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COMPETITION POLICY IN SMALL ECONOMIES

-- IRELAND --

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IRELAND

SPECIAL ASPECTS OF COMPETITION POLICY IN SMALL ECONOMIES

Small countries often implement policies to protect domestic producers, usually in order to further industrial or macroeconomic policy objectives. For example, “infant industry” protection is sometimes advocated to support the temporary protection of domestic producers until they have the strength and expertise to compete on the open international market. “National champion” protection is, by contrast, longer term in nature and is aimed at protecting domestic producers from either domestic or foreign competition. The following discussion focuses on the weaknesses of the national champion argument and also comments briefly on some other issues relevant to small economies.

1. National champions

National champion advocates argue that applying the principles of competition policy in small economies can be harmful because firms are precluded from achieving the necessary scale to compete internationally. Accordingly, industrial policy should encourage national champions, and normal competition rules should not apply. There are, however, several reasons why the trade-off between competition and other policy goals industrial policy can be considered small, or even non-existent.

1.1 *Geographic market definition*

In most cases the relevant market is wider than the national market and hence an accurate competition assessment, i.e. one based on the wider market, would not identify a competition problem. Thus, for example, Nokia’s strong position in the Finnish market is unlikely to be a competition problem.

1.2 *Distribution*

A sanguine position regarding a large or dominant firm, such as that above, depends critically on distribution and importation systems being open to competition, as this will mean dominant domestic firms are exposed to international competition in the domestic consumer market, not just in foreign markets. For this reason, small economies have all the more reason to apply competition rules vigorously in the importation and distribution sectors, and doing this would ease any adverse domestic implications from national champion firms. Furthermore, it should be noted that opening markets to international trade will not necessarily lead to greater competition in domestic markets, even where domestic industry supplies inputs to exporters. For example, Ireland is extremely open to trade but is also reliant on non-traded services and infrastructure, which in many instances are not subject to competition.

1.3 *Monopoly Profits versus Capital Markets for Funding Foreign Expansion*

Monopoly profits could in theory have a beneficial effect by providing a source of funding for the investment necessary to allow the national champion to compete internationally. However, a number of criticisms of this argument can be made.

Capital markets, rather than monopoly profits derived from domestic consumers, are a more efficient source of funds for investment abroad, and almost certainly result in more sound investment. Funds raised on capital markets, either via bonds or equity, impose obligations, controls and incentives on the shareholders and management of firms. By contrast where a firm has access to monopoly profits there is much less incentive to encourage sensible investment at home or abroad.

If monopoly profits are necessary to fund a foreign investment, then in effect the investment is only viable because of a cross-subsidise from domestic consumers. Consequently the overall effect on the economy would be negative as, in effect, the merger would be financed by a tax on domestic consumers to subsidise competition in export markets.

An alternative case might arise where a multi-product firm seeks to expand externally from a platform of a domestic merger but where in one product market the merger raises monopoly issues. (In this case, as opposed to the example above, the monopoly profit is not likely to be crucial to the viability of the merger and, if it is, the rationale for the merger must be weak). Rather than blocking the whole merger it would be more appropriate to apply competition remedies to the specific domestic market power problem.

1.4 *Domestic Product Market Competition as Launching Pad for Foreign Expansion*

It has been argued, by Michael Porter and recently also by the OECD, that the discipline earned by intense competition in the domestic market is the best stimulus to success abroad. Firms that have to compete domestically know how to cut costs, operate efficiently, please customers and win business. This experience gives them an enormous advantage when they expand into foreign markets. The example of Ryanair illustrates this point. Having developed a successful model as a new entrant into the UK-Ireland market, Ryanair is now expanding into the other European markets.

In general the evidence is very much against the benefits of domestic monopolies as a launching pad for mergers with foreign firms. In the Irish context there are few examples of domestic monopolies that were protected from competition at home and that used this to compete and expand effectively on foreign markets. Evidence, on the contrary, suggests that the monopoly profits were neither used to expand abroad nor returned to the shareholder (often the state) but instead were wasted in inefficiencies within these firms. These additional costs present problems in terms of transitional costs when an industry or sector undergoes restructuring.

1.5 *Summary*

In summary the arguments supporting the suspension of competition law to encourage national champions are weak. There are almost certainly better policy instruments available to encourage national champions than exemptions and protection from domestic competition.

2. *Other Small Country Issues*

As the Irish experience indicates, small open economies can face a variety of issues that would not affect larger economies.

2.1 *Market too small to enter*

It is possible that a small market may not present sufficient profitable opportunity for foreign competitors to enter. In this way the competitive threat of entry to the domestic market is blunted and incumbent monopolies can maintain their privileged position. This small country problem is exacerbated to the extent that domestic regulations inhibit rather than enhance competition and/or where distribution systems are country specific and hence less susceptible to a credible threat of market entry.

2.2 *Business bias (political considerations)*

Small economies are usually more open to trade. This puts national competitiveness centre stage (especially in currency union) and policy frequently involves promoting competition in export markets. Consequently policy is less focused on consumer markets or markets that do not serve exporting business. This can lead to the emphasis of domestic policy debate on exporting business interests (especially FDI companies), which in turn makes pro-consumer competition policy more difficult to promote or to implement.

It is, nevertheless, possible to pursue a pro-competition agenda by pressing the case for greater competition in sheltered sectors, starting with those that provide inputs to exporting firms (communication, transport, energy, financial services, etc). Often greater competition in these sectors, introduced to benefit exporting firms, will simultaneously benefit consumers.

2.3 *Rationalisation of Administration Functions*

If companies seeking to expand cannot merge domestically, then they may seek to merge with a firm in another country, which raises the possibility that some 'central office' functions will be consolidated and transferred to the larger country. This issue was highlighted recently by Horn and Stenneck¹ in the context of the prohibited Volvo-Scania merger. Similar arguments have also arisen in Ireland in the context of the Bank of Ireland's endeavours to expand through a domestic merger. As noted earlier, this is another area where policy instruments, such as small countries giving industrial policy incentives for the location of head office functions, may be more appropriate than the use of competition policy.

2.4 *Policy Development and Implementation*

Small economies may lack a critical mass of expertise in determining domestic competition policy. Larger economies generally have access to a larger pool of public and private expertise and talent. As a result, new legislation tends to be better formulated, drafted and considered more speedily, and to be subject to a more active domestic debate. The implication for small countries is to be open to benefit from the experience and expertise of larger countries.

¹ Henrick Horn and Johan Stennek "EU merger control and small member state interests" in The Pros and Cons of Merger Control Swedish Competition Authority 2002. The article highlights ex ante concerns with the issue but does not attempt to estimate whether this was the outcome in this case.