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## **OECD Global Forum on Competition**

### **HOW ENFORCEMENT AGAINST PRIVATE ANTICOMPETITIVE CONDUCT HAS CONTRIBUTED TO ECONOMIC DEVELOPMENT**

**Note by the Secretariat**

-- Session IV --

*This postscript note by the Secretariat supplements the Background Note for Session IV. It is submitted FOR DISCUSSION under Session IV of the Global Forum on Competition to be held on 12-13 February 2004.*

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## HOW ENFORCEMENT AGAINST PRIVATE ANTICOMPETITIVE CONDUCT HAS CONTRIBUTED TO ECONOMIC DEVELOPMENT

### *Postscript Note by the Secretariat*

#### **1. Introduction**

1. This Note is intended to serve as a “post script” to the Secretariat’s Background Note<sup>1</sup> for Session IV of the meeting of the Global Forum on Competition on 12 and 13 February 2004 [CCNM/GF/COMP(2003)7]. It is based upon the written contributions that have been submitted as of 30 January 2004.<sup>2</sup> While not attempting to summarise these contributions as such, the Note aims to highlight some observations on effects described in the contributions, discusses various difficulties in demonstrating the effects on economic development of enforcement against private anticompetitive conduct, and finally proposes a few points for the general discussion at the meeting.

2. The contributions submitted on present a number of competition law cases from national jurisdictions, as well as certain other measures aiming at the introduction or promotion of competition in various sectors of the economy. The outcomes and effects of those activities are described and discussed, mostly in qualitative terms but an attempt also has been made in some instances to quantify the effects. Typically, effects on the price of the product have been the most apparent, but noteworthy effects have also been identified in relation to quality, availability of products, market entry, market structure, and technical development. The contributions represent a variety of approaches, often in the form of anecdotal evidence. Effects on growth and economic development at large are not as easily demonstrated, although some contributions also discuss possible methods to measure the impact of competition law on economic development. Different kinds of effects described in the contributions are discussed in section 2 below.

3. There are obviously several difficulties involved in efforts to demonstrate how enforcement against private anticompetitive conduct has contributed to economic development. Firstly, competition policy has several branches, law enforcement being one of them, and the effects may be difficult to isolate from those of other measures like pro-competitive regulatory or structural reform. Another difficulty stems from the fact that the most important effects of competition may be indirect, and only manifest themselves in the long term. On the other hand, when discussing consequences of individual law enforcement cases it may be difficult to reach beyond the short term, direct effects. There are also the obvious difficulties in measuring, quantitatively, effects of competition law enforcement, as opposed to describing qualitative outcomes of halting anticompetitive behaviour. That leads to the issue of methodologies and measurement techniques. These difficulties are discussed in further detail in section 3 below.

#### **2. Observed and demonstrated effects**

##### **2.1 Price**

4. The most obvious effect of a price cartel is that participating companies are able to raise the price above the level established under competition. Consequently, breaking such cartels mostly has obvious and direct effects on the price – effects that may be calculated in quantitative terms.<sup>3</sup> The contribution from Pakistan<sup>4</sup> describes three cases of successful competition law enforcement against price cartels – two in the cement sector and one in the cable sector.

5. The contribution from Chinese Taipei<sup>5</sup> offers an example of quantifying the harmful effect of a cartel. Following a period of successively increased liberalisation of the markets for liquefied petroleum gas ('LPG'), two cartels were established that covered more than 90 per cent of the LPG bottling and retail markets in the northern part of Chinese Taipei. An assessment of the sustained price increases resulting from the cartel activities was made by the competition authority, showing a total effect of more than NT\$1 billion (approximately US\$30 million).

6. Another area where noteworthy price effects have been identified is where the competition authority challenges the regulated prices of monopolies, set by another regulator. As an example, the contribution from Ukraine<sup>6</sup> reports that such revisions of prices for electricity and water supply in 2 years have reduced consumers' costs with a total amount corresponding more than US\$ 200 million.

7. The telecommunications sector offers many examples of monopolistic pricing, due to the dominant position held by the incumbent operator also after liberalisation and/or privatisation. The contribution from Poland<sup>7</sup> reports several examples of abusive behaviour, including demands that customers contribute to joint investment schemes, pay undue interest on subscription payments, and pay extreme price increases for ISDN services. In all these cases, the enforcement activities of the Polish competition authority have led to direct economic gains for consumers.

8. The Swedish contribution reports on a case dealing with a frequent-flyer program. On domestic routes where the incumbent air carrier met some competition, offering bonus points to passengers was found to be an abuse of a dominant position that would endanger remaining competition in the market. An econometric study comparing fares in periods with and without the fidelity-rebate scheme concluded that this system increased fares by approximately 10 per cent. And another study estimated the bonus program to result in an average price increase of SEK 500 (approximately €55) per business passenger, corresponding to approximately 25 per cent of an average business fare.

9. Sometimes, even fears of enforcement action may have an effect on prices. Romania<sup>8</sup> provides an example of cement manufacturers reducing prices soon after the initiation of an investigation. Another Romanian cement case illustrates the delicate trade-off between efficiency and market structure. The outcome of the case enabled a merger under conditions, which on the one hand reduced the number of suppliers – to the extent of creating a monopoly in some regions – and on the other facilitated scale economies that were not attainable under the pre-merger structure. Consequently, the contribution concludes that the benefits of reduced costs might be passed on to consumers.

10. One of the mergers cases reported in the contribution from Pakistan had a direct effect on prices, as a result of a price reduction being one of the conditions for authorising the merger.

## **2.2 *Quality and technical development***

11. Liberalisation and privatisation of the telecommunications sector mostly calls for active enforcement of competition law in order to prevent anticompetitive behaviour by the incumbent operator. The Lithuanian contribution identifies effects on the economic development of this sector as a result of enforcement activities, in particular as regards modernisation of the existing network and improved quality of services, with network digitalisation reaching 88% and ADSL services being available to 85% of the telecom operator's customers.

12. A case submitted by Romania deals with slag used for the production of cement – a product which is an environmentally dangerous waste. As an outcome of this case, the dominant supplier of slag was prevented from concluding a joint agreement with the three existing manufacturers of cement, allocating sources of supply according to territorial and sales volume criteria. One conclusion from this

case was that the revision of the agreement would facilitate slag collection, thereby having positive effects on environmental protection.

13. Two merger cases reported in the contribution from Pakistan provide examples of conditions aiming at technical development. In one of the cases the merger was authorised on condition that the company would promote tea cultivation in a specified district. The other merger was authorised subject to the introduction of improved Japanese technology and cost-effective production.

### **2.3 *Availability and choice***

14. The Russian<sup>9</sup> contribution describes details of the *Western Union* case, where the provider of a system for money transfers attempted to prevent Russian banks from using other similar systems in parallel. The contribution concludes that the case illustrates how enforcement against private anticompetitive conduct has assisted the development of money transfer systems in the Russian Federation, which serves not only the promotion of competition in the financial services market but contributes to economic progress as well.

15. In a similar case, reported by Jamaica<sup>10</sup>, a local software operator complained that a competitor had been given an unfair advantage due to the technical specifications of the communication interface. As a result of the investigation initiated by the competition authority, the Central Bank agreed to configure its system for access in a way that allows cambio operators to use any software program developed for this purpose. Thereby customers and cambio operators were provided with a variety of choices allowing them to select the product that best meets their demands.

### **2.4 *Entry and market structure***

16. Merger control has an obvious link to issues of market structure. One of the cases described in the South African contribution resulted in the prohibition of a merger between two of the country's largest retail furniture chain stores. In the period after the prohibition structural changes took place in this market that reduced the impact of competition from third parties. Subsequently, the two parties that were prevented from merging were left as the most significant competitors in the market. The contribution states that "there is little doubt that, had the transaction been approved, low income South African consumers would be paying more for some basic elements of their consumption package".

17. Also when mergers are approved, conditions for the approval may have an impact on entry and market structure. A merger in the South African wine and spirits industry was authorised on condition that the merged entity divest itself of certain key spirit brands. As a consequence, the two competitors to the merging parties were able to enter the market with these successful brands, thus laying the basis for robust competition in the future.

18. Other cases reported by South Africa<sup>11</sup> deal with single-channel marketing arrangements in the agricultural sector. As a result of rulings by the Competition Tribunal on articles governing the association of new service providers to corporations in the raisins and citrus fruit sectors, new markets for the provision of key services to farmers have developed and there has been new entry in existing service markets.

19. One of the Lithuanian telecommunications cases provides an example of the incumbent operator trying to prevent competing Internet service providers from entering the market by installing filters on leased analogue telephone lines. Successful enforcement of competition law allowed the new entrants to lease such lines on competitive terms. In another case reported by Lithuania, enforcement action prevented the incumbent operator from excluding competitors from the Internet telephone services market. More than 30 companies attempting to provide phone services using the Internet had been blocked from the ISDN

flow, but were eventually able to provide such services due to the successful outcome of the case. Similar attempts by the incumbent telephone services operator to prevent new entry by down-stream competitors are reported in the contribution from Poland. In one case potential new entrants were requested to contribute to the development of the infrastructure facility owned by the incumbent operator. Other cases involved excessive fees being applied in order to prevent fixed and mobile operators and Internet service providers from leasing telephone lines. In all these cases the enforcement of competition law facilitated new entry and the growth of new markets.

20. Also the Romanian slag case, mentioned above, was envisaged to enhance competition in the market and remove existing barriers to entry.

21. The contribution from Pakistan refers to five cases that reduced shareholding in companies. These enforcement cases were applying a rule in the Monopolies and Restrictive Trade Practices Act preventing any individual to hold more than 50% voting power.

### **2.5 Growth and economic development**

22. One approach described in the contribution from Ukraine is to compare markets where competitive conditions differ. Thus, in those industrial sectors in Ukraine where there is competition in at least half of the activities – like the food, forestry and light industry sectors – growth is between 1.2 and 2 times higher than in the industry at large. And in the sector for road transport of passengers, which was opened for competition in the last three years, growth of the transport volume has been almost 6 times higher than in the railway transport sector, still under monopoly.

## **3. Difficulties in demonstrating effects**

### **3.1 Effects of enforcement against private anticompetitive conduct vs. other action promoting competition**

23. Several contributions provide examples from the telecommunications sector, where liberalisation and privatisation have opened markets for competition. At the same time, the former monopolist generally retains a strong position and controls the fixed line infrastructure. In such a market, regulatory measures are needed to prevent the incumbent operator from restraining competition, abusing its dominant position. Competition authorities have seen a call for active enforcement of competition law, especially where there is no sectoral regulator or an existing regulator is perceived to lack sufficient powers. Lithuania and Poland have provided examples of such cases in the telecommunications sector. Obviously, it is difficult or impossible to separate the effects of law enforcement from those of the liberalisation as such, recognising that the enforcement is linked to, and supports, the regulatory and structural reforms.

24. Also, Jamaica reports positive effects in the telecommunications market since the incumbent telephone services provider was exposed to competition. And the sole cement manufacturer in Jamaica experienced significant growth in revenue and profits during the periods when it faced most competition from importers of cement. At the same time, consumers benefited from shorter delivery time, lower prices, and better cement quality. This supports the conclusion that enhanced competition may bring both growth to producers and benefits to consumers, contrary to prevailing fears in some constituencies. The example from Jamaica also shows that it is easier to demonstrate the positive effects of competition *per se* than of the specific effects of enforcement against private anticompetitive conduct.

25. Another example of the links between liberalisation and need for action against private anticompetitive conduct is given by the contribution from Chinese Taipei. The former state monopolies in the markets for producing and distributing LPG were gradually removed, starting in early 1990's and ending up in a fully liberalised market less than 10 years later. However, anticompetitive practices were

soon unveiled, and the competition authority took action against 30 LPG bottling and transport companies in the northern region that had formed two cartels in order to monopolise the local bottling and retail markets. The contribution concludes that “solely relying on market liberalisation was not enough to guarantee a healthy market function and the benefits produced thereby”.

### **3.2 Short term vs. long term effects**

26. Competition is not an end in itself, but a means to achieve long-term goals. Such goals include economic efficiency, leading to economic development and growth and – particularly in developing economies – poverty reduction. Consumer welfare is often seen as a goal of competition policy, including through lower prices, better quality, wider choice, and new and better products. The outcome of an enforcement case, on the other hand, may mostly manifest itself in effects of a short term nature. Sometimes an immediate effect on the price may be observed or – for instance in merger cases – on market structure. Cases dealing with discrimination, for instance through an abuse of dominance, may have obvious effects for competitors that are assumed to enhance competition in the longer perspective. Sometimes the only demonstrable short-term effect is that an anticompetitive behaviour is discontinued.

27. One obvious difficulty in demonstrating the beneficial effects of competition law enforcement is to provide evidence that the observable short term effects lead to economic development in the longer term. A lower price does not under all circumstances lead to more economic efficiency than a higher price would have done. Improved conditions for a competitor are not always equal to improved competition.

### **3.3 Direct vs. indirect effects**

28. The contribution from Japan<sup>12</sup> quotes price reduction, quality improvement and cost reduction among the direct effects, whereas the prevention of competition law infringement by other companies is an indirect effect of measures against anticompetitive conduct. The direct effects are obviously easier to measure, whereas the indirect effects in the long run may be the more important ones. The contribution concludes that it therefore is necessary to develop a method to gauge indirect economic effects.

### **3.4 Qualitative vs. quantitative effects**

29. Most effects presented in the contributions are of a qualitative nature. Existing attempts to assess effects of competition law enforcement quantitatively have mostly been based upon price effects. Although it may be argued that the effect on prices is not the only impact of enhanced competition – maybe not even the most important one – prices may be a convenient quantitative indicator of the overall effects. A quantitative approach is indispensable for more advanced cost/benefit analyses of competition law enforcement, like the one presented in the contribution from Japan.

### **3.5 Perverse effects**

30. Enforcement of competition law implies an intervention into the free play of market forces. Such intervention is motivated when *laissez-faire* would lead to a less than optimal outcome in terms of market efficiency. However, the obvious difficulties in quantifying the effects of competition law enforcement in the individual case is a reminder of the importance of not creating perverse effects – that is, hampering efficiency, growth and economic development – through enforcement activities. The contribution from Jamaica quotes an example where an agreement between competitors in the petroleum market was found to enhance efficiency, which should ultimately benefit the consumer through lower prices at the pumps. Consequently no action against the agreement was taken by the competition authority. Thus, in the enforcement of competition law, avoiding intervention against pro-competitive conduct is as important as the intervention against anticompetitive conduct.

### 3.6 *Methodology issues*

31. The contribution from Japan describes a method for the measurement of effects of a cease and desist order in a bid rigging case. In order to overcome the difficulty resulting from differences in contents, scale, *etc.*, the competition authority examined changes in the ratios of actual contract prices to planned contract prices pre-set by the procuring public agencies. The result of this examination, related to a case on public procurement in the market for machines and equipment for automobile testing, showed an economic effect of the enforcement action of US\$4.4 million following from the reduction of the total procurement cost. In comparison, it should be noted that the competition authority spent only approximately US\$190 thousand in handling the case.

32. The Swedish contribution refers to an econometric study of the price effect following from the prohibition of a frequent-flyer program. The study was made by an independent researcher commissioned by the competition authority, who compared periods with and without bonus schemes using a regression model that includes up to 15 control variables (distance, population, competition from train, *etc.*). As a result of this analysis a 10 per cent price effect of the anticompetitive practice was identified.

33. A method for measuring the effect of opening markets for competition by comparing different sectors is referred to in the contribution from Ukraine, also mentioned in paragraph 20 above.

## 4. **Issues for discussion**

34. The following issues are proposed for the general discussion under Session IV of the GFC meeting:

- Should competition authorities take a more systematic approach to follow up effects of enforcement cases?
- Should competition authorities encourage economic research by academic institutions to demonstrate effects of competition law enforcement?
- Is there a need to develop methods for the evaluation of such effects that could be used by competition authorities or independent researchers?
- Is there a need for international co-operation aiming at joint studies of effects and efficiency of competition law enforcement?
- What lessons for economic development can be learned by comparing jurisdictions with aggressive enforcement histories with jurisdictions with modest enforcement histories?

**NOTES**

1. Background Note by the Secretariat, CCNM/GF/COMP(2003)7.
2. As of 30th January, contributions on the theme of Session IV have been submitted by Jamaica, Japan, Lithuania, Pakistan, Poland, Romania, Russian Federation, South Africa, Sweden, Chinese Taipei, Thailand and Ukraine.
3. See Secretariat Note CCNM/GF/COMP(2003)7, paragraph 11.
4. Contribution from Pakistan, CCNM/GF/COMP/WD(2004)18.
5. Contribution from Chinese Taipei, CCNM/GF/COMP/WD(2004)26.
6. Contribution from Ukraine, CCNM/GF/COMP/WD(2004)14.
7. Contribution from Poland, CCNM/GF/COMP/WD(2004)25.
8. Contribution from Romania, CCNM/GF/COMP/WD(2004)7.
9. Contribution from the Russian Federation, CCNM/GF/COMP/WD(2004)3.
10. Contribution from Jamaica, CCNM/GF/COMP/WD(2004)19.
11. Contribution from South Africa, CCNM/GF/COMP/WD(2004)11.
12. Contribution from Japan, CCNM/GF/COMP/WD(2004)13.