Economic Development, Competition, and Competition Law

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Competition law does not contain a blueprint for economic development or the establishment of a sustainable free market economy. Nevertheless, the number of countries that have adopted competition laws since the end of World War II has grown from a handful in the 1940s to more than 20 by the 1970s, and to over 100 since the year 2000. The most recent surge has been encouraged by the United States, the European Union, and international organizations as a means to promote economic development through the adoption of free market principles. The hopes of the promoters and the countries adopting competition laws are likely to be disappointed if they rely on competition law as a fast track to sustainable economic growth and development. No country has ever had a competition law at the time when it emerged from preindustrial poverty and developed a market economy.

Why then do so many emphasize the importance of competition laws for emerging economies? The answer lies in the way in which competition law has been presented. Competition law and policy have been described as defining a model for fairness and economic growth. Together, they set both a political goal for social organization and some practical guidelines for organizing some economic activities. By far, the import of competition law is most attractive as an ideal. The United States Supreme Court described that ideal in its classic statement in *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958).

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.

Although many may question whether the United States has applied its competition laws in a way that would accomplish these goals, the ideal remains and is reflected in the 2010 ASEAN Regional Guidelines on Competition Policy (at pp. 3-4):

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Competition policy introduces a “level-playing field” for all market players that will help markets to be competitive. The introduction of a competition law will provide the market with a set of “rules of the game” that protects the competition process itself, rather than competitors in the market. In this way, the pursuit of fair or effective competition can contribute to improvements in economic efficiency, economic growth and development, and consumer welfare.

Competition tends to bring about enhanced efficiency, in both a static and dynamic sense, by disciplining firms to produce at the lowest possible cost and pass these cost savings on to consumers, and motivating firms to undertake research and development to meet customer needs.

Economic growth – the increase in the value of goods and services produced by an economy – is a key indicator of economic development. Economic development refers to a broader definition of an economy’s well-being, including employment growth, literacy and mortality rates and other measures of quality of life. Competition may bring about greater economic growth and development through improvements in economic efficiency and the reduction of wastage in the production of goods and services. The market is therefore more able to rapidly reallocate resources, improve productivity and attain a higher level of economic growth. Over time, sustained economic growth tends to lead to an enhanced quality of life and greater economic development.

The notion of “rules of the game” that establish a “level playing field” are enticing metaphors for the substantive provisions of a competition law but they only hint at what those provisions might be. Even more attractive is the prospect of “sustained economic growth [that] tends to lead to an enhanced quality of life.” The reason that these words are so attractive is that most of the world’s population lives in poverty and there is a significant consensus that countries can reduce the poverty by adopting a market economy.

The assertion that market economies are the quickest and most effective method of promoting economic growth relies on two related assumptions. The first is that market economies automatically promote economic growth. The second is an assumption that emerging economies can enforce competition laws in ways that promotes economic development. Competition law may have a role to play in creating a sustainable market economy, but there is little evidence that total reliance free markets is the most effective way for emerging economies to grow their economies. Furthermore, there is little indication that newly formed competition authorities have demonstrated a capacity to enforce the kinds of provisions that are typically included in competition laws.

**CAN TRANSITIONAL ECONOMIES ENFORCE COMPETITION LAWS**

In my years at the United States Federal Trade Commission, I worked with and observed enforcement agencies charged with enforcing newly passed competition laws and have continued
that work since I left the FTC in 2005. It is my impression new competition agencies typically lack the understanding necessary to apply their laws. The gaps in their training and understanding of competition laws only suggests the extent to which other branches of their government lack an appreciation of what competition law is intended to accomplish. More important, there is an equal or greater lack of understanding by the business community that is supposed to abide by the competition laws and a similar lack of understanding among the businesses and consumers that are supposed to be protected by the competition laws.

The reason for the understanding gap is not difficult to identify. Modern competition laws have been written by competition law and economic experts in a manner that is understandable only to competition law experts. This design is not the result of an attempt to obfuscate the meaning of the laws. To the contrary, the hope is that the adoption of a competition law by a transitional economy will promote and police the development of a sustainable market economy. Unfortunately without an understanding of what constitutes a market economy, the language of competition laws seems devoid of meaning.

For example, even the EU treaty provisions, Articles 101 and 102, which reiterate the prohibitions of the 1957 Rome Treaty may be the most modern attempt to draft a short, comprehensive, and clear statement of competition law, require a prior understanding of how markets are supposed to function. Article 101, the less controversial, and putatively clearer, provision prohibits price fixing by competitors and other agreements that “distort” competition. Unless the reader of this provision has a model of what constitutes undistorted competition in her (or his) head, she is not likely to have a clear idea of what activities will distort competition.

As a consequence, the reader, enforcer, or business undertaking may have difficulty in distinguishing between a lawful price fixing agreement (such as a contract for the sale of goods to consumers or competitors) and an unlawful price fixing agreement (such as an agreement by all suppliers of a product to reduce supply of the product and raise its price to consumers). Indeed, the reader should be even more confused by this supposedly clear provision when told that an agreement on price between two inconsequential sellers of a product is unlawful even though their total sales are too small to have any impact on competition or the supply or the price of the goods being sold. The result in countries with little experience with market economies has been a discouraging number of instances in which otherwise educated and intelligent people expect deregulation of monopolies to lower prices and improve quality without competition, or in which well meaning groups of sellers ask competition agencies to tell them what the competitive price is so that they may set their prices at the fair level.

To be sure there are theoretical and practical explanations that can make clear distinctions for what are considered classic cases of lawful and unlawful behavior. The clarity of these distinctions is unfortunately quite fragile when we consider less extreme situations. The fragility of explanations is such that on January 14, 2011, the European competition authorities felt it necessary to issue a 94 page set of guidelines on horizontal agreements and state that “many
agreements” between competitors are lawful. This document, and similar documents issued by American competition authorities on the lawfulness of research joint ventures and other topics, illustrates that the way in which competition laws have been framed and the ways in which they are enforced require a very detailed examination of transactions in order to determine whether many types of agreements between competitors are lawful.

Moreover, there are other transactions involving “natural monopolies,” “network effects,” “essential facilities,” and intellectual property rights that present competitive issues of such complexity that there is little uniformity of view among competition experts about the kinds of business practices that should be considered lawful under competition laws. It would be unreasonable to expect that new competition agencies would be better able to resolve these more complex competitive issues.

Despite these obvious difficulties, it may be possible to increase the likelihood that transitional economies will be able to enforce competition laws if the laws were better designed to suit their needs. To formulate such laws, it is necessary to have an understanding of transitional economies that is more realistic than the neoclassical model of perfect competition where all economic activity is or should be determined by the laws of supply and demand. Given the aspirations for economic growth that is embedded in competition advocacy, it may be more helpful to consider first how a group of formerly poor countries have succeeded in growing their economies over the past 25 years. With that framework in mind it may be more possible to contemplate more understandable and useful competition laws for transitional economies.

THE GROWTH OF TRANSITIONAL ECONOMIES

The international Commission on Growth and Development issued a landmark report in 2008. It was the The Growth Report: Strategies for Sustained Growth and Inclusive Development. The Report is based on an analysis of nations that appear to have escaped the traps of poverty. Such “traps” have prevented billions of people from participating in the wealth that developed countries have demonstrated is technologically possible. The report of the Commission brings the good news that progress against poverty is not only theoretically possible, but it is happening in a significant number of high-growth countries. According to their calculations, “of the roughly 6 billion people on this planet, about 65 percent live in high-income or high-growth economies, up from less than a fifth 30 years ago.”

The conclusion that growth is possible is supported by the history of thirteen of the many countries that the Commission studied: Botswana, Brazil, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Malta, Oman, Singapore, Taiwan, and Thailand. (At least two other countries,

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2 The causes of poverty traps are well documented by Paul Collier in The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It (2007) and William Easterly in The White Man’s Burden: Why the West’s Efforts to Aid the Rest Have Done So Much Harm And So Little Good (2006). They discuss a variety of solutions to those traps that are beyond the scope of this paper.
India and Vietnam, are nearing their high-growth criteria.) Each high-growth country was indisputably poor fifty years ago. Each has experienced significant economic growth in its GNP over the past 25 years. Each has achieved an average annual growth rate in excess of seven percent in this time period. Each has and has had a very different political, economic, and cultural history. Some of these countries are large, like China and Indonesia, some are small, Malta has a population of less than half a million, some, like Botswana, Brazil, and Thailand, are resource rich, some, like Singapore have no natural resources. Some like Japan, Singapore, Korea, Malta and Taiwan, have already become high income countries. All are countries that have a market economy or are in transition towards a market economy. The lesson from the experience of these countries is that economic progress is possible for poor countries, that market economies are a key factor, but that economic growth requires sustained governmental effort that reflects the success and failure of public growth policies.

To be sure, some elements, such as the promotion of public education, health and physical infrastructure were present in all the countries. Also the report insists that growth requires integration in to the world economy to acquire technology, markets and other institutions. The Report lists five empirical findings that seem to constitute the parameters for the countries that were able to sustain economic growth: 3

1. They fully exploited the world economy,
2. They maintained macroeconomic stability,
3. They mustered high rates of saving and investment,
4. They let markets allocate resources, and
5. They had committed, credible, and capable governments.

The Report discusses varieties of strategies, and traps, as well as national and international constraints illustrated by the studies of both countries that have sustained economic growth, those who growth has stalled, and those who have failed to achieve growth. The Report is replete with common sense commentary based on the Commission’s studies and the lifetime work of its distinguished Commissioners.

However, to overemphasize the particular suggestions in the Report is to ignore what seems to be its central conclusion -- the economic progress of each country seems to have been a result of learning-by-doing, rather than the implementation of a common plan. Some protected domestic businesses (for a time); some subsidized businesses (for a time); some gave incentives for direct foreign investment (for a time); but no government program directed the economy. Government decision making is portrayed as essential to this economic development; but, more often than

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3 In a 2008 Commentary, "Moving Toward Growth in a Market Economy: Small Can be Beautiful,” that is posted on the American Antitrust Institute website, www.antitrustinstitute.org, I suggested that the international economic framework advocated by the Commission has demonstrated the greatest success but there are other development strategies that may be more effective in particular settings.
not, the key role of government was to terminate programs that did not work and to delegate, empower or support those individuals and programs that did work.

If there are general lessons, they are that these countries all borrowed heavily from modern commercial and industrial technology, but did not stop at licensing intellectual property; rather their investments in education and human capacities allowed them to improve on existing techniques. They promoted export industries over domestic consumption and by doing so they were able to save and reinvest. The focus on export industries gave them an international competitive benchmark that showed which investments were viable and which were not. Success was determined by the discipline that governments and their private enterprises showed in persevering to meet or exceed international standards and to abandon projects that could not meet the test of international competition. The recommendation of the Commission is that other developing countries learn from the successes and failures of these countries and try to find ideas for policies that are suitable for the time and circumstances of their development. 4

The detailed research and conclusions of the Commission demonstrate that high-growth economies and high-income status is not limited to some cultural uniqueness of European and North American countries. If anything, the Commission’s descriptions of successful strategies parallels many government policies that had catalytic effects on the growth of the 19th century American economy. Like the Commission’s high-growth countries, the United States pursued policies that aided businesses in general and rewarded favored particular businesses. Federal and state governments in the United States, for example, made land and resources plentiful for white European immigrants by exterminating much of the indigenous population and expropriating most of their land and resources, by enforcing slavery laws that made cotton agriculture more profitable on the depopulated lands of the American South, by raising tariffs on imported iron it helped establish the American coal and iron industries, by subsidizing public education it helped create a more able work force, by creating limited liability corporations it facilitated the raising of capital, by repressing worker organizations it made American manufacturing more profitable domestically and internationally more competitive, and by building or subsidizing the creation of an internal transportation system of ports, canals, and railroads, the governments helped develop a continent-wide national agricultural and manufacturing economy.

Although blind to the morally reprehensible governmental actions that stole lands from the indigenous populations, that enforced slavery until the 1860s, and that used violence against workers, the profits from these activities were not hoarded by an elite few. Rather, the resources and funds generated by its policies were made available to a wide range of Americans. Apart from its violations of now universally recognized human rights, the overall orientation of American government action was liberal, democratic, and market oriented. Like the high-growth countries studied by the Commission, the United States encouraged but did not direct investment

decisions that determined the growth of the American economy. Americans industry borrowed freely from the more advanced British and European technology, most famously with Samuel Slater’s illegal importation of British textile technology. The American policies were enormously successful in transforming the United States during the 19th century from a primarily agrarian society to a rich and powerful industrial nation.

We should contrast these development policies with what I have elsewhere referred to as the cookbook theory of market development. This view implicitly maintains that, with establishment of competition law, a properly structured market will provide the quickest most effective path to economic development. In my work on transitional economies, I have sometimes referred to a distillation of this view by listing legal institutions as if they were ingredients that would create or facilitate market economies. 5 They include:

1. Private property rights including the right to sell and transfer ownership.
2. The right to contract and enforce contract to sell or buy.
3. A set of legal rules that allows the creation of business entities such as partnerships and corporations.
4. The establishment of rules allowing businesses to raise capital by selling shares or borrowing money.
5. The creation of bankruptcy procedures that facilitate the reincorporation of assets and talents of persons who worked for failed businesses.
6. Trust between market participants and enforcement of the rule of law where participants fail to meet their contractual promises.

The importance of the cookbook ingredients can be summarized as follows: Ownership and the right to transfer goods give sellers an incentive to provide them to interested buyers. Trademark and patent rights provide businesses a way to protect investments in their inventions and their reputation for quality, service or low prices. The right to operate legally recognized enterprises that can borrow money and sell securities enables businesses to form complex ventures of unlimited size. Limited personal liability and bankruptcy rules encourage more people to risk investing in new or expanding businesses. Trust and judicial enforcement of obligations bind together the rest of the institutions in a manner that can create a market economy that produces low cost, high quality goods of the type described by ASEAN.

An economy can be promoted by the laws of supply and demand. They are expected to lower production costs, lower consumer prices and produce higher quality goods and services not because businesses will suddenly decide to be nice, but because, once the market is established, businesses have no other choice. As Adam Smith observed more than two centuries ago, a

5 See for example, my 2004 presentation at the Asian Law Institute, “Designing Competition Institutions for Transitional Economies,” or my article “Creating Effective Competition Institutions: Ideas for Transitional Economies.” Both are available on my website, [www.kennethdavidson.com](http://www.kennethdavidson.com).
businessman (or woman) “generally . . . intends neither to promote the public interest, nor knows how much he is promoting it . . . . [H]e intends only his own gain, and is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.”

Smith recognized that his invisible hand could be undermined by “people of the same trade [who] seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” Competition laws are designed to prohibit these private anticompetitive agreements. If the agreements are identified, and the laws are enforced, competition laws may be able to reduce or remedy the harms suffered by consumers.

The legal systems that constitute the cookbook recipe are consistent with the conclusions of the Report of the Commission on Growth and Development, but it is not clear that a competition law focus on protecting consumers from higher prices has been a priority for the countries that have developed high-growth economies. If anything export-driven growth has relied more on encouraging workers to save substantial portions of their income rather than spend their earnings on products produced elsewhere. The saved capital might then be preferentially allocated to export businesses that generate additional economic growth and domestic jobs.

The focus on export industries has an additional advantage for a transitional economy. As Smith noted the reliance on the market reduces the need to use judicial rule of law remedies. If the export company does not provide low price, high quality products according to it contract, it is likely to lose its foreign customer base. The market is likely to discipline the firms more quickly and effectively than domestic or foreign courts. Thus, in its initial stages, the export growth of countries like China may not depend greatly on an effective system of courts.

Export-based jobs are likely to pay higher wages that benefit workers and fund the domestic growth of transitional economies. Higher wages are likely to stimulate additional demand for housing, food, and other modern conveniences and luxuries as a country’s population moves towards industrial cities. As long as the export industries continue to expand, they will be attractive to workers. Although their wages are likely to be higher than wages of more traditional jobs, the rise in wages may be tempered by high unemployment or underemployment rates of countries like China or India. Economies like Japan, Singapore, Hong Kong and Taiwan that have already become higher income countries have shifted their once low wage production facilities to lower wage countries like Bangladesh to maintain their competitive export prices.

A ROLE FOR COMPETITION LAWS IN TRANSITIONAL ECONOMIES

If competition law is not a primary engine of growth for transitional economies, it may not be a high priority for the government of a transitional economy. Such a government may not want to

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invest its intellectual and monetary capital in a complex government enterprise that appears to have little immediate payoff for the country or its wealthiest residents. Indeed, the government may see the consumer bias of competition law as antithetical to its objectives of increasing savings rates at the expense of consumption and the professed protections of competition law for smaller businesses to be an esthetic or quixotic preference. Even worse, some countries may view the advocacy of competition law as a cynical addition by Europe and America that has been added to trade agreements which open their markets to products sold by high income nations. Such attitudes are understandable, but, I think, fail to appreciate the impact of anticompetitive actions on transitional economies. Competition laws have the potential to reinforce other policies that are designed to promote economic growth.

Since 1990, there have been over 150 prosecutions of international price fixing cartels. These price fixing agreements transfer funds of countries consumers around the world to a small group of sellers. Some prosecutions, like the recent settlement, of price fixing in the air cargo industry have a special impact on transitional economies that rely on air shipment of their export products. Transitional economies might be able to rely primarily on Europe or the United States to prosecute global price fixing conspiracies but the same cannot be said for domestic cartels. If, for example, local insurance companies, agree to raise prices for insurance domestic businesses, this would not only divert profits from those businesses, the higher costs of domestic businesses may make them less competitive internationally and are likely to impose higher costs on their domestic consumers. One issue for governments of transitional economies that seek to support their export industries is whether they are willing to have those efforts undermined by private domestic cartels that raise the costs of exporting companies.

Equally important is impact of domestic cartels on the costs of living for residents of the transitional economy. Higher prices imposed by a cigarette monopoly, for example, leaves consumers with fewer funds to buy other products made in the country. To the extent that a transitional economy has concerns about exhausting its foreign reserves on foreign consumer products, it may have options to limit those purchases by the ways it allocates those reserves.

Perhaps the most important feature of competition laws is the protection that they offer to small new businesses. This protection of small companies reflects a fundamental advantage of a market economy over a planned economy. It is possible to start a hundred or a thousand small companies for the cost of one huge manufacturing plant. Out of those hundred companies, one or two or maybe even ten will be successful. The market can decide which will be successful enough to grow and the rest may fail. Those that succeed may have the opportunity to build the financial and intellectual resources to grow large if they prove themselves in the market.

The one huge plant may succeed. That was the story of the POSCO, Korea’s first iron and steel company, but there were dozens of modern plants built with foreign aid in Africa that never sold a single product. In contrast, Hong Kong developed its export business through the efforts of hundreds of individual entrepreneurs who looked for markets in the United States and Europe.
No doubt most failed, but enough succeeded in starting small firms that grew larger to make Hong Kong a vibrant modern economy.

The same phenomenon characterizes the American and European economies. Today’s giant companies Microsoft, Intel, Google, Facebook and many others started as small low capital ventures that grew only because they were successful in the market. And yesterday’s giant companies have generally declined because some new company invented a better product or service than the research and development departments of the giants. The transitional economies that rely solely on large plants built with foreign aid or foreign direct investment funds that are totally controlled by foreign manufacturers do not seem to lead to a sustainable path of growth. The message of the Commission on Growth and Development to transitional economies favors smaller steps that are guided by market success and failure. This suggests transitional economies should favor building domestic capacities on foreign technologies in a way that permits the further development by domestic enterprises.

Competition law protects new powerless businesses in a variety of ways. It restricts the conditions that a more powerful company can put on those with whom it deals. Conditions that are unrelated to a sale that would forbid future competition are generally unlawful. Buying up competitors is generally unlawful. Foreclosing supplies or distribution outlets to competitors is generally unlawful. If transitional economies want to develop new innovative businesses they need policies that make it easy for new companies to form and competition laws to ensure that neither existing domestic or foreign companies can prevent the development of new companies.

These two concepts are the essence of competition law – prohibitions of business practices that would raise prices to domestic businesses and consumers; and, prohibitions of business practices would prevent the establishment of new domestic business ventures. Unfortunately, they are not well reflected in existing competition statutes or case law. Existing prohibitions are derived from American case law that looked at individual business practices. The EU has grouped these individual cases under two headings that focus on the distinction between unlawful collective actions and unlawful unilateral actions. Competition laws are more difficult to understand than they need to be because they focus on specific unlawful practices without providing any framework for explaining the criteria they use to declare practices unlawful. Competition cases are too often overloaded with disputes about legal procedures or economic theory that the trials and decisions are difficult to relate to any object of the competition law.

Transition economies need a more transparent explanation of competition laws if they are to be useful in facilitating their development. Competition laws serve no purpose if they are understood only by experts. If they are not understood by lawmakers that enact the competition laws, by the agencies that are created to enforce them, by the businesses that are required to obey them, or by the businesses and consumers that are intended to be protected by them, then they will not work. Transitional economies need a plain language presentation of competition law concepts if they are to be effective.
Laws would be more helpful if they began with a description of how a well functioning market economy operates. Others may be able to describe competition concepts better than I but the descriptions need to be understandable. They should indicate that a market promotes product variety, lower prices, and better service when the market is populated by a number of actual and potential competitors for each product. The existence of these competitors restrains the raising of prices, deterioration of quality and service. By protecting access to market for current and potential market participants, the market maintains a dynamic that allows for the development and sale of new, better, cheaper products and services. Such a description of a market economy could be elaborated and explained by examples to make the concepts clearer.

With even a fairly rudimentary description of how a market is intended to operate, it should be easier to understand why certain kinds of business practices are prohibited and others are not. It would be useful if the prohibitions explained how the prohibited practice would damage those who are supposed to be protected by the law or how the business practice endangers the existence of a well functioning market. Again, examples may help explain how or why particular business practices are prohibited and others are allowed.

This suggestion for enacting competition laws using plain language does not anticipate that such laws would have to be volumes long to cover the kinds of practices that are condemned by existing competition concepts, nor does it suggest that it will easily solve what currently appear to be difficult and complex issues. It will not make hard issues easy and obvious to resolve. Instead, it suggests that it is possible to frame basic competition law issues in a coherent manner that is understandable to persons who are not trained in competition law or economics. Armed with that understanding, businesses are likely to be better able to judge the lawfulness of their actions, investigators should have a clearer idea of what they are looking for to determine if a law violation has occurred and agencies should have a clearer idea of how to explain why they conclude that a particular practice is unlawful and to formulate remedies for violations that are likely to properly compensate victims of unlawful practices and how to repair damage to the market created by violations.

The virtue of this approach is that it can orient compliance and enforcement in the right direction. It does not guarantee that the result in every case will be “correct.” After the many twists and turns of American competition law over the past 120 years, it is unlikely that it would be possible to design any competition law that could provide eternally correct answers. Rather, the approach suggests that, like the market mechanism itself, competition decisions are likely to improve over time if they are made transparently and reexamined in light of their effects.

A plain language approach has one further advantage for transitional economies. If the language of competition law can be made comprehensible to businesses and consumers, the implementation of such a law will not require hordes of experts who have years of training that transitional economies can ill afford. Instead, an understandable competition law is more likely to be affordable, effective, and support the economic growth that transitional economies seek.
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