Chapter 8

Competition Policy for ASEAN

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In ASEAN, only four countries, namely Indonesia, Philippines, Thailand and Vietnam, have competition policies, although some others, including Malaysia, have enacted laws aimed at curbing monopolistic and restrictive business practices in a somewhat ad hoc manner. The ASEAN Blueprint expects all member countries to have full-blown competition policies in place by 2015, and intends to arrive at a set of guidelines for the crafting of competition policies by 2010. The main purpose of this study is to help ASEAN in its quest to have a set of competition policy guidelines.

Competition policy relates to a coherent and consistent body or structure of competition laws and mechanisms for effective enforcement. Competition law refers to the sets of rules enacted by governments to outlaw or limit anti-competitive practices.

This study provides some intellectual support for the introduction of competition policy in countries where it does not exist and underscores the need for an integration of competition policies among all ASEAN countries. This study however recognizes that there is no such thing as “one size fits all”, as the ASEAN economies are too heterogeneous.

The rationale for competition policies and laws is compelling, although empirical analysis is daunted by the paucity of data. A review of cross-country experiences does show that competition policy has served generally well. First, it is good for efficiency by promoting competitiveness. Second, it is good for economic growth through productivity gains and greater innovation. Third, it is good for price stability, as competition tends to keep prices low. Fourth, it is good for trade and investment, as it tends to make liberalization more effective and meaningful. Last but not least, consumers are the biggest beneficiaries, as it not only protects consumers against monopolistic and restrictive practices but also enables them to enjoy the fruits of competition in the form of lower prices and/or better products.

Developed and developing country experiences show that competition policy reinforces macroeconomic stabilization policies and contributes to industry development. One major outcome is the avoidance of abuses of dominance. "Dominant position of market power" refers to a situation where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control the relevant market for a particular good or service or group of goods or services.

There are three main types of business practices that can have anti-competitive effects. Practices undertaken by a single firm enjoying a dominant position and abusing its market power, anticompetitive mergers and acquisitions and restrictive agreements. Restrictive agreements are further classified into *horizontal restraints* (i.e., arrangements between competitors to restrain competition, as shown in Table 1) and *vertical restraints* (anti-competitive arrangements between firms along the production-distribution chain, as shown in Table 2).

Horizontal and vertical restraints include the following arrangements, which can be undertaken individually or in combination, as listed in Tables 1 and 2.

Table 1: Horizontal restraints

Price fixing	Competing suppliers enter into cooperative agreements regarding prices and sales conditions.
Restraint of output	Competing suppliers enter into agreements regarding output and product quality
Market allocation	Competing suppliers allocate customers amongst themselves, who therefore cannot benefit from competition by other suppliers.
Exclusionary practices	Competing suppliers employ practices that inhibit or preclude the ability of other actual or potential suppliers to compete in the market for a product.
Collusive tendering (bid rigging)	Competing suppliers exchange commercially sensitive information on bids and agree to take turns as to who will make the most competitive offer.
Conscious parallelism	Competing suppliers generally set the same prices, but without an explicit agreement
Other restraints on Competition	Generally characterized by suppliers entering into Cooperative agreements not to undertake certain actions of competitive value (e.g., advertising).

Source: MIER (2008).

Table 2: Vertical restraints

Exclusive dealing	A producer supplies distributors and guarantees not to supply other distributors in a given region.
Reciprocal exclusivity	A producer supplies on the condition that the distributor does not carry anybody else's products.
Refusal to deal	A supplier refuses to sell to parties wishing to buy.
Resale price maintenance	A producer supplies distributors only on the condition that the distributor sells at a minimum price set by the supplier.
Territorial restraint	A supplier sells to distributors only on the condition that the distributor does not market the product outside a specified territory.
Discriminatory pricing	A supplier charges different parties different prices under similar circumstances.
Predatory pricing	Suppliers sell at a very low price (or supply intermediate inputs to competitors at excessive prices) in order to drive competitors out of business.
Premium offers or loyalty rebates	A dominant supplier offers discounts or other inducements only to certain parties on the condition they do not sell someone else's products.
Tied selling	Producers force purchasers to buy goods they do not want as condition to sell them those they do want, or force resellers or wholesalers to hold more goods than they wish or need.
Full-line forcing	A supplier requires distributors, for access to any product, to carry all of the supplier's products.
Transfer pricing	May involve over-invoicing or under-invoicing of intermediate inputs between foreign affiliates. Under invoicing can be used to facilitate predatory pricing.

Source: MIER (2008).

To be sure, competition policy does not necessarily call for a proliferation of firms in small economies: it only requires two or three competitive producers, as long as there is the threat of entry by domestic firms or by foreign firms through imports or investment.

There is hardly any need for competition policy or competition laws if "perfect competition" prevails. Seen from the opposite angle, a market is not going to function "perfectly" if at least one of the following factors exists:

a) Imperfect information in terms of prices

b) Time lags in prices to "clear" markets
c) High transaction costs
d) Barriers to entry to new firms
e) Firm exit that involves significant costs to the company because of "sunk" expenditures
f) Circumstances for natural monopoly
g) Positive or negative externalities
h) Situations of "public goods"

The above list refers to a situation of "market failures" which is known to give sub-optimal level of social welfare. In a realistic environment of "market failures", there are still disagreements among economists on the best policy to follow. If one of the conditions is not satisfied, the best policy is to put in place the corrective measures to move towards the attainment of the social welfare optimum. If however more than one condition cannot be fulfilled, then it may or may not beneficial to satisfy one condition if the others cannot be met.

In reality, for policy makers, it is more useful to consider what is called "workable competition" and a fruitful competitive environment. Competition is good for producers, as it forces them to be continuously technologically efficient. "Technologically efficient" means that firms are always striving to reach their "possibility technology frontier", and once they have reached this frontier they always adjust to stay on the frontier. This "efficiency drive" pushes producers to be innovative realizing productivity benefits in order to gain (or maintain) their market shares.

Consumers, being at the receiving end of the chain, should be the ultimate beneficiaries of the firm efficiency gains under a competition regime. Consumers, under a competition regime, specifically profit from better price-value ratios, better choices and higher quality products.

There are different ways of defining a "workable competition". A simple way is to state that it is a situation where all economic agents (producers, workers and consumers) are limited in the economic power they can exercise over all other agents.

In a workable competition, firms do realise reasonable profits and government is also present, as this is not a pure situation of "laissez faire". Some government intervention is required to put in place measures favouring and protecting competition. Under proper "guidance" a competitive system is the engine of growth because firms have the *incentive* to improve their performance. However, a fully functioning competitive system is not self-generating. In a free market economy, firms would like to see competition for everyone while trying to secure a monopoly position for themselves.

Economies of scale pose a barrier for new entrants into the industry when the minimum efficient scale of new entrants constitutes a substantial proportion of industry sales as well as when the average cost of production increases substantially at sub-optimal scale. The larger the minimum efficient scale of the firm, the higher the entry forestalling price. When the minimum optimal scale is large relative to market size, new entry at that scale could significantly depress post-entry price, making the venture less attractive.

For industries with large capital requirements, the number of potential new firms is substantially reduced since the large amount of capital forms a cost barrier to entry as established firms incur lower unit costs than new entrants. This may arise due to several reasons. For example, well-established firms may have control of superior production techniques relative to new entrants, for instance through patents and trademarks. Alternatively, established firms may have access to superior resources, including management, and thirdly, new entrants may have to pay higher prices for inputs compared to established firms.

Product differentiation via advertising can also affect industrial concentration. High prevailing levels of advertising create additional costs for new firms as more advertising messages per prospective customer must be supplied to induce brand switching as compared with repeat buying. In addition, the effect of advertising on firm revenues is subject to economies of scale deriving from the increasing effectiveness of the advertising message per unit of output and also from decreasing costs for each advertising message purchased. Thus, a small firm will suffer an additional cost disadvantage.

Furthermore, if economies of scale exist either in production or in advertising, the need to obtain funds for advertising will give rise to additional capital requirement over and above those needed for the physical plant and equipment. Another important factor that influences industrial concentration is capital intensity of many industries. The more capital intensive the industry is, the more costly it would be to operate at less than minimum efficient scale.

Finally, high research and development (R&D) expenditures by incumbents leading to product and process innovations can deter entry. The use of high R&D and advertising expenditures by incumbents to deter entry is called in the industrial organisation literature "raising rivals costs".

In an open economy, if tariff rates were low, imports from abroad would enter the market when the selling price substantially exceeds transportation costs. The *threat from imports* may weaken monopoly positions and collusive agreements and individual firms may cut their prices in order not to lose their share of the domestic market to competing imports. In the case of exports, the existence of a competitive export market induces monopolists and oligopolists to be more competitive in pricing.

In a liberalised market open to *export competition*, firms find it difficult to discriminate between the domestic market and the global market, the monopolist then becomes a price taker in both domestic and world markets. The oligopolists tend to encounter great difficulty in achieving tacit collusion with foreign sellers due to the differences in markets and the business environment (which can include a strong competition law enforcement capacity in the second country). The relevant economic market for competition law purposes would no longer be a national market but rather regional multi-country markets or the total international market.

Another crucial market structure variable for developing economies is the presence of *foreign investment*, either in the form of foreign subsidiaries of MNCs or foreign-owned firms operating in the country. Foreign investment in many cases can be an important competitive market force, which improves the resource allocation of the domestic economy by bringing in large investments and more advanced technologies and business methods, and by providing strong competition in markets that previously could be characterized as monopolistic or oligopolistic markets**.**

Foreign investment can often be expected to reduce industrial concentration, reduce entry barriers, and help to reduce the market power enjoyed in the past by domestic companies that operated in monopolistic or oligopolistic markets. This is because the domestic incumbents may not have the necessary capital or expertise, technology and market access for their products to maintain their market power in the face of foreign investment, especially when the minimum efficient plant size necessary to capture the full economies of scale is large in relation to the local market.

However, there are counter arguments that foreign firms in many developing countries tend to cluster around industries with high levels of concentration and could in fact increase industry concentration. There is also the danger that foreign investors would introduce RBPs (which they employ in their home and other country markets) into the domestic market.

Over the past two decades, competition laws, enforcement practices and institutions in both industrialised and developing countries have become more similar in terms of their objectives, provisions, exceptions and exemptions, enforcement practices, analytical techniques, and kinds of competition law cases that are taken to their courts and tribunals. This process of greater uniformity and semi-harmonization -- sometimes called “convergence” -- results from both formal and informal processes of competition law harmonization.

The more formal processes large involve the European Union. Among the industrialised countries outside the EU, greater harmonization and convergence of competition rules and procedures have been promoted through information sharing and discussions at the OECD, WTO, APEC, NAFTA and other international forums, through bilateral competition law cooperation agreements, and through a large body of academic work on competition law and competition law harmonization that has been produced over the past 15 years.

The non-country analysis reveals growing similarity across competition laws and institutions. The major findings are summarised very briefly in the following Table 3.

To be meaningful and effective, the coverage of competition policy has to be broad and comprehensive so as to ensure that there is a level playing ground for all firms in all fields, including government-owned or government-linked business enterprises. Increasingly, competition laws entail an international dimension, as globalization, trade liberalization and rapid technological change bring about an inter-face of competition issues involving international corporations and multiple competition laws jurisdictions.

Table 3: Exceptional Features of Competition Laws in Other Countries and Jurisdictions

Country or Jurisdiction	Exceptional Features : Different From Other Countries
United States	Major use of private actions. Large number of competition law enforcement agencies at the federal and state levels. Greater emphasis on *per se* illegal anticompetitive offenses rather than offenses conditioned by the rule of reason (essentially a benefit-cost) approach. Large number of exceptions and exemptions built up through time that are now of questionable benefit and validity. Global leader in the development and application of best-practice analytical techniques and the application of advanced industrial organization and related economic theory in such areas as market definition, barriers to entry, corporate strategy, and defining and assessing the competition and efficiency impacts of RBPs.
Canada	Most enforcement activity largely concentrated in a single agency, the Competition Bureau, with relatively few private actions. Total efficiency test over the narrower consumer welfare approach in the U.S. (particularly important to merger review). Proactive approach conducted jointly with the business community to promote voluntary compliance with the Act. Major concerns with mergers and increasing concentration in the banking sector – recognizing that dominance in banking and other financial services will result in higher interest rates and bank service charges which in turn reduce new business formation, limits expansion of smaller businesses (that are more dependent on bank funding to finance investment) and reduces competition in non-financial markets.
European Union	Emphasis on economic integration in the European Common Market rather than economic efficiency and consumer welfare. Leading arguably to stricter treatment of intellectual property rights, exclusive territories and other vertical restraints that may be pro-efficiency but can deter cross-border trade. Quite extensive use of individual and block exemptions for horizontal and vertical arrangements that are deemed to be pro-efficiency. Use of competition law to discipline state aids/subsidies and to replace anti-dumping measures under trade law. EU agency responsible for competition law enforcement an integral part of the European Commission – leading to greater influence on all relevant EU economic and social policies at the expense perhaps of some loss of enforcement and policy independence.
United Kingdom	Objectives and assessments especially for mergers based on the public interest test rather than the narrower economic efficiency test or even narrower consumer welfare test. The new 1998 Competition Act, which replaced some but not all competition provisions – the merger provisions and some conspiracy provisions from previous statutes were retained. The alternative approach, which may better promote transparency, understanding and certainty among the business community and consumers, may be for the new law to completely replace all previous competition statutes and their provisions. This is the approach used in the 1986 Competition Act in Canada and by many other countries. Publication of guidelines on the web and in hard copy for all major provisions and competition issues under the new act. Separate regulatory bodies to apply competition law and other market regulation to previously regulated infrastructure sectors.
Central and Eastern European Countries	Modernization of existing competition laws and institutions to bring them more closely into line with EU competition rules – seen as a precondition for EU membership. EU competition rules for member countries and new members recognize that trade liberalisation must be complemented by competition rules in order to realize the full benefits from market integration.
Japan	Much more active enforcement of competition law since the early 1990s, initially in response to foreign pressure (particularly the U.S. and to a lesser degree the EU) and more recently as part of the domestic reform agenda.
Australia	Enforcing competition and consumer protection laws under the same commission. Major attention in recent years to expanding the scope of competition policy and law to newly deregulated industries and the legal, medical and other professions, to the actions of government owned corporations and of government ministries that conduct business, and to inter-state trade barriers that result from state government regulations and other state measures.

New Zealand	Specific competition rules and regulatory legislation for three industries – dairy, electricity and telecommunications – where there are concerns that competition issues may not be adequately addressed by the more generic competition rules of the Commerce Act. Separate competition rules and regulatory regimes are also found in the UK (infrastructure sectors) and Peru (electricity).
South Korea	Major attention in recent years to reducing market dominance and corporate concentration through disciplining the behaviour of the *chaebols*. South Korea since the East Asia crisis of 1997 has been one of the most rapidly growing economies in Asia and the world. Reducing the market size, influence and dominance of the *chaebols* may be an important reason for South Korea's current economic success – just as the break up of the zaibatsu helped to lay the foundation for the Japanese economic miracle in the 1950s and 1960s. Specific prohibitions on industry associations to prevent them from engaging in anti-competitive acts under the pretext of protecting the interests of the member corporations.
India	Proposal to establish the Competition Fund based on government grants and the fees charged by the Commission – to be used to cover the pay, allowances and other expenses of the Competition Commission.
China	Some competition-like provisions in the 1993 Unfair Competition Law, but most RBPs, including monopolies, abuses of dominant position, cartels and mergers, are not addressed. The 1993 law as well does not address in any detail how these provisions on unfair business practices are to be enforced, except for noting that the State Administration of Industry and Commerce is to administer the act. China reportedly is now drafting its first comprehensive competition law.
Chinese Taipei, Mexico and Brazil	Drafted concise competition laws of about 15 pages in each case. A concise statute makes the new law easier to understand, but may lack the detail to properly guide the enforcement agency and the business community. This guidance will have to come from enforcement cases/the case law as well as guidelines, information bulletins and other public documents.

Source: MIER (2008).

The study however cautions against rigid competition laws that do not permit innovative vertical arrangements. Provisions on vertical restraints would make sense only where there is room for exploitation of market power with barriers to new entry. Competition laws have to be flexible enough to accommodate the special needs of small businesses that look for horizontal and vertical arrangements.

Although it would be impractical for ASEAN countries to have a uniform set of competition policies and laws at this juncture, the study lends support to the call for some convergence of competition laws. This would make absolute sense, as ASEAN economies integrate with one another through intra-regional trade and investment. In the absence of a convergence of competition policies, there is the danger of the legitimacy of the competition law in one country being challenged under the existing laws in other countries.

Competition laws convergence is particularly noticeable where international and intra-regional factors come into play, especially in areas relating to the treatment of mergers or acquisitions and dominant positions, vertical restraints, R&D joint ventures, sectoral exemptions, anti-competitive effects of state aids and government subsidies, anti-dumping and other trade measures. The global trend favors competition agencies to be independent from government interference and free from undue political influence.

It is in the realm of analytical techniques and methods that there is greatest convergence taking place across countries, both developed and developing, especially with regards to the definitions and measurements of restrictive business practices, static and dynamic efficiencies, and barriers to entry.

Investigations into three sectors, namely cement, telecommunications and transport & logistics in selected ASEAN countries do provide further credence for competition policy. In addition, they also highlight significant differences in market conditions and outcomes in countries that have different competition policies.

Countries with fewer barriers to entry tend to have more competitive markets and more efficient outcomes. By encouraging competitive conduct, competition policy tends to promote competitive and efficient performance outcomes. There are signs of better market conditions and outcomes in countries where competition laws are more advanced.

In the sectors covered in the study, there is a fairly strong positive correlation between competition law status and market conditions and outcomes, especially in the case of cement and trade freedom. However, there are a few aberrations.

In the case of cement, the Philippines is rated above Indonesia and Thailand, both of which have more established laws, thanks mainly to greater excess capacity and lower barriers to entry. In the case of telecommunications, Cambodia (which has no competition policy) rates better than Thailand and Vietnam (which do have competition policy) in terms of market concentration, barriers to entry and prices, thanks primarily to early liberalization and trade reform.

In transport & logistics, there is greater trade freedom in countries that have competition laws. Interestingly, in sea freight, Malaysia, which is yet to formulate competition laws, rates better than Singapore and Indonesia, both of which have competition laws in place, thanks to its lesser market concentration and larger space for capacity expansion.

On the basis of the above findings, the policy recommendations can only be broad and general. Needless to say, country-specific recommendations are beyond the scope of the present study. Competition laws can make a significantly positive contribution, although they are by no means the sole determinant of how well markets behave and perform.

Based on the literature surveys and empirical observations embodied in the study, the following pointers to serve as ASEAN guidelines, which member countries should take into account in crafting their competition policy or fine-tuning what is already in place, are put forward:

- Enact competition laws, as they can make positive contributions to economic growth, price stability, industry development, macroeconomic stabilization efforts, and consumer welfare
- Pay special attention to the needs of small and medium enterprises (SMEs), which may include technical assistance to domestic companies in preparing licensing arrangements with much larger international corporations
- Adopt a relaxed or flexible approach to restraints on vertical arrangements, so as not to thwart innovations in establishing new distribution systems
- Include misleading advertising, misrepresentations and frauds in competition laws to enhance consumer protection
- Prepare concise laws with a clear focus on a comparatively few objects such as barriers to entry, market power and abuse of dominant positions
- Develop provisions directed explicitly at the abuse of intellectual property rights (IPR), as firms tend to hind behind the latter.
- Incorporate explicit provisions to ensure that all government business activities are adequately covered
- Craft specific laws to address the special circumstances of industries undergoing regulatory reforms
- Put in place explicit provisions that would empower competition agencies to handle the negative effects of local regulations on competition, e.g. inter-state trade barriers
- Apply competition rules in regional trade agreements, instead of anti-dumping rules or subsidy countervail, which serve to restrict entry and lessen competition

- Create provisions to address trans-border restrictive business practices (RBP) where the RBP activity takes place abroad with injury to consumers and industry in the home country through local counterparts
- Work toward convergence in competition laws and cooperative efforts in the enforcement of such laws with member countries
- Ensure that the legitimacy of the competition laws cannot be challenged under the existing laws in ASEAN
- Publish guidelines and other information products that explain the main purposes of the key provisions
- Develop a detailed program of work for the manpower of the competition agency to ensure smooth administration and effective enforcement.

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