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The relationship between competition and industrial policies in promoting economic development

Study by the UNCTAD secretariat

Executive summary

This study examines the relationship between competition and industrial policies in promoting economic development. It introduces competition and industrial policy concepts, practices and their implementation, and evolving roles. It explores the fundamentals of competition law enforcement and industrial policy dynamics. This includes handling of anti-competitive practices, exclusions/exemptions, the role of competition advocacy and the type of industrial policy tools applied. An analysis of the link between competition and industrial policies, synergies and tensions is presented. This study looks at the implications of the current economic crisis on competition and industrial policies, and raises issues for policy considerations and the way forward.

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Introduction

1. The ninth session of the Intergovernmental Group of Experts on Competition Law and Policy requested the UNCTAD secretariat to prepare a study on the relationship between competition and industrial policies in promoting economic development. Notwithstanding the very wide scope that this topic may reach, the current study covers specific areas of convergence and divergence. UNCTAD carried out a survey on the relationship between the two policies and considered the responses from member states.[1]

2. Competition and industrial policies are formed by the economic, social or political forces in operation at a given time. While industrial policy exists in many forms in almost all economies of the world, competition policy does not. However, the latter policy perspective is growing, especially in developing countries. Nevertheless, many jurisdictions still do not have concrete competition policies and the instruments that go with them.

3. This study is organized as follows. Chapters I and II review the objectives of competition policy and industrial policy, respectively. Chapter III reviews the respective policy tools, noting in particular where competition policy takes industrial policy into account. It also provides, for industrial policy, a review of country experiences. Chapter IV discusses some points where competition and industrial policies reinforce or conflict. Chapter V places the discussion in the context of today's "hard economic times", and the final chapter raises issues for discussion.

I. Concepts, scope, purpose and practices

A. Competition law and policy

4. *Competition* refers to rivalry among firms in the market place. It also extends to envisaged or potential rivalry. *Competition policy* refers to government policy to preserve or promote competition among market players and to promote other government policies and processes that enable a competitive environment to develop. [2] Competition policy has two major instruments. The first is a competition law which contains rules to restrict anti-competitive market conduct, as well as an enforcement mechanism, such as an authority. Competition law targets anti-competitive practices by private or public undertakings or enterprises. The second major instrument, particularly important in the interface with industrial policy, is competition advocacy. Competition advocacy can be used to promote less anti-competitive means of achieving other policies' goals. Other policies which significantly affect competition include, among others, consumer protection, standards, intellectual property rights (IPRs), international trade, investment and licensing.

5. Competition laws generally contain both core competition objectives and other objectives that vary among jurisdictions and over time. Core competition objectives in

[1] As of 16 March 2009, respondents to the UNCTAD survey included Albania, Argentina, Bulgaria, Chile, Colombia, the Czech Republic, the Dominican Republic, Ecuador, Estonia, the European Commission, Indonesia, Japan, the Republic of Korea, Latvia, Madagascar, Malawi, Mauritius, Mexico, Nicaragua, Panama, Poland, the Russian Federation, Sri Lanka, Sweden, Switzerland, Trinidad and Tobago, Uruguay and the United States.

[2] "Empirical evidence of the benefits from applying competition law and policy principles to economic development in order to attain greater efficiency in international trade and development" (TD/B/COM.2/EM/10/REV.1):5.

many jurisdictions "are to maintain and encourage the process of competition in order to promote efficient use of resources while protecting the freedom of economic action of various market participants".[3] The United Nations Set emphasizes the competition policy goal of promoting economic development, and many developing countries view competition as having this role.[4] In this context, "competition" is an intermediate objective and economic development is a final goal.[5] Other relatively common objectives are the promotion of small and medium-sized enterprises (SMEs), restriction of undue concentration of economic power and ensuring fair competition. Public interest objectives – which may be relevant to industrial policy – are fairly widespread among developing countries, but also present in some developed countries' competition laws, particularly with respect to mergers.[6]

6. The UNCTAD Model Law (2004) spells out the objective of a competition law to "control or eliminate restrictive agreements or arrangements among enterprises, or mergers and acquisitions or abuse of dominant positions of market power, which limit access to markets or otherwise unduly restrain competition, adversely affecting domestic or international trade or economic development".

7. Institutions – both formal, such as legal frameworks, and informal – are part of the unnoticed but necessary architecture of markets. Institutional architecture surrounding well-functioning markets (including those for capital and labour) play a critical role for economic development and efficiency. Unlike developed countries, many developing economies do not have well-functioning factor markets – such as stock exchanges and bond markets – and have often been unable to create institutions that support the operation of markets, such as bankruptcy codes, efficient contract enforcement and the like (Laffont, 1998). These "missing markets" and "missing institutions" alter the optimal, and perhaps feasible, policies with respect to competition in an economy. At the same time, these missing markets and institutions have implications for optimal, and perhaps feasible, industrial policies.

B. Industrial policy

8. Industrial policy is not a clearly defined term. White (2008) points out that, if industrial policy is defined in broad generalities, then every country has one and the issues that drive debates over industrial policies are missed. Rather, the relevant issues arise in the "more distinct notion, industrial policy [as] a concerted, focused, conscious effort on the part of government to encourage and promote a specific industry or sector with an array of policy tools…" UNCTAD (1998) implies that industrial policy consists of government

[3] OECD, "The objectives of competition law and policy" (CCNM/GF/COMP(2003)3). See also World Trade Organization (WTO) (1999), "The fundamental principles of competition policy", (WT/WGTCP/W/127, UNCTAD/ITD/15) (1995); and "The basic objectives and main provisions of competition laws and policies" (UNCTAD/ITD/15).

[4] Country studies were prepared for the Asian Development Bank by Ping Lin (Lingnan University); S. Chakravarthy; Seung-Wha Chang (Seoul National University) and Youngjin Jung (Woo, Yoon, Kang, Jeong & Han); Cassey Lee (University of Malaya); Deunden Nikomborirak (Thailand Development Research Institute); and Vu Quoc Huy (Institute of Economics). They were studied in greater detail as part of an Asian Development Bank regional technical assistance study (Brooks and Evenett, 2005).

[5] WTO study WT/WGTCP/W/228, 1998.

[6] Competition law and policy should not be confused with "competitiveness" policies. While more effective domestic competition generally aids domestic firms in competing in foreign or global markets, it is conceptually difficult to relate competition in markets to "competitiveness" among economies.

measures applied to sectors or industries in order to advantage them. Wade (1990) also alludes to policy instruments which target selected industries, directing resources in those industries to accord producers a "competitive advantage." Such privileges would not be available in the absence of industrial policy.

9. Advantages are conferred through industrial policy for the purposes of overcoming market failures and promoting structural change– that is, the transfer of resources from traditional activities to new goods and services using new technologies. One often-mentioned example of overcoming a market failure is to generate more positive spillovers that lead to economic development. In other words, some activities may be undersupplied because the person paying for them does not reap all the benefits; some of those benefits spill over to benefit others. Industrial policy would subsidize or otherwise induce more of that activity. On-the-job training of labour is an example: Employers undersupply it since workers can switch jobs and take their training with them. Another oft-cited example is overcoming coordination problems. Why invest in facilities to make goods for export if the transport infrastructure is inadequate? But why spend on transport infrastructure if there is nothing to use it? Perhaps the best known industrial policy measure is the support of "national champions" through subsidies, protectionism, procurement policies, etc.

10. Industrial policy may operate at the level of product markets, factor markets, international trade or investment to influence firms' rivalry. In addition to long-term development goals, it may have short-term goals such as increasing employment opportunities, enhancing foreign exchange earnings, and reducing income distribution gaps.[7]

II. Evolving roles of industrial and competition policies

11. During the Post-World War II era, the path taken by industrial policy in many developing countries varied due to economic conditions and the focus of the general economic policy each country was pursuing. Some countries, especially in East Asia, followed policies that included aspects of market entry/capacity expansion, state-initiated or tolerated mergers, and cooperation between firms in terms of exchange of information or even activities which would fall into the category of cartelization. In addition, there were measures geared towards infant industry protection, investment into selected priority sectors, technology enhancement and export performance subsidies. Some of these activities were directed towards specific firms, the national champions.

12. Until the 1980s, industrial policies had a more protectionist nature and were applied either according to import substitution industrialization or export-led growth models. In the 1980s, with trade liberalization and deregulation, markets opened up to competition. From the mid-1990s, with the establishment of the World Trade Organization (WTO), many industrial policy tools used in the past, such as export subsidies, were prohibited or became subject to countervailing measures by WTO member states. This changed the landscape for industrial policy instruments available to developing countries. One should also consider the role of conditions imposed on many economies by the International Monetary Fund (IMF) as part of structural adjustment programmes. After the 1980s, industrial policy took a different path towards the promotion of exports through export processing zones and foreign direct investment (FDI) by providing certain privileges to foreign investors, especially in developing countries. In the 1990s, in line with structural adjustment programmes, competition law and policy were increasingly supported and recognized by economic policymakers against the background of high global economic growth rates.

[7] Brooks, 2007.

13. Government policy in the 1980s and 1990s was more directed towards promoting private sector rivalry through trade liberalization, privatization and, in general, deregulation. But if these changes had not been accompanied by the appropriate regulatory framework, markets would have become vulnerable to anti-competitive practices and the gains from liberalization may not have materialized. Therefore, in many jurisdictions, these changes were accompanied by the enactment, amendment or reform of competition instruments. Around 100 countries have introduced competition measures of some form. Promoting competition has become an important policy in many countries, whether developed, developing or transition economies.

III. Competition and industrial policy fundamentals

A. Competition law enforcement and competition policy promotion

14. Enforcing competition law involves addressing anti-competitive practices and merger control. Anti-competitive practices may take the form of horizontal or vertical arrangements, or abuses of dominance. However, there may be exemptions from competition law. Competition advocacy is also part of competition policy. These are briefly reviewed below.

1. Agreements

15. A distinction is usually made between *horizontal* and *vertical* agreements. Agreements between independent enterprises which are at the same level of production chain or which are “competing or potentially competing in the same market”(UNCTAD, 2004) are horizontal. Vertical agreements are those between enterprises at different stages of the production or distribution process. These could be between manufacturers and distributors or suppliers, for example.

16. Over the years, despite differences in emphasis on different areas of competition enforcement, there has been convergence, especially in dealing with cartels. Cartelization includes practices such as price or output fixing, collusive tendering and market sharing. These are usually regarded as “per se” violations. Cartel detection in many jurisdictions has been a big challenge for both developed and developing countries. UNCTAD[8] peer reviews for Kenya, Jamaica, Tunisia, the West African Economic and Monetary Union (WAEMU), Benin and Senegal, and Costa Rica show that these countries have not been able to deal with cartel cases due to their complexity and secrecy. The Republic of Korea and South Africa are examples where the use of leniency programmes in dealing with cartels has had positive results.

17. Most other types of agreements are analysed on a case-by-case basis, each case on its own merit, to determine whether certain agreements are anti-competitive or pro-competitive in the given context. For example, vertical agreements between businesses – i.e. suppliers and distributors, franchisers and franchisees, etc. – may enhance efficiency, even though they may have anti-competitive aspects. The efficiency gains arising from these arrangements are weighed against the anti-competitive effects. This balancing of benefits against costs is referred to as the “rule of reason” approach.

[8] UNCTAD Voluntary Peer Review of Competition Policy; Kenya (UNCTAD/DITC/CLP/2005/6); Jamaica (UNCTAD/DITC/CLP/2005/5), WAEMU, Benin and Senegal (UNCTAD/DITC/CLP/2007/1); and Costa Rica (UNCTAD/DITC/CLP/2008/1).

18. Country experiences reviewed below under the industrial policy rubric show cartels have formed part of industrial policy. Some countries have specific procedures for the competition authority to examine the effect of cartels – whether export cartels, structural adjustment cartels, or other types – to limit, in principle, their anti-competitive effects.

2. Abuse of dominance

19. Abuse of dominance is another key area in the enforcement of competition law. The concern usually arises from conduct of a single enterprise, when such behaviour lessens or may lessen competition in a market or prevent market access. Mere dominance is not illegal. In most cases, abuse cannot be exempted or authorized on public interest grounds.

20. An objective of merger control is to avoid creation of a dominant position and thus possible abuse of dominance after the merger. Creation and protection of national champions may be an industrial policy measure. The 2002 merger between E.ON and Ruhrgas in Germany, an electricity and gas company, respectively, was approved by the Ministry of Economics on "national champion" grounds (NERA Economic Consulting, 2002). The approval went contrary to the prohibition by the Federal Cartel Office on competition grounds and the Monopolies Commission's negative evaluation on both competition and public interest grounds. This example shows how industrial policy can undermine competition enforcement.

3. Exemptions

21. While "best practice" advice suggests that competition law should apply to all sectors and firms in the economy engaged in commercial activity, in practice various types of exemptions are granted for social, economic and political reasons. The granting of exemptions, however, does not necessarily imply the weakening of competition law enforcement. On the contrary, granting exemptions may further various objectives of competition law and industrial policy. Two examples are research and development (R&D) activities and IPRs.

22. In many jurisdictions, certain R&D activities may benefit from exemptions under competition law. R&D may aim at activities ranging from pure research to improving production processes of specific products. These may result in new products and lower prices, which increase consumer choice and consumer welfare. In the pharmaceuticals and electronics sectors, for example, firms cooperate in R&D but compete vigorously in the pricing and sale of their respective products. In most instances, the exemptions are activity- and time-limited and apply only to the extent necessary for that cooperation. From an industrial policy perspective, R&D exemptions promote the objective of restructuring the economy towards more technology- or knowledge-intensive industries.

23. Exemptions accorded to IPRs grant statutory monopoly rights to firms in respect of the IPR protected product and limit the application of competition law on such matters as pricing, licensing and exclusive dealing. IPR protection supports industrial policy objectives by providing incentives to innovate and commercialize innovations. IPR protection is limited in view of the role existing intellectual property (IP) plays in generating new IP.

4. Competition advocacy

24. Competition advocacy is a tool to enhance voluntary compliance and policy coordination. Advocacy is a core activity, especially for young competition authorities where stakeholders need to be informed of the existence and objectives of a new competition law, and their rights and obligations. Over time, the role of the competition

authority as an advocate of competition issues to government in the areas of privatization, sector regulation and other policies should evolve.

25. Competition issues may arise in the course of industrial policy formulation and implementation. Therefore, competition agencies should sensitize industrial policymakers on the possible synergies and/or tensions which may arise from certain industrial policy measures, including but not limited to the creation and/or protection of national champions.

5. Merger analysis and concentrations

26. Merger control is an integral part of many competition laws. Merger provisions allow competition authorities to analyse proposals in an attempt to prevent those that would substantially lessen competition or lead to the creation or strengthening of a dominant position in a market. Merger control is a measure aimed at combating future market structure as opposed to current conduct of market operators. Most mergers, both in developed and developing countries, are cleared by competition authorities, with or without conditions.

27. Competition authorities weigh a merger's adverse effects on competition against its benefits. Public interest criteria may also enter merger review. Examples of these other criteria are promotion of employment (Kenya) and promotion of economically disadvantaged persons (South Africa).

28. Jurisdictions differ as to how the public interest is considered. In some – as in the examples from Germany above and the United Kingdom below – a minister may override the competition authority and must publicly explain the override. In others, the competition authority makes the trade-off. The following case illustrates how the Government of the United Kingdom recently applied a public interest test to the banking sector in the midst of the banking crisis (see box 1).

Box 1. Merger proposal between Lloyds TSB Group PLC and HBOS PLC

This merger proposal was announced on 17 September 2008. A day later, the Business Enterprise Secretary of State notified the Office of Fair Trading (OFT) under Section 42 of the Enterprise Act that he would lay an order before Parliament to introduce a new "public interest consideration". This order gave the Secretary of State the power to consider public interest issues of the *stability of the United Kingdom financial system*[9], together with other competition considerations in making his final decision on the proposed merger. This criterion would apply to mergers in the banking sector outside of the European Commission merger regulation ECMR 139/2004.

This addition to the public interest criteria was a reaction to the financial crises by the Government in consideration of the systemic importance of the banking sector to the economy. This development allowed the Minister to override the normal merger procedure in which the OFT refers mergers to the Competition Commission.

The OFT published an assessment of the merger, which indicated the likelihood of substantial lessening of competition in certain banking areas, including personal current accounts, banking services to SMEs, and mortgages. However, the Secretary of State cleared the merger on 31 October without reference to the Competition Commission. An appeal to the Competition Tribunal was dismissed on the grounds that the Secretary of State acted within the law to clear the merger on public interest considerations.

[9] See United Kingdom Business and Enterprise Department website at www.berr.gov.uk.

Vickers[10] argues that, with the introduction of the rescue package for the banking sector, the clearance of an anti-competitive merger would only result in a less competitive banking sector in the long run, and the costs would be borne by the general consumer. Therefore, even in the current economic crisis, policymakers should recognize the need to uphold economic regulation and to have a clear balance between short-term interventions which may provide only short-run relief and long-run economic sustainability.

B. Industrial policies

29. Unlike competition policy, industrial policy is not usually based on legislation. Rather, countries have specific policy frameworks, such as the National Industrial Policy Framework of South Africa and the Industrial, Technological and Foreign Trade Policy of Brazil. However, some jurisdictions do have laws, such as the Republic of Korea's Industrial Development Act, which act as frameworks for national industrial policy.

1. Industrial policy tools

30. Industrial policy tools cover a wide range of economic areas. Pangestu (2002) reports three sets of instruments and measures to implement industrial policy: (a) external market interventions, including import tariffs, quotas, licensing and local content programmes, and export promotion measures such as export subsidies, export processing zones and subsidized credit; (b) product market interventions aimed at promoting competition in domestic markets, competition policy and law; and (c) factor market interventions: FDI performance requirements and restrictions in the capital and finance markets, labour market and equity objectives.

31. Rodrik (2004) characterizes the right model of industrial policy as "strategic collaboration between the private sector and the government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them".

32. Support only to "new" activities, i.e. new products and new technologies, is a key feature of modern industrial policy today. According to Rodrik (2004), one important factor to consider in designing an effective industrial policy is to provide incentives only to new products and technologies. In such cases, he says, government intervention leads to the creation of a new market and competition concerns should be limited if government support is discontinued after the necessary investment and infrastructure are established.

33. The country experiences reviewed below illustrate the wide variety of industrial policy tools that have been used.

2. Country experiences

34. Country experiences in industrial policy implementation illustrate the policy's effects on development and competition. The East Asian experiences have been much elaborated by researchers and is the first focus of this brief review, followed by the experiences of Latin American countries.

35. The East Asian industrial policy measures were aimed at selectively developing capital and knowledge-intensive technological capabilities that would lead to profitable, internationally competitive industries and hence promote economic development. The

[10] See GCP website at www.globalcompetitionpolicy.org. Vickers, J. "The Financial Crisis and Competition Policy: Some Economics". December 2008.

World Bank issued a major study of the East Asian experience in 1993, concluding that "[I]n some economies…some selective interventions contributed to growth." But success depended on "'three essential prerequisites'. First, [the interventions] addressed problems in the functioning of markets. Second, they took place within the context of good, fundamental policies. Third, their success depended on the ability of governments to establish and monitor appropriate economic performance criteria related to the interventions – in the authors' terms, to create economic contests. These prerequisites suggest that the institutional context within which policies are implemented is as important to their success or failure as the policies themselves." (World Bank 1993:vi). An UNCTAD (1998) report echoes these findings: "Some factors contributing to success were selectivity in protection and incentives (necessary to ensure efficient resource allocation between technologies involving substantial learning costs and simpler activities), conditionality related to technological mastery and export performance, the institutional and administrative capacity to implement such policies and maintain some insulation from rent-seeking pressures, and inter-firm rivalry" (Lall, 1994). Further, according to the World Bank study, among the three sets of policy interventions evaluated, "the promotion of specific industries or industrial subsectors, directed credit, and the export–push strategy [the authors concluded] that promotion of specific industries generally did not work and therefore holds little promise for other developing economies. Directed credit has worked in certain situations but carries high risk. The export-push strategy has been by far the most successful of the three sets of policy intervention and holds the most promise for other developing economies" (World Bank, 1993:354).

36. In Japan, industrial policy dominated competition policy during the industrialization stage in the 1950s and 1960s. Japan utilized tools such as (a) subsidies and import tariffs; and (b) stimulation of demand for new products and innovation by setting standards through government regulation, promotion of patient capital and investment in education. Japan encouraged the formation of cartels and mergers in some industries to promote investment and increase productivity. High profits earned in domestic markets due to such measures were used to invest in upgrading technology.

37. The Japanese Government used the ability of firms to increase market share as a condition for the expansion of their productive capacities. This enhanced rivalry in the markets and these industries registered higher growth and attracted new entrants. The interaction between industrial and competition policies created an environment conducive to technological advancement and expansion into export markets. Amsden and Singh (1994) argue that, contrary to the conventional thinking, in Japan's case economic development stimulated competition by reducing industrial concentration.

38. In the Republic of Korea, the most common instruments were trade protection, selective credit subsidies and export subsidies. Amsden (1989) stresses the importance of the carrot-and-stick strategy utilized in the implementation of the industrial policies. The government set performance standards in exchange for subsidies. Another important strategy characterizing the Republic of Korea experience is the deliberate creation of large private conglomerates, the *chaebols*, which controlled a large part of economic activity. Evenett (2003) points out those sales by the top five business groups constituted 49 percent of national income in 1994. The Republic of Korea diversified its economic base, improved technological capabilities and attained international industrial competitiveness.

39. The experience of Taiwan Province of China is rich in industrial policy measures relating to competition. The government promoted mergers in sectors undergoing difficulties. Wade (1990) finds elements of free market economy in the industrial development strategy used. The government encouraged long-term relationships between buyers and sellers, and in some instances ordered firms in certain sectors to merge, for example in PVC and synthetic fibres industries.

40. Jiang (2002) demonstrates an example from China of the interaction between industrial policy and competition policy. From the late 1970s to the mid-1980s, there was a shortage of consumer goods in China. Therefore, China promoted the development of the consumer goods industry. It adopted policies that encouraged the entry of new non-state firms in these markets to increase output and improve efficiency, and introduced competition among monopolies by allowing them to produce more than their quotas and to sell the excess above state prices and to earn higher profits. The policies led to (a) an increase in the number of non-state firms in the market; (b) increased output; (c) a decrease in prices; (d) development of new products and technologies; and (e) transformation of the initially monopolized markets into competitive ones. This is an example of how industrial policy can introduce competition in monopolistic markets.

41. However, from the mid-1980s until the mid-1990s, there was a shift towards industrial policies which restricted competition. State-owned firms lobbied the government to limit production and/or the number of firms in the market. China has recently adopted a new competition law.

42. In Latin America, Brazil utilized an import substitution industrialization strategy after the World War II until the early 1980s, a strategy that created national champions. However, researchers noted that Brazil's protected industries remained infants for long periods and never matured to be competitive. This prompted trade liberalization and privatization policies in the 1990s, which led to the establishment of a competition regime.

43. In Chile during the 1960s, import liberalization yielded minimal results, due to the crunch on domestic firms which were previously protected. These firms were either driven out of the market, or they changed their production lines. From the mid-1980s to the 1990s, policy changed towards a more phased and sector-selective industrial policy that increased trade protection. This was followed by targeted liberalization, which spurred development.

44. The Latin American experience can be distinguished from the East Asian one in that Latin American industrial policies were biased towards incentives without setting performance standards, whereas the East Asian industrial policies had performance standards. In this way, poor or overly costly policies were discontinued.

45. While the experiences of East Asian countries demonstrate the potential benefit of industrial policy in economic development, even East Asian countries warn of possible adverse effects. In its contribution to the Organization for Economic Cooperation and Development (OECD),[11] the Republic of Korea states that its industrial policy "…seems to be an effective policy… when a country with little resources and small domestic market is in its early stage of industrialization. However, as the economy gets bigger and more complex, a government-oriented strategy that promotes national champions may deepen monopolistic market structure, create inefficiencies and have other adverse effects."

46. Many African countries – including Kenya, Nigeria, Uganda and Zimbabwe – experienced remarkable growth rates in the 1960s and part of the 1970s. However, the transition from an import substitution industrialization strategy to liberalization and privatization has not been successful in most cases, due to structural/historical difficulties.

[11] Contribution from the Republic of Korea, DAF/COMP/GF/WD(2009)26. OECD, 16 January 2009.

IV. Interaction between competition and industrial policies: synergies and tensions

47. Industrial and competition policies may have both synergies and tensions. There are synergies where an effective industrial policy requires competitive markets. Especially in developing economies, competition law and policy help ensure that domestic firms are not subjected to anti-competitive practices from foreign or domestic firms. If competition in input markets is distorted, this may increase production costs. This harms consumer welfare and decreases the competitiveness of export products. In cases where an industrial policy goal is to promote export competitiveness, effective competition law enforcement will contribute to the achievement of this goal (see box 2 below).

Box 2. Merger: Duferco Steel Processing Pty. Ltd. and Mittal Steel Company

In a recent merger review, the South African Competition Commission recommended the prohibition of the acquisition of Duferco Steel Processing Pty. Ltd. (DSP) by Mittal Steel Company on the grounds that the merger would "frustrate competition that would otherwise emerge as a result of the tribunal's ruling in the excessive pricing case" against Mittal.

DSP and Mittal are the only two companies that produce cold rolled coil and galvanized steel products in South Africa. Mittal, as a dominant producer of hot rolled coil (HRC), has a vertical relationship with DSP. The latter purchases HRC from Mittal.

The commission argued that maintaining DSP as an independent entity with access to competitively priced steel would provide an effective rival to Mittal. In its assessment of the merger proposal, the commission recognized the importance of steel as an input to infrastructure development, which is classified as a priority sector for South Africa's economic growth.12 This case illustrates a Competition Commission competition-based decision supporting industrial or development policy goals.

48. Competition and industrial policies may be congruent. For example, in many developing countries, the promotion of SMEs is part of industrial policy. Likewise, some competition laws have provisions supporting the participation of SMEs in the economy. In these cases, the policies need not conflict (see box 3 below).

Box 3. Abuse of dominance: prohibited price discrimination by Sasol Oil Pty. Ltd.

Nationwide Poles Pty. Ltd., a small producer of treated wooden poles, lodged a complaint on 30 April 2003 against Sasol Oil with the South Africa Competition Commission, citing prohibited price discrimination under the Competition Act. The commission issued a non-referral notice on the case on 12 November 2003. Nationwide approached the tribunal for a review of the case. In its submission, Nationwide alleged that Sasol's pricing structure for the wood preservative, creosote, constituted price discrimination and requested the tribunal to order Sasol to supply it on the same price terms as those available to Nationwide's larger competitors.

An objective of the SA Competition Act is "to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy". The tribunal, in its decision, considered the fact that the price discrimination against Nationwide, and similarly

[12] South African Competition Commission website: www.compcom.co.za, especially Competition News, edition 28, June 2008.

small companies, impeded their ability to compete in a market where they could otherwise compete effectively against larger rivals. Sasol was found to have violated the price discrimination provisions of the act. The tribunal noted that it took into consideration the industrial policy objective of promoting SMEs. Although the decision was overturned by the Competition Appeals Court, the court supported the tribunal's view that the act required the competition authorities to take note of "the need to ensure that small and medium businesses are able to use the act to protect their ability to compete fairly and freely".13

49. Brazil illustrates the coexistence of industrial and competition policies. Industrial policy has strengthened since 2002, when Brazil adopted the Industrial, Technological and Foreign Trade Policy and the Policy for Productive Development (PDP). These aim to strengthen and expand domestic industry by improving companies' innovative capacity.[14] Aimed at increasing fixed investments, private R&D expenditures and SME dynamism, antitrust is just one instrument among many. Other instruments include financial incentives, public and state-owned enterprise procurement, and support in the form of certification, export promotion and capacity-building. However, the PDP preserves a "level playing field" in the sense that no company is privileged to the detriment of others in the same sector, although certain sectors are favoured. Anti-competitive acts may be exempted if they meet certain criteria: if they are "taken in the public interest or otherwise required to benefit the Brazilian economy" and "no damages are caused to end-consumers or end-users". As of January 2009, no decision had been issued on the grounds of the provision. Implementation by both the competition authorities and the Brazilian National Agency for Industrial Development will determine how the coexistence of the two policies evolves.

50. Finland illustrates the complementarity of competition and industrial policies. The country underwent a very successful economic restructuring at the time of a major financial and economic crisis in the early 1990s, during which its GDP fell by 10 percent. The economy was transformed from being resource-based to a competitive knowledge economy. The Finnish case offers many lessons for a pro-competition, pro-competitiveness industrial policy (see box 4 below).

Box 4. The case of Finland following the financial and economic crisis in the early 1990s

In 1993, the Ministry of Trade and Industry issued the National Industrial Strategy White Paper that directed the focus of industrial policy towards developing and promoting a national innovation system through industrial clusters15 to benefit from knowledge spillovers. This strategy aimed at promoting competition and networking among firms, universities and research institutes. The focus of the new policies was to create advanced production factors and shape future factor conditions rather than providing incentives to selected industries and businesses. Public expenditures targeted R&D, education and technological infrastructure for the improvement of national competitiveness. The role of government was limited to intermediation and information dissemination. The policy focus was to achieve industrial growth and improve the business environment, as opposed to

13 See Decision of the Tribunal on Case No. 72/CR/Dec03 at: http://www.saflii.org/za/cases/ZACT/2005/17.rtf and the Judgment of the Competition Appeals Court in case 49/CAC/Apr05 at www.comptrib.co.za.

14 OECD (2009).Contribution from Brazil, DAF/COMP/GF/WD(2009)15. 19 January.

15 Industrial cluster is defined as agglomeration of producers, customers and competitors that increases specialization, promotes efficiency and competitive advantage (Dahlman et al., 2006: 39).

provision of subsidies to failing industries and picking winners.

In the 1980s, priority was given to technology and innovation policies for industrial diversification. After the early 1990s, the government progressively set up a national innovation system accompanied by the promotion of new knowledge-based products and services. The main objective was to improve the conditions for innovation and adoption of new technologies. The innovation system included the public sector, financing institutions, academic and research institutes and the private sector. A striking feature of the new industrial policies was the exclusion of tax incentives for R&D. Subsidy grants were based on the ability of a company to collaborate with other companies, research institutes and/or universities. The government sustained its commitment to the promotion of R&D activities and encouragement of the participation of SMEs in programmes during the economic crisis. This policy promoted rivalry between firms and continuous innovation. This collaborative effort assisted in converting invention into commercial application.

The focus of the strategy included the anticipation of promising economic sectors, such as information and communication technology (ICT). Private firms, such as Nokia, adopted a similar strategy and divested most of its traditional businesses and focused on the ICT sector, mobile phones in particular. The education system, based on free and equal opportunities for all, responded positively to the change of industrial policy towards ICT, and enrolment in the institutes providing higher education in this field increased substantially.

For developing countries, most of which are behind in ICT, the lessons to be drawn include (a) understanding and using existing as well as indigenous knowledge; (b) investing in basic technological infrastructure and technical information centres; (c) encouraging cooperation among the public sector, academic and research institutes, and the private sector through an education system providing free access to all; (d) encouraging all the stakeholders to work on adapting global technologies to their circumstances; and (e) anticipating and preparing for the future. advantage (Dahlman et al., 2006).

51. On the other hand, industrial policy measures may harm competition. Cartel activity, abuse of dominance and/or anti-competitive mergers conflict with competition law. Other industrial policy measures related to international trade and procurement, for example, may skirt competition law but still harm competition. Competition and industrial policies may conflict or reinforce each other in privatization policies and sector regulation, where they may favour the creation or protection of large domestic firms as national champions.

Box 5. Albanian case of conflict between competition and industrial policies

Albania offers a recent example where competition and industrial policies were in direct conflict. In 2008, the Competition Commission took a decision (No. 99, 30 December 2008) to eliminate discrimination between imports and domestic production of diesel. However, the government chose to protect the domestic production for one year and prohibited imports of the relevant product.

Source: Questionnaire response.

52. Certain industrial policy measures can obliterate the positive effects of competition. Subsidies change firms' incentives. Firms that receive subsidies expand in the market at the expense of their competitors. In general, they displace lower-cost competitors, so their expansion reduces economic welfare. This conflicts with competition policy objectives. Firms that do not receive subsidies will nevertheless change their expectations when others receive them. Firms with expectations changed in this way will, in general, take riskier

decisions because they have greater expectations of a bailout if the decisions turn out to be wrong. This harms competition over the long run.

53. Cartelization is one area where industrial policy measures collide with competition policy. In various stages of development, certain countries preferred cooperation rather than competition among their infant industries, perceiving it as a means to increase international competitiveness. But it also means that firms are less prepared for competition abroad. Depending on the provisions of the competition law, including exemptions available for government-sponsored cartelization, it may even be a violation.

54. Export cartels may aim to restrict exports to maintain high prices. An example of this is in the oil industry. But export cartels might also be a means for small firms to jointly establish export channels, which they would be too small to do individually. Competition or other laws may provide a procedure for an evaluation of the pro- and anti-competitive effect and a structured means to possibly grant an exemption.

55. Recession cartels in declining industries may be allowed or encouraged by government. These may limit production or capacity. Depending on rivals' reactions, they may be able to maintain higher prices or accomplish an "orderly exit." In the current economic downturn, countries are in search of policy measures to counter the effects of the crisis, especially in certain hard-hit sectors. Recently, as a reaction to the economic crisis, the chair of the (Republic of) Korea Fair Trade Commission announced the possibility of invoking the powers provided under the Competition Act to exempt certain cartels, as long as they did not engage in "direct price fixing".[16] This signifies a notable shift in dealing with cartel cases, since the introduction of a cartel leniency programme in the Republic of Korea. Alternatively, there are provisions in some competition laws for crisis cartels that allow competitors to agree on capacity reduction. But whether for price, output or capacity cartels, the question remains: What efficiency benefit is there from agreed price, output or capacity reductions when each firm can decide these matters independently?

56. Tensions between competition and industrial policies can be addressed in a number of ways. First, there may be areas where other laws take precedence over competition law. An example mentioned above is where the rights granted under IP law cannot be restricted under competition law. (Of course, competition law restricts e.g. abuse of dominance beyond rights granted by IPRs.) Second, there may be a specific law that works in tandem with the competition law to provide a special authorization mechanism. For example, agreements related to R&D joint ventures – or any joint ventures – may, in some jurisdictions, be subject to authorization via such a mechanism. The idea is to maintain competition standards and objectives, but provide a clear mechanism for the evaluation and, perhaps, authorization. Third, as mentioned earlier, the competition law may contain public interest exemptions that provide for industrial policy goals with respect to mergers.

57. Most competition authorities consider industrial and competition policies to be complements, so long as industrial policies do not target certain sectors or firms. This is according to the responses of several member states to the UNCTAD survey. Most countries have industrial policies to promote productivity, efficiency and competitiveness of economic activities. In these cases, competition law and policy is an essential component of the overall industrial policy. The responses show that most exemptions or exceptions to competition law promote SMEs, new technologies and R&D activities.

58. But competition authorities may be less sanguine about industrial policies that discriminate among firms – that is, that violate competitive neutrality in the pursuit of

[16] See the article by Harris HS, Wang P and Watanabe S, January 16, 2009 on www.mondaq.com.

developing a champion. Competition is seen as a generally more reliable way to discover champions, technologies and markets.

V. The current economic crisis: way forward for industrial and competition policies

59. The current economic crises stimulate increased demands for state intervention in the market. Governments are under pressure to provide economic rescue packages for industrial and financial companies. Competition authorities are under pressure to relax merger reviews and prohibitions of anti-competitive conduct in competition laws. Economic nationalism, in the form of trying to restrict the benefits of subsidies or state guarantees to domestic companies and consumers, can be glimpsed in some measures.

60. Economic nationalism harms all economies. With, in general, less diversified exports, developing countries and economies in transition are more exposed when non-tariff barriers are raised. More reliant on FDI for e.g. infrastructure expansion, they are at greater risk when domestic borrowers are privileged over foreign ones. Their governments will lose subsidy races against larger economies, and competition in all countries will be harmed by subsidies, since they obscure efficiency advantages. Policies adopted by each government should recognize, at least, spillover effects, and be designed to be in harmony with the interests of the global economy rather than only those of individual nations.

61. Lewis (2009)[17] points out that part of the current crises, especially in the financial sector, reflects regulatory failure. State intervention should therefore not ignore root causes. Financial and other regulatory authorities have a significant role to play. During these economic hard times, competition policy will be different from what it was during the great moderation of the past decade.[18] The core objectives – consumer welfare and preserving a competitive process – need not change, nor should they. Rather, given the different economic environment, one may expect a different mixture of decisions. There may be a greater incidence where the failure of parties enters the calculation, whether for merger decisions or for subsidies. More restricted finance and lower demand may limit entry, thereby changing evaluations ranging from dominance to vertical restraints.

62. Competition policy's relationship to industrial policy may change. Not only may there be more demand for government to solve coordination problems and information problems, which are often pro-competition industrial policies, but competition policy must also be prepared to differentiate anti-competitive from competitively neutral subsidies, procurement rules, standards and consortia – indeed the whole gamut of industrial policy instruments. While government may overrule competition authorities, the identification of anti-competitive industrial policies as such can mean that the measures' effects are truly weighed and that the overall harm to competition of responses to the crisis is limited. Competition authorities may also prepare for pro-competitive post-crisis restructuring and re-regulation.

VI. Issues for policy considerations

63. In the changing economic environment, the respective roles of competition and industrial policies are being revisited. In this connection, one may wish to consider the following questions:

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[17] See OECD: DAF/COMP/GF/WD(2009)22.
[18] Ibid.

(a) When are competition policy and industrial policy mutually reinforcing, and when are they mutually harmful?

(b) How should competition authorities respond to proposals for competition-harming industrial policy measures during the current economic crisis?

(c) What weight should be given to harm to competition in worldwide markets in evaluating the effect of aid (whether subsidy or other less direct types) to domestic suppliers?

(d) Competition authorities have developed cooperation mechanisms for the review of transnational mergers and the fight against transnational cartels. Is there a role for cooperation for the review of industrial policies having significant effects on transnational competition? If so, are competition authorities best placed or are other parts of government?

(e) What issues should competition authorities be considering now for the post-crisis era? For example, some transition countries had demonopolization plans for specific sectors during their transitions; should similar plans be prepared for sectors that may have become concentrated but will re-enter the private sector after the current crisis? How might competition authorities reinforce the credibility, post-crisis, of state aid control regimes and of merger control regimes?

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