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THE OECD INITIATIVE ON INVESTMENT FOR DEVELOPMENT A POLICY FRAMEWORK FOR INVESTMENT: COMPETITION POLICY

Michael Gestrin
Senior Economist, Investment Division, OECD

1. Introduction

This paper addresses one of the policy areas being considered for inclusion in the *Policy Framework for Investment* within the context of the *OECD Initiative on Investment for Development* -- competition policy.¹ Competition policy has long been recognised as being closely related to both development and international investment issues. However, it is also an area where considerable scope remains for building capacity and consensus. The purpose of this paper is to examine the various ways in which competition policy can contribute to creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to societies. It is intended as an initial input and to serve as background documentation for an eventual chapter of the *Policy Framework on Investment* on competition policy issues.

Section 2 briefly outlines the relationship between competition policy and development. Section 3 examines the relationship between competition policy and investment, including issues that are relevant from a foreign direct investment (FDI) perspective. Section 4 focuses on experience within the OECD with respect to international co-operation on competition issues. Section 5 concludes by outlining issues that policy makers should take into consideration as well as questions for further consideration, based upon experience both within and outside the OECD, in the formulation and implementation of competition policies in order to promote an attractive environment for domestic and foreign investment, and to maximize the contribution of investment to development.

¹ Other proposed policy areas to be covered in the *Framework* include, *inter alia* investment policy; investment promotion and facilitation; trade policy; tax policy; corporate governance and responsibility, and market integrity; human resource development; infrastructure development; and public governance. In addition to host country policy action, the contribution of international co-operation and developed countries will also be addressed

2. Competition policy and development

Competition policy has come to play an increasingly important role within the context of the global development agenda. For example, the Monterrey Consensus, the values and objectives of which underpin the OECD *Initiative on Investment for Development* and the *Policy Framework for Investment*, emphasized “the promotion of a competitive environment” in order to allow “businesses, both domestic and international, to operate efficiently and profitably and with maximum development impact” (paragraph 21). The Monterrey Consensus also called on members of the WTO to implement the commitments made in the Doha Development Declaration, which recognised “the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in [the area of competition policy], including policy analysis and development” (paragraphs 23-25).² Work undertaken at the OECD, UNCTAD, the World Bank and the WTO, among others, has underscored the relevance of competition policy from a development perspective. Furthermore, developing countries have been adopting competition laws and policies in ever increasing numbers, pointing to benefits that these would seem to associate with doing so. While approximately 27 developing countries adopted some form of competition law during the 1990s,³ an additional 35 were in the process of implementing competition laws as of February 2004.

In general terms, one of the key links between competition policy and development has been the role that competition policy can play in promoting economic efficiency. The efficient use of resources is especially important in the development context where resources are particularly scarce, an issue emphasised in the Monterrey Consensus. The economics literature generally distinguishes between static and dynamic economic efficiency. Competition policy has variously been ascribed a role in promoting both. The main static effects of competition are to reduce the ability of firms to raise price above marginal cost and to ensure that firms produce at the lowest possible costs. The dynamic consequences of competition can include incentives to innovate, to imitate, and to invest in the development of new technologies and know-how. Competition policy reinforces economic efficiency by preventing or providing remedies for market structures and business practices that weaken the degree of inter-firm rivalry in markets.

In addition to the potential benefits of the implementation and enforcement of competition law and policy in terms of static and dynamic efficiencies, competition authorities have also been ascribed a more general advocacy role. Although the advocacy role of competition authorities defies a precise definition, it has been associated with public education and awareness activities, development of a competition culture, research documenting the need for market-opening measures, and involvement in policy formulation and implementation beyond competition law itself. It has been suggested that these activities “may be among the most useful and high payoff activities undertaken by [competition authorities]”, especially insofar as

² A number of existing WTO agreements already contain provisions that are relevant from a competition and investment perspective. For example, the TRIPS agreement (the Agreement on Trade-Related Intellectual Property Rights) stipulates that Members of the WTO may take “appropriate measures...to prevent the abuse of intellectual property rights by right-holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology” (article 40). A number of regional agreements that deal with trade and investment issues have also incorporated provisions dealing with competition issues. For example, the North American Free Trade Agreement (NAFTA) contains provisions that address competition issues related to SOEs and also has provisions on co-operation between competition authorities (chapter 15). See *Trade and Competition Policies for Tomorrow*, Ch. 4, “Competition Elements in International Trade Agreements: A Post-Uruguay Round Overview of WTO Agreements” and Ch. 5, “Implications of the WTO Agreements on Basic Telecommunications,” OECD (1999).

³ By 2001, approximately 80 countries in the world had some form of competition law.

the removal or reduction of regulatory impediments to market entry across a range of policy areas (e.g. trade policy, investment policy, regulated industries, etc.) “can be central to the establishment of healthy market economies in developing and transition economies” (Anderson and Jenny, 2002, p. 7, cited in WTO, 2003, p. 14).

In addition to these overarching links between competition policy and development, a number of more specific contributions of competition policy to development have been identified in work undertaken by the OECD, UNCTAD, the World Bank and at the WTO, among others. These include:

- The promotion of consumer welfare;
- Preventing excessive concentration levels and resulting structural rigidities;
- Addressing anti-competitive practices of enterprises (including MNEs) that can negatively affect the trade performance and competitiveness, on both the import and export sides, of developing countries;
- Reinforcing the benefits of privatization and regulatory reform/deregulation initiatives;
- Establishing an institutional focal point for the advocacy of pro-competitive policy reforms and a culture of competition; and
- Increasing an economy’s ability to attract and maximize the benefits of investment.⁴

It is this last issue that the following section addresses, including issues that are particularly relevant with respect to the relationship between competition policy and the creation of an attractive environment for FDI in the development context.

3. The relationship between competition policy and an attractive environment for investment

Barriers to entry constitute an important impediment to investment.

Within the context of efforts by governments to create an environment which is attractive to investors (both foreign and domestic), a key challenge consists in identifying and eliminating unwanted barriers to entry.⁵ Barriers to entry consist in a wide array of factors that discourage investment. Some barriers to entry discourage investment directly, such as, for example, government prohibitions on investment in certain sectors. Other barriers to entry are less direct but nonetheless can also be prohibitive. For example, trade restrictions can make a national market too small for certain investments that require minimum economies of scale to be viable. More generally, and apart from outright government prohibitions on investment, barriers to entry usually consist in the various costs faced by prospective investors in the relevant market. Barriers to entry are different from ordinary costs that are a natural part of the everyday business calculus of firms in a market economy (e.g. the cost of capital). These ‘natural’ costs provide

⁴ One of the dynamic benefits associated with competition concerns the continuous investment in newer, more efficient technologies that supplant older products and processes. As such, competition policy is not just associated with the quantity of investment but (perhaps more importantly) the quality of investment that an economy is able to attract.

⁵ In some cases, barriers to entry are intentional and aim to serve particular policy objectives, as, for example, in sectors of the economy reserved for state-owned enterprises.

important economic signals to market participants, allowing these to make rational economic decisions. Barriers to entry, however, involve costs that are borne uniquely by entrants, as opposed to incumbents. They impede market entry and, indeed, are sometimes avoidable. For example, restrictive agreements might make it difficult for new airlines to obtain landing slots at some airports. An important role for governments is to identify and to try to eliminate or reduce unnecessary barriers to entry that unduly serve to discourage investment (e.g. onerous administrative requirements for new entrants).

Barriers to entry can take the form of structural barriers...

One type of barrier to entry consists in what is usually referred to as structural barriers. Structural barriers to entry pertain primarily to the various sunk costs (i.e. costs that can not be recovered by the firm in the event of exit from the industry) that firms must bear upon entry. In other words, sunk costs represent the investment that is put at risk by the investor.⁶ Generally speaking, sunk costs act as a barrier to entry when these push the total cost of the project (variable costs, plus sunk and non-sunk fixed costs) above the expected net present value of the investment in question.⁷ Other structural barriers to entry can include absolute cost advantages enjoyed by competitors (e.g. if the competitor has an inimitable technological advantage), economies of scale, and large capital requirements, including those associated with network industries (e.g. telecommunications).

...or behavioral barriers.

Another type of barrier to entry is generally referred to as behavioral in nature. Behavioral barriers to entry consist of the various ways in which incumbent firms (domestic, foreign or state-owned) can impede market access by abusing their market power (see Box 1). For example, if a firm maintains exclusionary arrangements with retail or wholesale distributors in a given market (reciprocal exclusivity), and access to this distribution network is essential for serving the market in question, this effectively acts as a barrier to entry (assuming that the cost of establishing a second distribution network is prohibitive). Another type of behavioral barrier concerns predatory behaviour, which involves undercutting rivals with a view to eliminating these from the market in question (or “foreclosing” the market to new entrants). This can and usually does involve selling products below their cost of production with a view to recouping losses once weaker rivals (or new entrants) have been eliminated and monopoly pricing can be implemented or resumed. Predatory behaviour can have both an immediate and a more long-term impact on new investment insofar as the threat of predatory behaviour by a powerful incumbent (e.g. based upon precedent and reputation) could act to discourage prospective investors.

⁶ Sometimes regulatory barriers to entry are treated as a distinct type of barrier to entry. However, many regulatory barriers can be seen as a specific type of sunk cost. For example, many performance requirements or requirements that attach conditions to entry, such as testing for product safety, represent sunk costs for firms that must bear them.

⁷ In other words, an investor will want to at least break even, i.e. the expected returns over the life of the investment need to at least cover sunk plus variable costs.

Box 1. Examples of restrictive conduct that inhibits entry

Business practices that serve to restrict market entry are usually classed according to whether they constitute horizontal or vertical restraints. The distinction between horizontal and vertical refers to the structural nature of the practice in question. In the case of horizontal restraints to competition, the restraint takes place across different firms which usually compete against each other in the same line of business. In the case of vertical restraints, the restraint takes place within the value-chain of a given firm (or group of firms). The following are illustrative examples of horizontal and vertical barriers to entry (including for foreign firms) into a market.

Horizontal restraints: predatory pricing, tying, and raising rivals' costs. Predatory pricing, for example, occurs when an incumbent firm sets a price so low that the only rational reason for doing so is to drive out or deter actual and potential competitors and thus, having eliminated competition, the incumbent raises price to a level that at least recoups the losses incurred earlier.

Vertical restraints: exclusive dealing, refusals to deal, resale price maintenance, and discriminatory pricing. A refusal to deal, for example, may inhibit entry when an incumbent firm in one market also has market power over an upstream input product and refuses to supply that product to an entrant in the first market.

In practice, the distinction between structural and behavioral barriers to entry is not clear cut, with behavioral barriers usually being facilitated by structural barriers (and both often underpinned by aspects of the regulatory or policy environment). In the absence of structural barriers to entry, new firms will normally respond to any abnormal profits being earned by incumbents by entering the market, thus bringing prices back down to competitive levels. One of the challenges faced by governments has been to sort out, between various structural and behavioral market barriers, those that do not unduly harm competition and those that can and should be eliminated.

A good example of the sorts of trade-offs that competition authorities have to deal with involves policies towards intellectual property rights (IPR). At the highest level of analysis, IPR and competition policies are complementary because they share a concern to promote technical progress to the ultimate benefit of consumers. Firms are more likely to innovate if they are at least somewhat protected against free-riding. They are also more likely to innovate if they face strong competition. The problem is that even completely legitimate use of IPR can restrict competition at least in the short run, thus producing a trade-off between the benefits of increased competition and the gains from further innovation. The protection of IPR is an example of a limit to competition that is generally considered beneficial. The difficulty for competition authorities lies in determining at what point such limits to competition begin to encounter negative marginal returns to society.⁸

Open trade and investment regimes can significantly reduce barriers to entry...

It has been argued that one of the best ways of ensuring that structural and behavioral barriers to entry do not impede investment is to simply maintain open trade and investment policies.⁹ The reasoning behind this line of argumentation is that competition from potential foreign investors or from imports will naturally act to discipline firms that would seek to exercise some form of market power. In effect, by maintaining open trade and investment regimes the relevant market is no longer limited to the national market. For example, a firm that enjoys a monopoly position in a given country (in the sense that it is the

⁸ "Roundtable on Intellectual Property Rights," Competition Committee Roundtable, OECD, 2004 (forthcoming); "Synthesis Report on Parallel Imports," [COM/DAFFE/COMP/TD (2002)18/Final], OECD, 2002; *Competition and Intellectual Property Rights*, OECD, 1998.

⁹ Indeed, it has even been argued that, especially for smaller economies, open trade and investment regimes can effectively substitute for competition law and policy.

sole producer located in the country) will nevertheless not be able to behave like a monopolist if monopoly pricing and above normal rents attract international competition which, in turn, drives prices back down. Alternatively, restrictive investment (and trade) policies are probably one of the “best” ways of establishing impediments to entry that enable incumbents to exercise market power.

...but experience suggests that open trade and investment policies are not sufficient to ensure that incumbents act competitively.

However, experience suggests that open trade and investment regimes are not sufficient for ensuring the maintenance of contestability in national markets (i.e. the threat of new entrants in response to signals indicating abnormally high rents). Structural characteristics in any given economy can act to ‘buffer’ incumbent firms from competition, even in the context of liberal trade and investment regimes. These can include, *inter alia*, the inherently local nature of some markets, the non-tradability of certain products and services, and regulations that are not *per se* restrictive from a trade or investment perspective (e.g. standards and licensing requirements). Furthermore, private restrictive practices, such as collusion in an adjacent (upstream or downstream) market, may inhibit trade and investment. Indeed, a number of countries with relatively open trade and investment regimes have reported on the need to complement open trade and investment regimes with active enforcement of competition laws (see Box 2 on the experience of Argentina).

Some barriers to entry are particularly relevant with respect to FDI...

One source of investment that has become increasingly important for developing countries consists of FDI. Although many of the barriers to entry identified above are ‘neutral’ insofar as they do not ‘discriminate’ between foreign and domestic investors (i.e. they will discourage both), some barriers to entry are more specifically relevant with respect to their potential negative impact on FDI. In some cases this is because foreign and domestic investors are provided different levels of treatment. In other instances barriers to entry are *de facto* pertinent to FDI because the latter is a major, if not the main, source of the type of prospective investment in question. An important policy implication of this observation is that competition authorities, in their capacity as advocates of a culture of competition, including competition from foreign investors, need to cast their nets wide in order to identify potential policy impediments to the entry of foreign investment, even where these are not labelled as such or directed at foreign investors.

Box 2. The experience of Argentina with competition law and policy in the context of trade and investment liberalisation

In 1989, the Government of Argentina launched a radical reform of the economic system, involving, among other reforms, the lowering of trade barriers, the privatization of the majority of state enterprises, the elimination of many industrial regulations, and the complete deregulation of foreign direct investment. During the early stages of this reform process, competition law and policy played a minor role in the expectation that the deregulation of markets and the liberalization of trade and investment would be sufficient to provide competitive discipline and to achieve economic efficiency. However, over time, competition policy came to play a more important role as it became clear that, although the liberalization of trade and investment did serve to encourage competition and economic efficiency in many sectors, this was not the case in all sectors. Examples of structural constraints and private business practices that served to constrain competition despite trade and investment liberalisation, and for which investigation by the Argentine National Commission for the Defence of Competition was deemed necessary, included:

- Concentration in the liquefied petroleum gas industry, including control over key parts of the value chain (port facilities in particular), was associated with domestic prices remaining abnormally high;
- Suspected collusion among incumbents within MERCOSUR in certain industries aimed to keeping out new entrants;
- Apparent 'stickiness' of response by potential new (especially foreign) entrants into the market in response to liberalisation due to structural barriers, including extremely strong brand dominance in one industry and the small size of the domestic market in another;
- Suspected differential pricing by a quasi-monopolistic supplier, according to which a key customer was offered the international (competitive) price and smaller customers, for whom international sourcing would have been more difficult, were offered a much higher price;
- Suspected discriminatory pricing by the subsidiary of an MNE with a dominant position globally for the product in question.

Source: UNCTAD (1997). See also OECD (2004) for similar examples from Russia.

...such as the granting of exclusivity as a form of FDI incentive;

As mentioned above, structural and behavioral barriers to entry often complement each other. In many instances, government regulation underpins this relationship. For example, one unusual issue at the inter-face of competition policy and FDI that has emerged in recent years concerns the granting of exclusivity to foreign investors as a form of FDI incentive. From the perspective of the firm offered this type of concession, the advantage lies in being able to exercise market power in the market in question (i.e. the firm enjoys some control over pricing and can therefore charge above marginal cost). From the perspective of government, the appeal of this type of incentive is that, at least on the surface, there is no immediately obvious financial cost and a firm that is granted some form of exclusivity is likely to be willing to pay more for the assets in question than would otherwise be the case. Indeed, the ultimate costs of this type of incentive are difficult if not impossible to calculate since these are borne by the customers of the supplier in the form of the above-normal prices the latter is able to charge and by the economy more generally in the form of the forgone benefits of subsequent investment, including FDI (i.e. subsequent investment that is barred as part of the exclusivity contract granted to the original investor).

For example, in 1995, the Sri Lankan government privatized the Colombo Gas Company through the sale of 51 per cent of the company to a foreign investor. As part of this deal, the foreign investor was

given a five year monopoly for natural gas in the Sri Lankan market, protected from both import and foreign investment competition. As in most cases involving exclusivity as an incentive to attract FDI, the foreign investor was immune from the Sri Lankan competition authority and competition law until the end of the term of the agreement (UNCTAD, 1997).

Setting aside the question whether the granting of exclusivity to attract FDI is a good idea or not, competition authorities should be involved in decisions such as these since they bear directly upon the competitive structure of an economy. Competition authorities have come to play an increasingly important advocacy role such that their mandate extends beyond merely enforcing competition law, and in the case of incentives for FDI based upon exclusivity this advocacy role should involve, at a minimum, an evaluation of the (largely hidden) costs associated with such arrangements.¹⁰

...granting privileged market positions to SOEs or other regulated firms;

One of the most important areas of government regulation that can impact negatively on the ability of MNEs to enter a national market through FDI concerns regulated industries, including industries dominated by state owned enterprises (SOEs). Regulated sectors occasionally fall outside the reach of competition law. Indeed, certain types of firm behaviour and industry structures that would normally be considered anti-competitive (or potentially anti-competitive) in the private sector are sometimes permitted in the public sector. The most obvious instance of SOEs or otherwise highly regulated firms acting as impediments to FDI is when these have a mandate to act as the sole supplier in a particular industry (i.e. private firms, either foreign or domestic, are simply not allowed to enter this market). This has been the case, for example, in the energy and telecommunications sectors in a number of countries. However, regulated firms can also serve to impede entry to the extent that they are able to engage, through their linkages to the private sector either as buyers or suppliers, in many of the restrictive business practices associated with private firms (see box 1). While recognizing that legitimate differences exist between countries with respect to the relative roles ascribed to the private and public sectors¹¹, it remains that competition authorities can play an important role in shedding light on the costs and benefits of policies that limit competition, thus contributing to more transparent, and informed policy formulation.

Competition authorities have sometimes found themselves at the margins of policy formulation and oversight of regulated industries,¹² including with respect to the wave of privatizations that swept through many regulated sectors during the 1990s. The motivation for many privatizations has been the recognition that many activities can be run more effectively and efficiently by the private sector. However, a concern of governments and competition authorities has been to avoid replacing public with private monopolies. This challenge has sometimes been complicated by conflicting objectives associated with privatizations, namely the desire to create more efficient industry structures, on the one hand, and the desire to sell state owned assets at the highest possible prices, on the other. Bidders for publicly owned companies, including MNEs, will be willing to pay more if they believe that they are buying a monopoly position in a particular market. However, as with the provision of exclusivity as a form of incentive to attract FDI, the primary consideration of competition authorities should be the long-term competitive benefits that FDI can bring to an economy rather than possible short-term budgetary wind-falls.

¹⁰ Including the possibility that a position of market dominance may last much longer than the formal period of exclusivity, unless special measures are taken to encourage new entry when that period ends.

¹¹ Indeed, the Policy Framework for Investment recognizes a country's sovereign "right to regulate".

¹² It should be noted, however, that in a number of economies competition authorities have come to play a greater role in policy-making and formulation concerning regulated industries.

...and in efforts to promote “national champions”.

Within the context of their development strategies, some governments have sought to promote “national champions”, which, by definition, involves granting preferential treatment to some firms over others on the basis of nationality.¹³ Although not SOEs, *per se*, national champions often do involve significant state involvement (both financial and with respect to management), and are usually granted some form of exclusivity (i.e. protection from trade and investment-based competition) in the national market. The arguments for national champions usually rely on considerations of dynamic (versus static) efficiency. They include arguments to the effect that economies of scale cannot be attained without restrictions on competition, these economies of scale allow for more spending on research and development, and, by extension, only once such economies of scale have been reached can firms realistically expect to be able to compete on international markets. The issue of national champions has been contentious and underlies one of the key difficulties in incorporating dynamic efficiency objectives into competition policy – how to find the right balance between static and dynamic efficiencies without reducing competition to such levels that any potential dynamic gains are completely eroded through “slack” – the inefficient use of resources within firms resulting from a lack of external market discipline, i.e. competition.

As in the case of “exclusive contracts” and regulated industries, efforts to promote national champions generally entail specific provisions aimed at limiting FDI. This is usually done on the grounds that the costs to the economy associated with limits placed on competition are outweighed by some other, either dynamic (e.g. promoting innovation) or social (e.g. provision of essential services) benefits. However, it remains that any policies specifically aimed at limiting competition in particular sectors run the risk of creating inefficiencies, reducing welfare in parts of the economy due to the exercise of monopolistic or monopsonistic market power, reducing investment in sectors of the economy that depend on protected firms due to the knock-on effects of higher costs, and creating powerful vested interests opposed to any reduction in protectionism. As such, there is a strong case to be made for the on-going involvement of competition authorities in the formulation and implementation of policies that would limit competition, especially with a view to ensuring that the costs of such limits (as difficult as these are to evaluate) do not outweigh any hoped-for benefits.

In addition to these general pre-establishment issues, FDI by MNEs can give rise to additional competition issues...

To this point, the discussion of the relationship between competition policy and the attractiveness of an economy for investors has focused on various barriers to entry that can impede domestic and foreign investment. In the second half of the discussion, several barriers to entry that are particularly relevant from an FDI perspective, such as “exclusive contracts”, regulated industries, and efforts to promote national champions, were highlighted. However, once FDI takes place, a number of additional issues can come into play. The main reason for this relates to the fact that many MNEs have considerable financial resources at their disposal, they operate in industries that are often dominated globally by a handful of large firms, and they are able to establish dominant positions in many national markets through their foreign investments (even when this dominant position is not offered by the government as an incentive). Within the development context, the two main concerns of governments and competition authorities with respect to MNEs have been; 1) that MNEs expressly seek to exploit particular national markets, and 2) that the activities of MNEs can have structural implications with potentially negative effects on competition in some national markets.

¹³ Such as protection from competition through restrictions on FDI and trade protection, exemptions from competition law and various fiscal advantages.

...such as international market sharing arrangements...

With respect to the possibility that MNEs expressly seek to exploit their positions in particular national markets through FDI, this issue has received increasing attention in recent years as competition authorities have become more active in prosecuting various anti-competitive practices, and as evidence that MNEs are able to engage in market sharing arrangements at the global level has come to light. Many examples of successful prosecution in competition cases have involved competition authorities in developing countries, indicating that the implementation *and enforcement* of competition laws is not limited to developed economies (see, for example, WTO, 2003). Furthermore, empirical studies indicate that countries that have implemented competition laws have generally experienced less egregious price gouging at the hands of international cartels than countries without competition laws, indicating that these can serve as an important deterrent to abuse of market power (see, for example, WTO, 1993, section III).

...and issues of concentration relating to mergers and acquisitions.

With respect to structural issues, one of the key links between competition policy and FDI pertains to the involvement of competition authorities in reviewing proposed mergers and acquisitions. The potential importance of this issue is highlighted by the fact that mergers and acquisitions constitute the predominant mode of MNE expansion into foreign markets, accounting for 57 per cent of FDI inflows in 2002 (UNCTAD, 2003). Mergers and acquisitions are routinely reviewed by competition authorities with a view to determining whether particular combinations might give rise to levels of concentration that could be inimical to competition and, hence, efficiency.

Although the role of competition authorities in reviewing cross-border mergers and acquisitions has been limited predominantly to developed countries, in some cases competition authorities in developing countries have intervened where a merger between firms based outside the country has had implications for industry structure and competition in the host economy. For example, the proposed acquisition of one United States multinational by another in 1996 would have given their Mexican affiliates up to 67 per cent combined market share for certain products. The Mexican Federal Competition Commission therefore ordered the acquiring multinational to divest five major brands, thus reducing the combined company's market shares to around 50 per cent or less.

In another case of an international merger having implications for levels of concentration between existing foreign affiliates, two leading tea suppliers to Pakistan fell under common control of a major multinational. The Pakistan Monopoly Control Authority found that the prices paid by the companies for tea imported from related suppliers were higher than prices paid to unrelated international suppliers and therefore required that the multinational withdraw one of its brands and reduce its shareholding in one of the affiliates to 40 per cent.

Apart from a few fairly specific issues raised in the context of mergers and acquisitions involving MNEs and the possible implications of such transactions for market structures in countries in which the firms involved previously competed, generally FDI does not present challenges for competition authorities that require these to distinguish between foreign and domestic investors.¹⁴ Indeed, competition law in most countries implicitly embodies the national treatment principle insofar as no distinction is made between domestic and foreign firms. As argued above, one of the overarching links between competition policy and an attractive environment for investment consists in ensuring that structural and behavioral impediments to market access do not discourage investment, irrespective of whether the investment is

¹⁴ See Trade and Competition Policies: Options for a Greater Coherence, Ch. 5, "Merger Review and Market Access," OECD (2001).

domestic or foreign. However, it remains that MNEs, by definition, operate across borders and thus create cross-border policy issues. Consequently, international co-operation among competition authorities has become more common with a view to addressing competition issues that span jurisdictions. This is the topic of the next section.

4. International co-operation on competition issues

International co-operation on competition policy issues has come to the fore in recent years in large measure due to the increasingly important role that FDI and MNEs have come to play in many jurisdictions. International co-operation has come to be associated with competition law enforcement to address the increasing incidence of anti-competitive activities across borders, as a means of minimizing jurisdictional conflicts, facilitating information and evidence gathering and sharing, and for reinforcing institution-building processes in developing countries. It has also been argued that international co-operation can help to address competition policy issues associated with MNEs that developing host country competition authorities may have difficulties addressing on their own.

Furthermore, co-operation with enforcement authorities in other jurisdictions has been identified as a helpful mechanism for building capacity with respect to competition policy in countries that have relatively young competition policy regimes. Towards this end, co-operation can include:

- case specific co-operation;
- informal meetings to discuss general analytical approaches, policies, practices or procedures;
- best practices reviews among peers;
- regular bilateral and regional meetings aimed at reinforcing dialogue and the exchange of ideas and information; and
- staff exchanges and secondments.

The OECD has a long history of facilitating co-operation between competition law enforcement authorities. For many years, this co-operation was limited to the authorities of OECD Member countries. The principal vehicle for that co-operation was and continues to be the regular meetings of the Competition Committee. During these meetings, high-level officials from different countries share their experiences, seek advice, and receive feedback and recommendations. Sometimes, these discussions have led to the identification of voluntary “best practices” for dealing with particular issues. In more recent years, OECD co-operation on competition issues has increasingly involved non-Members. Indeed, the Competition Committee now has six regular non-Member Observers,¹⁵ and the 2004 meeting of the OECD Global Forum on Competition included representatives from 38 non-members. Moreover, non-Members have made use of the Committee’s *Framework for Notification of Transnational Mergers*, and have been invited to associate themselves with the OECD’s Cartel Recommendation.

It was in 1967 that the OECD issued the first of a series of Recommendations on voluntary co-operation as a means of reducing conflict and promoting mutual assistance in competition law enforcement. Since then, the experience gained over 30 years culminated in the 1995 Recommendation concerning Co-operation between Member Countries on Anticompetitive Practices Affecting International Trade and the 1998 Cartel Recommendation, which expanded on some of the 1995 Recommendation’s provisions in the context of cartel investigations.

15 Argentina, Brazil, Israël, Lithuania, Russian Federation and Chinese Taipei.

One of the benefits of the 1995 Recommendation – for both Members and non-Members – has been its availability as a model for bilateral co-operation agreements.¹⁶ However, the Recommendation has also served as an operational international agreement on voluntary co-operation that may be invoked by any Member country and actually provides the basis for most OECD Members' existing co-operation. Thus, co-operation among most OECD Members is largely based on the Recommendation, under which any OECD Member may request co-operation by any other.

A detailed summary of the provisions of the 1995 Recommendation is beyond the scope of this paper. For the present purposes, it suffices to state that Part A of the document, which deals with notification, the exchange of information and co-ordination of action, articulates three general principles:

- when a Member country undertakes an investigation or proceeding which may affect important interests of another Member country or countries, it should notify these countries, if possible in advance, and, in any event, at a time that would facilitate comments or consultations;
- where two or more Member countries proceed against an anticompetitive practice in international trade, they should endeavour to co-ordinate their action insofar as appropriate and practicable;
- through consultations or otherwise, the Member countries should co-operate in developing or applying mutually satisfactory and beneficial measures for dealing with anticompetitive practices in international trade -- in this connection, the Recommendation specifies certain types of co-operation, including investigatory assistance.

Part B of the Recommendation contains various provisions designed to encourage consultation and conciliation in various circumstances, including by giving full and sympathetic consideration to the views expressed by the other Member country. In practice, OECD Member countries regularly notify each other when their investigations may affect each other's important interests, and they sometimes ask for and provide assistance subject to their applicable laws and important interests, including resource limits.

Finally, the merger control procedures of most countries provide in some fashion for notification of mergers to the national competition authority. The notifications typically contain information describing the merger transaction, the parties to it and their operations in the notified country, which assists the competition authority in analysing transactions according to its competition law. There tends to be a "common core" of this information that is reported to most countries, but countries specify the information to be produced in different forms or quantities. These inconsistencies in notification requirements may in some cases interfere with the efficient review of transnational mergers and impose significant transaction costs on the merging parties.

Harmonisation of merger reporting requirements across countries could have at least two benefits: transaction costs for the merging parties would be reduced to the extent that the parties are able to prepare and present substantially the same information to the authorities of more than one country; and co-operation among national authorities examining a merger would be enhanced to the extent they are reviewing the same or similar information. Further, in the longer run, harmonisation of information requirements could contribute to enhanced international co-ordination of other aspects of merger control, such as convergence in waiting period requirements.

However, variations in merger notification requirements, as well as in other areas of co-operation, are substantially a product of differences in national laws governing such notifications. Even where the legal

16 For example, co-operation among the three Baltic countries -- Estonia, Latvia, and Lithuania -- is modelled on the OECD Recommendation.

differences do not reflect significant policy differences, therefore, harmonisation of notification forms cannot be achieved simply by agreeing on some common definitions and formats. Moreover, to the extent that differences in national laws reflect real differences in countries' views on how their pre-merger notification system should run, complete harmonisation can occur only when and if the underlying policy differences are resolved.

In sum, experience with international co-operation, especially within the OECD, has highlighted a number of areas associated with competition policy where governments can co-ordinate their activities to promote FDI and avoid imposing unnecessary transaction costs on foreign investment. As OECD experience over almost 40 years indicates, such co-operation does not necessarily imply the harmonization of competition policy or law or even the negotiation of binding rules on competition at the multilateral or regional levels.¹⁷ Many of the benefits of international co-operation with respect to competition policy issues for countries that have recently or are about to implement competition law and policy could begin where many OECD countries began in the 1960s, with voluntary co-operation agreements based upon mutual interest and common objectives. In this connection, the outreach activities of the Competition Committee of the OECD, including through Global Forums¹⁸, have played an important role.

5. Conclusion: Issues for consideration

Competition authorities can play a positive role with respect to creating a healthy investment climate in developing countries. While competition policy should and usually does stay neutral insofar as it does not distinguish between foreign and domestic firms, this paper has highlighted a number of issues that competition authorities should take into consideration within the context of creating an attractive environment for both domestic and foreign investment. While recognizing that different countries at different levels of development will have different priorities, both between competition policy and other policy objectives and with respect to the internal objectives of competition policy itself, and also recognizing that significant differences exist with respect to the role ascribed to competition and the private sector by different governments, this paper has identified certain issues and questions that policy makers should address with a view to ensuring that regulatory and other impediments to competition, including competition from FDI, do not run counter to development objectives. These include:

1. Are anticompetitive practices by incumbents, including domestic, foreign, and state-owned firms, as well as firms enjoying significant state support, inhibiting investment?
2. Where governments have chosen to put in place regulatory barriers to FDI for various reasons, have competition authorities been involved in determining whether the benefits outweigh the costs and how to minimise the anti-competitive impact of those regulations?
3. With respect to industrial policies, aimed, *inter alia*, at creating national champions, have competition authorities been consulted?
4. More generally, have competition agencies been given the authority and the resources to “cast the net wide” in terms of evaluating the impact of various policies (e.g. tax policy, trade policy, policies concerning intellectual property rights, investment policy) on the ability of investors to contest the national market? Have the appropriate channels of communication and co-operation

¹⁷ See, for example, the 1998 OECD Recommendation of the Council Concerning Effective Action against Hard Core Cartels, in which the emphasis remains on co-operation and comity (as opposed to harmonization).

¹⁸ See, e.g., OECD (2004).

- been established between competition authorities and other relevant government agencies (e.g. patent offices in the case of IPR)?
5. When exclusivity is offered as an incentive to attract an investor, have the costs of such incentives been taken into account, including the costs associated with foregone future investment due to market closure?
 6. Have MNEs been engaging in global market sharing arrangements such that international anti-competitive practices are limiting market entry? Can this problem be addressed through the national competition authority? If not, could international co-operation provide a solution?
 7. What has been the role of competition authorities in the privatization process? Have competition considerations been adequately addressed?
 8. Have competition authorities kept track of international mergers and acquisitions that could have structural implications within the national market (even though the “names remain the same”)?
 9. Have various opportunities for international co-operation been exercised? Have appropriate regional partners been identified? OECD partners? Are there international issues that could or should be addressed through international co-operation?
 10. Have OECD countries lived up to their promises with respect to capacity building under the Monterrey Consensus and other international initiatives, such as the Doha Development Agenda, with respect to the development and strengthening of competition policy in developing countries? What could be done better?

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ANNEX

OECD INITIATIVE ON INVESTMENT FOR DEVELOPMENT: TOWARDS A POLICY FRAMEWORK FOR INVESTMENT

The Monterrey Consensus

Investment has proven to be a powerful catalyst for innovation, sustainable growth and poverty reduction. Despite positive trends in the past decade, business investment and enterprise development in non-OECD regions continue to fall short of development needs. The Monterrey Consensus identified private capital, including foreign direct investment, as “vital complements to national and international development efforts” and emphasised the need “to create the necessary domestic and international conditions to facilitate direct investment flows”.

The OECD Initiative on Investment for Development

In support of the Monterrey Consensus, the OECD launched the *Initiative on Investment for Development* in 2003 in Johannesburg, South Africa. The *Initiative* includes three closely inter-related projects. These involve: 1) the development of a *Policy Framework for Investment*, described below; 2) drawing lessons on the use of ODA in support of countries’ efforts to mobilise investment for development; and 3) sharing the OECD’s experience with investment policy peer reviews as capacity building mechanisms. The *Initiative on Investment for Development* is inspired by values that underpin the Monterrey Consensus: transparency, accountability and respect for human rights, including the right to development.

The OECD has a long history with peer learning, and consensual approaches towards the development of “best practice” across a wide range of policy areas that are relevant from an investment perspective. As such, the OECD is well placed as a forum for countries to share their experiences, to develop common understanding, and to elaborate policy guidance aimed at enhancing the contribution of domestic and foreign investment to development, as called for in the Monterrey Consensus.

The Policy Framework for Investment

Within the context of the OECD *Initiative on Investment for Development*, and in keeping with OECD Members’ commitment to the effective implementation of the Monterrey Consensus, the OECD Investment Committee and its partners have initiated work on a *Policy Framework for Investment*. The *Framework* is intended as a non-prescriptive checklist of issues for consideration by any interested governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. The *Framework* could also serve as a reference point for investment promotion agencies, donors as they assist recipient country partners in improving the investment climate, and businesses, trade unions, and NGOs in their dialogue with governments. The Policy Framework for

Investment recognises that the needs of countries at different levels of development call for a flexible and non-prescriptive approach that provides constructive policy guidance across a range of areas in order to maximise the contribution of investment to development.

While the Policy Framework for Investment is addressed to governments, it is to be seen in the broader context of other converging international initiatives to improve the investment climate, including the OECD Guidelines for Multinational Enterprises.

A partnership process

The *Framework* will be developed by a Task Force through a partnership process involving OECD Member and non-Member governments, in co-operation with civil society and other international organisations. The first plenary meeting of the Task Force took place at the OECD in Paris on 17 June 2004.

A horizontal policy approach

The Task Force agreed that the *Framework* will consist of a comprehensive stocktaking of sources of good policy practice across a range of policy areas that have been identified by international organisations involved in investment and development, and the Monterrey Consensus, as playing an important role when it comes to creating an enabling environment for investment and enterprise development.

The Task Force identified a preliminary list of policy building blocks for the *Framework*: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance and responsibility, and market integrity; human resource development; infrastructure development; and public governance. In addition to host-country policy action, the contribution of international co-operation, including through regional integration, and home-country policy action will also be addressed.

The work of the Task Force will be supported by the Investment Committee and other OECD committees with expertise in the policy areas being considered for inclusion in the *Framework*.

Next steps

The Task Force will take advantage of the OECD Global Forum on International Investment and various regional events organised by the Investment Committee as opportunities to discuss inputs into the *Policy Framework for Investment* in both global and regional contexts. A progress report on the *Initiative on Investment for Development* will be made available by the time of the 2005 OECD Ministerial Meeting, with the aim of completing the work of the Task Force in 2006.