At a Glance

The World Bank FPD Note No. 14 July 1994

Competition Law
Some guidelines for implementation

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High costs, poor economic performance associated with most forms of government interventions, large fiscal deficits and pressures to downsize the public sector, have led several developing and former centrally planned economies towards more market-oriented policies. These economies have highly concentrated industries, large state-owned sectors and/or inefficient firms operating in small markets insulated by trade barriers. Competition law will help them by strengthening market forces. Not only will the law help to lower costs and prices and increase consumer welfare, but it will foster sound business discipline, culture, and ethics—especially as state monopolies are being privatized. This is important in a world economy which is becoming more integrated, where countries can no longer protect their industries without loss of profitable opportunities and international competitiveness. This Note offers a framework for the design and implementation of competition law.

Overview
Competition law seeks to prevent anti-competitive business practices and the developments in industry structure which facilitate these practices. It stops unfair business tactics or abuse of market power to gain excess profits. The rules applied by competition law are not regulations, as some critics claim. On the contrary, they help to minimize government involvement in business. If governments have a clear set of competition rules it is easier to bat away lobbying by special interest groups for intervention.

Competition law touches most other economic policies affecting competition in local and national markets: for example, regulation of transport, power, telecommunications, and other sectors where natural monopolies are likely to occur; international trade; foreign direct investment; intellectual property rights; financial markets; and privatization. In other words a broad range of competition policies can play an important role in determining which markets are accessible to firms. These policies can all reinforce competition law. For example, just before the North American Free Trade Agreement (NAFTA) was signed, Mexico updated its competition law to lower internal market barriers and ensure nondiscriminatory treatment of business. Provisions in the EEC Treaty have similar objectives.
Some argue that liberalized trade and deregulation are sufficient measures to promote competition. However, this is not necessarily the case. A high and increasing share of economic activity is related to nontradeable products and services. In addition, competition law is better at addressing situations where:

- international cartels restrict competition with price-fixing and geographic market-sharing agreements;
- inter-firm contracts tie up scarce raw materials or distribution channels;
- high transport costs or the perishable nature of some products shrink the pool of suppliers; and
- there are government regulations, differences in product, safety, consumer protection, and technical standards.

The sequencing of competition law is important. For example, it needs to precede or simultaneously apply to privatization programs to prevent government monopolies from merely being transferred into private monopolies.

**Clear objectives**

Competition law should have clear objectives. The principal objective should be to maintain and encourage competition to promote economic efficiency and consumer welfare. However, in some countries, competition law has many goals under the rubric of “public interest”, including regional development or employment, “fairness,” pluralism, or diffusion of economic power through promotion of small and medium-size businesses.

Multiple objectives invite lobbying by different stakeholders in the economy. They can lead to inconsistent application of competition law which means that governments end up protecting some firms from competition. The result is at odds with competition law, which aims to protect the competitive process and not competitors. Trying to balance a wide range of (often-conflicting) social-political-economic concerns is sure to undermine long-term competitiveness, economic growth, and jobs. Different goals are better pursued by different policies.

Making economic efficiency the principal objective supports consistent application of policies and is more likely to limit vested-interest lobbying. This is especially important for countries with limited administrative capacity and weak institutional structures.

In recent years, Canada, the United States, the EEC, Italy, and New Zealand have placed more weight on an economic efficiency objective. Several developing countries, including Colombia and Mexico, have done the same. But some countries, notably France, India, the U.K., and emerging economies in Central and Eastern Europe, pitch competition law towards multiple objectives.

**Application**

Competition law can be applied in two ways. The first approach is structural, focusing on market share and industry concentration. The second is behavioral, where the focus is combating anticompetitive business practice and pricing policy.

**Structural**

Economic theory backed by empirical evidence suggests that industry structure has an important bearing on firm behavior and performance. Large firms operating in industries with few competitors are more likely to engage in anticompetitive practices. In reality, large firm size does not necessarily confer market power. If there are no barriers to entry, the market will be contested by new competitors every time large, established firms try to hike prices and cut output to make excess profits.

**Behavioral**

The behavioral approach focuses on how firms do business. Some business practices such as collusion between competitors to fix prices, reduce output, allocate customers, and share markets are clearly anticompetitive and should be *per se* illegal. These practices should be strictly prohibited and, to deter offenders, be subject to heavy fines and penalties. But the effects of business practices such as exclusive dealing contracts between sellers-buyers, inter-firm cooperation in research and development, and establishing product standards are not so easily decided. These need a case-by-case examination applying a *rule of reason* approach. Structural
arrangements such as mergers and acquisitions and joint ventures have to be examined in the same way.

*The need for balance* The structural approach needs to be used with care. Economies with large domestic markets do not have too much difficulty using it. Competition will generally be vigorous because there are more firms. Market share thresholds can be specified to trigger government action to maintain competition. Such thresholds are used in the administration of horizontal merger provisions in the United States and Canada.

However, the potential risks of misapplying competition law, and its impact on the economy, tend to be greater in countries with small markets. Here the domestic market may be frequently characterized by industries with few firms and high concentration. Applying structural measures to ensure competition may stop domestic firms from achieving the minimum optimal size needed to compete in international markets. In these circumstances, worries about high concentration can best be alleviated by removing government curbs on foreign trade and investment, and regulatory barriers to entry, such as licensing.

**Enforcement**

The best watchdog of fair competition is an impartial independent competition policy agency. Investigation, redress, and policy intervention are the main features of a sound process:

*Triggering an investigation* Competition law requires a mix of structural and behavioral criteria to touch off an investigation. There must be clear criteria by which cases or investigations would be triggered. Otherwise the law will create business uncertainty and undermine the competitive market process. Too lax an approach means that the monopolistic position of enterprises in the economy will become entrenched. It may take a long time for market processes to correct this. Conversely, too vigorous an application of the law may arrest the development of the market and slow economic growth.

Competition authorities can help business certainty by clearly indicating firm size beyond which the competition policy agency will examine a specific matter. Canada and the United States publish guidelines on market shares in merger transactions which would probably trigger a competition review. In other countries, market share figures define the monopoly, or “dominant” market position of a firm.
Virtually all jurisdictions identify which business practices are strictly prohibited or per se illegal (such as price fixing) and which ones will be examined on a case-by-case basis applying the rule of reason type approach (such as exclusive dealing and mergers).

**Administering a fair redress mechanism**  
Good competition law will include a redress mechanism for consumers and firms if they have suffered from anticompetitive practices. (Many complaints made to competition offices in industrialized countries are raised by business firms.) This provision must not become an instrument for firms and consumers to impede the competitive process. The law should apply equally to government and private firms. While competition law should apply to all sectors of the economy, some exemptions may be necessary to allow certain kinds of economic activity—for example, collective bargaining, underwriting new stock issues, and insurance—without restraining competition in the final market.

The investigation and prosecution functions of the law should be separate from adjudication. Otherwise a competition agency may become investigator, prosecutor, judge, and jury, rolled into one. Still the competition agency can negotiate settlements; for example, in merger transactions, firms may voluntarily agree to divest assets to maintain competition and avoid costly litigation. However, in a disagreement between the competition agency and the business firms, there should be alternative resolution mechanisms available. Countries without appropriate or adequately developed legal systems or where the courts get backed up can establish a separate competition board/tribunal of experts from the academic, business, government, and legal communities.

**Features of a competition policy agency**
- **Independent**, insulated from political interference.
- **Transparent**, well-designed administrative mechanisms, regulations and procedures.
- **Separate** investigation, prosecution, and adjudication functions.
- **Checks and balances** with rights of appeal, reviews of decisions, and access to information on legal and economic interpretation.
- **Expeditious and transparent proceedings** which safeguard sensitive business information.
- **Provisions for imposing significant penalties**.

**The competition authority should:**
- have a **statutory role** in the formulation of regulatory policies.
- have a **secure place** in government policymaking.

Private legal actions by business firms and consumers should also be possible. The burden of enforcing competition law does not have to rest solely with a government agency.

**Intervening in other government decisions affecting competition**  
An effective competition agency should spell out clearly the implications for competition and efficiency of public policies so that these are considered in government decisionmaking. This makes governments and competition agencies more accountable, increases awareness of the costs-benefits of alternative policies, and helps to ensure that government policy objectives do not work at cross purposes.

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