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What could anti-trust in the OECD do for development?

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Abstract

The extra-territorial effects of cartels, mergers and other non-competitive activities require consideration especially if they harm consumers and firms in developing countries. This paper provides an overview of the available empirical literature regarding the impact of cartels, mergers and abuses of dominance that are rooted in the OECD. Typically the available evidence is not yet sufficiently comprehensive to allow robust conclusions, but (with no claim on accuracy), it seems reasonable that the direct impact on developing countries is very substantial and in welfare terms may exceed the contribution by Official Development Aid. OECD countries could contribute to development through the activities of their competition authorities and appropriate changes in legislation.

Keywords

Cartel, merger, restrictive business practices, developing countries, competition policy

JEL classification

O1, L4

List of Figures

Acronyms

FDI	Foreign Direct Investment
ICN	International Competition Network
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PICDS	Private International Cartels dataset
SME	Small and Medium Enterprise
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

What could anti-trust in the OECD do for development?[1]

1 Introduction

The relationship between competition policy and development is a rather controversial topic. The competition policy community by and large wants to stay clear from issues related to development or other policy goals for that matter: antitrust should deal with competition only. The development studies community is equally sceptical about at least the strategic value of inclusion of competition issues in the multilateral negotiations mainly because of the perceived failure of the Washington Consensus that amongst others sees privatization, deregulation and competition policy as a necessary element of a viable development strategy. This dichotomy is not really productive, the more so since a problem would seem to exist regarding those external effects of anti-competitive behaviour and concentrations that become only manifest in other jurisdictions. Competition policy authorities could be expected to turn a blind eye on these effects because it is the negative impact on their compatriots (consumers, firms and tax payers) that motivates and legitimizes their actions against (hard core) cartels, abuse of dominant positions and mergers and acquisitions.

In this paper I will argue that the extra-territorial effects of cartels, mergers and other non-competitive activities require consideration especially if they harm consumers and firms in developing countries. An important issue of the discussion in this paper is that those competition authorities that in their mission statements focus on the benefit of their citizens are missing the point. Actually this may be a source of protectionism that needs to be addresses by international organizations such as the OECD or the WTO. These are the main points of the paper.

The first section provides arguments for this focus: economic analysis has a long tradition of analyzing how (market) power impacts on the international division of the gains from trade and developing nations have specific characteristics that makes them particularly vulnerable to the abuse of market power. This does not mean that the argument implies that only the abuse of market power by firms that are located in industrialized countries matter for developing countries. In contrast, I would agree with those that are arguing that non-OECD cartels and monopolies – both within non-OECD countries and organized by non-OECD countries – are very relevant (the OPEC cartel is a clear example of the latter). So the reason to focus on the impact that anti-competitive behaviour in the OECD exerts on the economies of developing countries is that this impact has so far hardly been explored in the literature. The second section provides an overview of the available empirical literature regarding the impact of cartels, mergers and abuses of dominance that are

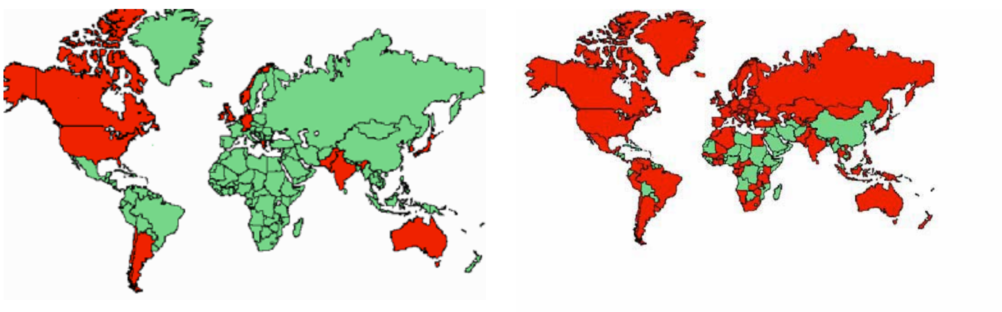
[1] Comments by Jarig van Sinderen are gratefully acknowledged. For comments on this paper: Bergeijk@iss.nl

rooted in the OECD area. Typically, the available evidence is not yet sufficiently comprehensive to allow robust conclusions, but the discussion provides ample evidence that the OECD countries can contribute to development through the activities of their competition authorities and through appropriate changes in legislation. The third section draws some policy conclusions and suggests issues for future research.

2 Why should economists study the impact on developing countries?

Research into the potential impact of multinational corporations and developed nations on market outcomes in developing countries has a long and broadly based tradition in economics ranging from (neo) classical theory via (neo) Marxist to business economics. Indeed, Ricardo ([1817] 1962, p. 231) already stressed the importance of power for the determination of the division of the gains from trade between the motherland and her colonies. At the end of the nineteenth century Hobson ([1902] 1988) examined the growing economic and political power of large private companies, typically exercised over less developed countries. In the 1960s and 1970s proponents of the so called dependencia theory related limited scope for growth in the developing countries to terms of trade losses due to low income elasticities in the rich 'centre' are low, so that an increase in export volume is associated with terms of trade losses (Griffin and Gurley 1985 provide an overview of this literature). Noteworthy is that the early UNCTAD rounds in 1968 and 1976 led to the adoption by the UN of the 'Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices'. In 1986 the OECD dealt with the issue in its 'Guidelines for Multinational Enterprises'. In contrast with progress achieved in policy, scientific interest seemed to wane a bit. The topic re-emerged on the top of the research agenda again due to the introduction of new more pro-competition policies in developing countries and emerging markets (Figure 1) that led to a new phase of globalization with increases in trade, foreign direct investment (FDI) and the number of multinational enterprises since the mid 1990s.

FIGURE 1
Countries with a competition law in 1980 (left) and 2005 (right)



Source: ICN (2005)

Modern global value chain analysis, for example, deals with power asymmetries focusing on the influence of large firms (typically global buyers) in managing and or governing international production networks (see, for example, Gereffi *et alia* 2005). In addition the topic of competition policy and its impact on developing countries gained weight due to the fact that it was prominently put on the agenda for the Doha trade round (see, for example, Holmes 2004). All in all the impact of multinational enterprises and/or explicit and implicit organizations of international enterprises on developing countries is a relevant determinant of market outcomes and thus worthy of economic research.

This is the more so since developing countries have a number of characteristics that make them relatively vulnerable for abuses of economic power. For one thing competition authorities in many developing countries are still weak due to lacking resources and manpower, but also because these economies often relied on command and control techniques and state companies rather than on decentralized production co-ordinated through market processes. Typically the number of firms is relatively small (concentration consequently is high), firms are in the small and medium enterprise (SME) segment and businesses have shallow pockets (all compared to an industrialized country). Finally, for many essential products only foreign sources exist. Indeed, a foreign firm that operates in developing countries will often be dominant in their markets even if this firm is not dominant in its home-country, mainly because it will be big and have deep pockets when compared to the firms in a developing country or emerging market. Finally, the countervailing power of developing nations is quite limited because of their relatively small market size. This matters because it is the threat of punitive damage that is the incentive to deter and prevent anti-competitive behaviour. Indeed, as Budzinski and Kerber (2006, p. 4) point out

> Praktische Erfahrungen unterstützen die Befürchtung auftretender Schutzlücken, insbesondere im Hinblick auf Schwellen- und Entwicklungsländer sowie kleine Volkswirtschaften die nicht über so bedeutende Binnenmärkte verfügen, als dass international agierende Unternehmen nicht notfalls auf einen ungehinderten Marktzugang verzichten könnten

All in all institutional and structural characteristics point to stronger susceptibility for the abuse of market power in developing countries.[2]

A closer look at the harm done by anti-competitive activities that originate in the industrialized world will provide other (semi)-legal evidence that so far has not been considered in the mainly macroeconomic (country level) and mesoeconomic (sector level) debates. Moreover, the findings that will be discussed in this paper have an alternative interpretation. The data that we will discuss often derive from investigations and procedures undertaken by competition authorities and thus offer a perspective on the external international effects of their activities. Indeed, the topic of the extraterritorial

[2] In this paper I do not deal with the question whether developing countries should pursue a vigorous competition policy or whether it is more appropriate to create artificial comparative and competitive advantages for their 'infant industries'. See, however, Singh and Dhumale (1999) and Fox (2007).

impact of competition policy is important from a global welfare point. Bernard and Ivaldi (2006, p. 17), for example, argue that 'asymmetry in the distribution of consumers and producers or company headquarters across countries drives to welfare inefficiency since authorities do not internalize the cross-border effects on other jurisdictions'. Typically these asymmetries are largest between the developed and the developing countries so that we can learn much from an evaluation of the impact on developing countries. Unfortunately competition authorities do not report such effects and the next section attempts to fill this gap to some extent as it presents available data and discusses the emerging empirical literature on this topic.

3 What can we tell about the direct impact on developing countries?

An increasing number of competition authorities around the world is publishing estimates of outcome, that is the harm that was been done by anti-competitive activities (cartels and abuse of dominance) and the harm that is prevented because of the prohibition of those contemplated mergers and acquisitions that would reduce welfare (see Don *et alia* 2008 and Postema *et alia* 2006, respectively). Typically the available estimates of competition policy outcome that have been reported by competition authorities relate to their own national (or in the case of the EU supranational) territory, thus leaving the impact on other jurisdictions out of the picture. This is the direct impact of anti-competitive behaviour that will be the topic of the remainder of this paper.

It should be noted at the start that the numbers that can presently be uncovered for several reasons will underestimate the full impact of international anticompetitive practices on developing countries. First we do not consider anticompetitive behaviour that originates in developing countries and emerging markets. In addition to the neglect of the purely domestic effects of domestic cartels (which are not occurring cross border and are thus rightly excluded from our set of observations and discussions) this means that South-South exploitation is neglected. This may, however, be a relevant source of anti competitive activity since both the originating and the source economy will typically have weaker competition policy authorities. Second, many anti-competitive activities are illegal and are hidden on purpose from economic detection. Both the duration and the impact on market outcomes of such illegal activities require sophisticated detection techniques (compare van Bergeijk 2008). Third, sometimes the abuse of dominance and other restrictive business practices are not illegal although they are clearly welfare reducing from a global point of view. A typical case would be a global buyer that abuses its market power only outside the jurisdiction where it is localized (an example is the market for cocoa where oligopsonistic and/or monopsonistic power is exercised, both at the farm gate and at the international level, see UNCTAD 2008). Fourth, developing countries may also be hurt indirectly through trade barriers in developed countries that were initiated by lobbying and petitioning sectors and cartels. Examples are EU and US agricultural subsidies and antidumping measures that reduce the market potential of firms located in the developing world. With these caveats in mind let us consider what we already know and where additional research will be needed.

3.1 The impact of private cartels

A priori one would expect that it would be most difficult to find data on the impact of private cartels. After all private cartels are illegal in the major jurisdictions and thus the most serious data difficulties could be expected for these often hidden activities. A number of studies, however, have dealt with hard core private cartels (that is when firms co-ordinate prices explicitly or when they divide up international markets).[3]

Scientific interest in international cartels, that is cartels that operate in more than one jurisdiction, has especially increased since competition authorities in the US and Europe stepped up their cartel-busting activities in the 1990s.[4] New laws, new (economic) detection instruments and the wide-ranging application of leniency over the period 1990–2008 uncovered some 516 international cartels with affected sales of $16 trillion (current prices) and a median overcharge ranging between 17% and 21%.[5] At the end of 2007 out of 433 cases 41 were closed and 73 still under investigation.

The first serious attempt to uncover the impact of private cartels is Levenstein *et alia* (2003). They analyze the impact of 42 successfully prosecuted international private hard core cartels on the international trade of developing countries in the 1990s (of which $ 55 billion could be related to import markets of developing countries). Levenstein *et alia* conclude.

> if the price of these imports increased an average of ten percent (the lowest reported price increase for this sample of cartels), then without adequate enforcement against international cartel, producers in industrialized high income countries could take from developing countries in higher prices approximately 15% of what their governments denote in foreign aid.[6]

Of course such numbers are surrounded by large uncertainties as Levenstein *et alia* are keen to point out themselves. Taking account of the fact that the classification of trade statistics does not always match actual relevant markets they estimate a lower bound in which about 2% of import markets in the developing world are contaminated. In this case the loss on average would

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[3] Thus defined these studies do not include the impact of state-run cartels (such as OPEC), private export cartels and tacit collusion.

[4] See Connor (2004) on these developments in the world's major jurisdictions.

[5] All cartel data in this paper (unless otherwise indicated) are from the private international cartels PIC dataset published in an independent appendix in Connor 2008, Tables.1, 2, 3 4 and 8 (these tables provide data for 1990-2008) and an update which appears as a set of presentation published through SSRN as Connor (2009) and that includes data for 2008 as well.

[6] Note that one of the messages of this paper is that an alternative interpretation of these findings exists since these cartels have actually been prosecuted and fined: competition authorities in the industrialized world added 15% to the foreign aid already supplied to these countries.

amount to 0.3% of Gross Domestic Product (GDP) or 5% of Official Development Aid (ODA).[7]

Also on account of other aspects of their methodology Levenstein *et alia* are on the rather cautious side. First their study only takes into account convictions, so that the data only describe activities, impact assessments and periods for which legal evidence exists. The requirements for legal evidence, however, may be quite different from those for economic evidence. Second, the focus on legal evidence leaves cartels out of the picture that were being investigated but had not (yet) gone through the legal procedures by 2007. Third, their methodology assesses damage on the basis of imported goods only, neglecting the impact of cartelized services of which tourism and shipping are examples of industries that are numerically very relevant for developing countries. Moreover, non competitive pricing of shipping services does not only increase consumer prices (through the cost of freight) but also and in addition has a negative welfare impact because it reduces substantially the volume of goods that are traded internationally (Hummels *et alia* 2009 estimate a 15% reduction for Latin America).

Fortunately, a Private International Cartels data set (PICDS) has recently been constructed (Connor and Helmers 2005) that presently not only covers an additional 10 years but also covers cases for which investigations were still ongoing by the end of 2008. Over the years 1990–2007 PICDS indicates that in terms of affect sales 17% and in numbers 33% of the global cartels relate to business and consumer services. PICDS also provides estimates of both the mean and the median cartel mark-ups for global cartels. These mark-ups are in the order of magnitude of 14 to 21%, considerably larger than ten percent increase considered by Lewenstein *et alia* Moreover, in the years 1990–2007 according to PICDS about three quarters of affected sales in the discovered cases occurred in those cases that had not yet been closed in the sense that either fines were imposed, or consent decrees c.q. settlement agreements had been reached, or that investigations were closed without punishment.

Therefore some obvious corrections suggest that the Levenstein calculations may underestimate the direct impact by 80 to 90%. With no claim on accuracy whatsoever, it seems reasonable that the direct impact on developing countries is very substantial indeed and in welfare terms cartel damage may exceed the contribution by ODA.[8]

Importantly the direct impact of the global cartels on average amounts to three quarters of total affected sales in the developing world (Figure 2) whereas this share in the US amounts to 31% and in Europe to only 5% (in the world total about 14% of the uncovered cartels is of a truly global nature). The upshot is that identified damage in developing countries is mainly induced outside the jurisdiction, whereas damage is mainly national in Europe and (to a lesser extent) in the United States. Indeed, the industrialized world is a substantial exporter of cartel damage. This is why competition policy in the

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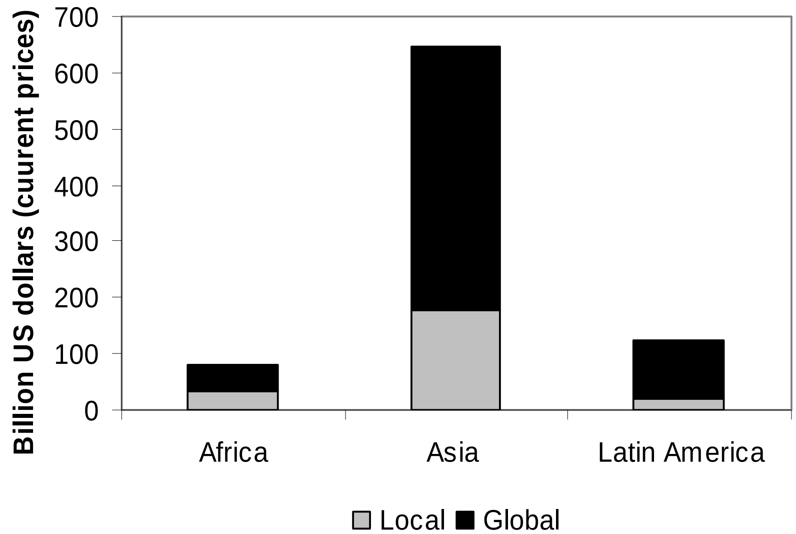
[7] Their upper bound assumes that 8.3% of trade is influenced by cartels. This translates into an average loss of 1.8% of GDP or the equivalent of 33% of ODA flows.

[8] The direct impact could be in the range of 50 to 300% of ODA.

OECD countries, if properly focused, could induce substantial welfare gains in the developing countries.

FIGURE 2
Affected sales of discovered local and global private cartels outside Europe and the US (1990-2007)



Source: calculations based on the PIC dataset

3.2 Mergers and acquisitions

The very strong growth of foreign direct investment (consisting of both a surge in green field investments and a wave in mergers and acquisitions) that occurred in the decade before the outbreak of the sub-prime crisis has given rise to many concerns that the increase in foreign market power could hurt developing countries (see, for example UNCTAD 2000). Singh and Dhumale (1999, p. 5) remark that

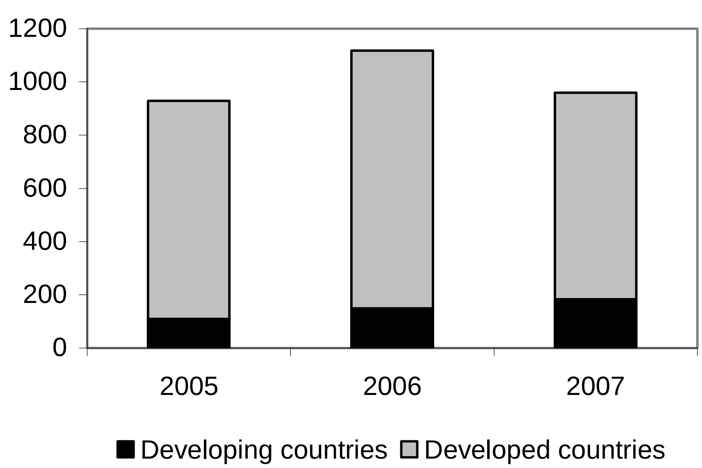
> Whether the mergers take place in the US or Europe or through cross border takeovers in developing countries themselves, there are serious competition policy concerns for developing countries. If the largest producers in, say, the US automobile industry merge, this may not only lead to anti-competitive behaviour in the US but also similar or worse behaviour in developing countries

Typically many mergers in the past have created market power and led to substantial increases in prices in a significant share of the cases. Gugler et alia (2003) in their review of 45.000 mergers in the period 1981–1998 identify about a third of the mergers as non-competitive cases in which market power increases alongside an increase in profits and a decrease in sales volume. It is not known whether the merging firms had a negative impact on buyers outside the jurisdiction of the competition authority that has judged the merger and whether these mergers were actually accepted for this reason. Moreover data are not available on the actual impact on developing countries.

It would, however, seem possible to use the approach set out by the study on cartel damage by Levenstein *et alia* (2003) that was discussed in the previous subsection. This would require disaggregation (for example of the Gugler dataset) by product group and/or industry type and to relate this to imports by developing countries. Typically one would additionally also want to classify incoming Foreign Direct Investment by product group because mergers may influence how FDI impacts the host country's economy. Haller (2009), for example, relates concentration in industries with strong FDI activity to the impact that multinational players have on markets that they enter. In addition from a development perspective some non-economic effects may be relevant, such as distributional consequences and the division of costs and benefits both between capital (shareholders) and labour (workers). Another relevant issue is the division of costs and benefits between countries, i.e. where the merging firms are located and the profits ultimately will be reaped and where the products are being consumed (Singh 2002, p.12). These highly relevant questions are left for future research.

It is probably true that cross border mergers and acquisitions could best be dealt with through appropriate legislation and institutions within the developing world (an example is the Malawi review of the merger of local subsidiaries of Total and Mobil in 2005, see Brusick and Evenett 2008, p. 288). Unfortunately it is doubtful whether competition authorities could make a difference for the impact of cross border FDI. Indeed, even though the share of developing countries in global cross border mergers and acquisitions increased slightly in recent years, it remained below about 15% (Figure 3). Also in this sense the merger review by competition authorities in the OECD is expected to be very relevant for developing countries.

FIGURE 3
Cross-border mergers and acquisitions (billions of US$)



Source: calculations based on UNCTAD World Investment Report 2008, Table II.1

All in all it is clear that further research is still needed before we can really understand how mergers, acquisitions, merger review and competition policies in the OECD influence prices and market conditions in developing countries and emerging markets.

3.3 Abuse of dominance and other restrictive business practices

As stated before no *a priori* reason exists why domestic firms could not exert an equally detrimental impact on market outcomes in developing countries, but for the context of this paper the focus is mainly on foreign firms that act anti-competitive. Typically it is difficult to get data on the involvement of firms located in other jurisdictions and/or foreign owned firms as this nationality and ownership generally speaking are not reported by competition authorities.

Some evidence of the frequency of the abuse of dominance by foreign firms can be gleaned from research based on events data in this field.[9] About 32% of all reported anti competitive practice allegations in Latin America and the Caribbean for the years 2004–2005 (Clarke *et alia* 2005, Table 4) and about 23% in Sub Saharan Africa in the years 1995–2004 (Evenett *et alia* 2006, Table 7) relate to abuse of dominance, predatory pricing, tying and so on, by explicitly mentioned foreign firms or subsidiaries. This at least suggests that the phenomenon is empirically relevant.

In addition recent studies document specific cases. Adam and Adler (2008, pp. 585–6 and 608–9) discuss exclusive dealing arrangement of Coca Cola in Zambia and Kenya, predatory pricing by Metro in Zambia and abuse of market dominance by Microsoft in South Korea. Brisick and Evenett. (2008, pp. 283–86) discuss the refusal to provide essential facilities by Telefónica in Peru, excessively restrictive conditions on local dairy- and farm-product suppliers enacted by Carrefour and Tesco in Hong Kong and Thailand and excessive prices imposed by large pharmaceutical firms in many developing countries.

Although case law thus exists, typically economic damage has not been estimated in these cases. So the available evidence is not sufficient to come up with a comprehensive estimate of the harm done to developing countries. It is noteworthy that sometimes estimates exist for specific sectors that suggest substantial costs of anti-competitive activities by foreign (and often multinational) enterprises.[10]

[9] Such data are typically identified on the basis reporting in the media.
[10] For example, analyzing international price discrimination by the pharmaceutical industry for a sample of 32 countries of which 16 are developing countries, Schut and van Bergeijk (1986) have estimated that indirect and direct price control could reduce prices by 15–20% See also Hummels *et alia* 2009 on price discrimination in international shipping.

4 Conclusions and future research

The empirical findings that we discussed in this paper can and should by their very nature not be considered to be conclusive. At the same time the discussion in the previous sections indicates that competition policy authorities could exert a strong and positive influence on market outcomes in developing countries. It is worth emphasizing that competition authorities to some extent are actually already doing so. The positive international externalities of competition policy that have been reaped in the field of international cartels over the years 1990–2008 are substantial and may exceed the contribution of more traditional instruments of development such as aid. Indeed it is undoubtedly beneficial for global welfare that competition authorities in the OECD have 'in-sourced' supervision on global markets thus reducing welfare losses in the developing world.

At the same time it should be noted that the institutional context in the OECD itself needs improvement in order to solve negative competition externalities that typically are located at the interface of trade and competition. Three relevant issues that need to be dealt with in the OECD are export cartels, the positive appreciation of international terms of trade gains in merger procedures and the replacement of anti-dumping trade policy instruments by normal competition policy procedures. As to export cartels, Evenett et alia (2001, Table 3) provide an overview of countries that allow national exemptions to competition law for exporters, including amongst others Canada, Germany, Japan, Germany, the United Kingdom and the United States. Regarding the inadequacy of merger procedures Röller *et alia* (2006, p. 137) point out that merger evaluation procedures in Canada, France, Sweden and the United Kingdom do consider improved 'international competitiveness' (for example, price increases that occur in other jurisdictions) as an essentially positive aspect of the merger).[11] With respect to the use of anti-dumping measures as a tool to increase the costs of market entrants by incumbent firms, the catching up of some emerging market economies is worrying (Knorr, 2004 and Vandenbussche and Zanardi, 2008). From a global point of view these essentially anti-competitive activities increase inefficiency and thus reduce welfare. Competition policy authorities in the OECD could play a vital role providing the arguments and data in the debate on these changes that will benefit development (and incidentally also their own consumers and firms)

While this paper thus provided some of the pieces of puzzle, the most important contribution is to show that pieces are still missing. In this sense one relevant conclusion is that it is important to design and provide reporting mechanisms that make it possible to generate information on matters that are essentially empirical in nature. It would make sense if these reporting requirements are allocated to the industrialized countries. Typically the existence and scope of export cartels as well as the extra territorial effects of

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[11] This contrasts strongly with the following quote from (Hoekman and Mavroidis, 2002, p. 10): 'antitrust methodologies generally make no mention of the nationality of the firms or products – what matters is whether business practices that have an effect on market outcomes reduce efficiency and (that) this is not offset by dynamic benefits'.

mergers and acquisitions should be reported to the relevant international organizations such as the ICN, the OECD or UNCTAD in order to be able to judge whether the international policy framework needs change. Of course there is a cost involved in data collection, but in the end providing objective data could help the advocacy for a global set of rules on restrictive business practices that strengthens competition and increases welfare in the developed and developing world.

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