RESTRICTED
WT/WGTCP/W/30
15 September 1997
(97-3668)

WORLD TRADE ORGANIZATION

Working Group on the Interaction between Trade and Competition Policy

Original: English

COMMUNICATION FROM NEW ZEALAND

The following communication, dated 10 September 1997, has been received from the Permanent Mission of New Zealand with the request that it be circulated to Members.

NEW ZEALAND PAPER ON AGENDA ITEM A OF THE 16-17 SEPTEMBER 1997 MEETING OF THE WTO WORKING GROUP ON THE INTERACTION BETWEEN TRADE AND COMPETITION POLICY

Relationship between the objectives, principles, concepts, scope and instruments of trade and competition policy

Introduction

1. The international economy is increasingly characterized by the globalization of production and finance. Globalization means that firms are increasingly looking to operate across national borders to service their businesses, source inputs, attract investment and develop markets in many different countries. The process of globalization has lead to further integration of both factor and production markets. The increased internationalization of business will shape governments' policy frameworks into the next century and has created both new opportunities and new challenges for the global trading system.

2. To share in the benefits that flow from the global environment it is increasingly recognized that governments must focus on those issues which affect the competitiveness of domestic markets. Sustained economic growth is most likely to be achieved by an open and competitive environment. An open and competitive environment creates profit making opportunities, provides consumers with greater choice, and thus strengthens the incentives for firms to improve continuously their efficiency and innovation.

3. Competitiveness depends on the ability of firms both domestically and internationally to contest particular economic activities. In essence the level of contestability in a market will depend on the degree to which barriers to entry exist. Hence a fully contestable market would be one where there are no substantial barriers to entry, in other words a situation in which the competitive process is unimpeded.

4. It is now recognized that even when traditional border controls are removed substantial barriers to entry continue to exist. Barriers to entry created by governments or barriers created by anti-competitive and collusive strategic actions of private firms continue to pose challenges to the global trading environment.

5. With the integration of business interests throughout the world, policy makers are focusing increasingly on the interaction between trade and competition policy. Businesses now have an increasing interest in the competition laws and the regulatory environment of countries, and are placing pressure on governments to provide a competitive trade and investment environment which allows them to operate with ease across national borders. Competition policy and trade issues are now inextricably linked. While traditionally focused on government-imposed border controls, the scope of trade policy has now extended to a range of "behind the border" measures that affect trade, as border restrictions have been reduced. Similarly, while competition policy has traditionally been focused on domestic markets, globalization has meant that competition policy-makers have been taking a greater interest in border measures and the impact that they have on domestic market performance. The expanding scope of both competition and trade policy has lead to a greater level of interaction between the two policies, and greater potential for both convergence and conflict.

6. The purpose of this paper is to explore the relationship between the objectives, principles, concepts, scope and instruments of trade and competition policy.

Competition policy

7. In the broadest sense "competition policy" refers to all policies which are directly aimed at enhancing the scope for competition between firms. It is concerned with both government interventions that have implications on the competitive environment and private sector anti-competitive practices. Every country has some form of competition policy, although the policies do not always go by that name. Competition policy is important because competition fosters economic efficiency, encourages firms to offer consumers good price/quality options and increases the international competitiveness of downstream users. Competition policy is not restricted to competition or antitrust laws. Deregulation policies which reduce the barriers to new competitors emerging in industries or reliance on increased competition rather than price controls to limit price increases are forms of competition policy. Privatization of state-owned firms, particularly where firms are exposed to competitive forces, can also be a form of competition policy. A wide range of other policies also have competition policy effects.

8. In general terms, competition policy seeks to promote the efficient allocation of resources by means of open and competitive markets. It is based on the principle that government or privately imposed barriers to entry or exit from markets should be minimized. To minimize barriers created by governments, competition policy-makers argue that interventions by governments should be made only where welfare gains are explicitly identified. Further, where government intervention is warranted, regulatory and administrative practices should be transparent, consistently applied, based on the principle of non-discrimination, and should involve minimum transaction and compliance costs.

9. Some jurisdictions pursue various other objectives such as the protection of small business and the promotion of national industrial policy. However, a difficulty with many of these secondary objectives is that they conflict with the primary objective. The protection of small business is achieved at the cost of economies of scale and scope. The provision of industry subsidies is achieved at the cost of the more efficient use of those resources in other sectors of the economy.

Trade policy

10. Trade policy describes the measures and practices relating to countries' trading regimes. It addresses two broad and interrelated issues. First, a liberal trade policy seeks to create trading opportunities, that is, it seeks to ensure freer trade by removing tariffs and non-tariff barriers. Second, it seeks to ensure fair trade by eliminating anti-competitive practices in international trade. This second concept of fair trade is more difficult to define. It should imply the creation of a more equitable trading

system where the conduct of trade is based on the competitive advantage of market players rather than the economic power and influence of Government.

11. Trade policy covers a range of government measures that address the two objectives of free and fair trade. However, as noted earlier, a liberal trade policy is no longer restricted to a focus on the reduction of traditional border restrictions such as tariffs and import licensing, but also covers non-tariff barriers including sanitary, phytosanitary measures and technical regulations which limit cross border access. In addition, policies aimed at promoting fair trade attempt to address domestic and export subsidies, and other forms of assistance which discriminate in favour of domestic producers.

12. The pursuit of free trade is consistent with the promotion of global welfare and increased economic efficiency. However, trade policy measures which are aimed at ensuring fair trade can run counter to the principles of trade liberalization if inappropriately applied. While in certain circumstances, such measures can be an effective tool against unfair trading practices and unjustifiable government intervention and thus lead to increased efficiency in the longer term, in other circumstances, when used as a disguised restriction to trade such measures will result in a net global welfare loss and a reduction of economic efficiency. This potential tension between the objectives underlying trade policy is discussed in greater detail in the next section.

The interaction between trade and competition policies

13. In broad terms competition policy and trade liberalization are trying to achieve the same thing - economic efficiency. Competition policy seeks to achieve economic efficiency by liberalizing domestic markets and by having laws that protect and promote competition. A liberal trade policy seeks to achieve economic efficiency by liberalizing markets. It has traditionally done this by removing barriers to trade at the border. In fact both free trade and competitive behaviour are necessary conditions for efficiency.

14. While the primary objectives of competition policy and trade policy are supported by economic theory and are compatible with one another, there remain some tensions between the two policies. In particular, there are concerns on the part of trade policy experts that anti-competitive behaviour of firms is reducing access to markets. On the other hand, there are also concerns from a competition policy perspective about the potential anti-competitive effects of some trade policy measures.

15. The interaction between the trade and competition policies are briefly discussed below.

Trade polices which affect competition

16. Generally, policies which reduce import and foreign investment restrictions will increase the contestability of domestic markets. As such liberal trade and investment policies tend to support the aims of competition policy.

17. Alternatively, trade policy measures can limit access for imports and reduce the scope for competition. Such measures, including both tariffs and non-tariff measures, are used for a number of reasons such as the promotion of domestic industry, revenue generation, national security and public health and safety requirements.

18. While traditional tariff barriers and various quantitative restrictions have been reduced over the last 10-20 years, there remain concerns to ensure that there is no reintroduction of so-called "grey area" measures. Such measures in the past included the likes of Voluntary Export Restraints, Orderly Marketing Arrangements and various other voluntary arrangements which distorted international competition.

19. A variety of trade measures, such as dumping, are purported to counter "unfair" practices applied by other trading partners. Dumping is the practice of selling goods in an export market at a price lower than the normal value in the economy of origin. Under WTO rules Members are able to take anti-dumping measures where dumping takes place and causes material injury to domestic producers.

20. The competition policy concern with such laws is that the analytical process provides only for a partial welfare analysis. The focus is on whether there is international price discrimination and, if so, whether domestic manufacturers are being harmed. This focus upon the impact upon domestic manufacturers allows border protection to be imposed without having to show that the overseas firm's pricing policies are causing damage to the domestic economy as a whole. This contrasts with competition policy analysis which also considers the effects of the pricing on other market participants (downstream producers, users and consumers). In other words, anti-dumping analysis does not consider the full impact of dumping on an economy. Hence, anti-dumping duties can be imposed against price discrimination that is pro-competitive or is beneficial to the importing country in terms of improving overall welfare of the economy.

<u>Competition policies and their effect on trade</u>

21. Competition policy measures which reduce artificial barriers to entry to various markets are likely to improve access for imports as well as domestic competitors, thereby supporting the aims of a liberal trade policy. However, competition policy measures which do not take into account the realities of the global environment, or which are ineffectively or inadequately enforced, may leave in place barriers to entry and be less supportive of free trade. These issues are discussed below.

Regulation

22. Globalization has heightened the awareness of the effects of the domestic regulatory environment. This has meant that there is a growing international interest in a variety of issues that were previously the domain of domestic policy.

23. Regulation is defined as the full range of legal instruments by which government institutions, at all levels of government, impose obligations or constraints on private sector behaviour. The regulatory environment has a direct impact on business growth. The need to comply to different sets of regulations throughout the world can reduce incentives to invest, and impede the flow of goods and services between firms both domestically and internationally. Effectively the result is that the costs of doing business increases, and hence in the long run consumers lose out.

24. A principal focus of trade policy has been on ensuring that the cost of complying with an economy's regulatory environment is no greater for foreign firms than for firms in the domestic market, i.e. the principle of national treatment. Such unnecessary impediments to the entry of foreign firms can occur when:

- a regulation is applied exclusively to foreign firms;
- a regulation is designed in such a way that although it is applied equally to both domestic and foreign firms, it creates significant disadvantages to firms which are not located in the country in which the regulation is imposed;
- a regulation favours incumbents and prevents new entrants, e.g. network-based services such as telecommunications and utilities; and

- domestic firms are more informed about the changing nature of regulations. Often compliance with regulations can involve significant sunk costs. When domestic firms have a greater awareness of the nature and forms of new regulations, their ability to adapt and adjust to the changing conditions at a faster rate, may create an advantage over foreign firms.

25. Such regulatory barriers not only affect the level of competition in goods but also in services. In fact, discrimination against foreign competition is most visibly evident in the services sector. Examples of such regulatory impediments to foreign competition include restrictions on foreign direct investment, the regulation of occupations, and access to networks and discrimination against foreign ownership.

Anti-competitive behaviour of domestic firms abroad

26. Another concern of policy makers with competition policies is the fact that many countries do not address anti-competitive practices of domestic firms operating abroad. While collaboration of firms can be efficiency enhancing by allowing smaller firms to take advantage of economies of scale, theory also suggests that such collaboration, if it results in dominance of a market, can lead to anti-competitive and hence welfare-reducing outcomes. Because of the domestic focus of competition laws, firms behaving in an anti-competitive way abroad may be exempted from competition law disciplines.

Competition policy exemptions

27. Many economies provide for the authorization or exemption of certain arrangements from the legislation where they further domestic welfare objectives, without regard to the effects on global welfare. Such exemptions may raise barriers to entry and reduce competitive forces in the relevant markets, leading to higher prices and lower output.

Different approaches to competition law and enforcement

28. There has, traditionally, been a wide variety of approaches to competition law and enforcement. In the past these differences were generally regarded as unimportant. However, globalization has lead to a greater interest in the compatibility of competition laws due to the increased internationalization of business law, particularly in relation to the rapid increase in transnational mergers, strategic alliances and practices.

29. There is now a general concern by trade policy makers that weak laws or inadequate enforcement adversely affect international trade. Either can allow domestic firms to regulate markets to the detriment of imports by such means as import monopolies, boycotts and market foreclosure. In addition, there are concerns that many competition laws contain exemptions allowing for specific business arrangements and practices, such as horizontal arrangements and vertical restraints. There is a need for a robust framework for economic analysis of these arrangements. Exemptions for such business arrangements as joint research and development undertakings and exclusive dealing arrangements, can also significantly reduce market access, even though they may enhance efficiency within the domestic economy.

<u>Conclusion</u>

30. The process of globalization has created new challenges and opportunities for governments. It is increasingly recognized that sustained economic growth cannot be achieved by trade liberalization alone, but instead governments must focus on all issues which affect the contestability of domestic markets.

31. It is now recognized that even when traditional border controls are removed substantial barriers to entry continue to exist. Barriers to entry created by the Government or barriers created by anti-competitive and collusive strategic actions of private firms continue to pose challenges to the global trading system.

32. This has also created new challenges for both trade and competition policy-makers. While trade policy has become more concerned with "behind the border issues" which affect international trade, competition policy makers are now taking a greater interest in border measures and the impact that they have on domestic market performance. This has lead to an increased interaction between the two policies.

33. The primary theoretical objectives of both competition policy and trade policy attempt to achieve the same outcome of economic efficiency and can be reinforcing. Competition policy can reinforce trade policy by dealing with government regulation and private conduct that frustrates the achievement of border liberalization. Likewise, trade policy can reinforce competition policy by opening up markets to import competition to restrain the market power of domestic industries.

34. However, there are circumstances when the two policies are not reinforcing. In particular, there are concerns when the full effects of trade policies on competition in the domestic market are not taken into account. Similarly, competition policies which are domestically focused, ineffective or inadequately enforced may put in place barriers to entry and be less supportive of free trade.

35. The challenge for trade and competition policy-makers is to agree on competition and regulatory principles which provide a coherent approach to all aspects of economic policy. This will in the end be achieved by ensuring that both policies focus on the single primary objective of efficient production and consumption in the economy. Over time it is likely that competition and trade policies will increasingly converge to the point where it may not be legitimate to maintain separate policy paradigms.