APPENDIX 5: SUBMITTED PAPERS

Competition, Trade and Regulation – Towards a Competition Checklist

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A STRATEGY FRAMEWORK

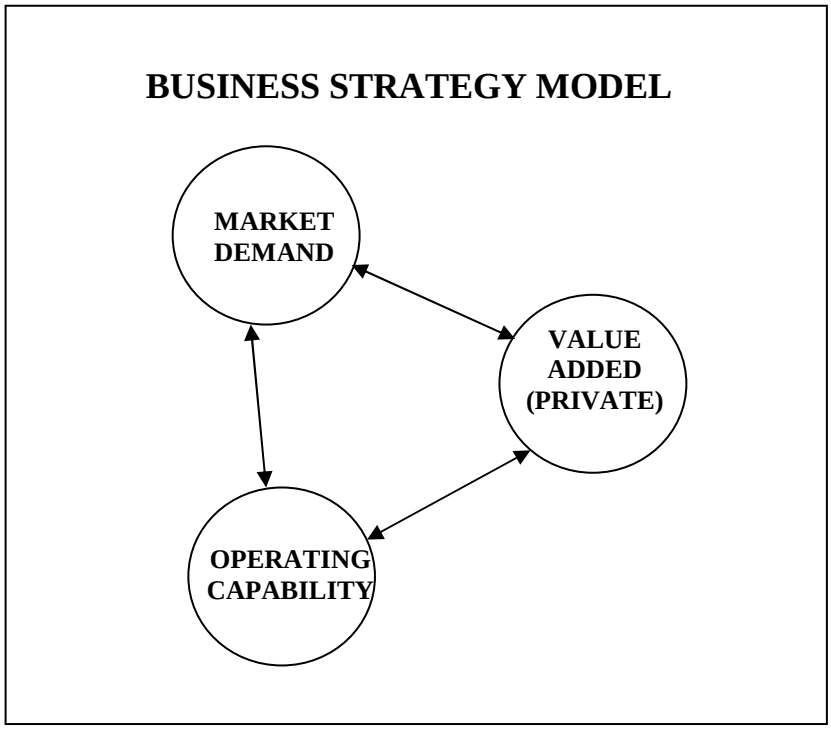
One framework has been developed by Professor Mark Moore[2] of Harvard's Kennedy School of Government, a teacher at the Australian and New Zealand School of Government (ANZSOG). It is an adaptation of a private sector business strategy model.

A Private Sector Model

One class of private sector model focuses on three key variables and their relationships. Essentially a business's strategy can be analysed by reference to:

- its output, or value added
- market demand
- its operating capability

and by reference to their relationships to one another.



2. See Moore, M. 1995, *Creating Public Value: Strategic Management in Government*, Harvard University Press, Cambridge, Massachusetts.

The only variable that requires elucidation is "value added", the difference between the cost of the inputs purchased by the business and the market value of its output.

Value added can be increased either by reducing the amount of input used to produce a given output or by increasing the quantity or quality of output with a given input (or by some mixture of these two).

"Value added" is either the actual or desired output of the business, depending on whether the purpose of the analysis is positive or normative.

Each variable can be fruitfully analysed in depth.

Then the interrelationships of the three variables can be studied to throw light on the effectiveness of the firm's strategy *e.g*. value added may not match demand; or operating capability may not be sufficient to support the value added dictated by demand.

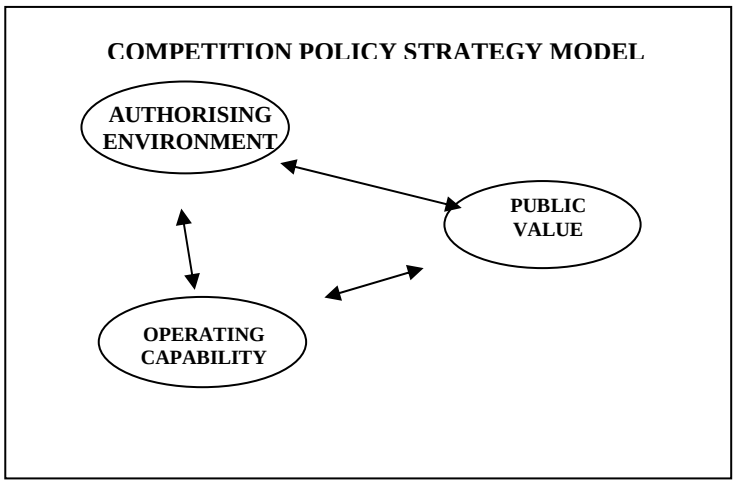
The model is useful in focusing on three key variables in a business strategy, in studying each in depth, in considering their interrelationships, and in reminding one that no one variable can be considered in isolation from the other variables.

A Competition Policy Strategy Model

Adapting this for a competition policy strategy, the key variables are:

- the value added to the public (public value);
- the operating capability. This includes the resources and strengths and weaknesses of the policy. (The model can also be extended to include "co-producers");
- the "authorising environment" *i.e*. the political environment which gives rise to legislation, regulation, and other political requirements and values which govern the work of the competition policy strategy.

This model is shown below:



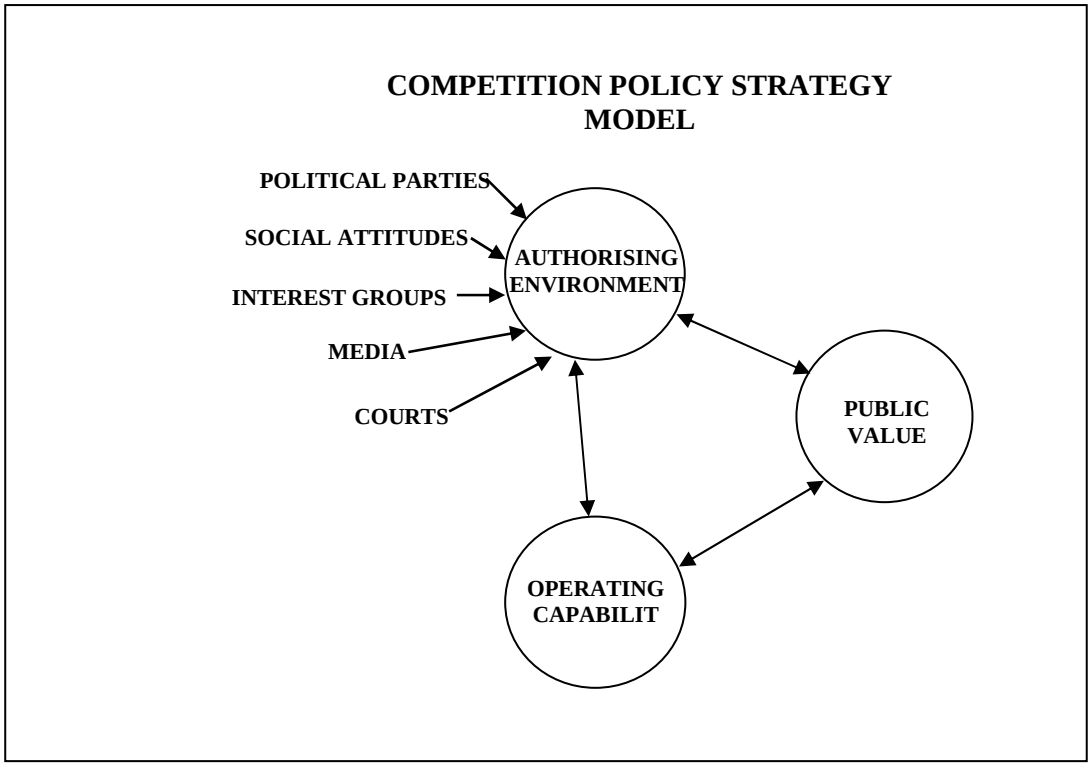
A few brief comments on two of these variables are:

- the nature of "public value added" is more difficult to determine and measure than in the private sector. In the private sector output is measured by price times quantity (and is evaluated or determined by market demand) and input is also measured by input price times quantity.

One feature of this concept is that it highlights the fact that value added can be increased by increasing the quantity or quality of output, or by decreasing the input quantity or price.

In the public sector it is often difficult to determine what and exactly how much output is of public value, and how output relates to desirable outcomes. Moreover, even where there is a measurable output (say reduced number of breaches of laws), questions of proper process arise as part of public value (*e.g.* reducing number of breaches by unlawful or undesirable methods would reduce public value) in a way that does not occur very much in the private sector. Questions of fairness also arise. Sometimes "output" is sacrificed in the pursuit of fairness.

- the "authorising environment" refers to the laws and regulations (and other explicit or implicit values) which authorise the nature and scope of the public value which a competition policy strategy seeks to achieve. However, even though those implementing the policy are bound to comply with its instructions, nevertheless it is impossible in any strategy analysis to ignore the factors which drive that environment and which cause it to be unstable or changing, or to be the source of ambiguity, conflicting directives and so on. An analysis of the authorising environment requires some analysis of interest group pressures, the media, social attitudes**,** political parties, the courts and so on.



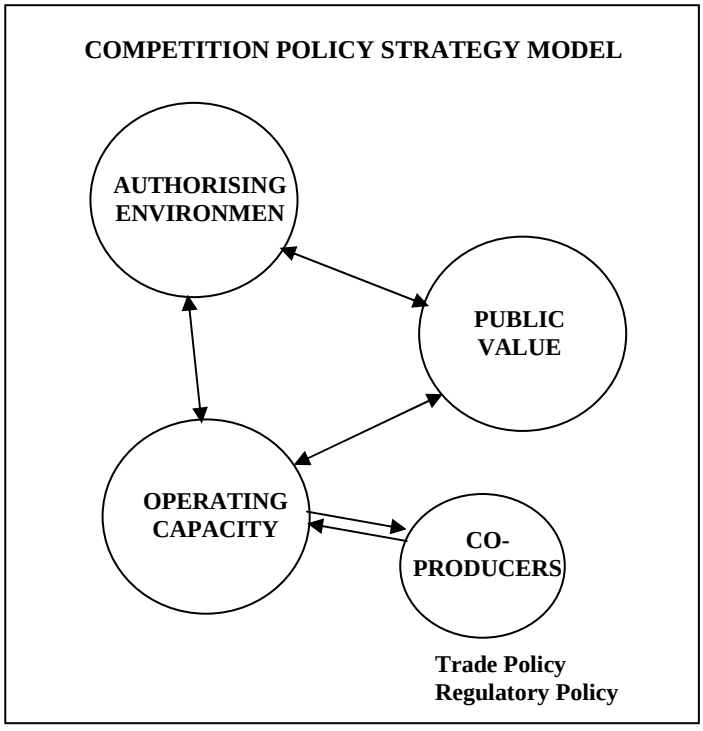
Once again in order to analyse competition policy strategy fruitfully it is useful to probe deeply each of the three circles.

It is also useful to relate the three circles to one another to determine if they are in alignment. If they are this is not necessarily cause for complacency *e.g.* the authorising environment may set a low public value on an important activity. However, even more interesting is a misalignment *e.g.* the public value is less than or greater than that desired by the authorising environment. Such misalignments tend to be unstable.

The value of the model is that it enables the analyst to look at the key variables but also to consider constantly their interrelationship. Often the manager focuses exclusively on one variable *e.g.* the need to minimise costs without looking at the bigger picture which includes the quantity and quality of output, whether the output is of public value, and whether it is in line with the wishes of the authorising environment.

This model is a useful way of organising discussion about a competition policy strategy, or part of it.

It is sometimes useful to extend the model to cover instances where those implementing the strategy receive help (or hindrance sometimes) from others *e.g.* trade reform helps competition policy.



COMPETITION, REGULATION AND TRADE

How do competition regulatory and trade policies relate to one another? Are they complementary or conflicting? Are they mutually reinforcing or pulling in opposite directions?

There is little doubt that for the most part they *should* be fully complementary, reinforcing and consistent and that there are relatively few occasions on which there needs to be conflict between the pursuit of competition, trade and regulatory goals. However, in the real world this is not the actual state of affairs. In the last forty years there has been a growing perception of the fact that much trade policy

inhibits international trade and international competition; that regulation is very often anticompetitive, quite often by deliberate design and at other times as a by-product of the single-minded pursuit of values other than those of economic efficiency and competition.

A very important challenge for policy then is to devise appropriate policies that harmonise competition, regulation and trade policies and minimise the conflict between them. Where there must be conflict this should be very transparent and the harm done to competition and efficiency should be minimised.

In this situation it is highly appropriate to try devise policy checklists. These are flexible tools that can used for a variety of purposes within governments. They are management instruments intended to draw attention to priority areas and to facilitate action by officials responsible for regulation. They can be helpful to create a framework in which such priorities are targeted. Checklists can also raise awareness and benchmark capacities. They can identify options, provide information to decision makers, and help design legal instruments to be drafted. They also provide reference points against which the decisions themselves will be made, and quality standards to assess how well regulators are doing.

This particular workshop is concerned with competition policy checklists and is intended to be relevant both to APEC and OECD nations.

COMPETITION AND TRADE

Our main focus today is on the relationship of competition and regulation but we need to note the relationship between competition and trade as part of the background story.

Much trade policy is anticompetitive, for example import restrictions. The harm caused by anticompetitive trade policy is not central to our agenda today. We should note that most of what is called "trade reform" is procompetitive (usually). Trade reform may not work well unless accompanied by an effective competition law within the trade liberalising country. For example, suppose that import barriers are removed with the intention of making foreign goods available to consumers. Suppose, however, that domestic manufacturers facing this competition enter in to restrictive agreements with local retailers under which those retailers agree not to purchase any imports for their customers, no doubt in return for favourable incentives. Such an agreement may be anticompetitive (depending upon the circumstances) and will frustrate the workings of trade reform unless competition law exists and is seriously enforced in the liberalising country to prevent this kind of behaviour.

It is also worth noting that sometimes regulation harms both trade and competition. For example, in the cases we have given above, the real problem may be regulation. For example, in a competitive economy the importers in some sectors maybe able readily to bypass established distribution and retail outlets and set up their own distribution and retail arrangements *e.g.* by establishing shops of their own. However, if there are shopping restrictions (for example on the number of shops, their size, their hours of opening, their location etc) then the real reason trade liberalisation would not work would be the existence of anticompetitive regulation.

COMPETITION AND REGULATION

A starting point in the analysis of the relationship between competition and regulation is that as a general rule economic efficiency stems from competitive markets. Economic efficiency broadly means that consumer demands are met at least cost and goods and services match precisely the demands of consumers in terms of quality, service, a variety of choice etc.

Efficient outcomes are likely to be impeded by the existence of laws which restrict competition; in some cases the existence of monopolies especially those brought about by legislation; private sector anticompetitive business actions such as cartels, anticompetitive mergers, abuse of market power; anticompetitive distortions and behaviour when governments engage in business and take advantage of their position to gain a special advantage (*e.g.* no tax payments); and inappropriate regulation of monopolies or social or environmental regulation.

Regulatory reform therefore involves:

- the removal of unwarranted anticompetitive laws and regulations;
- the elimination of anticompetitive business actions through the vigorous and application of competition law;
- appropriate policies to ensure that government businesses do not enjoy special advantages over private sector competition;
- the appropriate economic regulation of monopolies so that the harm they would otherwise cause is minimised;
- appropriate social and environmental regulation that achieves objectives that go beyond those of economic efficiency but in a way that does minimum harm to competition and efficiency.

As a general proposition then any necessary regulation in economy should harm competition and efficiency minimally, should remove public or private barriers to competition and meet high quality standards in terms of proper public decision making criteria.

COMPETITION POLICY – GENERAL CONSIDERATIONS

Before discussing competition policy in detail, some general features should be noted. They are:

- Competition law normally involves substantial government intervention to achieve competitive market, so-called “free competitive markets”. This is in some respects a paradox and it can create unusual constituencies which either favour or oppose competition law. Some promarket minded persons oppose competition law because too much intervention is needed to achieve good market outcomes. Other persons who temperamentally do not enthuse about the working of markets or who have some kind of antimarket attitude are often supportive that competition policy is applied because it is seen as striking at big business, a worthy target at all times.
- A further important related feature of competition policy is that it requires very detailed enforcement and administration. It differs from some other policies where, once the law has been enacted, there is relatively little for the government to do. A tax rate change or an import tariff rate change, once enacted, requires relatively little implementation by the government. The law is changed at the stroke of a pen and nothing remains but for the market to get to work to reallocate resources. Competition law is quite different. Once the law has been enacted a plethora of activities must occur; the establishment of institutions such as regulatory institutions and courts; the undertaking of investigations; decision making in the light of investigations; judicial processes including appeals; educational activities and so on.

Another important characteristic of competition law is that it encounters somewhat contradictory seeming attitudes by those affected by it. Most people and most businesses want their suppliers and their customers and sometimes their competitors to be subject to the stringent application of competition law. This is for their own benefit. However, when the law is applied to themselves they do not welcome it. It is usually harmful to their interests, and they put these ahead of any acceptance that their may be public interest considerations. And in any case they often fail to see the public interest considerations that may be involved in cases affecting their own immediate interests.

This inevitably leads to strong pressures against competition law. The losers from competition are most often a powerful lobby while the winners are a weak one. Moreover, the size of the property rights involved in competition law is very large and this exacerbates the tensions. In just about every country there is quite strong opposition by business lobbies to the vigorous application of competition law. They seek its watering down, they may support its general application but seek special exemptions and special deals, and since the amounts of money involved can be very large they press vigorously to weaken competition law. This is one of the reasons why the question of competition advocacy must be addressed in discussions about competition law.

- Another general issue concerns the notions of broad and narrow competition policy. Traditionally, especially in North America, the home of antitrust, the major element in competition policy has been the application of antitrust law. However, in many countries the most serious impediment to competition arises from government actions – government laws and regulations that restrict competition; that establish protected monopolies; or that involve governments themselves conducting businesses in anticompetitive manner or sometimes subsidising particular businesses in ways that are harmful to competition. It is generally important that both aspects of competition policy be part of the policy agenda.

COMPETITION POLICY AGENDA

It follows from the preceding that we can identify some broad elements of a competition policy agenda that would be relevant to any checklist. The most obvious elements are:

- removing laws that are unnecessarily anticompetitive

- the removal of barriers to international and intranational trade

- where governments have established protected monopolies, the minimisation of such anticompetitive structures by horizontal and vertical break-up (as has happened in many parts of the energy sector around the world)

- applying competition law vigorously and properly to cartels, anticompetitive mergers, misuse of market power and so on

- the regulation of monopoly including, in appropriate cases, access to “essential facilities”

- the achievement of competitive neutrality. This means that where governments conduct business activities of their own that they should have no artificial advantage over private sector competitors, for example because of softer tax treatment. We should also note that in some parts of the world the question of state aids is very important. This refers to the fact that sometimes governments subsidise particular businesses in particular parts of a country (perhaps for employment or social or regional reasons) and thereby confer on them a major competitive advantage over non-subsidised businesses.

ANTICOMPETITIVE REGULATION

Often the biggest but most administratively tractable issue in developing countries is anticompetitive legislation and regulations.

It is desirable to review all anticompetitive laws in all sectors of the economy to ascertain if they are in the public interest; and if public interest objectives could be achieved less anticompetitively. A similar approach should be adopted to review monopoly structures established by governments *e.g.* monopoly public utilities in energy, telecommunications, transport and agriculture. It is important that such reviews be done very transparently and by persons who are independent of the political process.

COMPETITION LAW ELEMENTS

We now turn to traditional competition law (or antitrust law or trade practices law or commerce law). It has various appellations.

First there are some questions about policy objectives. Are the policy objectives concerned with the promotion of competition solely or economic efficiency, or is there are wider public interest objective, and if so how important is efficiency as an element in the public interest? There are also some debates about the extent to which producer economic benefits should be regarded as an element of public economic benefits and not likely to be passed onto consumers.

In developing countries there is an important debate about the linkage of competition law and the need for industry development. Are these objectives in harmony? Or do they conflict?

Another important element in competition law concerns its substantive content. The substantive content of competition law is that it generally prohibits anticompetitive agreements of various kinds, for example regarding prices, market sharing, collective boycotts and a range of other forms of agreements that lessen competition. This is the cartel dimension. Competition law also prohibits anticompetitive mergers although sometimes this is subject to some kind of efficiency or public interest exemption. Competition law also prohibits the misuse of market power for anticompetitive purposes *e.g.* by predatory pricing, anticompetitive refusal to supply, anticompetitive vertical trade restraints *e.g.* exclusive dealing, and the use of market power in one market to harm competition in another market.

There is a debate about the sequencing of these elements of competition law when they are first introduced in developing countries. Most would favour an initial emphasis on cartels but some countries such as South Africa have found it is very useful to focus on mergers.

Subject to this sequencing point, there is a surprisingly high degree of consensus on what the substantive elements of competition law should be. The only further area of debate is whether or not one would include consumer protection law within the ambit. In some countries competition law and consumer protection law are closely linked while in others they are kept separate. The argument for their linkage is that consumer protection law especially focuses on any false advertising or misleading or deceptive conduct. The provision of incorrect information to markets hinders the working of competition therefore the policies should be linked.

Another important question is the sectoral coverage. Nearly every individual, firm, industry or sector wants an exemption from competition law, usually with little justification. Moreover, they want politicians to dispense this exemption rather than independent regulators who weigh up cases on their merits. One of the difficulties in not having full sectoral coverage is that it creates further pressure once a particular sector is exempted for other sectors to be so exempted.

Generally, however, competition laws are limited to product markets, to markets for goods and services. They do not apply to labour markets. This is a value judgement that most countries make. Another very interesting exemption is that of export cartels in most countries.

LINKS WITH OTHER POLICIES

The issue of the relationship of competition, regulation and sectoral regulation frequently arises. There is a multitude of sectoral regulators. To take telecommunications as one example, most countries have a competition regulator and a separate telecommunications regulator both addressing competition issues, often in different ways. An important element for any checklist of policies is to ascertain the amount of overlap, cooperation, and conflict between such regulators and to determine whether steps can be taken to improve the situation. There are similar issues about the relationship of competition and social and environmental regulation and, as we have earlier mentioned, between competition policy and trade. With developing countries there is a special opportunity to consider at an early stage the optimal links between policies.

INSTITUTIONAL ARRANGEMENTS

So far we have dwelt on some of the economic prescriptions for competition law. However, as noted earlier, there is a vast administrative and enforcement challenge involved in competition law. It is of great importance to devise appropriate administrative and institutional arrangements. This is a great challenge especially in developing countries.

There is a very long list of desirable institutional arrangements. Here are some:

- because of the serious property rights conflicts it is important to separate competition law decision making from immediate political influences by establishing independent regulators and independent courts.

- it is also vital that there be due process. This is important in any area of public policy in any country. Justice must be done and be seen to be done. It is especially important in competition law because it adds greatly to its legitimacy. The absence of due process enables critics of competition law to take steps to have the whole of competition law weakened, damaged or even overthrown. By focusing on bad process opponents can distract attention from the need for policies to bring about important economic results.

- An especially important process requirement of competition law is that it should be as transparent and public as possible. This builds public support and trust. It also means that difficult policy questions can be debated by the experts and by the community. Competition law cannot be managed by behind closed doors arrangements: accountability requires that it be as transparent as possible, though there are some constraints owing to the need for confidential business information to be protected.

- In most countries the courts have a key role. They have in general good processes. They sometimes have difficulty with economics. They are in many countries accepted as legitimate forums for the resolution of important disputes over property rights. In all countries, but perhaps especially in developing countries, they need education in this area of the law.

- Substantial regulatory institutions need to be set up. They need to develop appropriate, economic and legal skills. In developing countries they can benefit from technical assistance and other help with capacity building. Sometimes regulatory institutions are in a weak position at the outset of the policy process and this means in turn that the law must be limited in its ambitions.

GOVERNMENT-OWNED BUSINESS ACTIVITIES

An area of some importance is that where governments themselves conduct business activities. They are often considered to have unfair advantages over private sector competitors. They may not pay tax, they may have an ability to borrow at low rates of interest and have other advantages.

In order to avoid harm to competition, policies of competitive neutrality should apply under which the net advantages that government bodies have over the private sector should be removed.

As we have already noted, another related issue concerns the use of state aid to limit competition.

ADVOCACY

There is in most countries a substantial political challenge to the implementation of competition law. This gives rise to important questions about advocacy for competition law and policy. One important question concerns institutional arrangements. It is arguable that competition regulators should be closely involved and consulted in relation to any government laws that restrict competition. In some countries the chairpersons of regulatory bodies are actually members of the cabinet. In the European Union the Competition Commissioner is present at the table when all decisions about European Commission policy on all subjects are made and the Commissioner has an opportunity to intervene in all such matters. In other instances regulators are kept at arm's length from government. Their role then is often limited to making public statements about the impact of competition law. The importance of publicity in these matters cannot be overstated. Competition policy generally works in the public interest. The more public support and understanding that can be harnessed, the more likely competition policy is to work well.

THE STAGE OF DEVELOPMENT OF COMPETITION

Competition laws and policies are at different stages of development in different OECD and APEC countries. This can mean differences in objectives, substantive content, coverage, institutional arrangements and the like.

Much capacity building and technical assistance is needed.

The checklist is relevant to all of these questions.