A WTO Agreement on Competition Policy: Prospects and Pitfalls

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This paper briefly reviews the debate over inclusion of competition policy in the WTO and offers some ideas of where such negotiations might lead. It discusses the main sources of conflict that have precipitated the move to a multilateral agreement and analyses whether the WTO is capable of resolving them. The main conclusion is that the prospects of bringing competition policy into the WTO are rather dim, in part because the current system works fairly well and in part because the machinery of the WTO at present, is not well suited for handling competition issues.

Introduction

The November 2001 declaration of the Fourth WTO Ministerial Conference in Doha, Qatar, provided a contingent mandate for negotiations on a range of subjects previously thought to be outside of the domain of international trade policy. One of the most important and complex of these subjects is competition policy. The core of competition policy is competition law (i.e., antitrust law), the set of rules and disciplines maintained by governments relating either to agreements between firms that restrict competition or to the abuse of a dominant position-including attempts to create a dominant position through merger.[2] Exactly which aspects of competition law might come under negotiation has yet to be determined–that decision has been left for ministers to decide at the Fifth Ministerial in 2003. However, that negotiations might occur at all, and that national competition law might one day become subject to a degree of WTO control, is both remarkable and controversial.

Proponents of including competition law in the WTO argue that globalization has increased the degree to which national competition laws have international effects. To the extent that each nation neglects the interests of its neighbors in making its competition decisions, there is a case for an international agreement. Of particular concern for the WTO is that national governments may come to use competition law as a protectionist device, thereby undoing the very trade liberalization the WTO has worked so hard to achieve.

Opponents of a WTO competition agreement argue that cases of conflict between national competition authorities are empirically unimportant and too small to justify the trouble of negotiating and maintaining an international agreement. Such an agreement, if part of the WTO, would divert attention from more important trade reforms, unnecessarily tax the WTO dispute-settlement system, and strengthen the popular perception of the WTO as a usurper of national sovereignty. Moreover, opponents argue that there is a fundamental incompatibility in objectives between competition and trade laws: competition law seeks to maximize welfare-in which the interests of consumers figure prominently-whereas trade law is generally based on mercantilist principles of import protection and export promotion.

This paper offers a brief review of the debate over inclusion of competition policy in the WTO, along with some ideas about where the proposed negotiations might lead. It begins with some examples of international conflict over competition policy that have led to calls for an international agreement. It then discusses some of the pitfalls that may be encountered when attempting to establish and maintain such an agreement. Finally, we discuss the current institutions and the extent to which they form a basis for multilateral agreement. The main conclusion is that the prospects of bringing competition policy into the WTO are rather dim, in part because the current system works fairly well and in part because the machinery of the WTO, as it currently works, is not well suited for handling competition issues.

[1] The views expressed in this article are those of the author. They are not the views of the U.S. International Trade Commission (USITC) as a whole or of any individual Commissioner.

[2] Hoekman and Holmes (1999) define competition policy to include both competition law and other policies designed to promote competition in domestic markets–such as deregulation, privatization, and antidumping. This paper focuses on competition law, as these other policies have not been at the center of OECD or WTO discussions on competition policy. Whether antidumping, in particular, should be included in competition policy is a matter of controversy in the WTO.

Archetypes of International Conflict over Competition Policy

In principle, there are many ways in which national competition laws can have international spillovers, and quite a few of them involve direct effects on international trade. In practice, the competition issues that have generated the most conflict between governments–providing the impetus for negotiations–are relatively few. The four main issues that have occupied the attention of policymakers and scholars on this subject are vertical restraints, mergers, parallel imports, and international cartels.

Vertical Restraints

Perhaps the most common complaint by WTO members is about vertical restraints,[3] arrangements between vertically related entities (e.g., manufacturers, wholesalers, and retailers) that exclude competitors. Some regard the use of vertical restraints by domestic firms to exclude foreign competitors as an impediment to international trade. A further concern is that governments may contribute to the exclusion of foreign suppliers through lax or discriminatory application of competition law.

The United States confronted the WTO with this issue in the recent case involving photographic film giants, Kodak and Fuji. Kodak alleged that its access to the Japanese film market had been unlawfully blocked by Fuji, through the latter's control of the local film distribution system. By excluding Kodak from access to film wholesaling networks, Fuji had forced Kodak to sell directly to retailers at higher cost. The key allegation was thus of an anti-competitive vertical relationship between Fuji and its primary distributors. But what started out as a dispute between private firms quickly turned into a spat between governments. In 1996, the United States brought the case to the WTO charging that the Government of Japan had aided Fuji. They brought this case as a so-called non- violation complaint under GATT Article XXIII:1(b). This non-violation provision allows members to challenge government measures that "nullify or impair" trade liberalization commitments even though the measures themselves are not subject to WTO rules (Hoekman and Mavroidis, 1994). Japan responded that the control by Fuji of wholesale networks was irrelevant, since most of the retailers they served also bought imported film and that Kodak's own distribution system amounted to the creation of a wholesale system of its own.

[3] This view is supported by surveys of WTO member governments taken by the WTO Working Group on Trade and Competition Policy. See WTO (1998a).

The WTO dispute panel accepted the U.S. argument that measures taken by Japan, including the Japan Fair Trade Commission's failure to find Fuji's practices anti-competitive, could potentially affect trade. However, it concluded there was no actual impairment of U.S. market-access rights in this case (WTO, 1998b, p. 421). Thus, even though the United States lost its case on the facts, it did establish the principle that vertical restraints may be considered denial of market access to foreigners and that a government's failure to prevent such practices may nullify or impair the benefits of a trade agreement.

Mergers

The last decade or so has seen a major wave of mergers, many of them with cross-border effects. Even when the merging firms themselves are from the same country, competition authorities from different countries can assert jurisdiction if the firms' exports to those jurisdictions constitute a significant market share. If different authorities use different criteria, or the merger is likely to have different effects on different countries, then a merger approved by one country might well be rejected by another. At best, this would be burdensome to the merging firms. At worst, competition authorities may apply standards to such mergers based on protectionist motives.

While the vast majority of global merger cases are handled without interjurisdictional conflict, the recent merger of Boeing and McDonnell Douglas, a case reviewed by both U.S. and EU competition authorities, illustrates the potential for problems. The Boeing–McDonnell Douglas merger involved two U.S.-based firms whose combined sales in the EU were sufficient for the EU to claim right of scrutiny. While the United States approved the merger, the EU refused to grant its approval, unless Boeing agreed to give up certain of its long-term exclusive sale contracts with several airlines, contracts that prevented the airlines from buying aircraft from the EU-based Airbus. The contracts in question pre-dated the merger. Thus, the EU objection was not designed to prevent a merger that would result in higher prices for aircraft buyers. It was to force Boeing to give up market share to Airbus (Hoekman and Holmes, 1999). In the end, the EU approved the merger, but only after Boeing agreed not to enforce the exclusive contracts.

This case illustrates several features of the current merger system that have led to calls for better international cooperation. Different countries may have very different views of the same merger case, and the cost of satisfying these diverging concerns falls squarely on the merging firms. If the firms are foreign, then a national competition authority may have little incentive to take these costs into account. Furthermore, a national competition authority may use its power to protect its domestic firms. In the extreme, a

government might even use merger approval as an instrument to achieve objectives entirely unrelated to promoting competition.

Parallel Imports

The control of parallel imports involves both trade and competition law and, in practice, it usually involves intellectual property rights (IPRs) as well. When a firm has a monopoly on a product, say, due to copyright or patent, it normally distributes that product through its own authorized channels. Parallel imports are products that enter a country outside of the firm's authorized channels. Parallel imports interfere with the ability of the monopolist to price-discriminate between different countries.

A recent case involves the United States and New Zealand. In 1998, the Government of New Zealand passed an amendment to its Copyright Act legalizing parallel imports. This prompted U.S. copyright holders in the film, music, software, and publishing industries to complain to the United States Trade Representative that parallel imports would impair their ability to detect and combat piracy and reduce the value of their property rights both in New Zealand and elsewhere. In response the USTR began a Special 301 review and placed New Zealand on its Special 301 "watch list" in 1999. In December of 1999, New Zealand announced that it would impose restrictions on parallel imports, not, it said, to satisfy U.S. demands but to foster the development of its own cultural industries. So far it has not changed its policy (USTR, 2001).

A country's treatment of parallel imports hinges on whether it adopts a principle of international exhaustion or of national exhaustion (or regional exhaustion in the case of the EU). Exhaustion refers to one of the legal limits of IPRs. The right to control the commercial exploitation of an IPR-protected product are said to be "exhausted" once the product has been sold for the first time. Unless otherwise specified by law, subsequent acts of resale, rental, lending or other forms of commercial use by third parties can no longer be controlled by the IPR holder. There is a fairly broad consensus that this rule applies at least within the context of the domestic market (national exhaustion), but there is no consensus as to whether it should apply to the world market (international exhaustion). The treatment of parallel imports is likely to become an important issue in the WTO negotiations on competition law, with small countries pushing for the principle of international exhaustion, and large countries that export branded, copyrighted, or patented products, insisting on the principle of national exhaustion (Cottier, 1998).

International Cartels

The only area in which there appears to be widespread support for reaching a common standard in competition policy is in the prosecution of "hard core" international cartels. Hard core cartels are defined by the Organization for Economic Cooperation and Development (OECD) to be "anti-competitive agreements by competitors to fix prices, restrict output, submit collusive tenders, or divide or share markets" (OECD, 2000). The reason for the convergence on this issue is that the EU and United States already have very strong and quite similar rules against cartels, whether domestic or international. As most of the known cases of international cartels involve firms from industrialized countries, developing countries rarely see any benefits from cartels (other than state trading firms) and thus are willing to support an international agreement to prohibit them.

The magnitude of the problem of international cartels is not known for certain, as the sample of known cartels consists of only those that get caught. During the 1990s, the United States and the EU prosecuted some 39 international cartels on charges of price fixing. According to OECD and World Bank estimates, these cartels cost consumers worldwide tens of billions of dollars in higher prices. The most notorious cases were the global cartels in citric acid, graphite electrodes, lysine and vitamins, the French TGV (*train à grande vitesse* or high speed train) cartel, and Spanish sugar cartel.

Do These Cases Justify a WTO Competition Agreement?

Except in the case of cartels, there has been no serious empirical work to determine the magnitudes of the problems discussed in the previous section. This has led many to dismiss an international competition agreement on the grounds of empirical irrelevance. However, if it is not known how important the various international competition issues are, it may be possible to predict whether they will become more or less important over time, as globalization proceeds. If trade and investment liberalization makes international competition problems more severe, and further liberalization is seen as desirable or inevitable, then this would support the current push to put in place an international competition policy framework.

The simplest argument on the relationship between globalization and competition goes like this: as globalization increases the frequency of international transactions, it increases the likelihood that an anti-competitive practice perpetrated by any firm will harm the residents of another country. Thus, competition policy will increasingly become a global

issue. The equally simple counter argument is that globalization itself makes markets more competitive and this decreases the efficacy of anti-competitive practices (which normally require a firm to have a dominant position to begin with). Support for this latter view comes from the considerable empirical evidence that increased international competition reduces price-cost margins (Roberts and Tybout, 1997).[4] Thus, under this view, trade liberalization actually reduces the need for an active competition policy.

A more subtle argument focuses on the effect of trade liberalization, not on firm behavior, but on the regulatory behavior of governments. The concern is that as trade liberalization takes away many of the traditional instruments for trade protection, governments will turn to competition policy as an instrument for giving their firms an advantage over their foreign competitors. Richardson (1999) and Horn and Levinsohn (2001) have examined this proposition for the case of merger policy and found it lacking. While trade liberalization is shown to affect government choices on competition policy, there can be no general presumption that governments will move in a direction that is anti-competitive.

To sum up, there is no good measure of the importance of the types of business practices that give rise to international competition policy conflict. There is also no good reason to suppose that international competition problems are likely to get worse.

But the lack of measurement is itself due to a far deeper problem that plagues efforts to create an international agreement on competition policy, which is that the firm practices at issue are not necessarily anti-competitive. There is a considerable literature on the question of whether vertical restraints are anti-competitive. The answer is highly dependent on the circumstances of the market and the contracting environment (Bernheim and Whinston, 1998). Because of this, competition authorities apply the "rule of reason" (meaning they weigh the facts on a case-by-case basis) instead of banning exclusive contracts outright. The same is true of mergers. Mergers are frequently motivated by potential efficiency gains made possible by consolidated operation. Such efficiency gains may well offset any anti-competitive effects that might come from a more concentrated market. Even the prohibition of parallel imports is not necessarily anti-competitive. While the price discrimination that the prohibition of parallel imports makes possible means higher prices in some markets, it may mean lower prices in other markets. This tailoring of prices often results in greater worldwide sales, even though consumers in the high-price market may not be happy about it.[5]

[4] This is also supported by a preponderance of theoretical work. See the survey by Neven and Seabright (1997).

[5] Malueg and Schwartz (1994) explore the welfare consequences of parallel imports, and find that they may either increase or decrease global welfare.

The difficulty in identifying the anti-competitive effects of many common business practices poses several serious problems for the creation of international competition agreement. First, the identification of anti-competitive effects (as well as remedies for those effects) requires the judgement of a competition authority and, in practice, judgments are often little more than educated guesses. It is simply impossible to write down an international agreement that tells a competition authority how it should rule in every possible contingency that can arise. This means that there will inevitably be disputes in which governments challenge each other's judgements about what constitutes an anti-competitive practice. Many have questioned the wisdom of bringing such complex and subjective issues into the WTO dispute-settlement system, a system that authorizes trade sanctions to be used in the event of an impasse.

Second, although anti-competitive effects may be hard to identify, business practices almost always have redistributive effects that are plainly evident. A vertical restraint that has no negative effect on consumers in the domestic market, for example, may still reduce the market share of foreign firms. In such cases, there is no scope for agreement, as there are no mutual gains from eliminating the practice, but there is plenty of scope for conflict, as each country has an incentive to fight for the market share of its own firms (Bacchetta, Horn, and Mavroidis, 1997). As the previous section documented, these conflicts are driven not by competition authorities interested in protecting consumers interests, but by trade authorities interested typically in pursuing producer interests through export promotion. Many have questioned the wisdom of trying to link together trade and competition policy, given the radically different objectives of trade and competition authorities.

Building on Existing Institutions

The current push to have a WTO competition agreement comes in response to real conflicts that have arisen in the WTO in recent years. However, the previous section suggests that any attempt at a full-blown competition agreement is likely to create more problems than it solves. An awareness of these dangers is probably what accounts for the relatively modest language found in the Doha declaration. That declaration calls for the clarification of the principles of nondiscrimination, transparency and procedural fairness, provisions against hard core cartels, and voluntary cooperation. In essence, it seeks to build on institutions that already exist.

The WTO principle of nondiscrimination (notably most-favored-nation treatment and national treatment) does not impose a uniform international standard for

competition policy, but does require that countries avoid applying different standards based on country of origin. In other words, governments would be free to set their merger policies or regulate vertical restraints according to national preferences, so long as they applied them even-handedly. Nondiscrimination is certainly a core principle of the WTO, and it may solve some problems. However, it is not at all clear that this would do anything to solve future vertical restraint cases, such as the Kodak-Fuji dispute. The issue in that dispute was not that the government applied a discriminatory standard but that it was lax in applying its standard, which enabled the domestic firm to discriminate against foreigners. Nondiscrimination, like all WTO principles, applies to governments, not firms. Thus, equality of market access for all firms, regardless of origin, is not guaranteed automatically by a WTO agreement.

The Doha declaration's reference to voluntary cooperation suggests that recent bilateral initiatives on competition policy–most notably the EU and U.S. "positive comity" agreements–will lead the way in any future WTO agreement. In many areas of competition law, especially mergers, the main issue is assertion of jurisdiction. Both the EU and United States rely on the so-called effects doctrine such that a country asserts jurisdiction when it is or likely to be affected by a particular merger, be it an effect on its consumers or its producers, whether at home or abroad. This is an extremely broad use of extraterritorial enforcement of national competition law, which must be contained to avoid conflict. The 1991 "positive comity" agreement between the EU and United States, strengthened in 1998, and extended to numerous other countries thereafter, is an attempt to cooperatively manage extraterritorial enforcement. It establishes various procedures as to timing and information-sharing in antitrust cases, but most notably this bilateral agreement established the idea of positive comity–which is that the initial responsibility for investigating antitrust cases with international effects falls to the jurisdiction where the alleged anticompetitive conduct occurs. (DOJ, 2000).

While the Boeing/McDonnell Douglas merger loomed large as an example of the breakdown of positive comity, critics of a WTO competition agreement point to the vast numbers of international mergers that have occurred without incident as evidence of the success of the current system. However, the important question for the next WTO round is not whether positive comity agreements are problem-free but whether a more ambitious agreement could do any better. This has been the focus of much of the theoretical literature on the subject of international mergers (e.g., Barros and Cabral, 1994; Head and Ries, 1997; and Bond, 1999). Most recently, Neven and Roller (2000) have shown that the current system of overlapping jurisdictions produces almost the same results in merger cases as we might expect from a centralized world competition authority (the ultimate form of international coordination), provided that the centralized authority used the same market definitions and the same market concentration rules as the EU and United States have used traditionally in evaluating merger cases. This does not mean that, under the current decentralized system, countries always agree on which merger should be accepted or rejected. It only means that the mergers rejected by at least one country would also be rejected by a centralized authority, and mergers acceptable to all countries would also be acceptable to a centralized authority. All of this suggests that the current system of decentralization with overlapping jurisdictions is fairly robust and is not likely to be improved upon by a more centralized approach. But there is one important caveat to this result: it is only true if the merger cases are decided on the basis of standard market definition and market concentration rules; if other objectives besides these are inserted into the process (e.g., export promotion), the result breaks down. This suggests that the paramount concern for an international agreement should not be to limit the power of national competition authorities but to *insulate* those competition authorities from possible pressure from trade authorities brought on by trade policy concerns. Whether this can be achieved in a WTO agreement remains to be seen.

Conclusion

The idea of bringing competition policy into the WTO is attractive. Many of the current international frictions over competition policy are directly related to trade, and thus it would appear that they are well within the WTO's domain. Moreover, when it comes to international agreements, few if any institutions have a better system for enforcing compliance and resolving disputes than the WTO. Theoretically, adding competition policy to the WTO may be seen as the inevitable next step in creating a comprehensive and fully integrated regulatory regime for the international flow of goods, services, and factors, thereby realizing the long deferred dream proposed under the 1946-48 negotiations of the Havana Charter for an International Trade Organization.

However, in reality, the current system works surprisingly well. Many of the frictions that do arise are the result of: (a) actions by private firms, over which the WTO has no control; (b) inevitable disagreements about the distribution of gains, which the WTO can do nothing to resolve; or (c) unwarranted intrusions of mercantilist objectives into competition matters, which the WTO would more likely foster than prevent. Thus, it is not at all clear that a WTO regime on competition policy would improve upon the current situation. Alas, it would seem that unless the WTO can muster the foresight and subtlety necessary to tackle an issue as broad and complex as competition policy, the dream of a WTO competition agreement will probably have to be deferred a little longer.

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