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COMPETITION POLICY IN SMALL ECONOMIES

-- KOREA --

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KOREA

SPECIAL ASPECTS OF COMPETITION POLICY IN SMALL ECONOMIES

1. Introduction

A small economy may be small in terms of its size of national income, per capital GDP, domestic market, population or territorial size. There seems to be no clear definition of a small economy or a threshold for the factors to determine an economy as small or large. Nevertheless, size of an economy does not change the need for competition law and policy.

In a small economy, trade liberalisation is very important to overcome its limit of small-sized economy and facilitate competitive market environment, but competition policy has an important role to play as follows.

First, trade liberalisation can be achieved by lifting or easing trade barriers. However, there can still be anti-competitive practices by corporations, which acts as private entry barriers even after the trade liberalisation. In this respect, competition policy can enable trade much more easily by reducing entry barriers to foreign competitors through advocacy role of competition authority. Second, implementation of competition policy can deter anti-competitive practices of not only the domestic firms but also the foreign firms. It should be noted in particular that trade liberalisation is not enough to guarantee a level playing field. Whereas official barrier has been lifted by the trade liberalisation, anti-competitive behaviours such as cartels or exclusionary practices by the parties may remain.

In Korea, when Korean government tried to introduce a competition law in the 70s, many doubted the need for a competition law. There were many who believed that Korea needed national champion to overcome Korea's relatively small market by competing in overseas market. Consequently, the establishment of competition law had been delayed. The delay in adoption of competition law in part was the reason for high concentration of Korean market. The ill effects of market distortion became more profound.

In the end, the Monopoly Regulation and Fair Trade Act (MRFTA) was legislated in 1980 and came into force in 1981. The result was quite remarkable that the concentration ratio of industry (CR3) decreased from 62.4% in 1980 to 45.4% in 1999, and, the behaviour of corporations have become more competitive rather than being collusive.

Especially after financial crisis in 1997, competition policy was reinforced, which played a crucial role in strengthening competitiveness of Korean firms through reform. For the past five years after the financial crisis, regulatory reforms driven by strong advocacy role of Korea Fair Trade Commission has contributed to the creation of a more favourable environment for businesses and foreign direct investment.

Since its establishment, KFTC has promoted competition in the markets through law enforcement and advocacy role in decision-making in the government and regulatory reforms. It has also contributed to lifting and easing numerous entry barriers, which had been established in the name of industrial policy imposed by other ministries since 1960s, the period when Korea was actively pursuing government-led growth strategy.

In retrospect, one might argue that it was Korea's industrial policy that made Korea an important player in global economy. However, Korea could not have maintained its status had it not been for competition policy that made Korean firms more competitive.

2. Special Aspects to Consider in a Small Economy

Although the principle of competition remains the same regardless of the size of an economy, small economies have their unique attributes, which must be taken into account when applying competition law.

2.1 *Productive and Allocative Efficiencies*

Basically small economy has several bottlenecks when compared with a large economy. One crucial attribute is the economies of scale. That is, if scale economy exists, domestic demand can support only small number of firms because of the small size of the economy. In this case, there will be a trade off between productive efficiency and allocative efficiency.

In a large economy, since market concentration in the most industries is smaller than in small economies, productive efficiency and allocative efficiency could be achieved simultaneously. However in a small economy, if competition authority emphasises allocative efficiency, and so does not allow mergers, which could increase market concentration in an already concentrated markets, then the economy would lose productive efficiency if such mergers can achieve economies of scale.

Therefore, the application of competition policy in a small economy need to be adjusted or tailored depending on market conditions (demand condition) of each economy and technological condition (minimum efficient scale). In other words, relative weight of demand size compared with minimum efficient scale should be considered.

This does not mean that a small economy does not need a competition law. In a liberalised economy MES (minimum efficient scale) is not restricted to a domestic market. Moreover, large firms of national champions should not be allowed to obstruct possible new entry or engage in anti-competitive practices at the cost of consumer welfare. It should be noted that for hardcore cartel and group boycotts and etc., large economy and small economy face the same problem since those anti-competitive behaviours are against public interest, harming consumer welfare without enhancing competitiveness of firms.

As we have seen, in a small economy, there are other factors for competition authority to consider. However, such factors do not change the need for competition law.

2.2 *Small Geographic Market*

In general, a small economy has a small geographic market. An economy with relatively large population and national income might have some special factors considered if it is geographically small. Smaller geographic market can be easily captured by pre-emption of the first mover or incumbents in the area of distribution channel and after-sales service network and etc. Exclusive dealership or after-sales service network by incumbents could work as a serious entry barrier to potential entrants, especially to potential foreign competitors.

Domestic manufacturers fully capitalise on this geographical attribute. That is, they could easily deter foreign (or domestic) potential competitors by establishing exclusive distribution channels. Domestic incumbents could easily set up exclusive distribution channels, since area to be covered is relatively small. If the incumbents pre-empt exclusive distribution channels in most of the (relevant) locations throughout the country, it will not be easy for the new entrants to establish distribution channels in a wide range of locations.

Relative to exclusive distribution channel, general distribution channels (which carry vast number of brands) may not be developed because of very powerful and exclusive distribution channel. Manufacturers may also cover after-sales service network exclusively. This can become a strong entry barrier. Therefore, a country with relatively high population and national income but with small size in terms of geography such as Korea might face the problem of this kind, because the first movers could easily foreclose the market. In this case, competition policy should also pay attention to these kinds of structural characteristics, such as distribution channels or after-sales service network.

In small economies, where the number of business elites is very small, their relationships are closely knit with family or academic backgrounds. This increases the likelihood of collusive action and exclusionary business practices. Such an environment calls for a stronger advocacy role by the competition authority.

2.3 *Position in the Government*

Competition authority in a small economy often start as a branch of government ministry and expand into a fully independent government agency. This was the case in Korea. KFTC started out as a part of Economic Planning Board, in 1981 and became an independent government agency of vice ministerial level in 1994. In 1996, the organisation of KFTC became a ministerial body and the Chairman of the KFTC became a member of the cabinet meeting.

In an earlier stage of competition policy implementation, a country might opt for a competition authority within an existing government agency to promote harmonisation with trade or industrial policy. However, Korea experienced that competition policy can be distorted when the competition authority is not endowed with independence from other government bodies. The lesson was that a competition authority should be independent to enforce the law without interference from government and to play its competition advocacy role more effectively.

2.4 *Need for International Co-operation*

It is strongly possible for competition authorities of small economies to face significantly greater obstacles in gathering evidence, especially when investigating international cartels initiated generally by MNEs which normally try not to keep significant documents in foreign jurisdictions (here small economy). In order to resolve this issue, international co-operation needs to be sought through both bilateral and multilateral approaches. Competition authorities of other countries can aid investigation. Since small economies are susceptible to MNE's threats of withdrawal from its market when it tries to sanction violators, it needs assistance from international organisation such as the WTO within a framework of multilateral agreement.

Korea, although it is not a small economy, has suffered from international cartel in the area of graphite electrodes and other intermediate goods. Studies show that the harm from cartels is greater for the developing countries that tend to be small economies. Last year, the KFTC made its first extraterritorial

application of its competition law (Monopoly Regulation and Fair Trade Act), for the first time to international cartel of graphite electrodes. Since it was the first time to apply MRFTA to international cartel, the enforcement was not easy. But since evidence was already gathered and proved by other jurisdictions, it was much easier for KFTC to conduct its investigation.

3. Conclusion

Indeed, small economies have different attributes from larger economies. By taking into account of such differences, the enforcement of competition law will be facilitated as there is no competition law that "fits all".

However, it was examined that the difference in size should not change the need for a competition policy. Although the markets of small economies might be relatively concentrated with small number of firms for MES reason, this does not mean that competition law is not necessary. This is because level playing field must be guaranteed and the consumers must be protected from anti-competitive practices of corporations, which harm consumer welfare.