# THE ROLE OF COMPETITION ADVOCACY IN TRANSITION AND DEVELOPING ECONOMIES

**Prof. Dr. Hans Wiesmeth**
Dresden University of Technology Faculty of Business and Economics
Chair of Economics, esp. Allocation Theory
E-mail: hans.wiesmeth@tu-dresden.de

**Associate professor, Ph.D. Nazim Uzbey Hajiyev**
Chief of division in Research Institute for Economic Studies
Azerbaijan State Economic University
E-mail: nazimxx@yahoo.com

## Abstract

The purpose of the study is to investigate the practical issues to protect and develop competition in transformation countries on the basis of the experience of industrialized countries. The research work applies methods such as a scientific abstraction, system analysis and logic synthesis. The result of the study emphasizes that in transitional and developing economies the protection of competition is of outstanding significance. In particular, trade liberalization, careful economic regulation, appropriate state support for local governments, privatization and other policy areas should be continuously promoted by an independent competition agency. The practical significance of the study is its potential to enrich the academic and practical knowledge of specialists working in this field. Moreover, experts conducting research into the creation and development of sound and effective environmental policies will be supported by the effective implementation of competition policy. The originality and scientific novelty lies in the fact that the research work analyzes and systematizes experience of developed and developing countries; moreover it gives recommendations to look into these countries regarding their practices for the protection of competition.

**Key words:** competition policy, competition advocacy, protection of competition, competition agency.

**JEL Classification Codes: D41**

## Introduction

Competition law generally aims at preventing private restrictive business practices that significantly lessen competition, reduce consumer welfare, and result in inefficient use of resources. However, competition may be lessened significantly by various public policies and institutional

arrangements as well. Indeed, private restrictive business practices are often facilitated by various government interventions in the marketplace. Thus the mandate of the competition office extends beyond merely enforcing the competition law. It must also participate more broadly in the formulation of its country's economic policies, which may adversely affect competitive market structure, business conduct, and economic performance. It must assume the role of competition advocate, acting proactively to bring about government policies that lower barriers to entry, promote deregulation and trade liberalization, and otherwise minimize unnecessary government intervention in the marketplace. The relevance of the question of what is "unnecessary government intervention" becomes in particular apparent in environmental policy, which gains increasing importance in rapidly developing countries.

**The role of competition advocacy**

Through competition advocacy a competition agency can influence government policies by proposing alternatives that would be less detrimental to economic efficiency and consumer welfare. It can serve as a buttress against lobbying and economic rent-seeking behavior by various interest groups. And it can foster greater accountability and transparency in government economic decision-making and promote sound economic management and business principles in both the public and private sectors.

There is a direct relationship between competition advocacy and enforcement of a competition law, and the connection is especially strong in transition and developing economies. Many markets in developing and transition market economies initially tend to be highly concentrated, and sometimes dominated by a single or a few large firms that engage in anticompetitive business practices or lobby the government for special favors. The aim of competition advocacy is to foster conditions, in particular framework conditions that will lead to a more competitive market structure and business behavior without the direct intervention of the competition authority. The more unpalatable alternative is for the competition authority to exercise close and continual supervision of the dominant firms under the competition law. This alternative is more resource intensive, and the results less satisfactory. It represents a return to broad government intrusion in the marketplace, reminiscent of the systems that governments in emerging market economies are leaving behind.

There may be both an explicit, statutory basis for the competition agency's competition advocacy functions and an implied or informal basis. The laws of some countries, such as Canada, Italy, the Republic of Korea, the Russian Federation and the Republic of Azerbaijan, give the competition agency a specific mandate to submit its views on particular matters to the appropriate ministry or regulatory agency, for example, on the restructuring of the telecommunications industry. In other countries the law may be silent about the role of the competition agency in such areas. Unless the law forbids participation by the competition agency, however, the agency should, through its law enforcement role, actively seek opportunities to state the case for competition in the public forum. This has been largely the practice in France, Germany, and the United States, for example. It is unlikely that any other party would do so, or be as effective. The benefits to the economy and to consumers from effective competition advocacy are almost certainly to be significant, at least as great as those from more traditional competition enforcement.

There is also a role for competition advocacy in the broader, public arena. The successful establishment of a market economy requires the existence of a competition culture within the country. Both consumers and the business community must have an awareness of competition policy and an understanding of how it will benefit them. The competition agency has an important role in this educational process. In many countries the public does not have significant experience with competition policy or an appreciation of the benefits that flow from the process of competition. Moreover, the first experience many individuals have with free markets, especially in countries in transition from planned economies, is likely to be negative, not positive. With liberalization of markets often comes disruption, as misallocated and inefficient assets are cast aside and jobs are lost, and prices of some products, formerly controlled, rise abruptly to market levels. Under these circumstances the competition agency's task of building public support for competition policy is especially challenging.

The business environment in which firms operate is conditioned by many economic policies. The degree of competition in an economy can be strengthened or weakened according to the way in which these policies are developed and applied. Competition advocacy in transition and developing economies can be most important in the following policy areas:

- Trade liberalization.
- Economic regulation.

- State aids and environmental policy
- Operations of local government authorities.
- Privatization.

**Trade liberalization**

Trade policy has important implications for the development of competitive markets. Domestic markets are relatively small in most transition and developing economies and often characterized by dominant firms. Economic, social, and political pressures pose obstacles to opening up such markets by breaking up dominant domestic firms. Imports, on the other hand, can bring about new competition relatively quickly. Thus liberalized trade policies such as reducing tariffs, investment controls, import restrictions and quotas, domestic production or content requirements, and the like are among the most significant measures that can be advocated by the competition agency.

Advocacy of trade liberalization is likely to be controversial. Domestic producers may put up a strong resistance as they may be unable to adapt quickly to new market conditions, and they may find themselves vulnerable to competition from more efficient foreign producers. Moreover, foreign investors in emerging markets may also demand nd protection against competitive imports as a condition of their investment. As a consequence, protectionism for domestic markets is often politically popular in the early years of new market economies, which makes it difficult for the competition authority to advocate trade liberalization. Indeed, there may be some valid policy reasons, including social concerns, for temporary tariff and nontariff trade barriers in an emerging market economy. In this context the competition advocate may urge that protectionist measures be strictly related to restructuring programs and that they be temporary.

The role of the competition advocate in the formulation of trade policy is often one of educator - informing policymakers and consumers of the true costs of trade barriers. For example, in most countries the agricultural sector enjoys significant political power and has succeeded in erecting trade barriers that protect locally produced agricultural products. Such measures are grounded in an important social policy – the preservation of agricultural jobs – but often result in significant costs to consumers. Such costs are likely to be relatively greater in transition and developing economies, where citizens spend on average a greater proportion of their income on food than in more developed countries. Experts in the competition agency can make reasonable

estimates of the costs to consumers of such measures, which then can be compared with expected benefits. If the costs are disproportionate compared with the benefits, as they are likely to be, the agency can suggest that the social policies embodied in the trade barriers be addressed in a more efficient manner - for example, through direct government subsidies to individuals who lose their jobs as imports increase.

It must be borne in mind that promotion of competition is a long-term process. The competition agency will not always be successful in its efforts to promote trade liberalization, but it should not be discouraged by failures. National economic policies are often the result of compromise. The role of the competition advocate in the formation of trade policy is to ensure that policymakers and the public at large are fully informed of the benefits of liberalized trade to competition and consumer welfare.

**Economic regulation**

Competition advocacy can play an important role in the legislative process in transition and developing economies. Often the legal system in these countries undergoes dramatic change in a relatively short period of time, and it is important that competition policy be established in the new regime as cohesively as possible. The competition agency should strive to ensure that competition rules are properly and consistently inserted into new legislation and regulations where appropriate.

The competition agency should also be active in promoting competition in regulated industries. Recent technological developments and rethinking by economists have questioned the traditional arguments advanced for economic regulation of sectors (such as electricity and telecommunications) previously considered natural monopolies. Not all aspects of the operations of enterprises in these types of sectors necessarily display increasing returns to scale such that there is room for only one or a few firms in the market. Often the monopoly rights granted by the government are extended through vertical integration into economic activities that can be subjected to competitive pressures. In many cases it is possible to separate natural monopoly elements from potentially competitive activities and the regulatory functions from commercial functions, and also create several competing entities through restructuring.

In several industrial countries (notably Australia, Canada, New Zealand, the United Kingdom, and the United States) such initiatives have been successfully adopted. Thus in the provision of electricity, separation has been made between generation, transmission, marketing, and after-sales service. Similar separation has been put into effect in telecommunications, especially in the markets for long distance services and the provision of equipment, so that consumers are accorded greater choice and lower prices thorough competition. Similar headway has been made in the provision of services in other markets that were previously subjected to extensive regulation - namely, airlines, trucking, intercity bus services, railways, and water and sanitation. Few economic issues are likely to be more important or controversial in transition and developing economies than the privatization and restructuring of these infrastructure industries. The competition agency can and should participate in the debate on these issues.

The competition agency may also participate in a limited and appropriate way in the setting of industry standards by government authorities, such as safety and environmental standards or license requirements. The role of the competition agency is not to intervene in the technical aspects of such standards-setting, but to help ensure that the standards are transparent and nondiscriminatory and that they do not unnecessarily restrict competition among service providers.

The competition authority may also act as competition advocate on a case-by-case basis in regulated industries. To the extent that the law permits, it can intervene in specific regulatory proceedings to present the case for competition. Such activities are resource-intensive, however, and the agency should choose its cases carefully. Participation in regulation cases often requires intensive preparation. The agency needs to acquire some technical expertise in the relevant industry if it is to be effective in the proceeding. In such cases it is often useful to work with independent, outside experts who have specific industry expertise.

Finally, in countries that do not have specific laws applying to natural monopolies, the competition authority may have a significant role in the regulation of these sectors. The relevant government ministry may continue to exercise control over the industries, including control of prices and market access, but the competition authority may decide, usually on a case-by-case basis under the competition law, concerns relating to the monopoly's equitable treatment of both new entrants and consumers.

**State aids and environmental policy**

A general goal of competition advocacy should be to ensure equal conditions for all market operators. This equality may be distorted by government policy establishing different rules for domestic and foreign companies, for state-owned and private firms, or for large and small enterprises. In this regard state aids should receive careful scrutiny by the competition agency Subsidies, tax and social security rebates, preferential loans, capital injections, public procurement, and other benefits for selected market operators, sectors, or regions can be harmful to competition. For example, a subsidy given for promoting the use of natural gas may place oil suppliers at a competitive disadvantage. To the extent that there are other socioeconomic welfare objectives, such as reducing pollution, a careful cost-benefit analysis needs to be conducted. Otherwise subsidies provided to certain companies producing environmental technologies may adversely affect other parts of the private sector of the economy or may prove disadvantageous to achieve an environmental goal.

Like restrictive trade practices, state aids are addressed in many international agreements, including the General Agreement on Tariffs and Trade (GATT) as part of the regulations of the World Trade Organization (WTO) and several regional integration and trade agreements. Nevertheless, almost all governments continue to employ state aids in some form, and the practice is likely to be more widespread in transition and developing economies, as those governments strive either to make their domestic industries competitive in the world economy or to protect them from more efficient foreign competitors. The experience across countries suggests that these types of policy measures rarely yield successful results, however. They tend to dampen firms' incentives to become efficient. They foster rent-seeking behavior and give rise to high levels of ownership and market concentration – a phenomenon particularly observable in transition and developing economies. Moreover, governments are notoriously poor predictors of market developments, and the adopted strategies soon become costly in several ways. In addition to resulting in various inefficiencies, these practices contribute to fiscal deficits and the development of anticompetitive practices.

The competition agency can act to improve public awareness of the issue and in particular to promote understanding of when certain forms of state aid might be appropriate in addressing specific problems that arise in the transition period. Thus temporary and specific state aids might be appropriate in connection with implementation of restructuring programs in disadvantaged

regions and sectors, promotion of research and development activity, and provision of temporary support for enterprises undergoing a difficult adaptation to new, free-market conditions. On the other hand, state aids may inappropriately delay structural changes necessary to render enterprises or sectors economically viable. As in the case of trade policy, the competition office can show how the long-run negative effects of such policies may outweigh their short-run benefits and suggest more direct and efficient means of addressing the social issues that may underlie the policy.

Regarding environmental policies, the competition agency should cooperate with the environmental agencies in order to jointly develop framework conditions which stimulate the relevant economic agents – households and companies – to comply with the goal of a particular policy. This is not an easy thing to accomplish as the economic agents can respond to such a policy with a variety of "avoidance strategies", which are not always taken care of by the environmental regulations. On the other hand, some government influence is required as environmental commodities are characterized by public good properties and external effects.

In some countries government procurement practices are a form of state aid, with the state purchasing goods and services from favored enterprises at higher than market prices. The competition office can urge that government procurement be conducted in a transparent and competitive fashion that gives all qualified sellers an equal opportunity to compete. The agency can help to develop procurement procedures that ensure competitive outcomes. It can also assist the government in adopting measures that help to prevent bid rigging and price-fixing on government contracts. In virtually all countries, cartel conduct in government procurement is a serious problem.

**Operation of local government authorities**

In some emerging market economies, especially those in transition from centrally planned economies, economic reforms result in ownership by local governments of communal service facilities, such as water supply services and public transport. A conflict of interest exists in this situation, since the authorities are both the owners of these assets and the representatives of citizens' interests. As the owner, the authority is interested in the profitability of its business, which can be enhanced by increases in prices and lessening of quality of services; but such actions clearly may be contrary to the interests of the citizens whom the authorities represent. In most countries (the countries of the former Soviet Union are a notable exception) the competition

authority cannot legally intervene against local and national government authorities under the competition law. Thus competition advocacy is the means by which these anticompetitive practices are addressed.

In this situation the competition agency may recommend privatization of the productive assets and the introduction of competition wherever possible. If elements of natural monopoly exist, competition can be introduced through competitive bidding for selection of the most efficient service provider. In other situations public authorities may interact with private enterprises. For example, public transport may be provided both by the local authority and private enterprises. Competition advocacy should attempt to ensure that there is no discrimination in favor of the public authority in the granting of subsidies. When the public authority is in control of an essential facility, competition advocacy should attempt to prevent participation by the authority in potentially competitive upstream or downstream markets. When such integration exists, competition advocacy should prevent discrimination in favor of the public authority in terms of access to the essential facility. However, the experience with public-private-partnership (PPP) programs in many industrialized countries should also be taken into account in this context.

The competition authority may also inform local authorities of some of the most common restrictive business practices of service providers and suppliers, such as bid rigging, and assist them in adopting practices that prevent or detect such practices. The competition agency should also strive for transparency and fairness in administering state aids at the local level.

**Privatization**

Considerable empirical research has found state-owned enterprises to be less efficient than privately owned firms and has identified a diverse set of explanatory factors (the nature of managerial compensation and incentives, inefficient organizational form and structure, lack of direct accountability and of hard budgetary constraints for managers). In most countries state-owned enterprises are insulated from the discipline of competitive market forces. Aside from benefiting from government-imposed barriers to entry, price regulations, and subsidies, state-owned enterprises in most countries (again, countries of the former Soviet Union are a notable exception) are exempt from the application of the competition law. In every country that makes a serious com-

mitment to the development of a market economy, therefore, privatization of state-owned enterprises has a high priority.

There is an obvious tension in the privatization process between the desire of the state to obtain the maximum price for the privatized assets and need for the creation of efficiency-enhancing, competitive markets. Investors frequently are hostile to competition and are willing to pay more for assets that enjoy a position of market dominance. Thus there is an important role for the competition agency-to ensure that state monopolies are not simply transformed into private ones. The task is not an easy one, however. Privatization is a core element of market-oriented reform. Hence, the competition agency must not create unnecessary obstacles to the process. There may be both legal and political constraints on direct intervention by the agency in the privatization process, but within such limitations the agency's mandate is to seek the creation of markets in which competition can flourish.

In most transition and developing economies a separate agency is created to conduct privatization. However, in many countries the laws also provide for formal participation by the competition agency. Ideally, the competition agency would be notified of significant privatization cases. The agency might have the power to intervene directly in a given privatization case, or it could proceed under the merger control provisions of the competition law. The agency should have the power to require the parties to submit relevant evidence, including information on the assets, operations, and revenues of the enterprise to be privatized and actual and potential competitors. The agency's inquiry should focus on the traditional issues associated with identification of dominance, including proper definition of product and geographic markets, market structure, entry barriers, and other aspects of the market relating to the ability of the privatized enterprise to exercise market power, including particularly the likelihood that imports could discipline such anticompetitive conduct.

If the enterprise would not have a dominant position, the agency should not oppose the proposed transaction. However, if the enterprise would be dominant, the agency should consider requiring (or recommending, if its powers to intervene directly are limited) measures to eliminate the dominant position. The simplest remedy is to encourage new entry by lowering entry barriers, including trade barriers. Sometimes a partial divestiture from the dominant firm of an essential facility or important proprietary technology might be sufficient. The most drastic remedy is a complete restructuring of the enterprise into two or more entities before

privatization. Such a restructuring may be possible if there is one or only a few state-owned monopolists operating many plants or facilities, but it is likely to be difficult, both practically and politically. Care must be taken that the assets of the newly created entities are viable, that the firms can operate on an efficient scale, and that they have access to necessary inputs and distribution facilities.

Finally, privatization can be an intensely political exercise. The competition agency should intervene in privatization proceedings judiciously and in a nonbureaucratic manner. The agency should be well informed and take fully into account the positions of the enterprise and the privatization agency. It must seek to reach a result that is both procompetitive and feasible. And given the political nature of the privatization process, it must convince all participating parties and the public at large of the correctness of its position.



### Building public awareness of competition policy

The competition agency faces a formidable task in building awareness and support for competition policy among the citizens and the business community, especially in transition and developing economies.

As a general proposition, the competition agency should conduct its business in public as much as possible, though it faces significant limitations in practice. Many of the agency's deliberations, as is true for all government agencies, are conducted on a confidential basis. Moreover, all competition laws contain strict confidentiality requirements relating to information acquired in investigations or enforcement proceedings. To the extent possible, however, the agency should make information about its activities publicly available.

The agency should regularly publish its enforcement decisions in bulletins sent to interested parties (state administrations, local authorities, business organizations) that are influenced by competition enforcement. In addition, summaries of decisions, and comments by case handlers, should be publicized in the media. Press conferences are an efficient way of developing contacts with journalists.

A useful but technically difficult educational tool for competition agencies is the promulgation of guidelines on specific substantive competition policy areas. Many competition agencies have published merger guidelines or guidelines on restrictive agreements. Most competition laws are written in sparse, general terms, and such enforcement guidelines can help businesses conform to the law. The agency must draw up such guidelines carefully, however. Although the experience of other countries can be relevant (the U.S. Horizontal Merger Guidelines are often consulted in other countries, for example), each country's guidelines must reflect conditions and practices in that country. The agency will be held accountable for its decisions according to its own guidelines, which become the standard by which the relevant conduct is judged in that country. The agency can also organize conferences, seminars, and workshops to promote understanding of the role of competition in a market economy and to show how its enforcement activities further such goals: how competition benefits both consumers and businesses by ensuring the supply of goods and services at the lowest possible price and highest possible quality; how producers in competitive markets are forced to respond to the demands of their customers; and how competitive markets result in the most efficient allocation of resources, to the benefit of the entire economy.

Competition enforcement will be more effective when there is a community whose members understand and support the concept of competition policy. Such members could include private lawyers who practice in the competition and regulatory arenas, academics with expertise in business and economics, consumer organizations responsible for protection of consumer interests, politicians interested in market-oriented reforms, and the business community itself. The role of the business community is ambiguous, of course. Although business people prefer not to compete with other sellers (or with other buyers in their role of purchasers), they nonetheless benefit from competition among their suppliers and customers. The majority of competition cases in most jurisdictions arise from complaints made by business people against firms that may have foreclosed important distribution channels or sources of inputs or have charged higher prices through collusion. Vigorous competition in domestic markets provides domestic suppliers with lower prices and hence costs, and makes them more competitive in international markets.

**Lessons from other countries**

Competition law enforcement is both the foundation and the tool for fostering sustainable competitive markets that result in healthy inter-firm rivalry, opportunities for new entry, entrepreneurship, increased economic efficiency, and consumer welfare. Competition advocacy can augment these and other benefits of competition. Experience has shown that several factors lead to successful competition advocacy:

- The competition agency must develop relationships with government ministries, regulatory agencies, and other bodies that formulate, enact, and administer policies affecting demand and supply conditions in various markets. Such relationships, based on mutual respect, recognition of professional expertise, and appreciation of the respective responsibilities and policy mandates of different organizations, will facilitate communication and a search for alternatives that are less harmful to competition and consumer welfare.

- Competition advocacy often entails formal appearances and public statements to promote or defend positions in favor of competition. However, competition advocacy need not be confrontational; public opposition to other agencies is at times risky, difficult, and counterproductive. A preferable strategy is to encourage debate and provide accurate information in order to promote better and more informed economic decision-making.

- The competition agency must have specific expertise (or must be able to acquire it from outside experts) in the areas in which it seeks to intervene. The agency should suggest alternative policy measures to address competition concerns. Compromises may often have to be made so that the government can achieve other socioeconomic objectives.

- Competition advocacy should be conducted in an open, transparent manner in order to safeguard the integrity and credibility of the competition agency. When confidentiality is required, the competition agency should publish news releases explaining why.

- Competition advocacy is likely to be most effective if the competition agency is independent and insulated from political and bureaucratic interference.

- An informed business press is invaluable for furthering the objectives of competition law policy. Competition agencies need to establish good media relations and explain the role and importance of competition law policy as an integral part of the governments' economic framework.

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