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Working Group on the Interaction between Trade and Competition Policy

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The following communication, dated 18 April 2002, has been received from the Permanent Mission of Canada with the request that it be circulated to Members.

Two Principles for Technical Assistance with regard to Competition Policy

Globalization and liberalization of world markets has fostered a growing international interest in competition policies. This reflects, in part, the increased market orientation of governments world-wide and the growing recognition of the key role that competition can play in efficient markets. In parallel, there is a recognition that competition policy can help structural adjustment and can assist an economy in withstanding and adapting to international economic changes and pressures. The promotion of competition law is not an end in itself; it is pursued because rivalry in the economy promotes the best use of scarce resources. In this light, this paper sees an aspect of technical assistance as being a policy process for coming to grips with the core economic underpinnings of competition policy and adapting this thinking in the design of new competition systems suitable to a given economy.

This note sets out two broad economic concepts that are important to any sound competition law and enforcement program regardless of the specific statutory structure under which it operates, namely:

- the concept of economic efficiency, and

- the protection of competition and the competitive process, not competitors.

These two principles should ideally underpin the early policy choices with regard to competition policy and its development. From a broad policy perspective, the primary objective of technical assistance is to encourage the elaboration and adoption of welfare-enhancing, economy-wide competition rules that will promote a solid basis for growth and development. Flexibility and adaptability, underpinned by sound competition law and policy, are essential characteristics of a successful economy capable of generating sustained economic and social development. Competition policy has an important social component: it fosters a society based on achievement and merit. It ensures that human resources and capital are put to their most efficient use. Competition law enhances economic and social developmental goals, opens the way for investment, including investment in human skills, and provides positive incentives for generating growth and sustained development.

Although competition policy is taking root in different socio-economic environments and thus includes many viewpoints on specific issues, recognition is also growing that the design of an effective competition policy system needs to be underpinned by core principles. In selecting two such principles for this note, we seek to avoid focussing on the specific differences that may exist among various competition regimes. The goal is to present a short introduction to two concepts which are important for any competition law and enforcement program regardless of its maturity or the specific statutory, legal environment or institutional considerations under which it operates.

Protect Mutually-Advantageous Transactions: Central Role of Economic Efficiency

Competition forces firms to become efficient and to offer a greater choice of products and services at competitive prices. In a competitive market economy, price and profit signals tend to be relatively free of distortions and this creates incentives for firms to redeploy resources from lower-to-higher valued uses in line with consumer preferences. The objective of competition policy is to promote competition by eliminating or preventing those private restraints that adversely interfere with the competitive process.

In almost every country with an antitrust law and an enforcement institution, competition policy must reflect on the potential benefits of reducing the wasteful use of human, capital and physical resources. The concept of economic efficiency has a fairly clear economic meaning. It refers to the ideal of ensuring resources are put to their most productive uses, producing those goods and services that society values the most. Efficiency gains are often determined for a given transaction with regard to price, quality, output, innovation and ultimately, consumer welfare.

The concept of economic efficiency supports developmental objectives: it encourages each jurisdiction to put its resources to their most socially-desirable uses. The focus of economic efficiency yields the best allocation of resources based on prices that adequately reflect costs.

There is a recognition that markets will shape the distribution of income and that under competitive conditions, the result in part will be based on individual productivity. Free markets promote sustained economic growth by facilitating efficient allocation of human skills and investment. Growth lifts economic and social prospects for all participants. Nonetheless, the resulting jockeying between winners and losers from competition leads to a consideration of other objectives for competition law, which are broadly grouped in the literature as fairness considerations, for example the protection of small retailers, consumers or particular occupational groups. If competition policy is, in part, to address fairness concerns in any jurisdiction, then a consensus will need to be fashioned as to what constitutes the public interest, i.e. a formula for the balancing of economic efficiency and fairness considerations.

At one end of this debate is the view that the sole purpose of competition policy is to maximize total wealth and growth. Under this view there is a limited justification for socio-political criteria such as fairness and equity. The opposite view, of course, is that competition policy should also be based on certain equity considerations reflecting a variety of social preferences, which its proponents hold should not be ignored. Within the spectrum, there are a range of views on the relative weight to be attached to different factors.

Attempts to take into account multiple objectives in the administration of competition policy may give rise to conflicts and inconsistent results. For example, protecting small business and maintaining employment in certain circumstances could conflict with attaining economic efficiency. Competitors rather than competition may be protected. These multiple objectives cannot be easily quantified and are usually the subject of a compromise.

At the same time, caution must be exercised so that the fairness/equity concept not be used, or more accurately misused, in favour of ensuring an equality of outcomes in the marketplace or for buttressing protectionism. For this reason, the examination of efficiencies always remains at the heart of competition evaluations.

Protect Competition not Competitors: Industrial Policy and Market Rivalry

Industrial policy refers to actions that a country may take to affect the mix of its industrial activities. Countries embrace industrial policies because they have collective preferences about the composition of their industrial sectors.

When markets work, all participants are better off. Industrial policy is called into service when markets are perceived to have failed. The natural tasks of industrial policy then become apparent, according to Caves, Frankel and Jones in *World Trade and Payments:* "Fix any defects in factor markets that keep the returns of a factor from being equalized among industries, and fix any defect in a product market that causes it to employ too few factors (such as a monopoly) or too many (restricted outward mobility)."

Industrial policy proponents often advance a sectoral allocation of resources motivated by a blend of factors: attempts to correct for market failures, belief that a country requires a presence in a sector or to reward a variety of vested interests. Thus, in the broadest sense, industrial policy refers to the full range of measures that governments employ to promote an efficient industrial structure. In a narrower sense, industrial policy describes a subset of economic measures designed to provide special advantages or assistance to particular industries or firms.

If one focuses on the broader concept, competition policy itself constitutes a key element of an effective industrial policy. It strengthens incentives for continual innovation and the systemic upgrading of products and production processes. On the other hand, some applications of industrial policy in the narrow sense, for example tariffs or the creation of monopolies through regulation, can be antithetical to economic efficiency objectives. Indeed, economic literature suggests that, in many cases, the effect of such policies is to frustrate the operation of competitive forces, thereby advancing the interests of specific groups within society.

Economists have traditionally been skeptical about the practical effects of picking national champions and their contribution to sustained economic performance. One reason for such skepticism has to do with the concept of "rent seeking". This concept recognizes that, in practice, government support for specific industries is influenced by pressures from interest groups. As a result, legitimate objectives related to economic efficiency may be supplanted by protectionism and the unwarranted preservation of inefficient industries.

Competition policy has a dual role to play in relation to industrial policy. On the one hand, it contributes directly to an effective industrial policy through the maintenance of inter-firm rivalry. Specific aspects of competition law, such as the treatment of efficiency gains and R&D joint ventures, can also contribute to efficient structural adjustment. On the other hand, a key role of competition policy in a modern economy is to challenge industrial policy interventions that restrict competition without a sound efficiency-related basis.

In general terms, antitrust law and enforcement should not become enmeshed in picking winners or buttressing the prospects of national champion firms. The competition policy focus needs to be on maintaining the competitive process rather than ensuring a privileged position for incumbents or dividing the market among a fixed number of players. It is, of course, recognized that this principle will undergo adaptation and refinement in responding to particular challenges and circumstances.

All economies will face issues related to market failure. In such circumstances, competition policy has an even more critical, stepped up role to play, namely, encouraging an informed debate about the relative merits and costs of the industrial policy responses selected to address the perceived market failures.

Implications for Technical Assistance

The central role of economic efficiency and the protection of the competitive process are two broad principles underpinning competition policy and its enforcement. These two principles form part of the economic foundation for competition policy. In practical terms, these principles provide competition policy-makers with a degree of flexibility to respond and to adapt to changing socio-economic circumstances. As countries build a framework for competition policy analysis, law and its enforcement, these principles will need to be addressed and tailored to specific circumstances. The possibilities for success in preparing new legislation or designing new enforcement institutions are likely to increase if such initiatives are informed by the core economic principles underpinning competition policy and are based on careful study as to how these principles can be best adapted to a country's socio-economic context.

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