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

(Background note by the Secretariat)

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**CHALLENGES/OBSTACLES FACED BY COMPETITION AUTHORITIES
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THROUGH THE PROMOTION OF COMPETITION**

1. Introduction

1. Competition authorities face a number of challenges or obstacles when they promote competition, whether that promotion is through enforcing a competition law or through trying to persuade society and government of the advantages of competition. The “lack of a competition culture” has been identified elsewhere as the central impediment. Many challenges and obstacles follow from this central impediment.

2. It appears that the “lack of a competition culture” is due to the self-interest of those who expect to lose with the introduction of competition and who have the power to oppose it. Competition promotes and accelerates economic change, which can redistribute wealth as it increases overall wealth. Even when everyone’s wealth increases, there may nevertheless be a sense of redistribution if individuals or groups value relative changes in wealth. Expected “losers” in the redistribution may oppose competition. The success of their opposition depends on their political power. The expected “winners” from the introduction of competition may not individually gain much, or may be unaware that they would gain from competition. The typical concentration of “losers” and dispersion of “winners” from individual policy changes makes the organisation of opposition easier than that of promotion. Experience points to the importance of persuading the dispersed winners and the politically powerful to support the introduction of competition.

3. In addition to the reasons for a “lack of a competition culture,” three other types of impediments to competition promotion are identified in this note.

4. The first type consists of the specific features of small developing economies. The local markets in these economies may currently be supplied by means of inefficient technology that would be displaced by more efficient technology optimally operating at significantly larger scale, if trade protection were removed and international competition were introduced. Furthermore, the business and political elites may be sufficiently small in these economies that collusion is easy. In micro-states, GDP may be too small to justify the fixed costs of competition enforcement. And, finally, the bargaining position of governments of small economies vis-à-vis large multinational enterprises may be such that competition law enforcement is difficult or not credible.

5. The second type arises in the informal sector. The rural location of much of the informal sector in developing countries may put it beyond the reach of urban-based competition authorities. The small size of enterprises and of markets renders the benefits of both competition law enforcement against enterprises and the design of competition-promoting reforms too small given the cost. Criminal parts of the informal sector may spill-over to distort competition in the formal sector.

6. The third source of impediment is the slow adaptation of institutions, networks of institutions, and individuals to a cultural change.

7. This note is organised as follows. The first major section provides a framework within which to analyse impediments to competition promotion. The second major section provides specific examples of challenges and obstacles. The second section is intended to inspire delegates to submit or present other examples of challenges or obstacles to competition promotion at the OECD Global Forum on Competition in February 2004. It is hoped that discussions of the examples submitted by delegates would lead to the exchange of experiences about how these challenges have been addressed, a revision of the analytical framework proposed here, and the identification of effective ways to overcome the challenges/obstacles or to attenuate their effects.

8. The note ends with questions for discussion.

2. A framework for identified challenges or obstacles

2.1. Challenges and obstacles identified

9. A number of competition authority representatives and other experts have identified challenges or obstacles to competition. These challenges range from the superficial—lack of financial resources—to the profound—the lack of a competition culture. To label a challenge superficial is not to downgrade it, but rather to acknowledge that it is the proximate manifestation of deeper causes. Whether the better response is a head-on assault on the profound causes, or a softly-softly oblique approach working from the proximate challenges, is a topic for discussion.

10. In a 2001 World Trade Organisation regional workshop, representatives from developing countries identified the following as impediments to competition promotion:

- lack of equipment
- lack of sufficient personnel
- lack of financial resources
- lack of access to information both for research and to prosecute cases
- lack of appropriate training for staff
- lack of technical ability within the competition authority
- the existence of bureaucratic self-interest
- corruption
- lack of independent institutions and individuals, including the impossibility of the competition authority to make any decision or impose any sanction without the approval of the relevant minister
- lack of an appropriate legal framework
- lack of political will
- lack of a culture of competition.¹

11. To these woes might be added challenges inferred from other discussions:

- difficulties in winning cases in court, including due to procedural difficulties
- difficulties of applying competition law to the informal sector
- the distortion of competition in the formal sector from spill-over of criminal activities in the informal sector
- difficulties of introducing competition in small developing countries, including a tendency to be ignored by large multinational enterprises

¹ These items, some of which have been combined, are from WTO 2001a, pp. 12, 15 and 19.

- insufficient powers of investigation
- insufficient sanctions for violation of competition laws or for slow or incomplete compliance with mandatory demands for information
- government—at local, state and national levels—taking actions that undermine competition in their regulatory, procurement, privatisation, subsidy and entrepreneurial policies.

12. These impediments can be organised into four types. The largest and perhaps most important group are those related to a lack or a weakness of a competition culture. The three other types are specific to particular types of economies. First are those specific to small developing countries. Second are those specific to “informal sectors,” particularly those in developing countries. Third are those in which competition was recently introduced and institutions lag behind. The following four sub-sections of this note address these four types of impediments, respectively.

2.2. *Challenges and obstacles due to the lack of a competition culture*

13. Most of the challenges listed above follow from the lack of a competition culture. As one author has expressed it, “[I]n the long run, competition policy must be consistent with publicly accepted goals and values, which are expressed in the political process.” [Wise 2002] This sub-section first offers a definition of “competition culture.” It then describes how some challenges follow from the absence of a competition culture. It provides arguments as to why a competition culture may be lacking, as well as some empirical support for those arguments. Finally, it discusses an approach that has been used for establishing a competition culture.

2.2.1. *“Competition culture” defined*

14. “Competition culture” as used here means that there is political support to use competition in markets as the default or “normal” way to organise economic activities outside the family, government bureaucracies and single economic entities (or single enterprises), and that this support is translated into competition actually being the default or “normal” organising principle.²

2.2.2. *Challenges that follow from the absence of a competition culture*

15. The derivation of many of the above-listed impediments to the introduction of competition from the absence of a competition culture can be seen as follows.

16. First, the lack of political will for a competition authority follows from the lack of political support for competition, i.e., the “lack of a competition culture.” Support of an objective without support of the usual means to attain that objective, and without offering an alternative means, cannot be considered support.

17. Second, lack of political will translates into specific weaknesses of the competition authority because government, reflecting the political will, does not delegate a sufficient part of its resources or powers to the competition authority. The specific weaknesses include:

² To avoid confusion, it should be noted that the phrase “competition culture” has another, related meaning. This meaning is provided *inter alia* in a speech by a Canadian official. “[C]ompetition culture”...refers to an awareness among both the public at large and economic actors of the rules of competition.” [Speech by Sally Southey avail. at <http://cb-bc.gc.ca/epic/internet/incb-bc.nsf/vwGeneratedInterE/ct02476e.html>; an almost identical definition is offered by the International Competition Network, p. iii] The two meanings are related in that broad support for competition law enforcement is necessary for it to be effective in democracies. Building awareness is one step toward gaining support.

- Inadequate resources (financial, appropriate quantity and quality of personnel,³ appropriate training for personnel, access to information for research and prosecution, equipment)
- Inadequate powers including inadequate autonomy (e.g., to open an investigation without a formal request or permission, to hold proceedings or to bring prosecution to a court, to investigate—enter premises, seize documents that will be accepted as evidence in a proceeding or court, compel witnesses to testify or to require the production of documents or written responses to questions—to sanction or request a court to impose sanctions either for the timely and complete provision of documents/information or for violation of the competition law itself, to credibly promise either not to prosecute or to limit penalties [e.g., in the context of a leniency programme], to initiate competition advocacy without a formal request)
- The exemption, exclusion or simple non-application of the competition law to some economic activities.

18. Some of these weaknesses can have sources other than the lack a competition culture. In particular, “inadequate powers” for the competition authority can result from broader social values about government power. In jurisdictions with a not-distant history of abusive information-gathering or sanctioning by the state, the political will to provide these powers to any part of government, even a well-intentioned competition authority, may be weak or absent.

19. Lack of political will or support typically also translates into other institutions both within and outside of government being unsupportive of competition. Governments at local, state and national levels may take actions that undermine competition in their regulatory, procurement, privatisation, subsidy and entrepreneurial policies. Also, they may provide late or incomplete information about their regulatory initiatives to the competition authority for comment or oversight. Courts may be reluctant to impose large sanctions for competition violations because the sanctions may appear to be disproportionate and morally unfair in the political and social environment.

20. Lack of political will also translate into tolerance of broader problems that incidentally reduce the effectiveness of the competition authority, such as corruption and bureaucratic self-interest.

2.2.3. *Why a competition culture may be absent*

21. In many countries, there is not political support to use market competition to organise economic activities outside the family, government, and single enterprises. It is fair to say that a number of philosophies popular at one time and place or another do not support widespread market competition. Leaving aside philosophical disputes, bald self-interest is also a basis for opposition to market competition. Self-interest is the focus of this section.

2.2.3.1. The basic thesis

22. Economic change produces winners and losers. In the context of economic growth, this process has been called the “creative destruction” of the process of Schumpeterian competition. In this process,

³ One specific but recurring complaint is the difficulty of attracting professional, well-trained and motivated personnel to a competition authority. Absent political will to make a limited exception to the civil service rules for the competition authority, these rules may cap salaries below the market level for such persons, or may require superfluous staff from elsewhere in the bureaucracy to be employed in preference to better-qualified new recruits, or may impose other constraints. In many economies, competition officials moving to private sector employment can triple or more their salary.

better products or more efficient production displace existing ones or, in Schumpeter's more graphic description, the process of creative destruction is "the...process of industrial mutation...that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one." [Schumpeter, p. 83]

23. Increased economic competition promotes and accelerates economic change. This can be illustrated by two classes of examples. One class is when regulatory reform introduces competition where it had been suppressed by economic regulation. In particular, regulators have less information than regulated firms, have limited instruments to control regulated firms, and often pursue objectives other than economic efficiency. When the "creative destruction" of competition is introduced and allowed to operate, then often excessive profits or benefits are reduced, and less efficient firms lose out to more efficient firms since the former are no longer protected by the umbrella of regulation. Earlier investments made under the old regulatory regime may be rendered less valuable, perhaps even worthless, perhaps making owners of those investments losers from economic change. (Gains elsewhere may make them net winners.) A second class of examples is when tearing down administrative barriers to entry increases competition. Allowing airlines in the United States to fly routes of their choosing at prices of their choosing led to the bankruptcy of a number of firms and, eventually, a more efficient pattern of air transport and the expansion of Southwest, a very efficient airline. Air travellers benefited from lower airfares as well as more frequent and higher quality service to smaller cities.

24. The opponents of a competition culture are presumably those who expect to lose from economic change, those who do not want to risk losing, and those who do not expect to gain from economic change.^{4,5} While the loss may be economic, it could also be a loss of power (e.g., as a bureaucrat making decisions), or a loss of other social values.⁶ "Losing" does not necessarily mean losing wealth. The introduction of competition generally increases overall wealth. However, if persons also value their relative

⁴ This is consistent with the view in Parente and Prescott 1999 and 2000. They attribute the observed differences in incomes across countries to differences in TFP (total factor productivity). Differences in TFP are attributed to differences in policies. (The stock of useable knowledge is the same across countries.) They find that the policy constraints that have the largest effects are those on work practices and on the use of more productive technologies. They hypothesise, and provide examples, that many barriers to the adoption of new technologies are put into place to "protect the interests of groups vested in current production practices."

⁵ Some authors argue that economic redistribution is not the reason welfare-enhancing economic change, such as the introduction of competition, is blocked. Rather, they argue that the redistribution of political power is the reason for opposition. Acemoglu and Robinson argue, for example: "[T]he effect of economic change on the political power is a key factor in determining whether technological advances and beneficial economic changes will be blocked. In other words, we propose a 'political loser hypothesis.' We argue that it is groups whose political power, not economic rents, will be eroded that will block technological advances. If agents are economic losers but have no political power they cannot impede technological progress. If they have and maintain political power (are not political losers) then they have no incentive to block progress. It is therefore situations where agents have political power which they expect to lose that generates the key incentive to block. Our analysis suggests that we should look more to the nature of political institutions and the determinants of the distribution of political power if we want to understand technological backwardness." [Acemoglu and Robinson 2000a]

⁶ For a detailed discussion of the problems of evaluating policies from the point of view of economic welfare, see Hausman and McPherson 1996 especially Ch. 7 "Efficiency." The authors conclude the chapter with, "One cannot reasonably evaluate policies, institutions, or states of affairs exclusively in terms of their success at satisfying the interpersonally non-comparable preferences of individuals. For welfare is not preference satisfaction, and it seems that things such as freedom, equality, and justice also matter." [p. 99]

wealth then “losers” includes those who become wealthier absolutely but poorer relatively as others with whom they compare themselves gain yet more wealth.

25. Ignorance plays a role in opposition to competition. Some who would gain from competition do not support a competition culture because they do not know that they would be among the winners. Risk-aversion also plays a role. Some persons prefer not to risk being losers even though they have a chance of being winners instead, and overall can expect to gain. There may be a relatively large group of persons who do not expect to gain from economic change. They may be indifferent to change, or they may prefer no change if they perceive it to be disruptive.

26. There is a strong argument for broad support of competition, even when it produces winners and losers. Competition generally improves economic efficiency and thus economic welfare.⁷ Greater economic welfare means that winners could afford to compensate losers and everyone would benefit. Such compensation is rare. (The payments made for so-called “stranded costs” in the electricity sector in a number of countries were exceptions.) However, if there are many linked efficiency-enhancing policies, each with different sets of winners and losers so that any particular person is a winner as often as she or he is a loser, then the long-run effect will be for most persons to be net winners. And in these circumstances, persons will support such a long-run set of efficiency-enhancing policies if they do not know in advance that they will be among the net losers, and they are not too risk adverse.

27. At least three issues follow. First, jurisdictions are not coterminous with economies. This is particularly true for small jurisdictions. Thus, it is possible for a policy to increase economic welfare but for the policy to predictably make persons in one jurisdiction net losers. Unless, as noted earlier, there are many linked policies and the winners and losers wash out over time, then those democratic jurisdictions populated with net losers will oppose an economically efficient policy.

28. Second, it may be difficult to predict the distributional effect of economically efficient policies. Where wealth and power are concentrated, the re-distribution caused by economically efficient policies may either further concentrate or erode that wealth and power. If erosion cannot be prevented in advance, then an economically efficient policy will nevertheless be opposed by the politically powerful.

29. Third, there may be a built-in opposition to welfare-increasing economic change. In particular, it may be difficult for winners to “buy off” losers. It is a truism that losses from change tend to be concentrated, e.g., amongst the shoemakers, and the gains tend to be dispersed, e.g., among those who wear shoes. The losers can more easily marshal their resources to fight change than can the winners to promote it since cheaters, in this case free riders (those who would benefit from a policy direction but who do not contribute to the cost of getting that policy adopted), are easier to identify in a small group.

30. The opposition to redistribution caused by competition may persist over a long period of time. In a study of the differing development of Canada and the United States among New World economies, the authors suggest that the initial factor endowments (such as climate and soil types) resulted in differing degrees of inequality in wealth, human capital and political power. This inequality has been preserved, they posit, by the institutions that were developed and the effect of those institutions on access to economic opportunity. They suggest that, “Overall, where there existed elites who were sharply differentiated from the rest of the population on the basis of wealth, human capital, and political influence, they seem to have used their standing to restrict competition.” [Sokoloff and Engerman 2000]

⁷ There are well-known exceptions such as where there are large economies of scale or scope, where there are externalities, or where certain information about the characteristics or actions of some economic actors is not known to others.

31. The principal thesis of this note is that opposition to the redistribution of wealth caused by competition is the main obstacle to the development of a competition culture. Successful opposition requires sufficient political power. Because competition is generally beneficial, producing greater overall wealth, managing the redistribution can be one of the key sub-objectives for the successful introduction of competition. This can explain why we see competition laws not applying to powerful sectors where, on a theoretical basis, the law could reasonably be applied.

2.2.3.2. The empirical support

32. There is much empirical support for the thesis stated above. The support is anecdotal, but the anecdotes are from both developing and developed countries. In these anecdotes, the redistribution of wealth, and to some extent political power, is the primary reason competition is opposed. Redistribution of wealth is probably also the reason introducing competition to specific sectors is opposed. Examples include taxi drivers opposing increasing the number of taxi licenses where they are subject to numerical limits and domestic producers opposing reducing tariffs or eliminating quotas that had hindered foreign competition.

33. In Indonesia, academics had discussed a competition law for some time, but the introduction of a competition law was delayed until after substantial political change. A description of this process illustrates the relationship between the incidence of anticompetitive conduct and the economic self-interest of those in political power. It also points out the possible role of outside institutions in spurring change.

“The interest in developing a comprehensive competition law in Indonesia dates back to around 1990. It was at this time that legal scholars as well as members of various political parties, nongovernmental organisations, and certain government institutions began to discuss the need for such a law. In fact, a number of different groups, including the Indonesian Democratic Party and the Indonesian Ministry of Trade (in co-operation with the Faculty of Law University of Indonesia), produced draft competition laws. These proposed draft laws, however, were not given serious attention by those in power at the time, because much of the unfair business competition and monopolistic practices that was taking place, often by Indonesia’s largest industries and businesses, was the result of direct and active government support. Crony capitalism was the order of the day under the so-called "New Order" government of former President Suharto, right up to about 1998.

“While Law Number 5’s passage in 1999 came about in part to satisfy conditions of a Letter of Intent entered into between the Indonesian government and the International Monetary Fund in July 1998, the law’s passage also drew much support from politicians, the government, the public, and the press as a means to address growing concerns about monopolistic practices and unfair business practices stemming from the closely related practices of rampant corruption, collusion, and nepotism (known by the Indonesian acronym "KKN") that had been taking place in Indonesia between the government and favoured businesses.” [OECD 2001, pp. 56-7]

34. The second anecdote is from Bangladesh where GrameenPhone has introduced wireless telephone service into rural areas. The explanation of the founder of GrameenPhone as to why GrameenPhone’s model has not been widely replicated provides insights as to why the broader introduction of competition is difficult. “Good ideas aren’t replicated instantly; GrameenPhone took nearly five years to go from concept to launch.[I]n most developing countries, it takes months to incorporate a new company and years to get a cellular license, not to mention the difficulties in assembling management and attracting capital. And in many countries, government bureaucracies resist entrepreneurial activities that may redistribute power. Vested interests protect private and public monopolies and quasi monopolies. There are systemic obstacles and huge barriers to entry.” [Harvard Business Review 2003]

35. Resistance to redistribution caused by competition is also present in developed countries with experienced competition authorities. Procurement by local government in Japan is the subject of the third anecdote. “*Dango* [the formation of cartels to determine the outcome of tenders for public contracts] is a custom that has been around for 100 years in Japan, which is impossible to just suddenly destroy,” according to Yoji Otani of Credit Suisse First Boston in Tokyo, as quoted in the *Financial Times*. Mr. Otani goes on to say, “In particular, local governments want to protect smaller contractors and their employees, and look the other way when these things happen.” The same article provides a measure of the significance of the practice: the gross profit margin for public works contracts is 10-15 per cent, compared with 5-10 per cent for private projects. [Financial Times 2003] A response has been the Act Concerning Elimination and Prevention of Involvement in Bid Rigging etc. of 31 July 2002, which is aimed at preventing so-called “government-involved bid rigging,” in which employees of central and local government ministries and agencies and specified public corporations have been involved in bid rigging organised by bid participants. [OECD forthcoming]

36. The final example is an observation about the relationship among the concentration of political power, the concentration of economic power, and economic competition. This is a topic that has been well-explored especially in European discussions of the role of competition policy.⁸ However, at least some authors see a very different dynamic in today’s developing countries.

“[T]he most formidable problem the developing world faces is structural—and it’s one the West has little experience with. It’s the phenomenon of the market-dominant minority, ethnic minorities who, for widely varying reasons, tend under market conditions to dominate economically the impoverished “indigenous” majorities around them....In free-market environments, these minorities together with foreign investors (who are often their business partners), tend to accumulate starkly disproportionate wealth, fuelling ethnic envy and resentment among the poor majorities.

“When democratic reforms give voice to these previously silenced majorities, opportunistic demagogues can swiftly marshal majoritarian animosity into powerful ethno nationalistic movements that can subvert both markets and democracy.” [Chua 2003]

37. The handful of observations provided here support the view that the self-interest of those who will lose, or who do not expect to gain, from the economic changes wrought by competition are the main opponents to the widespread adoption of competition. In the Indonesian example, the causal link between political change and the adoption of a “competition culture” is very clear. But it is of perhaps more immediate interest to consider how, in a climate of more gradual political change, impediments to the adoption of a “competition culture” can be overcome. This is the subject of the next sub-section.

⁸ Four political objectives of competition protection have been discussed, as described by Gerber. Three of these are at least arguably about the relationship between political and economic powers. First, the protection of economic freedom (a legacy of nineteenth century liberalism) is seen as intertwined with or even equal to the protection of economic competition. Second, the promotion of competition is seen as a way to promote other social ideals, typically “protecting competition in order to create and maintain structures of power than are valued by the society or by communities within it.” For example, to prevent excessive concentration of economic power and the accompanying threat to democracy, or to reduce international barriers in order to construct the internal market of the European Union. Third, competition protection is seen as promoting social justice, sometimes expressed as “fairness” for SMEs as compared with large competitors, sometimes as “fairness” for purchasers. Fourth, competition protection is seen as promoting economic policies, such as inflation reduction, or reducing barriers to economic change, or increasing the capability of domestic firms to compete in international markets. [Gerber 1998, pp. 418-420]

2.2.4. *How some competition authorities have promoted a “competition culture”*

38. Many competition authorities publicize the benefits of competition, which may increase awareness among masses of persons who would otherwise be unaware of how they would benefit. This can be seen as trying to help voters in democracies make, over the longer term, informed choices about where their interests lie. The greater difficulty is, perhaps, convincing those who hold greater political influence that they, too, would benefit from more competition. The Mexican competition authority provides an example below of persuasion to both groups.

39. In Mexico, a competition culture has been spreading through the political and economic system over the past decade or so. The competition authority, established in the early 1990s, is a symbol of the gradual acceptance of competition. A representative of the Mexican competition authority outlined its strategy for establishing the authority and strengthening support for competition. The authority found it needed support from government, from the various corporate sectors, and from the public. Transparency—so that interested parties could follow the agency’s actions and draw conclusions about its long-run usefulness—was used to counter the jeopardy into which support by the relevant part of the corporate sector was placed as soon as an investigation was launched. Strategic choice of case was used to demonstrate to the public the importance of competition for a healthy market economy and public welfare. [WTO 2001b, Para. 100]

40. In Indonesia, too, attracting broad support for a competition law was considered important. “The most important challenge [in implementing the competition law] that was being faced was to establish that the law would improve the welfare of the people.” [WTO 2001b, para. 92] However, as the earlier quotation makes clear, gaining popular support was not alone sufficient; opposition from crony capitalists also had to be overcome.

* * * * *

41. This section has suggested that perceived self-interest is the main reason for individuals and groups to oppose, or to not support, competition as the default way to organise economic activities. Both the basic thesis for this and observations consistent with the thesis were offered. Observations on the sector-by-sector introduction of competition would support the overall view developed as regards the economy-wide introduction of competition. The best response to the causes of opposition to competition depends on the specificities of each jurisdiction. These can include trying to persuade those likely to win under competition but who incorrectly expect to lose or, while not ideal, to carve out exceptions and exclusions to fissure the resistance, or other strategies.

2.3. *Challenges and obstacles in small developing countries*

42. Small developing countries face specific challenges to the promotion of competition. These were discussed in the OECD Global Forum on Competition in February 2003, but for completeness some of those ideas will be repeated here. To introduce the topic, this section begins with a description by Trinidad and Tobago. Next is a description by an anonymous country—size and level of development unknown—illustrating that the bad outcome from introducing foreign competition feared by Trinidad and Tobago may indeed occur. Following these descriptions, some of the challenges which are more common in small developing countries are identified and discussed. These relate to minimum efficient scale to supply some markets being large relative to demand in those markets, small population, small GDP relative to the fixed costs of a competition agency, and to asymmetric bargaining positions of governments of micro-states vis-à-vis large multinational enterprises.

43. Trinidad and Tobago described its economy as, “monoculture producers, export-oriented and import dependent” with “major productive sectors [dominated] by multinational corporations,” and “[l]ocal producers [which] are largely micro-firms by international standards, and family firms in many cases.” It expressed the following concerns regarding competition:

“(1) With the increased opening of the economies, could welfare-creating effects of competition leak out of the economy if new entrants are foreign firms and they displace local incumbents? Because of the smallness of the economy, displacement effects could be widespread and there could be social repercussions. ...

“(2) Will smaller economies be able to effectively discipline large MNCs, given the power asymmetry? In many cases, the GDP of the country is a fraction of the annual income of the MNC. A competition law becomes meaningless if it can only in theory stop abuses of dominance....”[WTO 2000]

44. A representative from an unnamed country reported the effect of opening markets in his country: “[L]ocal production suffered due to the influx of foreign imports. Massive unemployment, loss of income and social crisis resulted and the economy effectively came to a standstill.” [WTO 2001a, p. 13] This seems to reflect some of the concerns expressed by Trinidad and Tobago.

45. The purely economic challenges are addressed first. There seem to be two different categories of markets concerned:

a.) International markets where a small country owns a small part of a key input, e.g., land and climate suitable for growing a particular crop. “Economic rents” may be generated by the country’s assets, e.g., perhaps its soils are especially well suited, or perhaps the regulation of the market causes rents to be generated. Selling those assets to foreigners would indeed mean that the economic rents no longer go to the small country. However, the natural follow-up question would be why these assets would have been sold for less than the value of the economic rents.

b.) Local markets in which various technologies can be used to supply the market, an inefficient technology currently predominates, and the most efficient technology has such significant scale economies that competition in a small country will not develop. (The minimum efficient scale is large compared with demand.) As discussed in the OECD Global Forum on Competition in February 2003, this situation can produce challenges to competition. However, it seemed that in practice concerns of competition and of equity usually outweighed concerns of efficiency losses, that is, that having more competitors operating at inefficiently small scale was usually preferred to having fewer competitors operating at larger, efficient scale.

46. A second type of challenge identified in the 2003 OECD Global Forum relates to population. In a small or a developing country, the business elite and the political elite are small. The small size of the business elite may make explicit collusion easier to hide, and tacit collusion may be easier. The closeness of the political and business elites is also a complicating factor.

47. A third type of challenge identified relates to GDP. A small economy may be able to provide only limited enforcement resources. In addition, there is a concern that a minimum-sized authority would be “too large” for a very small economy, for example, that its beneficial effects on prices would be spread across too few goods and services so the direct cost of the authority would be larger than its benefits. However, this argument is valid only for a very small country indeed.⁹ A possible strategy is to combine

⁹ A recent paper estimates that the “annual welfare benefits in the [United States] from deterring the exercise of market power through the antitrust laws as they are enforced today could readily exceed 1 percent of GDP, or \$100 billion per year.” (This is an estimate of avoided deadweight loss plus losses due to rent-

competition enforcement with a related field, such as consumer protection. Alternatively, small countries may also seek to reduce costs and increase “clout” by joining a regional law enforcement body.

48. A fourth type of challenge identified relates to asymmetric bargaining positions. Trinidad and Tobago is concerned that large multinational firms may threaten to leave the country if they do not get their way on competition (or other) issues. The feared behaviour is similar to that which actually occurred in one transition country. There, a foreign company conditioned its purchase of a domestic company on *inter alia* its removal from the State Register of Dominant Enterprises. (In this country, enterprises on the State Register of Dominant Enterprises were subject to special price supervision.) The minister responsible for that company signed the agreement. However, the minister responsible for competition consented only if many aspects of the company’s conduct were regulated. The final outcome is not known to the Secretariat.

49. Small developing countries present a specific set of challenges to the promotion of competition. The challenges range from those due to economies of scale in non-traded sectors, to those due to having a small population or small GDP, and to those due to being in an asymmetric bargaining position vis-à-vis large multinational firms.

2.4. Challenges and obstacles in the informal sector

50. The promotion of competition in the “informal sector” (IF) presents specific challenges and obstacles. While superficially the IF would appear to be highly competitive, anti-competitive conduct affects markets there. In addition, the IF is significant in some countries. In some developing countries, the IF absorbs a majority of employment. The competition promotion challenges relate to the specific characteristics of the IF. First, much of the IF is rural and the rural IF may be beyond the reach of urban-based authorities. Second, the absence of larger enterprises may render the cost of enforcement, even taking into account beneficial deterrence effects, too costly. Third, the small size of many IF markets may make the design of competition-promoting reforms too costly for the likely benefits. Fourth, the competitive effects of criminal activities in the IF are probably not a law enforcement priority. Nevertheless, some enterprises may cause sufficient anticompetitive harm and be sufficiently prominent that it may be beneficial for an authority to enforce a competition law. And other, broader means of promoting competition, such as promoting regulatory reform for important inputs into a range of IF markets, such as financial services and land, may be sufficiently beneficial to be cost-effective to pursue.

seeking, i.e., the “deadweight loss triangle” plus a portion of the “profits rectangle” estimated to be dissipated in rent-seeking.) [Baker 2003]

If the “effectiveness” of enforcement were the same in the United States and in Trinidad and Tobago, meaning that many conditions of comparability were satisfied, then this suggests that in Trinidad and Tobago, 2002 GDP estimated at USD 9.372 billion, a competition authority costing less than USD 9.4 million per year would be cost-effective. Cost, here, includes not just the direct cost but also the additional costs imposed on the judiciary and compliance costs imposed on business. And the hurdle of USD 9.4 million is probably too high, since the effect of a small enforcement authority on prices in internationally traded goods—which can be a large fraction of imports in a small economy—is probably not measurable. If the country’s exports compete with a number of exporters in other countries, then the marginal effect of competition enforcement in those markets by a small country may also be immeasurable.

The figure of USD 9.4 million greatly exceeds the minimum size of a competition authority. For example, the 2002 budget for the Latvian Competition Council was about LVL 200,000 or about USD 350,000. [Latvian Competition Council 2002.] This compares with a GDP in the same year just smaller than that of Trinidad and Tobago at USD 8.406 billion.

51. This section begins with a brief description of the informal sector. Next, an example of pro-competition regulatory reform outside the IF having positive effects on the IF is provided. Finally, some characteristics that make promoting competition in the IF difficult are identified.

52. Informal sector activities can be divided into two main types. First are coping strategies or survival activities: casual jobs, temporary jobs, unpaid jobs, subsistence agriculture, or holding multiple jobs. Second are “unofficial earning strategies” which can be divided into two sub-types. First among these is tax evasion or avoidance of other regulations including company registration. Second among these sub-types are crime and corruption.¹⁰

53. Estimates of the size of the IF are available, despite the understandable difficulty of measuring it. The IF accounts for more than half of the total labour force employed in some low-income countries. But it accounts for only 4-6% in the high-income countries.¹¹ Table 1 (see appendix) from the International Labour Organisation provides more detailed statistics, including a breakdown between rural and urban. Poverty and participation in the IF are strongly linked. The IF spans a variety of sectors including agriculture, manufacturing, trade, services, construction, and transport. [Blunch et al]

54. Competition problems in the IF include limited or no access to inputs such as information, finance, land, and technology, and similarly limited or no access to markets.¹² In addition, there can be anticompetitive conduct such as exclusion from access to key inputs or exclusion from the most efficient marketplaces. [Varcin 2000] The informal sector may also have negative effects on competition in the formal sector. Goods and services sold in the formal sector can be used to launder money generated by criminal activities in the informal sector. The benefits from the laundering mean that the seller does not require the same returns as a non-criminal seller does. Hence, goods and services used for money laundering can displace those supplied by non-criminals. This displacement in the absence of greater efficiency is a distortion of competition.

55. Competition-promoting reform outside the IF can have positive economic effects on the IF. According to a World Bank report, “Market-oriented reforms that [*inter alia*] ...dismantled various forms of state intervention (price supports, input and credit subsidies, [and] support for marketing products)—have generally increased agricultural [output and productivity] growth.” The resulting growth in agricultural incomes meant there was more local demand for goods and services provided by non-farm

¹⁰ There is evidence that informal sectors are larger in countries with greater “burdens” on formal enterprises (taxes, regulations) and with more corruption. [Johnson, Kaufmann and Zoido-Lobaton 1998] However, there is also an argument that relieving small or informal enterprises of the “burden” of complying with regulations and taxes makes it impossible for political authorities and the informal sector to reach agreement on strategies that aid development in the longer run, such as reducing environmental degradation, improving workplace safety, expanding social security, and increasing tax yield to better fund public services. [Tendler 2002]

¹¹ World Bank “Concept of Informal Sector,” at: <http://inweb18.worldbank.org/eca/eca.nsf/Sectors/ECSPE/2E4EDE543787A0C085256A940073F4E4?OpenDocument>.

¹² “There is also overwhelming evidence that informal sector participants face a variety of constraints including limited or lack of access to resources and markets as well as to land and physical infrastructure (see Sethuraman 1997, Tokman 1990).” Quoted in Blunch, Canagarajah and Raju 2001.

“Work in the informal economy is characterized by low levels of skill and productivity, low or irregular incomes, long working hours, small or undefined workplaces, unsafe and unhealthy working conditions, and lack of access to information, markets, finance, training and technology.” [International Labour Organisation, “Working Out of Poverty,” 2003, p. 29 avail at (<http://www.ilo.org/public/english/standards/relm/ilc/ilc91/pdf/rep-i-a.pdf>)]

rural poor. These goods and services include some which are typical of the IF such as rural construction, personal services, simple manufacturing, and repair. The growth in these markets also reduced poverty. Access to land plays an important part in poverty reduction. [World Bank 2001, p. 67]

56. The small size of markets involving poor people has been identified by the World Bank as a barrier to reform in those markets, despite such reforms being potential “powerful forces for poverty reduction.” [World Bank, p. 72] This is presumably because it is costly for policymakers to design reforms appropriate for the economic, social and political context. But the Bank notes, too, barriers to SME entry into certain markets that are familiar to competition authorities—requirements for experience, complex or expensive procedures for registration and tendering, and noncompetitive behavior in markets—so designing appropriate reforms may well be less costly than feared. Much of the IF involves these same markets.

57. Two other observations can be made that suggest that promoting competition in the informal sector may call for a different strategy than that applied in the formal sector. First, competition authorities are typically located in the largest cities in a country. The transport and communications difficulties that cut off rural businesses from markets also work in reverse, cutting off urban competition authorities from the anticompetitive conduct in rural areas. Complaints may not reach the authorities and, if they do, an adequate investigation may be too costly. Second, the enterprises involved in the IF tend to be very small. (The ILO defines a small or micro-enterprise as one involving fewer than 5 or 10 persons.) The small size of enterprises attenuates the deterrence effect of prosecuting a single enterprise under the competition law. In particular, it is rational for competition authorities to use their limited resources on more significant violations and violators. In turn, it is rational for other small enterprises to believe that the competition authority will not devote resources to prosecute a second small enterprise, after a first one has been prosecuted. Indeed, it may take a whole string of prosecutions to change their beliefs. Therefore, prosecuting one small enterprise will not have a deterrence effect on the others. Thus, the small size of IF enterprises may mean they escape competition law enforcement.

58. The informal sector in developing countries presents specific challenges and obstacles to the promotion of competition. The small size of enterprises and markets, combined with their sometimes difficult-to-reach locations, may require different strategies. These alternative strategies might include reform of input markets and reducing barriers to markets for outputs.

2.5. Challenges and obstacles from the adaptation of institutions including the judiciary

59. After the adoption by a society of competition as the organising economic principle, it takes time for institutions to adapt to the new demands. Institutional adaptations imply also adaptation of individuals and of networks of institutions.

60. Often, individuals must learn and adapt. For example, the same persons who once administered price control may now enforce a competition law. Or a judge who once arbitrated disputes between state-owned enterprises under one set of laws in one political-economic system may now decide lawsuits brought by a government competition authority against enterprises under a completely different set of laws.

61. Potentially, institutions adapt with greater difficulty than do individuals. For example, the “institutional memory” and resulting analytical approaches can remain long after all the individuals who participated in the events have departed. For example, where competition authorities had been involved in repeated or permanent price controls, the basic attitudes and analytical approaches have reportedly persisted long after the policy and fundamental purpose of the institution had changed.

62. Different institutions adapting at different speeds may add to the challenges. For example, the laws may have changed but the regulations and procedures still need to catch up. Or the law schools may not have study materials to produce graduates prepared for the new system. Or the competition law may use economic concepts while the judiciary is uncomfortable with economic reasoning. This might be solvable case-by-case if the competition authority could explain the economics of a case before the judge, but lawyers who matured under the old system may be unprepared to make economics arguments. The court rules for witnesses may make it difficult for an economist acting as an expert to make those arguments. And there may be no provision in court practice for economics-savvy “masters” who could work directly for the judge. The result could be that economic arguments are not made in court. This would mean that they would not be explored during a competition investigation, and thus that evidence to support or refute economic arguments would not be sought. In this way, limits on the rate of change of individual institutions may limit the rate of adaptation of networks of institutions.

63. In addition to the difficulties of bringing economics into the judicial reasoning, there may be other ways in which judicial institutions augment the challenges to competition promotion in their role of resolving disputes between enterprises or between enterprises and the competition authority. In particular, courts may be slow and backlogged, so disputes are settled only with a commercially intolerable delay. They may have difficulties in resolving complex disputes such as competition cases. And legal professionals may not have had the exposure to relevant foreign precedents and norms to speed the development of consistent decision-making. [OECD 2000, pp. 187-8]

64. Finally, sub-national government can lag behind changes at the national level. Whereas national institutions and their employees may receive much technical assistance, changing the skills and perspectives of employees of thousands of municipalities may be beyond the capacity even of the most prolific capacity builder.

65. In sum, the pace of adaptation of institutions can impede competition promotion, independent of the strength of a competition culture amongst the politically powerful or public at large. Among these challenges are providing individuals with the resources and incentives to learn. Other challenges are to spur long-lived institutions to adapt, or to replace them with entirely new institutions, and to maintain sufficient coherence and momentum for change as different institutions adapt at different speeds.

* * * * *

66. This section took as its starting point the set of challenges or obstacles to competition promotion that have been identified by competition authorities and other experts. These were organised into four groups of challenges according to their possible fundamental cause. The largest group, and perhaps the most significant, were those attributed to a “lack of a competition culture.” The other groups were those that followed from the characteristics of small developing economies and of the informal sector in developing countries, and the adaptability of institutions. The “lack of a competition culture” was attributed to the self-interest of individuals and groups, to the fact that economic change produces losers and winners, and that competition accelerates economic change. Thus, opponents of competition are presumably those who expect to lose from it, or who are afraid to take the risk that they might lose from it, or who are not aware that they are likely to gain from it. While it is rational for many, even most, individuals and groups to support competition since they are net winners over the longer run, there are circumstances where individuals or groups will rationally oppose competition. Two points follow. First, managing the redistribution that may result from competition can be a key sub-objective of promoting competition in an economy. Second, demonstrating to those who are likely to be net winners that competition will benefit them can be another key sub-objective.

3. Specific examples of challenges or obstacles

67. This section provides some specific examples where competition authorities faced challenges and obstacles to the promotion of competition. These examples are not for discussion as such, but rather are meant to inspire delegates to submit or present other examples of challenges or obstacles to competition promotion at the OECD Global Forum on Competition in February 2004.

68. These examples are organised according to a rough classification of (1) direct effects on competition, (2) competitive neutrality, (3) interfaces with regulation, and (4) government promotion of anti-competitive market structure. Two additional sections are on corruption and on challenges and obstacles faced by the competition authority as an institution. No position is taken on whether anticompetitive actions were inadvertent or deliberate, perhaps due to a political desire to help particular entrepreneurs, or to increase revenues from local government-owned assets, or due to corruption or something else. However, where it seems that there were conflicts of broad public policy objectives, these are noted.

3.1. *Direct effects on competition*

3.1.1. *Government as purchaser*

69. Governments are frequently active in markets. They regularly purchase goods and services or license providers of goods and services that will be sold to its citizens. There are a number of ways buyers can increase or decrease competition by changing their conduct vis-à-vis suppliers. They may hold competitive tenders. They may broaden the range of goods or services they are willing to buy. They may bundle purchases to increase the size and decrease the frequency of purchase. They may change the amount or timing of information competitors have about other firms' offers. Governments have these and other strategies available to promote competition. But they do not always make use of them.

70. Government can harm competition directly: It can eliminate competition by designating monopoly suppliers without holding competitive tenders. Or it can designate more than one supplier without competitive tender. A specific example of choosing a service provider without competitive tender took place in a country in which the Ministry of Privatization owned 40% of one of the stock exchanges. The Ministry chose to sell stock owned by the government through that exchange even though the shares were going to be listed on two exchanges. A complaint was made. The competition authority recommended changes that were accepted by the Ministry.

71. Sometimes, it is indeed more efficient to have only one supplier in a given territory. This is the case, for example, when there are large "economies of density," that is, when the average cost of supplying the service in a given area is lower when there are more customers or when each customer consumes more. Garbage collection is one service that exhibits "economies of density" and is frequently purchased by local government. It is often sensible for a municipality to hold a competitive tender to be the only garbage collector (perhaps in the entire municipality, perhaps only in certain quarters) rather than to allow several collecting firms to compete on each street each day. This is called "competition *for* the market" as distinct from "competition *in* the market." Governments can promote competition by choosing appropriately between "competition *for*" and "competition *in* markets," and in ensuring that subsequent competitive tenders do not advantage incumbents. In one specific example, a national competition authority investigated a complaint about how the contracts for competitive tendering for municipal garbage collection had been designed, that is, the authority investigated whether competitive within the market would be efficient. In this particular decision, it found that competing *for* the market was most appropriate, so the complainant—who had wanted a part of the competitively awarded contract—was disappointed.

72. A competition authority may get involved in promoting competition by recommending governments to write clear rules for competitive tenders. In at least one country, the competition authority has sent a notice to the authorities in the capital city that they must develop and publish rules on competitive tenders. These rules could address a number of issues, such as when tenders need to be held, how they will be publicised, when a tender would be considered invalid (e.g., if there were too few bidders), how winners will be decided, and how the public announcement of the winner will be made both to ensure public oversight against corruption and to ensure that the municipality does not inadvertently help in cartel enforcement.

3.1.2. *Government as cartel member and access denier*

73. Sometimes, government harms competition by joining cartels and at other times it harms competition by charging high access fees to an essential facility, or even joining a group boycott to deny access. The next set of case descriptions--and one "fact situation" since there has been no decision whether any competition law violation has occurred--illustrates, or potentially illustrates, each of these possibilities.

74. In one case, several taxi companies complained to the competition authority that they were discriminated against in taxi regulation. The competition authority investigated and discovered a taxi cartel. The members of a taxi association had drafted an agreement on uniform prices. They then committed to the municipality that they would comply with the price agreement. The competition authority prosecuted the taxi association and its members, but had no jurisdiction over the municipality.

75. That now-finished competition case bears a resemblance to events unfolding in Ireland in 2002-3. There, the association of all the main beef processors, the Beef Industry Development Society, proposed a plan to reduce the number of plants. Owners of plants remaining in business would compensate owners of plants that were closed. Enterprise Ireland, the state agency responsible for indigenous industry, supports the plan. In 2002 the Irish Farmers' Association expressed concern that the consolidation would adversely affect farmers by enabling the processors to manage output and therefore prices. In 2003 the Competition Authority initiated High Court proceedings against the plan, but in late 2003 the dispute remained unresolved.

76. Charging a high access fee may also distort or prevent competition, though in practice competition authorities often find it difficult to determine "how high is too high." This problem is illustrated with two examples.

77. In the first example, the operator of the town dump was a "public utility budgetary entity," not sufficiently separate from the municipality to be a legal person. However, the dump operator—rather than the municipal authorities—set the price of using the dump. A competitor who used the dump complained that the access price was too high. The competition authority recommended to the municipality that the dump operation (a local monopoly) be split off from the garbage collection, which could potentially be performed by several firms. The municipality took the advice.

78. In the second example from a different country, the local governments typically own electricity distribution companies and charge high prices for access to the grid. (They do not deny access.) This distorts competition since more efficient, competing generators cannot make offers below the prices charged by the local company. Also, consumers pay higher prices overall for electricity. The local governments use the funds thus generated to pay for other municipal services. In this instance, there appear to be conflicting policy objectives.

79. This next example is of a group boycott in which a municipality participated. Here, municipalities and garbage collecting companies agreed to limit access to the local dump to members of

their agreement. Eventually, other municipalities in the area contracted with other garbage collecting companies. But when these companies asked to use the dump, the municipality that owned the dump complied with the agreement and did not allow them access. The competition authority ordered the removal of the restriction on who may use the dump.

3.1.3. *Government as competition promoter*

80. Sometimes, local governments actively promote competition. Two examples of this are provided here. In the first, the municipality lowered the cost of inputs that competitors need. In the second, the municipality directly increased competition by modifying the anticompetitive terms of a license it had issued.

81. In the first example, a near-monopoly had inherited, from the Communist era, essentially all the “good” locations currently in use for selling newspapers and magazines. In response, the municipality designated new, additional locations and held competitive tenders to allocate them. This allowed new press distribution companies to get started.

82. In the second example, the municipality promoted competition in cable television by modifying license terms. The municipality had held a public competitive tender to choose a new cable television provider using superior technology. Numerous small cable television companies already supplied consumers in the municipality. Under the terms of the license, the existing suppliers could neither supply municipal-owned housing nor could they expand their services without the consent of the tender winner. Also, no new CATV companies could enter. After investigation, the competition authority suggested that the municipal government amend the CATV license to eliminate those restrictions, thus enabling competition *in* the market to persist.

83. Normally government, whether local or national, is seen as affecting competition in its role as regulator, as the setter or enforcer of rules. However, these cases illustrate that government is often active in markets as a purchaser or as a provider of a necessary input. And in those roles, it can act to help or hurt competition.

3.2. *Competitive neutrality*

84. Government can treat state-owned enterprises more favourably than private enterprises, or enterprises owned by another state. This discrimination harms competition and reduces economic welfare by distorting economic choices. “Competitive neutrality” is when the government ownership of an enterprise does not give it any competitive advantages or disadvantages relative to its private sector competitors simply by virtue of its government ownership. As the examples below illustrate, some competitive neutrality issues shade off into state aid issues.

85. Applying differing licensing rules is one way to discriminate between state- and privately-owned enterprises. In one country, the Cabinet of Ministers decided to require licenses for a particular service. The Cabinet granted exclusive conditions for state enterprises and exempted them from paying license fees for five years. The competition authority found the decree to be discriminatory and to create insuperable barriers to entry for private enterprises. At the time, private enterprises held a cumulative total of 55% of the market, so their exclusion would have had a significant effect. The authority applied to the Cabinet with a request to suspend and reconsider the decree. The Cabinet did so.

86. In a separate case of discriminatory licensing, a private undertaking wished to begin offering waste transport services in the city of Jõhvi in Estonia. But the traffic rules prohibited it from operating heavy trucks on the streets of the city. By contrast, a public utility undertaking in Jõhvi had a permanent traffic permit to operate such trucks. The Competition Board found that conditions for getting traffic

permits to enable enterprises to offer waste transport were unequal and said that all enterprises should be subject to a uniform competition restriction arising from road conditions. Subsequently, the Jõhvi City Council adopted a new regulation on traffic permits for heavy vehicles, establishing a fee. However, the fee could be reduced for transport services financed from the city budget. The Competition Board found this provision to be discriminatory and recommended it not be applied. The City Council repealed the provision, and submitted a draft regulation to the Competition Board for comment. [Estonian Competition Board 1998]

87. Subsidizing commercial services from public funds is another means of discriminating between state- and privately owned enterprises. In the first case described here, the subsidies funded predation. In the next two cases, SOEs were charged substantially less than POEs for identical services.

88. Competitors of the state-owned radio company in one small country alleged that the state company's commercial programme was offering advertising at predatory prices. The competitors alleged, too, that the commercial programme was being subsidised by the parent company, who in turn received allocations from the state. The competition authority found the state-owned radio company to be dominant and found it to have been offering advertising at predatory prices. The authority ordered the state-owned radio company to completely separate the costs and profits of its commercial programme from the rest of the company, and prohibited the commercial programme from further predatory pricing. In the same country, the same state-owned radio company was not required to pay the National Meteorology and Hydrology Institute (NMHI) for weather reports and forecasts, while the private radio companies had to pay. The competition authority found this to be discriminatory and the NMHI changed its pricing practices to eliminate that discrimination.

89. In the final example of price discrimination, a legal monopoly was subject to price-cap regulation when it sold to governmental economic entities but was not regulated when it sold to non-governmental entities. The monopoly subsequently charged non-governmental entities double the regulated price, for the same service. The competition authority found that there was no cost basis for the price difference and noted that charging different prices conflicted with the constitution, which guaranteed no discrimination on the basis of form of ownership. Both the price discrimination and the high prices were found to violate the competition law. During the investigation, the ministry that regulated the monopoly revised its tariff rules to end the violation.

90. Competitive non-neutrality is sometimes alleged when state-owned enterprises expand into markets that are supplied by privately-owned enterprises, or conversely when privately-owned enterprises wish to expand into markets that are supplied by state-owned enterprises. Private enterprises' concern is that SOEs' capital cost advantages and possibly weak requirement to earn a commercial rate of return on investment may be compounded by obscure accounting. Private enterprises are concerned that these factors acting together may allow less efficient SOEs to displace more efficient private enterprises in competition to supply a market. While POEs have their private concern of displacement, the reduction of the efficiency of markets is a public concern.

91. Prohibiting illegal state aid can form part of promoting competitive neutrality. The idea is to prohibit state aid that distorts or threatens to distort competition by favouring certain firms or the production of certain goods. Under the European Union rules, perhaps the most extensive rules on state aid, "state aid" is any aid granted by a Member State or through State resources in any form. Aid can take a variety of forms such as state grants, interest relief, tax relief, state guarantee or holding, and provision by the state of goods and services on preferential terms. The legal status of the aid does not depend on whether the recipient is privately or state-owned.

92. In many countries, complaints about competitive non-neutrality centre on exemption of state-owned enterprises from various taxes, exemption from complying with regulatory oversight, or in having access to lower cost capital due to the (explicit or perceived implicit) guarantee against bankruptcy enjoyed by state-owned enterprises. However, as illustrated above, competitive non-neutrality can take yet more virulent form.

3.3. *Interfaces with regulation*

93. Regulation can contradict, replace, attempt to reproduce or use competition. The emphasis in this section is on instances when regulation contradicts competition. Regulation may serve legitimate public policy purposes. Sometimes, competition is not advisable; it would hinder or prevent the achievement of the public policy goal. In other cases, the competition authority may be able to help identify how to achieve the public policy objectives at lower overall cost using competition. This section includes a discussion of one country's principles for addressing the competition-regulation interface, and then particular examples where the competition-regulation interface could be improved.

94. Some countries have developed general principles of how to approach the interface of competition with regulation. One example is the United States. The federal structure of the country means that competition interfaces differently with regulation at the federal level as compared with regulation at the state level. With respect to the federal level, regulation does not usually displace competition. The exception is when there is "plain repugnancy between the antitrust and the regulatory provisions." This exception has been applied in only a few circumstances. With respect to the state level, the principle of federalism has been given priority. The states are sovereign under the Constitution; only Congress may subtract from their authority. If a state both "clearly articulates" and "actively supervises" conduct, then that conduct cannot be found to violate the antitrust law. (This is the "state action doctrine.") Under a 1984 law, local government cannot be sued for damages under the antitrust law. The OECD has recommended the United States to "Undertake a comprehensive study of the extent and effect of the state action doctrine, in preparation for legislation to reduce its scope or even eliminate it." The OECD explains, "The impact of the state action doctrine, and of anti-competitive state and local legislation, is a matter of concern. State regulation and special legislation impairs competition and may delay reform, not only in professional services and distribution, but also in telecommunications and electric power." [OECD 1999, ABA 2002, pp. 1213-1222] Despite the state action doctrine, the competition authorities make use of public comment opportunities to advocate for better regulation to state and federal regulatory authorities.

95. The following example illustrates a contradiction between the pricing standard in the abuse of dominance provision of the competition law and the pricing standard in electricity regulation. The example is taken from a transition country in the mid-1990s. The Council of Ministers had passed a resolution that changed the way electricity prices were regulated. (Electricity was a monopoly.) Whereas the old method was cost-based, the new method was not. Prices rose to a level significantly higher than what the competition authority felt to be an appropriate measure of cost. The authority therefore found the pricing to constitute an abuse of a dominant position. The authority suggested to the Council of Ministers that it cancel the changes in pricing methodology.

3.3.1. *Regulation unnecessarily excluding substitutes or new suppliers*

96. Governments sometimes exclude competitors by setting regulatory standards that are too high. That is, there may be enough consumers who prefer a lower quality service or good at lower cost, but regulation limits this option. One example is provided by a taxi regulation that required the boot (trunk) to be larger than a certain size. This rule excluded an entire make of cars, cars that had previously been used for taxis. The competition authority asked the municipality to change the regulation in order to allow more competition.

97. In another example of over-specification, one country's school regulations required children to wear a particular design of textile shoe indoors at school. At the time of the competition authority's investigation, only one shoe manufacturer made shoes meeting those specifications, although other domestic manufacturers made other shoes, including other textile shoes. Not long after the investigation, however, other manufacturers have begun supplying shoes meeting the regulation.

98. The next example is of regulation that would have excluded substitutes and prevented new entry, had it remained in place. The Ministry of Trade had introduced new rules prohibiting the sale of a number of products by small-scale retailers. These products included spirits, clothes, footwear where there are no facilities for trying on, precious stones, as well as firearms, medicines, medicinal herbs, poisons and narcotics. The complainants claimed that these new rules limited competition and favoured state-owned entities and those entities in the Ministry's "system." The competition authority learned that the sale of many of these products was licensed by other ministries or executive bodies, and that only the licensors may revoke a license. The antimonopoly authority issued an instruction to the Ministry of Trade to end its violation by repealing or modifying the new rules.

3.3.2. *Regulation harming competition in a related market*

99. Public utility regulation could provide many examples of regulation of an essential facility harming competition in a related market. The example provide here is unusual in the sector—financial services—and audacity.

100. In this example, legislation designated a monopoly in one market and the monopolist tied a competitive service to the monopoly service. Legislation designated the national Savings Bank of a transition country to be the unique entity to offer privatization accounts. More than a hundred other banks and companies were authorized to trade in privatization certificates. The Savings Bank refused to service privatisation accounts if the client wished to trade privatisation certificates with any other company. Since the Savings Bank had a legal monopoly, the competition authority recommended the Minister of Economy to review the licensing regulation.

3.3.3. *Delegating regulatory authority*

101. The delegation of regulatory powers to enterprises that are then in a position to inspect and control their competitors has obvious negative effects on competition: It will be easier for the firm with regulatory powers to disadvantage rivals or even to expel them from the market. However, in a number of instances, local government has in fact delegated its authority.

102. Local governments have delegated regulatory powers to one of several competing enterprises in the following services: urban transport (busses), advertising on signboards, posters, and billboards, and parking in the historical district. In one variation, the inspectors for urban transport (taxis, minibuses, buses), who were state employees, also owned enterprises in the market for which they were inspectors.

103. National governments have occasionally also delegated regulatory authority to competing enterprises. One national government has put one association, to which a minority of enterprises belonged, in charge of certifying entities placing seamen abroad. In another country, the national standards governmental body assigned the same entity both the right to certify products and the unique right to accredit other certifying organisations.

104. Competition authorities have responded to such delegation of regulatory authority by sending suggestions directly to the municipal authorities, even in countries where competition authorities have no power to impose their suggestions. Sometimes the suggestion is as straightforward as to set up regulatory bodies independent of the regulated enterprises, or that they recuperate the authority to regulate.

105. On the other hand, some authorities go beyond straightforward suggestions. In one instance, the competition authority had performed an in-depth investigation of allegations of unfair competition in urban transport in a city. At the end of the investigation, the authority sent comments both to the national transport ministry and to the city council. To the ministry, the authority suggested improvements in the regulations as well as in the employment rules, to prevent inspectors from having interests in the enterprises they inspect. To the city council, the authority sent a request to design an economically-based regulatory scheme for urban transport, along with their own analysis of passenger flows, and a request to improve the design for competitive tenders.

3.4. *Government promotion of anti-competitive market structure*

106. Despite longstanding advice from competition authorities, academic economists, and other pundits not to privatise monopolies or other non-competitive structures, this practice continues. Among outsiders, the presumption has been that national treasuries want their cash immediately and heavily discount consumer benefits from greater competition that would presumably flow from a more competitive structure. Other reasons could be that managers and workers would find adjustment to competition and to smaller enterprises too painful and convince privatisation agencies of their point of view. Or that privatisation is faster and easier if just one enterprise is for sale and not several, perhaps because it may be easier for buyers to perform due diligence on an enterprise with a longer track record.

107. A related issue are instances when ministries or governments take steps to increase concentration in ways that harm competition. A possible example of this was provided earlier, in the Irish beef industry.

3.4.1. *Privatisation of a non-competitive structure*

108. Enterprises engaged in a wide variety of activities have been privatised as monopolies. In addition to utilities such as electricity, natural gas and telecommunications, some countries have privatised or discussed privatising activities such as river steamship services and river port services, movie theatres, technical gases, pharmacy sectors from production through wholesaling to retail pharmacies, and general and food retailers.

109. The structural concerns have been horizontal and vertical. Horizontal concerns have been the creation of a private monopoly or highly dominant firm when economies of scale would have permitted several efficiently-sized competitors. While this might not be too serious in the longer run if barriers to entry had been low, in the time and place where some of these monopolies were privatised, the factor markets, notably land and financial markets, were not yet operating.

110. Vertical concerns have been that some enterprises would not get access to an essential facility because it had been privatised incorporated into a competitor. The classic example is petrol (gasoline) retailers and storage facilities in an isolated region of a vast country. Retailers in the region could get petrol only from local storage facilities: Distances were too great for them to use storage facilities elsewhere. New petrol retailers wanted to enter the market to compete against the incumbent. But the local storage facilities had been privatised along with most of the retail outlets, and that firm refused to rent any storage to the new retailers. In addition, the dominant firm had been vested with the right to license petrol retailers in the region.

111. A second example of vertical integration posing competition problems was the river steamship and port enterprise on a major river, mentioned above. The proposal was to privatise the steamship lines, part of the vessel repair plant, a major river port, and the communication and radio navigation system into a single enterprise. This would have had obvious effects on competition in transport services and the competition authority proposed a more competitive structure.

3.4.2. *Promoting anti-competitive concentration*

112. In one example, a country's sugar beet processing plants had been separated into competing enterprises after the end of Communism. Subsequently, the Ministry of Agriculture issued a directive that the sugar factories must join up (it is unclear whether this was a merger or a tight association). Very high sugar prices resulted. The competition authority ordered the withdrawal from the merger/association of those sugar factories that had been directed to join. It also ordered them to quit coordinating purchase and selling prices. In Poland, a similar consolidation of sugar producers into four holding companies was proposed and the Antimonopoly Office sent a memorandum to the Prime Minister opposing the draft ordinance of the Council of Ministers that would have given effect to the plan. [OECD 1997, p. 501]

113. The Polish competition authority figures in another set of examples spanning the economy. During the early years of the transition, representatives of the competition authority in Poland had participated in teams preparing restructuring and privatization projects for the steel, oil, black coal mining, shipping and rail industries. The authority tried to introduce provisions that would guarantee the emergence of a competitive structure within the industry (restructuring) or deter excessive concentration as a result of privatisation. However, often competition had to give way to other objectives, such as "the necessity of introducing capital to the industry or to the needs of social policy (recession, unemployment)." [OECD 1995, p. 408]

114. It remains unclear why proposals to privatise monopolies continue to be accepted. In particular, it may be useful to identify instances when such proposals were rejected in favour of a more competitive structure and then to identify why a "competition culture" viewpoint won the political argument. It may also be useful to explore whether the public purpose for government-sponsored concentration is always as a means to overcome barriers to exit from a market. And, if so, it could be useful to explore whether less anticompetitive strategies to overcome barriers to exit have been successful.

3.5. *Corruption*

115. Corruption can directly reduce competition in a number of ways. Among them are to bribe the procurement officer to accept a particular bid or to not look too hard for competing bidders, bribe the sales managers of the potential competitors not to act too competitively, bribe the official writing the bid specifications to make them conform to one company's product rather than those that would best match the need, and bribe the official who inspects whether what was actually delivered met the specifications. One series of examples of corruption directly reducing competition is reported by the Parliamentary Accounts Committee in Uganda in 1999. The Committee found that the total net proceeds to the State from privatization were close to zero. The reason was that sales were rigged by collusion between members of the tender board reviewing bids and either one of the bidding companies or the former management team of the para-statal in question. [Transparency International (UK), pp. 14-15] Corruption during periods of privatization can undermine popular support for economic liberalization in general, including economic competition in particular.

116. Causality can also go the other direction. That is, less competition can promote more bribery. One soon-to-be-published study of bribes paid to utilities in 21 transition economies in Eastern Europe and Central Asia found that bribes paid to utilities are higher in countries with greater constraints on utility capacity, lower levels of competition in the utility sector, and where utilities are state-owned. [Clarke and Xu 2003]

117. But corruption can also indirectly reduce competition by raising barriers to entry or by making some competition-promoting arrangements infeasible. A survey carried out by Transparency International in Bangladesh found that about 65% of urban households said that it was almost impossible to get a trade

license without money or influence. [TI(UK), p. 24] The need to fund universal service is sometimes used as a reason to prohibit competition. It is argued that a monopoly is needed in order to generate the excess profits to be used by the same company to also supply uneconomic services. One solution is to require consumers—regardless of their supplier—to pay into a universal service fund which is then used to pay for uneconomic services. But where government cannot ensure that universal service funds will not be embezzled, this sort of arrangement is not feasible.

118. Corruption can seriously undermine competition. It may do this directly through “skewing the playing field.” Or it may undermine competition indirectly by making entry into markets more difficult, or yet more indirectly by undermining popular support for competition more generally.

3.6. Challenges and obstacles faced by the competition authority as an institution

119. A number of challenges and obstacles that have been identified by competition authorities can be classified as institutional weaknesses. These include weak powers, insufficient resources including human resources, and insufficient independence.

3.6.1. Investigatory powers

120. Some competition authorities feel they have insufficient powers to investigate. This includes powers to enter premises to search for and seize or copy documents that may provide evidence of a violation of the competition law. It includes powers to require documents and written responses to questions to be delivered to the competition authority, and powers to require witnesses to answer questions orally. In at least one jurisdiction, the competition authority officials may not enter a business premises without permission from the business. Others have no such powers at all. One issue for some authorities is whether only business premises may be searched, or whether private homes, cars, or even persons may be searched. With respect to documents, if only copies may be taken away from an inspection, then this could entail loss of information—was the same pen used on both of these documents?—and potential difficulty in presenting copies as evidence in court.

3.6.2. Sanctions

121. The lack of powerful sanctions reduces incentives to comply with the competition law. In particular, it could be more profitable for a firm to repeatedly pay low fines, or take the chance that it might one day have to pay a low fine, than to quit illegal anticompetitive behaviour. There is a parallel argument regarding weak sanctions if a person addressed with a mandatory request for information provides an incomplete or untimely response.

122. A “leniency policy” can help promote competition. Once it has been established that violations of the competition law are subject to powerful sanctions and that violations are in fact sanctioned, then providing the competition authority with the capacity to offer lower sanctions in return for evidence to help prove other competition law violations (i.e. a “leniency policy”) can help the authority to promote competition through enforcement.

3.6.3. Independence

123. The “independence” of the competition authority from day-to-day political influence can affect the authority’s capability to promote competition and public confidence in its work. (Clearly, a competition authority must be independent from any enterprises or associations subject to its jurisdiction.) Independence is seen as important for consistent, predictable and transparent enforcement of competition law and advocacy of pro-competition regulatory reform. In part this is due to being able to focus on

competition, rather than having to make tradeoffs internally between conflicting public policy goals. Thus it can enhance the appearance of impartiality.

124. Competition authorities identified “greater independence” most frequently as the step/measure likely to lead to better promotion/attainment of the embraced objectives. In this survey—of competition authorities invited to the OECD Global Forum on Competition in 2003—about one-third of the respondents gave this response. (Note, though, that 50% of the respondents to that questionnaire reported that they consider themselves to be totally independent from political influence, while a further 45% reported that they consider themselves to be highly independent from such influence.) [OECD 2003]

125. On the other hand, some competition authorities regarded as effective are not formally independent. This group includes the Antitrust Division of the United States Department (i.e., Ministry) of Justice and the Bundeskartellamt of Germany. They illustrate the point that the formal law is not as important as the political support of their independence. And the political support depends on the existence of a “competition culture.”

3.6.4. *Resources, including staffing*

126. The influence of size and budget on the effectiveness of competition authorities is not straightforward. More resources typically allow an authority to become more effective. Thus, the OECD Secretariat has recommended increases in the resources of competition institutions in several reviews of its Member countries. But in a small economy with relatively few appropriately educated persons, the effect can be very different. If government jobs are restricted to citizens, then expanding the competition authority could mean that other policy areas are starved of human resources, at least until more people are appropriately educated.

127. Further, as the competition authority becomes more effective, enterprises and associations hire competition experts to assist them in their dealings with the competition authority. These purchasers of competition expertise thus compete for the few experts, and in some countries pay multiples of civil servants’ salaries. These large salary differentials cause rapid staff turnover in the authorities. The high turnover raises the authorities’ training costs. Perhaps more importantly, the high turnover can mean that the authority is routinely represented by relatively less experienced personnel than those experts representing enterprises.

128. Resource constraints are not the entire story, however. Sometimes a very small competition authority can be very effective. For example, when there was a real probability that banking would be exempt from competition law, the four-person Albanian competition authority teamed-up with the central bank and won the political battle to make banks fully subject to the competition law.

4. **Questions for discussion**

129. Competition authorities face a number of challenges or obstacles when they promote competition. This paper has suggested that the “lack of a competition culture” is the fundamental cause of the largest group, and perhaps the most significant group, of such challenges. It has attributed the “lack of a competition culture” to the self-interest of individuals and groups who oppose the economic change that competition produces. But there are other challenges which are attributed to the characteristics of small developing economies, of the informal sector in developing countries, and to the adaptability of institutions.

130. In small developing economies, some challenges were attributed to scale economies in non-traded goods and services, and to the displacement of smaller scale technologies by newer larger scale

technologies. Others were attributed to the small size of the business and political elites, or small GDP, or to asymmetric bargaining positions vis-à-vis large multinational enterprises.

131. In large informal sectors, the challenges were attributed to the often rural and typically small size of enterprises. They are difficult to reach, and the markets they supply are typically very small.

132. The specific examples of challenges or objectives illustrated government's various effects on market competition. There seemed to be more examples from local government. While this may be a statistical fluke, it may also be due to national governments possibly having broader public policy perspectives than local governments.

133. Delegates are invited to consider:

- *What challenges and obstacles are important in their own country or economy?*
 - *Is the absence of a "competition culture" the root cause of impediments to competition?*
 - *Are there impediments specific to small developing countries?*
 - *Are there impediments specific to the informal sector?*
 - *Are institutional impediments significant?*
- *What are effective responses to these challenges and obstacles, perhaps based on their own experiences? Can some profound causes be addressed directly?*
- *What other lessons can be learned, e.g., mistakes to be avoided, from the experience in their country or economy?*

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