Forum

The relationship between economic development and competition policy

The following is an edited version of a presentation by Hisami Kurokochi, Commissioner of the Fair Trade Commission, Japan to the 6th Asian and Oceanic Antimonopoly Conference held on 15 and 16 November, 1999 in Canberra.

Introduction

It is well known to us all that the Asia–Pacific Economic Cooperation (APEC) dealt with the issue of 'Strengthening the Market' as one of the main themes for discussion this year. The theme was raised by New Zealand, which currently holds the presidency of APEC. The discussion took place on the basis of the recognition that the recent economic crisis demonstrated the need for improving the functioning of markets to achieve sound economic growth. The tangible result was the adoption of the 'APEC Principles to Enhance Competition and Regulatory Reform' at the economic leaders' meeting.

In this document, the economic leaders endorsed core principles on promoting competition policy and deregulation, namely, non-discrimination, comprehensiveness, transparency and accountability. To achieve this, leaders also agreed on specific actions. Although the principles are non-binding in nature, it is quite significant that leaders share the common recognition that competition policy and deregulation play an important role in sustainable growth and that they agree on the specific actions in the document.

The document also stated that APEC economies recognised the need for flexibility in implementing the framework, taking into account their diverse circumstances. Depending on stages of development, each economy faces different problems in the field of competition policy.

Thus, our task now is to cooperate closely with each other in addressing the concerns expressed by developing economies.

Concerns of developing economies about competition policy

The relationship between competition policy and economic growth has been discussed not only in APEC but also in other international fora, including the World Trade Organization (WTO) and the United Nations Conference on Trade and Development (UNCTAD). The major concerns of developing economies appear to be the:

1. relationship between competition policy and competitiveness;
2. political and social impacts of competition policy;
3. priority between competition policy and industrial and other policy objectives; and
4. resource constraints of the competition authorities.

Relationship between competition policy and competitiveness

The first concern about competition policy and competitiveness is that competition policy may adversely affect state-owned enterprises or conglomerates. It has been argued that these can play a leading role in developing economies by providing the public with goods and services of the same quality at the same price. This is especially important in developing economies since they are more vulnerable to market failures than developed economies.

The other concern is that competition policy could hinder competitiveness of enterprises by imposing restrictions on their size. It would be useful to get economies of scale through mergers to cope with international competition, to develop domestic capital and to ensure increased synergy effects. Therefore, merger regulations could obstruct the growth of developing economies. Furthermore, it could be argued that monopoly or oligopoly is desirable in the market of developing economies. This is because there exists a minimum scale of efficiency for an enterprise, and the optimal number of enterprises in a market is relatively small in developing economies.

Responding to these concerns, I would like to cover three areas.

Domestic market competition

First, it is important to ensure competition in the domestic market. In theory, competition expels inefficient enterprises from the market, and helps remaining enterprises increase their efficiency and competitiveness thus contributing to economic growth. In practice, industries facing vigorous competition in domestic markets are more successful than those protected by regulations.

Some may still believe that Japan achieved a dramatic growth in the post-war period because the government and enterprises worked together as 'Japan Inc.' in promoting industrial policy. In fact, severe competition among domestic enterprises in the automobile, semiconductor and some other industries drove the economic growth. Conversely, inefficient enterprises have been protected by regulators and have lost their competitiveness during the recession in areas such as financial and transportation services. The government did restrict competition in some industrial fields by introducing exemptions from competition law enforcement. Yet it did so in declining industrial fields that lost international competitiveness, such as textiles, fertilisers and sugar.

State-owned enterprises and monopolies

It has been noted that state monopolies, state-owned enterprises and conglomerates tend to become inefficient because of irresponsible management and the lack of competition. One might argue that the domestic situations of each economy must be taken into account in discussing whether they should be retained. It has been widely recognised, in particular, that state-owned enterprises are vital for building infrastructure such as transportation and communication networks and public utilities. Governments have traditionally played a leading role in building infrastructure because of its public nature and economic scale. Sometimes the government has acted to prevent duplication of plant and equipment or it has responded to other market failures. However, because of recent technological innovation and economic globalisation, it has become feasible to introduce competition in this area as well.

In 1985 the Japanese Government privatised Nippon Telegraph and Telephone Public Corporation, which is presently known as NTT. Since 1987 other enterprises have entered the telecommunications market. More competitors and the development of technology have reduced telecommunication charges and substantially raised productivity. For example, according to Japan's Economic White Paper of 1997, the telephone charge between Tokyo and Osaka, at a distance of approximately 500 km, decreased in 1996 to only 27.5 per cent of that in 1985. The productivity increased 89 per cent from 1986 to 1995, 41 per cent of which was estimated to be from reinforced competition.

Firm size and growth

There seems to have been no significant analysis made to prove that expansion improves managerial performance such as profitability, growth rates, productivity and return on equity. Mergers are believed to reduce expenses by synergy effects comprising knowledge sharing, complementarity of resources and integration of functions. Clearly, one needs to conduct a comprehensive and careful case-by-case analysis. In addition, productivity is determined in principle not by the size of an enterprise but by the production capacity of each plant. Even a small enterprise with a single plant can maintain competitiveness if its plant is efficient. Conversely, a big enterprise cannot be profitable if its individual plants are inefficient.

Political and social impacts of competition policy

Next, I would like to turn to the second category of concern, namely the political and social impact of competition policy. It is claimed that competition policy could lead to increased unemployment and endanger incumbent industries and enterprises, including regional small and medium-sized ones, and that political and social context generated by competition policy cannot be ignored.

Since competition policy expels inefficient enterprises from the market, bankruptcy and unemployment would most likely occur. Such costs of competition policy cannot be ignored in a political and social context. This is true not only in developing economies but also in developed economies. However, it should also be noted that anti-competitive practices, if overlooked, would raise prices, thereby imposing excessive burdens on consumers and user industries and ultimately hampering the growth of national economic welfare.

Therefore, a desirable approach would be to increase national economic welfare by actively implementing competition policy but minimising its negative impact. This would be done by creating new industries, promoting job mobility and providing relief measures for the unemployed as well as taking income reallocation policies to the extent permitted by social consensus. At the same time, the government should explain to the business community and the general public the benefits of competition policy. This would help people understand that, in the long run, competition policy produces more economic advantages than disadvantages; and that the short-run cost of competition policy could be compensated for by taking appropriate countermeasures, thus allowing the pace of competition policy reform to be maintained.

Japanese program of economic structure reform

Japan is now making the utmost effort to overcome damage caused by the long recession. The Cabinet adopted a program which is called 'Strategy for Revitalising Industries' in January 1999. This program aims to create employment opportunities and new businesses and to expand investment for increasing productivity.

In concrete terms, the government provides incentives for start-ups and venture businesses. The government also supports incumbent enterprises that have abundant managerial resources by setting conditions for them to improve efficiency in the existing business fields and to develop new business within themselves or do so by dividing themselves, drawing on such resources.

Before adopting the program the Japanese Government had chosen 15 new and growing fields including health and medicare, information and telecommunication services that merit more encouragement and support. These industrial fields were designated in the 'Action Plan for the Economic Structure Reform' adopted by the Cabinet in May 1997. At the same time the government is focusing efforts on greater mobility of human resources with a view to resolving mismatching of employment and improving individual vocational abilities (employability).

Priority between competition policy and industrial and other policy objectives

Some would say that competition policy should be implemented after achieving economic growth through industrial policy. Others take the more liberal view that competition policy should be introduced after trade liberalisation, which would realise economic growth. The former view, 'first development by industrial policy, then competition policy', favours promoting domestic capital over introducing foreign capital as a way to increase economic growth. Promoting this view reveals not only the desire to have domestic enterprises that can be boasted of to the world, but also distrust of foreign enterprises. In other words, they believe that domestic enterprises commit themselves to the economic growth of the country, while multinational enterprises from developed economies could contribute to it to some extent but withdraw from the market once they regard it as unfavourable.

The latter view of 'first trade liberalisation, then competition policy', appears to be based on the belief that trade liberalisation would increase players in the domestic market and leave less room for anti-competitive practices, thereby playing an alternative role to competition policy.

In assessing this approach the relationship between competition policy and industrial policy and that between competition policy and trade liberalisation policy need to be considered. Import restriction policy, export promotion policy and government regulations relevant to competition policy are also important.

How much does government support help economic growth?

Government support for domestic enterprises may contribute to the expansion of the scale of an enterprise and enhance national prestige. However, the scale is not directly related to profitability or growth of the enterprise. It will have little incentive to manage itself efficiently unless it is exposed to competition in the domestic market. Therefore, large enterprises are not necessarily competitive in the export market either. Nor do they contribute to economic growth or inflow of foreign capital.

In Japan the government provided various incentives to industries, including favourable taxation treatment, public loans and subsidies. However, the industrial policy promoted certain sectors of industries and did not support specific enterprises. In successful industries such as semiconductors, industrial policy was applied, but the competition in the domestic market was not adversely affected. Software industries, such as the TV game software industry, have gained strong international competitiveness without any benefit of industrial policy. They have acquired it through vigorous competition in the domestic market. In my view, competition policy is compatible with industrial policy, and industrial policy is not always the requisite for growth.

Relationship between competition policy and trade liberalisation

There is no doubt that an increasing number of players brought about by trade liberalisation reduce the room for anti-competitive practices in the market. In this sense, trade liberalisation complements competition policy. However, because successive trade liberalisation has diminished tariffs and other border measures, anti-competitive activities across the national border are increasing, and activities in foreign economies sometimes affect one's own market. Furthermore, it should be noted that non-tradable goods or tradable goods with high transportation costs would face no real competition from imports. And even the competition of tradable goods could be affected by existing government measures such as regulations, standards and licence requirements. For these reasons I do not believe that trade liberalisation can justify the moratorium on competition policy.

Relationship between competition policy and import restriction policy

Restrictive measures, such as import quota, tariffs and regulations on foreign capital, should be removed if competition is to be promoted, because these measures limit the scope of the market and the number of players therein. However, developing economies presumably find it difficult to implement competition policy vigorously for fear such a policy could hinder efforts to develop domestic capital.

The promotion of competition policy in domestic markets should be considered separately from the diminishing of trade barriers. In other words, removal of anti-competitive practices and expansion of the coverage of competition laws are two separate issues. In fact, competition policy becomes more important for economic growth in closed markets that cannot benefit from trade liberalisation. Therefore, efforts are needed to implement competition policy regardless of the degree of trade liberalisation.

In the automobile industry of Japan, for example, there was vigorous competition among automakers in the 1950s. The Ministry of International Trade and Industry was concerned about excessive competition and drew up a plan for a 'national car' in 1955. This plan aimed to concentrate automakers into one entity that would produce small and low-priced cars exportable to foreign markets. However, this plan was not realised since one of the companies vigorously resisted it and chose to continue to compete. While competition in the domestic market was severe in other areas, trade liberalisation did not take place until 1964 for passenger cars. In the successful auto industry of Japan, trade liberalisation was preceded by competition in the domestic market.

Relationship between competition policy and export promotion policy including export subsidies

Export promotion policy would help domestic export-oriented enterprises grow by expanding their market. At the same time, to improve the ability to negotiate with their trading partners on the sale of their goods, such enterprises may be tempted to realise concentration. If they are successful in increasing the volume of their exports, they might be obliged to take measures to restrict competition in export markets, by forming an export cartel or by imposing a voluntary export restraint to avoid friction with the importing economies. Furthermore, domestic enterprises could collude to keep the export price significantly lower than the domestic price to promote their exports. Such practices apparently run counter to competition law and policy.

Reviewing government regulations

Government regulations should be constantly reviewed because they limit the scope of the domestic market and the number of players, domestic or foreign. As was widely recognised in the WTO working group on trade and competition, advocacy of competition policy could play a major role in regulatory reform in developing economies.

Resource constraints of the competition authorities

It has been argued that institutional and capacity building of competition agencies is the priority for developing economies. In this sense, developing economies should grapple with the task, receive technical assistance and, starting with high priority areas, develop competition policy in a staged manner. According to such a staged development policy, it has been suggested that the first stage should focus on restricting horizontal cartels and on promoting competition. The second stage should focus on mergers and vertical restraints and the third on regulatory reform from the viewpoint of competition policy.

I agree that competition policy should be implemented in a staged manner since competition agencies need to strengthen capacities and build public trust. Specifically, primary focus should be on those practices that clearly hinder competition. There are, for example, unreasonable restraints of trade including cartels, concerted refusal to deal, resale price maintenance, dealing on exclusive terms and interference with a competitor's transactions. Then come the practices that restrict competition in a less serious manner and those that require consideration of other policy objectives. In Japan, these practices correspond to most unfair trade practices, mergers and acquisitions and restrictions imposed on subcontractors.

It is important that government bodies and agencies gradually allocate more finance and personnel to the competition agency through active competition advocacy that would help enlighten the public and the relevant authorities on the importance of competition policy.

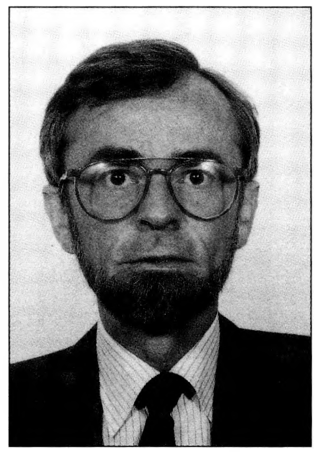
In this sense we must carefully consider the effective way to advocate. Competition policy brings benefits extensively but thinly to all users and consumers, while it clearly causes short-run losses to vested interests. The political power of vested interests is normally much greater than that of consumers and makes competition agencies vulnerable to their pressure. Given this tendency it is crucial to win support for competition policy through advocacy from users, particularly consumers and the civil service. Academic circles should also be in the pro-competition group because they are often involved directly in working out competition policy. In holding seminars and conferences on competition policy, the competition agency should ensure the active participation of those academicians. Moreover, I would like to stress the importance of the principles of non-discrimination and transparency in enforcing competition law and policy because, if it is enforced in favour of specific incumbents, it could block entry into the market.

Conclusion

Existing systems must be reformed to keep pace with the changes in circumstances as competition policy gains in importance worldwide. Many Asian economies, including Japan's, experienced economic crises in the recent past. It seems to me that this is because their systems have long been protected by border measures and regulations and have more or less become out of date. We are required to promote competition policy in addition to pursuing structural reform and deregulation, so we can respond to the need to globalise the economy and enhance productivity. This will be helped by those in the field of competition law and policy sharing experiences and knowledge.

The Fair Trade Commission of Japan is cooperating, mainly with the economies in the Asia–Pacific region, to promote competition law and policy. Specifically, it invites trainees of competition agencies and sends experts when requested. In the Partners for Progress (PFP) program of APEC, it and the Department of Internal Trade of Thailand have been jointly organising seminars on competition policy.

Globalisation, competition and trade policy: issues and challenges



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For the past three years the trade and competition communities have hotly debated the question of how to address the interface between trade and competition in the context of the globalisation of markets. Scores of conferences have been held, hundreds of papers produced for academic conferences, and all of the international organisations that study international economic relations have spent considerable time on this issue. At times the debate has been highly emotional, at times highly sophisticated. It has also been complex because the study of the interface between trade and competition in the context of the globalisation of markets raises political, economic, legal and institutional issues at both domestic and international levels. Markedly different opinions are still being expressed on how to deal with this issue and some may feel we are no closer to building a consensus than we were three years ago and may wonder if all the energy that has gone into the debate has been spent in vain.

Yet, if we go beyond the political posturing which is inevitable before any upcoming WTO ministerial, it should be recognised that we are not where we were three years ago. For one