports the development of competition policy in many countries has several discrete elements.

58. First and perhaps most important is the system of higher education. Countries with well-established competition systems rely heavily on universities to train students in the fundamentals of the law and economics of competition policy.⁴⁷ Key components of higher education are law schools that teach sophisticated courses in antitrust and economics departments or business schools that teach undergraduate and graduate courses dealing with microeconomics and industrial organization. For example, in the United States, professors who teach such courses can choose from a multitude of instructional materials that incorporate the latest developments in analytical techniques and policy. The U.S. competition agencies recruit numerous entry-level attorneys and economists from these programs.

59. In a number of countries, universities also generate substantial amounts of research and commentary that address phenomena relevant to competition policy. Supplementing the work of universities are countless institutes and think tanks. Some think tanks are located in government ministries, others are affiliated with universities, and still others are private institutions that perform research for public or private bodies on a fee basis. Numerous scholarly journals publish papers on antitrust and industrial organization topics, and such journals are widely accessible to government officials and practitioners. The academic community is the equivalent of a large network of competition policy research and development laboratories that supply the antitrust system.

5.3 *The Transmission Grid: The Media, Professional Societies, Trade Associations, and Consumer Groups*

60. Media organizations, trade associations, professional societies, and consumer groups provide useful networks for distributing the results of research relating to competition policy.⁴⁸ Collectively, they constitute the transmission grid for ideas concerning competition reform. Competition agencies and other bodies with an interest in promoting competition reforms tend to be proficient in using all three types of networks to make the case for competition policy.

61. In many competition policy systems, the results of research performed by government competition bodies or by external researchers are distributed through a variety of information conduits, including an expanding array of media organizations. In some countries, specialized media organizations regularly report on developments in competition policy and other forms of business regulation. These organizations provide means for various external constituencies, such as other government agencies and the business community, to obtain the results of competition policy research. The activities of media

- *Pre-Reform Study.* The design of new competition policy systems ought to proceed from a careful pre-reform analysis of the host country's initial conditions. Making such research a component of the technical assistance life-cycle helps ensure that the drafting of a new statute and creation of implementing institutions rests upon a sound understanding of local economic phenomena, the political landscape, and institutions whose operation will influence the application of competition policy.
- *Research as an Element of the Competition Agency's Mandate.* The new competition

NOTES

1. Organization for Economic Co-operation and Development, OECD Global Forum on Competition, Secretariat Background Note, *Challenges/Obstacles Faced by Competition Authorities in Achieving Greater Economic Development Through the Promotion of Competition* (CCNM/GF/COMP(2003)6; 27 October 2003) (hereinafter *Background Note*).
2. This paper uses the term “competition policy” to encompass advocacy, law enforcement, research, publicity, and related tools by which a competition authority seeks to encourage reliance on competition as the means for organizing the economy. See William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 *Chicago-Kent Law Review* 265, 281-86 (2001) (hereinafter *Institutional Foundations*) (discussing various tools by which public competition authorities seek to promote reliance on competition).
3. The Background Note defines “competition culture” to mean “there is political support to use competition in markets as the default or ‘normal’ way to organise economic activities outside the family, government bureaucracies and single economic entities (or single enterprises) and that this support is translated into

9. See William E. Kovacic, *Competition Policy, Economic Development, and the Transition to Free Markets*

18. See Gary Goodpaster & David Ray, "Competition Policy and Decentralization" (Partnership for Economic Growth: May 2000) (discussing impact of tax policy upon competition in Indonesia) (hereinafter *Decentralization*).
19. For an articulation of the concept and its application to institutional reform in transition economies, see Mancur Olson, *The Hidden Path To a Successful Economy*, in *The Emergence of Market Economies in Eastern Europe* 55 (Christopher Clague & Gordon C. Rausser eds., 1992). The possible lessons of public choice theory for economic law reform are summarised in Thomas S. Ulen, *Law's Contribution to Economic Growth*, in *The Law and Economics of Development* 59 (Edgardo Buscaglia et al. eds., 1997).
20. See Capelik & Slay, *Antimonopoly Policy*, at 84 (discussing resistance by state-owned enterprises and state ministries to market reforms in Russia); Kovacic, *Competition and Consumer Protection Reforms*, at 1203-05; William E. Kovacic, *The Competition Policy Entrepreneur and Law Reform in Formerly Communist and Socialist Countries*, 112.9(me(y)]T.2(i)n)105(d)den4(s)89.1(u)20.2(d]TJU(y)]T.2(d]Ti8(i)60.2(e)6-13

We know what makes for rich countries. We know the characteristics of productivity. We even know the kinds of institutions that must be put in place. The rule of law, property rights that provide incentives for people to be productive, and investment in human capital: all of these are necessary. We know all of this; but we do not know how to put in place the formal rules of the game accompanied by the informal rules and enforcement characteristics that are necessary for success.

28. See William E. Kovacic, *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine, and Zimbabwe*, 44 DePaul Law Review 1197, 1202-14 (1995) (discussing importance of studying existing transition economy conditions as basis for drafting new laws); Spencer Weber Waller & Rafael Munte, *Competition Law for Developing Countries: A Proposal for an Antitrust Regime in Peru*, 21 Case Western Reserve Journal of International Law 159, 165 (1989) ("a sophisticated political and economic analysis of the activities carried out by the enterprises in a national economy is an important aid in designing competition legislation for that country"). The Ray & Goodpaster paper, *Decentralization* cited above is one outcome of a substantial research program that various donors sponsored in Indonesia to analyse local institutions relevant to the

37. See Thomas K. McCraw, *Prophets of Regulation* 222-29 (1984) (describing key role of Alfred Kahn in executing airline deregulation initiatives during Kahn's chairmanship of the U.S. Civil Aeronautics Board in the late 1970s).
38. See, e.g., George W. Douglas & James C. Miller III, *Economic Regulation of Domestic Air Transportation: Theory and Policy* (1974).
39. The impact on subsequent reforms of empirical work on the costs of limits on entry and pricing in the U.S. airline sector is examined in Kaplan, *The Changing Airline Industry*, in *Regulatory Reform: What Actually Happened* 40 (Leonard Weiss & Michael Klass eds., 1986).
40. See Crew & Rowley, *Feasibility of Deregulation*, at 17 ("The role of the political economist as entrepreneurial provider of hypotheses concerning institutional reform is not to be underestimated.").
41. The value of *ex post* analysis as a component of a research agenda is considered in William E. Kovacic, *Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy*, 9 *George Mason Law Review* 843 (2001).

- Legacy of Doi Moi*, 29 New York University Journal of International Law and Policy 555, 566-72 (1997) (discussing the significance of law school education to the process of economic law reform in Vietnam).
48. On the role of professional bodies in disseminating information relevant to competition policy, see William E. Kovacic, *Creating Competition Policy: Betty Bock and the Development of Antitrust Institutions*, 66 Antitrust Law Journal 231 (1997).
 49. INDECOPI's creation and early operations are examined in Peru's Experience in Market Regulatory Reform 1993-1998 (Beatriz Boza ed., 1998). Boza's role in designing measures to enhance the intellectual foundation for policymaking in INDECOPOI is discussed in William E. Kovacic, *Lessons of Competition Policy Reform in Transition Economies for U.S. Antitrust Policy*, 74 St. John's Law Review 361, 370-72 (2000).
 50. See, e.g., The Role of the State in Competition and Intellectual Property Policy in Latin America: Towards an Academic Audit of Indecopi (Beatriz Boza, ed., 2000).
 51. See also International Competition Network, Working Group on Capacity Building and Competition Policy Implementation, Capacity Building and Technical Assistance – Building Credible Competition Authorities in Developing and Transition Economies 45-69 (2003) (identifying useful elements of technical assistance programs).
 52. See Murrell, *Missed Opportunities*, at 236 (proposing that foreign aid programs “aim to create a capacity for information gathering, research, and analysis”); see also Comprehensive Legal and Judicial Development 273-338 (Rudolf V. Van Puymbroeck ed., 2001) (series of essays discussing, inter alia, the value of dedicating technical assistance resources to the improvement of legal education as element of law reform in transition economies).