

Suggested Issues for Discussion

I. Competition Policy and Privatisation

In every country that makes a serious commitment to the development of a market economy, privatisation of state-owned enterprises has a high priority. There is an obvious tension in the privatisation process, however, between the desire of the state to obtain the highest possible price for the privatised assets, on the one hand, and the need for the creation of efficiency-enhancing, competitive markets, on the other. Investors are willing to pay more for assets that enjoy a position of market dominance. Thus, there is an important role for competition policy in the privatisation process -- to ensure that state monopolies are not simply transformed into private ones.

The application of competition policy to privatisation can take place in any of several ways, according to the applicable laws and procedures of each country. At the outset, it would seem to be important that the country's competition agency have a significant role in the process. In most countries, especially in emerging market economies, a separate agency is created to conduct privatisation. The laws of some countries also provide for formal participation by the competition agency in the process, however. Ideally, a procedure for notification to the competition agency of significant privatisation cases would exist. The agency may have the power to intervene directly in a given privatisation case, or it could proceed under the merger provisions of the competition law. If the agency cannot participate formally, it usually can participate as competition advocate, providing its views on relevant aspects of competition in selected cases.

The goal of competition policy in privatisation cases is usually fairly straightforward; it is simply to prevent the creation privatisation of a dominant firm. The dominance analysis, on the other hand, is anything but easy. It requires the accurate definition of a relevant market, the determination of the position of the assets to be privatised within that market, including in particular their market share, and an assessment of the significance of barriers to entry in the relevant market.

If it is determined that the privatised firm would be dominant, an equally difficult issue of remedy is presented. The simplest remedy of this kind is the encouragement of new entry through the lowering of entry barriers, including trade barriers. Alternatively, a partial divestiture from the dominant firm of an essential facility or important proprietary technology might be sufficient. The most drastic remedy, of course, is a complete restructuring of the enterprise into two or more entities prior to privatisation. Such a restructuring may be possible in situations where there were one or a few

state-owned monopolists operating many plants or facilities, but it is likely to be difficult, both practically and politically. Care must be taken that the assets of the newly-created entities are viable, that the firms can operate at an efficient scale and that they have access to necessary inputs and distribution facilities.

Finally, as noted above, privatisation can be an intensely political process in any country. The competition advocate should exercise its powers of control or intervention judiciously and with restraint. It should be well informed in the cases in which it participates, and fully take into account the positions of the enterprise to be privatised and the privatisation agency. The advocate should state the case for competition policy in a manner that is persuasive to all parties involved as well as the public at large.

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- How is competition policy implemented in the privatisation process in participating countries? To what extent does the competition agency participate officially in privatisation?
 - How can competition policy be implemented most successfully in the privatisation process? What methods are effective in promoting competition policy in the face of government and business interests favoring less competition?
 - What substantive competition standards are applicable in privatisation cases? Do they differ in any respect from the customary analysis of dominance? What remedies are most often applied?
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II. Competition Policy and Regulation

The rapid pace of globalisation of the world's markets is forcing all countries to improve the efficiency and competitiveness of their national economies. At the forefront of these efforts is regulatory reform. A growing number of countries -- OECD and non-OECD alike -- have embarked in recent years on ambitious programs to reduce regulatory burdens and improve the quality and cost-effectiveness of regulations that remain. Within this effort competition policy has a vital role. Reform that sharpens competitive pressures provides powerful incentives for firms to become more efficient, innovative and competitive. These improvements can boost the productivity of entire industries and often bring sharp and swift price reductions and improvements in the quality and range of products and services, to the benefit of consumers and user industries.

Competition policy significantly impacts regulation in two contexts: where market competition is possible but not yet achieved, and in situations of natural monopoly. In the former, unnecessary regulation should be eliminated,

and competition permitted to flourish where possible. Recent technological developments and re-thinking by experts have resulted in challenges to the traditional arguments in favor of regulation of sectors previously considered as natural monopolies, such as electricity and telecommunications. Not all aspects of the operations of enterprises in these sectors necessarily display increasing returns to scale such that there is room for only one or a few firms in the market. In many cases it is possible to separate natural monopoly elements from potentially competitive activities and the regulatory functions from commercial functions, and also create several competing entities through restructuring. Where such separation of natural monopoly and competitive functions is achieved, issues of cross-subsidization of competitive activities by revenues from non-competitive markets and exploitation of vertical linkages to extend market power from non-competitive markets to competitive ones must be addressed.

Where natural monopolies exist and regulation is necessary, competition policy has much to say about the types of regulation that will stimulate the most efficient outcomes. In appropriate circumstances, for example, “contracting out”, or franchising, introduces an element of competition by creating competition for the market rather than competition in the market. The creation of discrete, geographically distinct regulated monopolies within a sector, where possible, permits “yardstick competition” between them. There are different forms of price regulation, but within the context of the industry the regulatory scheme should offer maximum incentives for efficiency and cost reduction.

The competition agency is well placed to influence the process of regulatory reform that is underway in many countries. The agency is likely to have a degree of independence from other parts of government, thus permitting it to represent the interests of consumers in the debate. While the returns to consumers from the successful implementation of competition policy in regulation are high, participation by the competition agency in the process is resource-intensive. The agency should select carefully the matters in which it participates. Also, in any given sector the issues are likely to be highly technical. The agency should acquire expertise in the relevant industry if it is to be effective in the proceeding.

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- What is the current state of regulatory reform in participating countries? In what sectors is competition being introduced where it previously did not exist? How is the restructuring being accomplished?
 - What are the most effective means for the implementation of competition policy in regulatory reform? What should be the role of the competition agency?

III. Market Definition

Market definition is usually the first, and often the most important, task in competition analysis. All calculations, assessments and judgments about the competitive implications of any given conduct depend upon the size and shape of the market in which the conduct occurs. In a case involving possible abuse of dominance, for example, if the relevant market as defined is relatively small, and the enterprise that is the subject of the investigation has a large share of that market, then the enterprise could be a dominant firm. If on the other hand the same enterprise is competing in a larger market in which its share is small, it could not be dominant. In the case of a merger, the relevant market may include both merging firms, in which case their merger is more likely to affect competition adversely, or they may operate in separate markets, in which case there is less cause for concern.

Defining a relevant market in competition analysis is a unique exercise. Its purpose is to describe the context in which the exercise of “market power”, which can be defined as the ability of a firm or combination of firms acting in concert to profitably raise price above competitive levels for a significant period of time, could take place. (“Price,” in this context, includes all attributes of a product, including quality, as well as ancillary services provided with it.) A producer of a particular product will lack market power if a significant number of buyers can and will switch to other producers or to substitute products to avoid paying too much. Thus, a market is well defined and useful for competition analysis only if it includes all good substitutes for the product and its producers that are the subjects of the investigation.

A commonly accepted methodology for the identification of such substitutes is to focus on the demand side. According to this paradigm, which is articulated in the United States Horizontal Merger Guidelines, one inquires as to the willingness of buyers to switch to substitute products if the price of the product in question should rise a modest amount relative to other products. The geographic component of the market is determined in the same way: to what locations of supply would a significant number of buyers switch if the price at the location in question should rise a modest amount relative to sources of supply at other locations? This inquiry, while theoretically rigid and precise, is in practice heavily fact-intensive. The investigator must learn about the attributes of the product (or service) in question, about how it is made or provided, and how it is distributed and sold. It is usually necessary for the investigator to learn from market participants -- both sellers and buyers -- about the willingness and ability of buyers to switch between products. Even

with a great deal of such anecdotal evidence, however, it is seldom possible to define the precise boundaries of a market in a scientific manner.

While there is much common ground among competition officials on the subject of market definition, both theory and practice may differ in some respects among countries. Thus, it is useful for competition officials from different countries to compare methodologies for market definition. Participants in the private sector can provide important insights on the issue as well. Improved understanding among both competition officials and market participants of the market definition process will contribute significantly to more accurate and effective competition enforcement .

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- What are the theoretical underpinnings of market definition in participating countries? Is the “hypothetical monopolist” paradigm articulated in the United States Horizontal Merger Guidelines now generally accepted and employed by most competition authorities?
 - How does the market definition process differ among countries having different characteristics? Is it different as between small countries and large ones, for example, and do the results similarly vary?
 - How have the phenomena of globalisation and regional integration affected geographic market definition? Do relevant markets increasingly extend beyond national borders?
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IV. Barriers to Entry

In the broadest context, barriers to entry determine the degree to which markets may be considered “contestable”, a situation in which potential entry inhibits the ability of incumbents to engage in anticompetitive conduct. The difficulty of entry, or the lack thereof, is likewise an important element in competition analysis. Within a given market, a firm with a high market share may or may not enjoy a position of dominance, depending upon whether entry into the market is easy or difficult. A merger of two firms may or may not substantially limit competition, depending, among other things, on entry conditions in the market. The process for analysis of entry barriers resembles that employed in market definition: if a market incumbent or group of incumbents were to attempt to exercise market power -- that is, to raise price a modest amount above the competitive level for a significant period of time -- would the action attract sufficient new entry within a reasonably short period of time so that the attempted price increase could not be profitably sustained?

As with market definition, the inquiry can be an intensely practical one. In most cases the investigator will attempt to learn how entry into the relevant market can be achieved. What steps are required? What is the

optimum level of capacity for new entry? What are the necessary expenditures? How long will it take to begin production or sales in the relevant market, and how long will it take for a new entrant to begin to have a significant competitive impact on the market? Becoming informed of the entry process, however, is only the first step in the analysis. The ultimate determination of whether entry would be sufficient to blunt an attempted exercise of market power must then be made.

There can be at least two components to that inquiry: whether significant entry would be likely to occur in response to an attempted, modest exercise of market power, and if it were to occur, could it be accomplished relatively quickly. From a practical standpoint the “timeliness” issue is often addressed first, because it is relatively straightforward factually, and it can be determinative of the entry inquiry. Timeliness is important because if it takes a long time to enter the relevant market, consumers would be harmed for an unacceptably long period before entry would cure an exercise of market power. There is no universally accepted benchmark for timeliness, but many competition experts employ a period of two years.

Assessing likelihood of entry is more difficult and less precise. There is not unanimity among competition experts about what constitutes “true” entry barriers. There is growing agreement, however, that a necessary component of an entry barrier is that the expenditures necessary to overcome it must be “sunk,” that is, not recoverable upon exit from the market. Entry barriers can include government regulations, which limit entry or make it slower and more costly, exclusive supply agreements with suppliers of necessary inputs, making it difficult for new entrants to acquire necessary inputs, and the need to overcome reluctance of buyers to do business with new entrants because of costs of switching or the entrant’s lack of reputation for quality.

Varying conditions in different countries may affect relevant entry barriers. Thus, the cost of capital is ordinarily not thought to inhibit effective entry, but in countries where capital markets are not efficient, which may be true in some emerging market economies, capital costs may be a barrier. An important factor in assessing likelihood of entry is the magnitude of economies of scale in the relevant market. If they are large relative to the expected returns that a new entrant could expect to gain after a modest exercise of market power by an incumbent, it is less likely that new entry would occur in response to such an act. As with other aspects of competition analysis, however, the theoretical usually gives way to the practical in assessing entry barriers. There is no substitute for acquiring a great deal of practical information about how entry occurs in the relevant market, from

which a judgment can be made about the likelihood that entry would prevent or overcome an attempted exercise of market power therein.

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- Predictions about future entry are necessarily imprecise and at least somewhat speculative. How do competition authorities in participating countries make judgments on this difficult issue?
 - How has the trend toward globalisation of markets affected assessment of the entry question? Is potential entry by foreign firms becoming increasingly important in analysis of competition cases?
 - How do barriers to entry differ among countries, especially as between economically developed countries and emerging market economies?
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V. Assessment of Market Power

As noted above, market power is generally considered by competition experts as the ability of a firm or combination of firms acting in concert to profitably raise price above competitive levels for a significant period of time. Assessment of market power is a critical element in almost every competition case. Unilateral action by a market participant cannot significantly harm competition if the firm does not have market power. A merger is not competitively harmful if it does not create or enhance market power. Horizontal agreements among firms usually are not condemned under competition laws if the participating firms together do not have market power (in countries where cartel conduct is *per se* illegal, market power analysis of such conduct is technically not required, but practically, a cartel cannot be successfully sustained if the participating firms do not together have market power), and most vertical agreements are not proscribed unless at least one of the participating firms enjoys market power in its market.

The assessment of market power, as noted above, can only be conducted in the context of a properly defined market, and if entry into that market is easy, any attempted exercise of market power, even by a putative monopolist, would not be fruitful. Within these parameters, the first step in market power analysis is to analyse concentration in the market and the market shares of the firms that are the subjects of the investigation or proceeding. Only in markets where concentration is relatively high, and where the subject firms themselves have significant market shares, is the exercise of market power thought by competition experts to be likely.

Market concentration can be determined in more than one way, and there are no rigid rules in competition policy about what constitutes high concentration. Two methods of calculating concentration are most commonly employed: aggregating the shares of the three or four largest firms into a

“concentration ratio” (described in shorthand as the CR3 or CR4), and summing the squares of the shares of all the firms in the relevant market (referred to as the Hirschman - Herfindahl Index, or HHI). The HHI is thought by some experts to be superior to the CR3 or 4 because it takes into account all firms in the market, not just the largest, but it gives relatively more weight to the larger firms. A CR3 or 4 of 75% or more is generally thought to represent high concentration. There is greater divergence about the HHI; some experts consider an HHI of above 2,000 as representing high concentration, while others do not become concerned until the HHI reaches 4,000 or so.

Also, the market share of the firm or firms whose conduct is the subject of the investigation or proceeding is obviously relevant. In some countries, mergers of firms having combined market shares of 30 percent are considered potentially anticompetitive if the market is otherwise concentrated, while in others much higher market shares are required. In analysing possible abuse of dominance or restrictive agreements, a lower threshold of 30 or 35 percent is often employed, below which dominance or shared market power cannot exist. Conversely, market shares of 70 percent or more sometimes give rise to rebuttable presumptions of dominance or market power, while market shares in the midrange are ambiguous.

It is common in competition analysis that low concentration in the relevant market is taken as sufficient evidence that the conduct at issue would not be competitively harmful. Minimum concentration thresholds are employed as “screens”: experts consider it necessary to inquire no further into conduct in the context of low concentration. Many competition experts do not consider the opposite to be true, however. High concentration is usually not determinative of the existence of market power. Easy entry, of course, negates the potential market power of a firm having a high market share. Beyond the entry issue, however, competition experts increasingly require careful analysis of the conduct at issue, to determine its actual or potential effect on competition. In the case of a merger, the potential for post-merger anticompetitive conduct of various types may be analysed. In the case of possible abuse of dominance or restrictive agreements, the actual and potential effect of the conduct in question is analysed, and the benefits of the conduct are also considered. Thus, assessment of market power, like the other components of competition analysis, usually requires a careful, specific analysis of the conduct in question, in the context of the relevant market and its structure.

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- How is market concentration calculated and analysed in participating countries? What are the upper and lower thresholds that are employed, if

any, and what is their significance? How does the analysis differ among countries, especially as between large and small countries?

- To what extent does the market power analysis extend beyond mere determination of high concentration in participating countries? What techniques are most successful in conducting this analysis?

VI. Case Study Session

In two sessions on 12 July, competition officials from participating countries will discuss approximately six cases involving mergers and abuse of dominance that have arisen recently in some of the participating Latin American countries. Each case will briefly be presented by an official from the country in which the matter originated, after which a panel of competition experts from OECD countries may ask questions or make brief comments. All participants will then be invited to discuss the case.

The discussions will focus on the principal competition analysis issues that are presented by the case at hand. The participants will share their views on applicable analytical and investigative techniques in the context of the case. The discussions will deal objectively with the issues, however, and not on the outcome of the matter or the performance of the competition agency.

Alternative Session

VII. Competition Policy and other Economic Policy Issues

The interplay between Competition Policy and other economic policy areas is highly complex. Specific sessions on the interaction between privatisation and regulation, and competition policy, have been organised. In this session, an overview of the relationship between competition policy and other policy areas will be discussed. Issues that could be considered include:

- The relationship between trade liberalisation and competition policy.
- The role of competition policy in promoting competitiveness.
- The scope for coordinating competition policy and macroeconomic stabilisation programmes.
- The possible impact of anticompetitive structures-behaviour in the financial sector on interest rates. Is it possible to link competition policy and interest rate policy?
- What is the relationship between competition policy and policies aimed at modernising financial systems? Is there a systematic relationship between market concentration in the financial sector and intermediation margins? What is the experience with strategic investment capital rationing by

financial firms controlled by conglomerate or holding groups aimed at preserving or enhancing dominant positions in other markets, and are there any relevant policy implications?

- What is the relationship between competition policy and exchange rate policy? Could anticompetitive structures or behaviour in foreign-currency markets lead to (temporary) over- or undervaluation of a currency, or do they have an impact on the volatility of exchange rates under floating exchange rate regimes? Can market concentration affect the sustainability of fixed exchange rate regimes? Does market concentration increase the scope for currency speculation? How can policy-makers deal with these issues?
- What is the likely impact of anticompetitive structures/behaviour on long term economic growth prospects through sub-optimal allocation of investment resources and inadequate strategic planning/positioning in world markets?

VIII. Competition Policy and Due Process of Law

There are several aspects to ensuring adequate due process in the enforcement of national competition laws. They include the role and structure of the competition agency, its relationship to other parts of government, the extent of its authority and the legal and human resources provided to support its mandate, the fairness and transparency of its internal deliberative procedures, and adequate and impartial judicial review of its decisions.

For maximum effectiveness and impartiality, the competition agency should have a significant degree of independence from other parts of government. Its cases may affect, on the one hand, strongly entrenched business interests that possess significant political power, and on the other, powerful government agencies whose mission and interests may not always coincide with those of consumers. The agency should be free from political influence on its decisions as much as possible. Likewise, competition officials themselves should be free of external influence upon their deliberations. They should be subject to effective conflict of interest rules.

The competition agency may be created in any of several forms, such as a multi-member commission or in a more traditional hierarchical structure, but there are attributes that should be common to all, including:

- a sufficient staff of experts, including expert economists;
- adequate tools for acquiring information, including documentary evidence and oral testimony from both the parties to the investigation and impartial “third parties”, and a concomitant requirement of confidentiality applying to the information so acquired;
- fair and transparent rules for presentation of evidence to the decisionmakers;
- reasonable time limits applicable to deliberations of the agency;

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- transparency of decisionmaking, including procedures for publication of decisions and the reasons therefor, where practicable.

The decisions of the agency should be subject to impartial judicial review. In some countries appeal of competition cases is made to courts of general jurisdiction, while in others specialised tribunals are created to hear competition cases and possibly other cases that involve predominantly economic issues. Neither system is necessarily better or more effective, but in either situation the judges who hear competition cases should have some familiarity with competition policy principles. Where cases are heard by courts of general jurisdiction, some informal training of judges in competition policy might be advisable.

Finally, the law should provide adequate remedies for redress of violations. The competition authority or court should have the power in appropriate cases to impose fines of sufficient size to deter future violations. The authority should have the ability to impose or apply for orders forbidding or mandating certain conduct necessary to redress a violation, including, in appropriate circumstances, the breakup or restructuring of businesses. There should be means for the recovery by private parties of damages suffered as a result of competition violations. In some countries, citizens have the power to institute their own civil proceedings to recover such damages. In others, citizens may make complaints to the competition agency, which can recover damages on their behalf. In the latter case, however, the agency should have sufficient discretion to decline to initiate a case, when in its considered and good faith judgment a case is not warranted.

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- How successful are participating countries in ensuring the independence of the competition agency? What methods or organisational structures have been most effective?
 - What problems have been encountered in the process of judicial review of competition cases? How can judges become better informed about issues of competition policy?
 - What is the role of the private sector in enforcing the competition law, in particular in instituting private competition cases?
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IX. Extraterritoriality and International Co-operation

The reach of national competition laws cannot fully keep pace with the growing internationalisation of markets. Increasingly, anticompetitive conduct in one country can have negative effects in another. Pursuant to the generally accepted “effects doctrine,” the competition laws of the second

country can apply to conduct committed abroad that has a direct, substantial and foreseeable effect on the domestic or foreign commerce of that country. There are impediments to the full exercise of such jurisdiction, however. National competition authorities often do not have access to foreign-located information that is necessary for detection or prosecution of the conduct. Or they may not have personal jurisdiction over the businesses or individuals involved.

If prosecution by a national authority of conduct committed abroad is possible, however, it may also be subject to principles of international comity, pursuant to which important interests of a foreign country must be taken into account in determining whether the application of extraterritorial jurisdiction is proper. Finally, there continues to be debate over whether national competition laws can or should be applied to conduct committed abroad that solely affects exports of the prosecuting country.

An obvious means of dealing with the jurisdictional limitations of national competition laws is for national authorities to co-operate in enforcing their respective laws, such as is done in other substantive legal areas such as taxation and securities regulation. Co-operation of this kind is indeed increasing. There is a growing number of bilateral co-operation arrangements between national competition agencies, pursuant to which they agree to provide notifications, share information and co-ordinate simultaneous investigations. Co-operation arrangements in the context of regional integration agreements are also becoming more common. On a multilateral basis, the OECD has promulgated a Recommendation by its Council which sets forth recommended procedures for co-operation by its Members in competition enforcement.

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- What are the legal and practical limits on the exercise of extraterritorial jurisdiction by national competition authorities?
 - Every country has laws providing strong confidentiality protections for information obtained in the course of a competition investigation or proceeding. To what extent do these protections inhibit international co-operation in competition enforcement, and how can co-operation be enhanced in this environment?
 - What is the extent of current co-operation in competition enforcement among Latin American countries and what are the prospects for future co-operation?
 - To what extent is a multi-national set of competition rules, including an enforcement mechanism, necessary in the globalisation context? Is agreement on such a set of rules feasible, and under what authority, for example, the World Trade Organisation, would it exist?