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Joint Group on Trade and Competition

ASSESSMENT OF WTO AND COMPETITION RULES FOR ENTERPRISES WITH EXCLUSIVE OR SPECIAL RIGHTS

Note: This document cancels and replaces the document with the same cote issued yesterday, which was erroneously labled "Unclassified". The document has not been declassified and remains "For Official Use Only"

In the 9 June 2000 Joint Group Meeting, Delegations considered this Note. Delegations found that the paper had gone as far as it could at the moment and agreed to conclude the paper by written procedure. It was agreed that Delegations would submit any written comments to the Secretariat by 14 July 2000, and the document would be revised on that basis and sent back to Delegations for final approval under written procedure. In addition, the Co-Chair observed that one significant regulatory question arising out of the study was the separation of competitive from non-competitive parts of an industry. He also noted that the work programme includes regulatory reform, and suggested that possibme follow-up work to the study could therefore be undertaken on vertical separation after the CLP had completed its work on the subject. The note was revised in light of the comments received, and was approved under written procedure on 7 November 2000.

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Executive Summary

1. The objective of this paper is to assess the existing WTO and competition rules with respect to enterprises with exclusive or special rights that limit market entry. The topic is important for the following two reasons. First, behaviour of such firms sometimes can be seen to fall within a border area between autonomous commercial activity of a firm, which is subject to competition policy, and state intervention, which is subject to the WTO rules. And, secondly, such enterprises are still commercially significant. The study focuses on three sectors: electricity supply, telecommunications and agriculture.

2. At the outset, it is worth noting several caveats about this study. Although the study does draw certain conclusions from the analysis of each of these sectors, it also notes that it is difficult to make comparisons across these sectors because of their different economic characteristics, regulatory histories and rationales and social underpinnings. These differences are particularly stark between the agricultural sector on the one hand and electricity and telecommunications on the other hand. The study does not cover state owned enterprises *per se*, although it relates to all enterprises with exclusive or special rights, irrespective of ownership. Finally, although the study focuses on enterprises with exclusive and special rights that limit market entry, not all delegations agree that exclusive and special rights to export in effect limit market entry, and suggest that a fuller assessment of the competition and trade effects of such rights would require a deeper analysis of the conditions of competition, including distortions caused by trade measures, subsidies and other state aids.

3. In the 9 June 2000 Joint Group Meeting, Delegations considered this Note. Delegations found that the paper had gone as far as it could at the moment and agreed to conclude the paper by written procedure. It was agreed that Delegations would submit any written comments to the Secretariat by 14 July 2000, and the document would be revised on that basis and sent back to Delegations for final approval under written procedure. In addition, the Co-Chair observed that one significant regulatory question arising out of the study was the separation of competitive from non-competitive parts of an industry. He also noted that the work programme includes regulatory reform, and suggested that possible follow-up work to the study could therefore be undertaken on vertical separation after the CLP had completed its work on the subject.

1. Exclusive or special rights

4. This study identifies four types of exclusive or special rights that limit market entry, according to their policy objectives: regulation of natural monopoly and/or protecting universal service; protection of domestic industry from import competition; raising fiscal revenue and/or protecting public health;[1] and enhancing co-operation among producers and/or their bargaining power in marketing. Exclusive or special

[1]. A government does not necessarily pursue both of these two objectives (i.e. fiscal revenue and public health objective) in granting an exclusive right.

rights do not necessarily create market power. However, they may do so when their conduct is not effectively constrained by the existence of substitutable goods or service.

5. Exclusive or special rights regulating a natural monopoly and/or protecting universal service exist commonly in OECD economies in public utilities, although the notifications to the WTO referred to in this paper cover only a small proportion of them. Most governments have not notified public utilities (electricity, gas and water), even if they have been given exclusive rights.

6. While natural monopoly conditions are deemed to exist in the provision of network services, such as electricity transmission and distribution, a utility firm is often granted a geographic supply franchise, so that exclusive rights cover potentially competitive areas as well.

7. Exclusive or special rights for policy purposes such as a universal service obligation and revenue purpose may sometimes be substituted by more efficient and less trade and competition restrictive alternatives. However, whether such a substitution is appropriate in any given case would require, *inter alia*, an analysis of the social underpinnings of the existing regulatory regime.

2. Major trade-oriented competition issues in electricity supply, telecommunications and agriculture

8. In telecommunications and electricity, while important reform in removing exclusive or special rights or limiting their scope has begun, barriers to competition and trade still remain. In electricity, exclusive territorial franchises for the retail sale of electricity are still retained except for largest consumers in most OECD economies, and in telecommunications market structure remains highly monopolistic for local network services. In both industries, non-discriminatory and efficient access to the network service is the key issue for the development of competition and international trade. An efficient, non-discriminatory access regime encompassing pricing and other terms could facilitate promotion of competitive entry, reduction of price for consumers, and the maintenance and development of the network service. Separation of the monopoly and competitive segments, e.g., electricity transmission from generation, is one way to promote entry and market access into the competitive segment.

9. While the gains from trade are likely to be substantial in these industries, there exist concerns about asymmetric liberalisation in terms of international bargaining power, competition and stranded costs.

10. In the agriculture sector, lowering the high tariffs bound in WTO schedules has become an important issue not only for expanding the gains from international trade, but also for promoting competition in the domestic market. As long as the tariff is set very high, imports cannot constrain domestic prices.

11. While there is some concern over the possibility that export-oriented state trading enterprises in agriculture exercise monopsony and monopoly powers for gaining “unfair” export competitiveness, competition in the world market may constrain these powers.

3 Assessment of competition policy and WTO rules

12. WTO rules do not address directly the existence of exclusive or special rights. Competition laws do not directly address the existence of these rights either, with certain exceptions in the EU, although competition authorities indirectly address them through competition advocacy in some countries.

13. WTO rules oblige member governments to avoid taking measures that can undermine the non-discrimination principles of the WTO or liberalisation commitments by governments. The WTO rules also, to some extent, oblige member governments to prevent an import monopoly or a monopoly service supplier from undermining these principles or commitments. Thus, WTO rules address both government measures applied to enterprises with exclusive or special rights and their autonomous conduct, which may cause discrimination against foreign products.

14. However, there may exist some important gaps:

- The GATS requires a government to ensure non-discriminatory conduct by a monopoly service supplier only with respect to those services provided to foreign services or service suppliers in the markets that are subject to liberalisation commitments.

- In the view of some Delegations, WTO rules effectively address market power of only the supply side or the demand side -but not both- of an enterprise with exclusive or special right.

15. Somewhat paradoxically, there is a danger that the current WTO disciplines may become increasingly inadequate as entry liberalisation takes place, since, once exclusive or special rights are removed, the WTO provisions relating to such rights cease to be applicable, even if a firm continues to have strong market power. In this respect, the reference paper of the Basic Telecommunication Agreement may provide important lessons.

16. There do not seem to exist major gaps in competition law in covering the conduct of enterprises with exclusive or special rights, which have anti-competitive exclusionary effects. Thus, , competition law, where it exists, can support strongly the non-discrimination principle of the WTO to be applied to the network.

17. It is important to ensure coherence between regulatory and competition policies, e.g., in market definition and in identifying market power and anti-competitive conduct, given that regulatory policy has increasingly played an important role in promoting competition, in particular, in enforcing non-discriminatory access to the dominant network. The task of competition law enforcement is facilitated when the monopoly segment is separated from competitive ones.

18. Cartels in the agricultural sector are exempted from competition law prohibitions in some countries, although cartel exemptions typically do not extend to exclusionary cartels or joint boycott.

19. Appropriate implementation of domestic policy, including competition policy, will significantly reduce the risk that removing exclusive rights will harm the liberalising country even if liberalisation is unilateral and asymmetric. Internationally co-ordinated efforts for market liberalisation will further strengthen such a prospect. To ensure that liberalisation results in active international competition will require competition policy enforcement to prevent international collusion.

20. Finally, in the view of some Delegations, as wholesale and/or retail competition is liberalised, one potential question arises in the case of electricity. Once a vertically integrated firm is transformed from a monopsony buyer of electricity to a monopoly transmission service seller, do the GATT provisions for a monopoly importer or the GATS provisions for a monopoly supplier apply to the network services supplied to foreign electricity generators?

Introduction

21. The objective of the study is to assess the existing WTO and competition rules with respect to enterprises with exclusive or special rights in OECD Member countries. Analysing this area from a trade and competition perspective is important for the following two reasons. First, behaviour of such firms sometimes can be seen to fall within a border area between autonomous commercial activity of a firm, which is subject to competition policy, and state intervention, which is subject to the WTO rules. Second, while entry liberalisation has been taking place in many sectors, enterprises with exclusive or special rights are still significant commercially.

22. At the outset, it is worth noting several caveats about this study. Although the study does draw certain conclusions from the analysis of each of these sectors, it also notes that it is difficult to make comparisons across these sectors because of their different characteristics, regulatory histories and rationales and social underpinnings. These differences are particularly stark between the agricultural sector on the one hand and electricity and telecommunications on the other hand. The study does not cover state owned enterprises *per se*, although it covers all enterprises with exclusive or special rights, irrespective of ownership. Finally, although the study focuses on enterprises with exclusive and special rights that limit market entry, not all delegations agree that exclusive and special rights to export in effect limit market entry, and suggest that a fuller assessment of the competition and trade effects of such rights would require a deeper analysis of the conditions of competition, including distortions caused by trade measures, subsidies and other state aids.

23. It has four sections. Section I provides definitions and typology of exclusive and special rights. On the basis of this typology, Section II presents a statistical overview of state-trading enterprises with exclusive rights as notified to the WTO by OECD countries. Section III contains an analysis of major trade-related competition issues, as well as of the coverage of WTO provisions and competition rules, for enterprises with exclusive or special rights, based upon sector reviews, covering: electricity, agriculture, and telecommunications. Section IV presents an assessment.

I. Typology of enterprises with exclusive or special rights

Working definition of exclusive or special rights in this study

24. The primary focus of this study is on enterprises with exclusive or special rights that limit market entry. For the purposes of this study, such rights include the right to operate in a market subject to some form of regulatory entry restriction. An exclusive right limits the grant of such a right to a single firm, such as a monopoly franchise for a particular market or a monopoly marketing right of a particular product. A special right limits the grant of such a right to two or more competing firms, based on such policy consideration as demand-supply balancing policy.[2] Such entry restrictions are likely to create market power when business conduct is not effectively constrained by the existence of substitutable goods or services. Enterprises with exclusive or special rights under this working definition may be either government owned or privately held, or some combination of both. Special access to financial assistance

2. The EU directive on telecommunications in March 1996 has the following definition of special rights: special rights which limit to two or more the number of undertakings authorised to provide telecommunication services or to establish or provide such networks, otherwise than according to objective, proportional and non-discriminatory criteria.

from government is outside the scope of the study, since this is being treated essentially as a "subsidies" matter.[3]

25. As for the relationship with State-Trading-Enterprises under Article XVII of the GATT, the enterprises with exclusive or special rights defined above would be only a subset of the enterprises covered by Article XVII. Although the GATT has not provided a precise definition of a state-trading-enterprise, the 1994 Understanding on Article XVII provides a broad definition: "[governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports". On the other hand, the class of enterprises with exclusive or special rights as defined above is likely broader than the range of suppliers covered by GATS Article VIII. Article VIII covers a small number of exclusive service suppliers, authorised or established by a state, only when competition among them is substantially prevented.[4]

Typology of enterprises with exclusive or special rights

26. A government may grant an enterprise exclusive or special rights over the following activities: domestic sales of a product, import, production, sales of domestic products to both domestic and export markets, and export of domestic products. The first two exclusive rights allow a firm to control the level of supply (of imported and domestic products) to the domestic market, while the last three exclusive rights allow a firm to control, or substantially influence, the supply of products produced domestically.

27. It is important to note that an exclusive right to purchase domestic product has an equivalent effect as an exclusive right to sell domestic product. Either right can create market power with respect to both purchases and sales. The same point applies to an exclusive right to sell to the domestic market or to purchase for the domestic market. Either right can confer market power on both the supply and the demand side. Exclusive or special rights do not necessarily create market power. Most importantly, the exercise of market power on the supply side can be constrained by product market competition, if an exclusive right covers only a limited part of the competitive supply available for a relevant market. In addition, the exercise of market power on the demand side can be constrained if suppliers to the firm with an exclusive right effectively control its operation.[5]

28. There are four broad policy objectives for which the government provides these exclusive or special rights to a firm (See Table 1).

Regulating natural monopoly and/or protecting universal service

29. In industries such as electricity and gas, exclusive rights are usually based on natural monopoly considerations. Entry is restricted to prevent wasteful duplication of investment in these industries, which would increase the average cost of supply. While natural monopoly conditions are deemed to exist in the

3. However, this is not based on the presumption that the existing WTO subsidy rule adequately covers subsidies.

4. Article VIII(5) provides that: "(Article VIII) shall also apply to cases of exclusive service suppliers, where a Member, formally or in effect, (a) authorizes or establishes a small number of service suppliers and (b) substantially prevents competition among those suppliers in its territory."

5. Often a co-operative provides an organisational structure under which member suppliers prevent the firm entrusted with a common service such as inventory and marketing to exercise its market power with respect to themselves [see Milgrom and Roberts (1992)].

provision of network services, such as electricity transmission, a utility firm is often granted a geographic supply franchise, with the result that the scope of exclusive rights granted covers potentially competitive operations, such as electricity generation, as well. When such a sales franchise is national in coverage, it implies an exclusive right to purchase as well as to import. When such a franchise is local, local franchisees may compete in purchasing products on the wholesale market, as in the case of the US electricity industry, although they may have a monopoly power in the local market.

30. A related, but separate rationale for granting exclusive rights is to preserve a firm's financial capacity to provide universal service, such as a uniform postal service within a country. Under this obligation, the same good or service must be provided at the same price irrespective of significant cost differences in servicing different geographic areas or categories of customers, and irrespective of different levels of demand from such customers. When such is the case, competition in the liberalised segment could eliminate the source of funds for the non-profitable segments of the market. From this perspective, entry would be allowed in so far as it does not negatively affect the profit of an incumbent firm obliged to provide universal service.[6]

31. A Similar rationale may be observed in some import-oriented agricultural state trading enterprises especially in developing countries. The stated objectives of these enterprises are to ensure availability of food supplies for domestic consumers at affordable prices and to realise economies of scale in trade operations.[7]

Protection of domestic industry from import competition

32. Exclusive rights on imports are usually granted to protect domestic industry. The restriction of imports makes the domestic price higher than the international price, while shifting demand to domestic industry. The import monopoly can also insulate the income of domestic producers from the fluctuation of international prices by adjusting the level of mark-up. Import monopolies for this purpose used to be prevalent in the agriculture sector. Exclusive rights with respect to domestic sales may be used to protect the domestic industry too, when the firms with such a right discriminate against imported products by, for example, applying on them a higher mark-up than for domestic products. However, under WTO rules, monopolies are not permitted to afford protection on average in excess of a member's bound commitments.

Raising fiscal revenue and/or protecting public health

33. The government may grant an enterprise the exclusive right to sell a particular good, regardless of origin, domestic or foreign, in order to raise revenue and/or to control the consumption of goods which are regarded as harmful to health. Alcoholic beverages, tobacco, and salt have been chosen by some countries for these objectives, since domestic demand for these products is relatively price inelastic[8] and, in addition, the government may have a public health objective of reducing their consumption. These two objectives do not necessarily go in tandem. A government may pursue only one of these two objectives in granting an exclusive right. Since these enterprises have an exclusive right to sell the

6. The European Court of Justice presented a clear view in this line with respect to the interpretation of Article 90(2) of the Treaty of Rome in 1991 (Corbeau (C-230/91). It stated that "the exclusion of competition is not justified as regards specific services dissociable from the services of general economic interest (...), in so far as such specific services do not compromise the economic equilibrium of the service of general interest performed by the holder of the exclusive right."

7. A state trading enterprise with such objectives is one type of "canalizing agency" as that term has been used by some developing countries (See WTO (1995)).

8. Low price elasticity means low dead weight loss from mark-up of price above marginal cost.

specified category of products, they may well have an implicit exclusive right to purchase and to import as well. Instead of an exclusive right to sell, an enterprise may only be granted an exclusive right to produce the designated product, when imports are controlled by a tariff.

Enhancing co-operation among producers and/or their bargaining power in marketing

34. Another government objective for granting exclusive rights is to promote co-operation in marketing and other economic activities among producers in order to improve their efficiency and to enhance their bargaining power in marketing.[9] Some agricultural exporting countries have maintained such state trading enterprises, which have the exclusive right to export domestic products either as a single seller or as a single licensing authority. These exclusive rights are aimed at reducing risk for farmers by pooling market risks and at promoting production and sales by sharing the costs for R&D as well as for information gathering and sales promotion.[10] In addition, exclusive rights may also aimed at enhancing the international bargaining power of domestic producers and facilitating price discrimination across markets. This may typically be the case when their share of the world market is significant. Producers often effectively control these enterprises, with an industry representative overseeing their operations. Some of these enterprises also have the exclusive right to sell the domestic product in the domestic market as well.

Table 1. **Types and objectives of exclusive or special rights limiting entry**

	Exclusive or special right	Natural monopoly/ Universal service	Protection of domestic industry from import competition	Fiscal Revenue/ public health	Producers' co-operation/ Bargaining power
Control of domestic market	Domestic sales of all competing sources of a product	•	(•)	•	
	Import	(•)	•	(•)	
Control of the supply of domestic product	Production	(•)		(•)	
	Marketing of domestic product				•
	Export of domestic product				•
Example		Public utility	Import-oriented agricultural state trading enterprise	Tobacco and liquor monopoly	Export-oriented agricultural state trading enterprise

(Note) • suggests main exclusive or special rights and (•) suggests supplementary ones.

9 . Of course, some argue that these traits may also enhance the international competitive advantage of such enterprises.

10. See WTO (1995) and OECD (1996) for efficiency rationale of export-oriented state trading enterprises.

Alternative Policy instruments

35. Granting exclusive or special rights is not the only policy instrument available for pursuing the aforementioned objectives. There often exist efficient alternatives, which may be less restrictive of trade and competition, while addressing potential market failures which exclusive or special rights were intended to address. This section of the paper discusses some of these alternatives. However, in the view of some Delegations, ultimately choosing among alternatives is a complex policy decision that understandably will involve the consideration of many factors, including the social and historical context of the existing regulatory measures.

36. Protection of a natural monopoly from inefficient entry does not always require exclusive rights covering all stages of the supply chain in a particular industry. These rights can be limited to natural monopoly operations, while permitting entry and competition in the competitive parts of the industry (economic efficiency would also require, *inter alia*, an efficient access regime).[11] It is important to note, moreover, that the large sunk investments made by an incumbent that often characterise such an industry make the natural monopoly structure self-sustainable and discourage inefficient duplication of network infrastructures. An efficient access regime also reduces substantially the incentive for inefficient bypass of the existing network infrastructure.

37. A universal service obligation does not necessarily require exclusive or special rights either, at least on an ex-ante basis. Allowing an incumbent to re-balance the price structures in line with incremental costs would remove the possibility of cream-skimming entry. Even if regulated price structures remain distorted, establishing a scheme to independently finance unprofitable segments of the universal service will remove the necessity of entry restrictions. For example, bidding for subsidies to supply telecommunication services to remote areas would make competition possible both in profitable and unprofitable regions, and reduce total costs of the service.[12] Even if regulated price structures remain distorted, and independent finance for universal service is not available, appropriate access pricing would still enable both liberalisation of entry (ex-ante) and preservation of the financial capacity of the incumbent firm to provide the service. Such access pricing could compensate the incumbent firm for the loss of profit due to cream-skimming entry in high price segments of the market.[13]

38. Protection of domestic industry from import competition does not necessarily require exclusive import rights. Tariffs, unless prohibitively high, provide protection without eliminating competition from international trade. Tariffs are also transparent with respect to the level of protection provided to domestic industry. Furthermore, for the purpose of maintaining farmers' income, direct income support rather than market price support by import restriction can be more efficient, since the latter intervention may reduce both efficient import and consumption. And, for the purpose of income stabilisation, financial instruments for hedging against price fluctuation risks of farm products are sometimes available. The markets for such instruments may become more efficient and less costly for farmers to use as national agricultural markets

11. It is also important to note that entry liberalisation by itself does not harm the benefits of vertical integration between a business activity having natural monopoly characteristics and other business activities.

12. In Australia, for example, the universal service obligation in telecommunications can be put out for tender. The winner of the tender becomes an exclusive supplier of the service during the contract period, but it does face competition ex ante.

13. For an example, if a cream-skimming entrant causes one unit of sales loss to an incumbent firm by selling one unit in the market whose price is regulated at a high level, an access price covering both the marginal cost of access as well as the profit margin of the incumbent firm in that market could compensate for the incumbent firm's financial loss due to such entry (see Armstrong et al (1994)).

are integrated by international trade and risks are more efficiently pooled. Similarly, taxation can substitute for exclusive import and domestic marketing rights for the purpose of raising revenue, while allowing competition in international and domestic trade. Higher efficiency of supply resulting from such competition allows a government to raise revenue with less economic costs. Joint ventures can sometimes promote co-operation among producers on specific activities without necessarily restricting competition among them.

II. Statistical overview of state-trading with exclusive rights in OECD economies

39. This section provides a statistical overview of state-trading enterprises with exclusive rights, as notified by the OECD economies to the WTO from 1995 to 1996. According to the notifications, a total of 62 state-trading enterprises exist in about half of the OECD countries (see Table 2).[14] Since this overview is based on the notifications under the GATT, telecommunications and other service enterprises, even if they have exclusive or special privileges, are not covered. Before turning to the analysis, it is worth noting that the focus of this paper is on enterprises with exclusive and special rights that limit market entry. Not all delegations, however, agree that exclusive and special rights to export in effect limit market entry, and those Delegations would therefore exclude from the analysis below consideration of exclusive and special rights to export. They would suggest that a fuller assessment of the competition and trade effects of such rights would require a deeper analysis of the conditions of competition, including distortions caused by subsidies and other state aids.

40. In what follows, we focus on enterprises with exclusive rights. No enterprise with special rights (under the definition given in section I) was notified. As illustrated in Table 2, 36 out of the notified 62 enterprises have exclusive rights for at least one of the following five activities: domestic sales of a product, import, production, marketing/procurement of domestic products, and export.[15]

41. The following points are worth noting:

- These enterprises belong predominantly to the agricultural sector: 28 out of 36 enterprises. Three additional enterprises are agriculture-related (salt and industrial alcohol).

- There is a question of how complete the notification is for natural monopoly/universal service.

- Only two countries notified enterprises in the gas and electricity sectors, even though an electricity/gas company with a monopoly franchise for the entire national market would have, formally or in effect, an exclusive right to electricity import. Notifications cover three electricity and gas enterprises.16 In addition, almost no OECD country has notified sub-federal enterprises or agencies that may have exclusive or special rights in local markets in electricity, gas or water supply.

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14. In counting the number of state-trading enterprises, regional state-trading enterprises, which deal with a common product, such as provincial liquor boards in Canada and regional power marketing administrations in the United States, are counted as one entity. Firms with a parent-subsidiary relationship are also counted as one enterprise. An enterprise selling substantially different products (for an example, tobacco and alcoholic beverage) are counted separately for each product.

15. The notifications are not always clear on what exclusive or special rights are provided to these enterprises, and how binding they are. Thus, tabulation in Table 2 is a preliminary exercise.

16. They own the grids and have exclusive rights to import, export or both. Although not described in the notifications, it is likely that these enterprises also have the monopoly franchise for domestic sales.

- The scope of protectionist import monopolies in agriculture was narrowed down significantly, further to the Agreement on Agriculture in the Uruguay Round,[17] although very high tariffs have often been introduced instead. There exist only two import monopolies, which explicitly serve this purpose, out of 28 agricultural state trading enterprises. Both of them deal with rice and have been the exceptions to the tariffication of protection by state-trading enterprises.[18] The remaining agricultural state trading enterprises are either for fiscal revenue/public health objectives[19] or for producers' co-operation.

- Tobacco, alcohol and salt monopolies are still significant. There exist ten such enterprises in six countries. Most enterprises have exclusive rights for both domestic sales and imports. Some enterprises have exclusive rights only for production, presumably because imports are restricted by tariffs.

- According to the notifications, state-trading enterprises oriented to producers' co-operation/bargaining power are concentrated in three large agricultural exporting countries. Around one half of these enterprises have marketing rights for both domestic and export markets.

Table 2. **Enterprises with exclusive rights in OECD economies notified as state-trading enterprises (preliminary tabulation)**

		Agriculture	Others	Total	Major products	No. of Countries	Exclusive rights as notified
Natural monopoly/Universal service		0	3	3	Electricity and gas	2	Import, export and (domestic sales)
Protection of domestic industry from import competition		2	1	3	Rice	3	Import
Fiscal revenue/public health		10	3	13	Tobacco, alcohol, salt, opium	6	Domestic sales and import, or only production
Producers' co-operation/ Bargaining power	Marketing (or procurement) of domestic product	7	1	8	Sugar, grain, fish, hops	3	Both domestic sales and export
	Export	9	0	9	Grain, wine, and dairy products, fruits	2	Export
Total		28	8	36			

Note: 1) In total, 14 OECD countries notified the existence of state trading enterprises, and 11 OECD countries notified those with exclusive rights from 1995 to 1996.
2) The scope of sectors covered by agriculture generally follows the coverage by the Agreement on Agriculture, which includes tobacco and alcoholic beverages, and excludes fish and salt.

Source: Notifications to the WTO.

17. This number does not include enterprises which have exclusive access to the tariff rate-quota.

18. One such exception was the import of rice by Japan. However, in April 1999, the Japanese government implemented tariffication for rice by replacing its import quota for rice with a tariff-rate quota.

19. However, it is important to note that some alcohol and tobacco monopolies did discriminate against imports, as shown by trade dispute cases in GATT and within the EC.

III. An analysis based on sector reviews

42. This section analyses how competition and WTO rules address the potential restraints of competition and trade by enterprises with exclusive or special rights, based on sector reviews covering electricity supply, agriculture, and telecommunications. It reviews exclusive or special rights, market structure, major trade-related competition issues, and application of competition and WTO rules. In terms of competition policy, the electricity and telecommunications sectors raise the same issue of controlling market power of an often vertically integrated network. In agriculture the effects of state-trading-enterprises on international competition is the main issue. In terms of WTO rules, GATT applies to agriculture, and GATS to telecommunications, while both GATT and GATS are relevant to electricity[20].

Exclusive or special rights and market structure

43. Most OECD economies have been implementing policy reforms in telecommunications and electricity, with a view to removing exclusive or special rights or limiting their scope. In telecommunications, exclusive or special rights limiting market entry have been abolished in most OECD countries, as the WTO Agreement on Basic Telecommunications Services entered into force in February 1998.[21] In electricity, many countries have started liberalising the production and sale of electricity by limiting exclusive rights only to transmission and distribution activities, and by ending exclusive territorial franchises, starting with the largest consumers.

44. This liberalisation process in telecommunications and electricity has been driven by the recognition that narrowing the scope of exclusive or special rights will open up the hitherto protected sector to competition, and will correct inefficiency in regulated monopoly areas. The experience with regulatory reform in many OECD countries has now clearly demonstrated the existence of significant economic gains from competition, in terms of lower price and cost, and better product choice.[22] It is also recognised that policy objectives such as universal service, revenue generation and income protection can often be achieved by alternative more efficient and less restrictive instruments. At the same time, it is important to note that the introduction of competition can raise some serious transition problems, such as stranded costs for some incumbent firms, and loss of privileges for some categories of consumers. The design and implementation of appropriate mechanisms to cope with these problems is a necessary element in getting political support for reform.

45. In agriculture, the WTO Agreement on Agriculture, with a few exceptions, resulted in the conversion of non-tariff measures such as quantitative import restrictions and other measures maintained through state-trading enterprises, to bound tariffs subject to reduction commitments. In some cases, the resulting tariffs are too high to provide for effective competition from imports in the domestic market. In other words, even in circumstances where private firms are now permitted to enter the market for trade, the

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20. We assume in this report that generated electricity itself is a good while its transmission and distribution is a service, given that all OECD countries, except for some island countries, have bound tariffs for generated electricity. The EU article 37, which is one of the key articles for securing free movement of goods within the EU, has been applied to electricity (see the second footnote for Para. 34). However, there is little authoritative guidance from the WTO rules or from panel or Appellate Body decisions whether electricity is service or not. (However, it has been suggested that GATT drafters assumed that electricity is a service [WTO (1998*b*) on energy services]).

21. Governments covering 82% of world revenue from basic telecommunications services committed to full competition as of February 1998 and another 6% on or before 2005 [WTO (1998a)].

22. See OECD (1997), IEA(1999), Armstrong et al. (1994) and Helm and Jenkinson (1998).

high level of tariffs may continue to prevent them from importing. Foreseeing this, WTO Members also committed to granting minimum levels of access at lower tariff rates through tariff-rate quotas (TRQs). These rates are also bound and subject to reduction commitments. Some state trading enterprises have maintained their status as sole importer in cases where they are granted the quota allocation under the TRQ or have a role in its administration. These market access provisions under the WTO Agreement on Agriculture did not affect any exclusive export rights granted to state trading enterprises, but the Agreement does prohibit state-trading enterprises from restricting trade through non-tariff measures.

Market structure

46. In network industries such as electricity and telecommunications, monopoly segments of industry are still important. In the electricity sector, transmission and distribution will remain natural monopoly activities. In telecommunications, incumbent firms still have dominant positions in local networks even in those countries which liberalised local services a decade ago (See Table A2 in the Statistical Appendix). As a result, these network services are often subject to price regulation.[23] In addition, the incumbent firm owning the network facility is often vertically integrated, and operates in both the regulated and unregulated markets.

47. Unlike network utilities - with market power arising from highly concentrated market structure and a huge sunk cost of entry - most agricultural markets have competitive structures although the exclusive rights enjoyed by state trading enterprises may create market power under certain circumstances. Exclusive import rights can easily create market power in the domestic market of a country that does not have a comparative advantage in agriculture. This is because the level of imports affects domestic price significantly in such a country. However, while some Delegations argue that some agricultural markets, such as international grains markets, are highly concentrated. Others argue that the limited market share of exporting state trading firms in the agricultural sector means that it is likely that few, if any, have effective market power, rather they are likely to be price takers in the global market. (See Table A.3 in the Statistical Appendix). These enterprises face competition with each other and with private firms in the world market, even if each of them has an exclusive right to export its national product.

Major Trade-related competition issues

Major competition issues

48. In telecommunications and electricity removing exclusive or special rights restraining market entry is a necessary step for opening up economic activities for which competition is feasible and efficient. It is also a critical step for the development of international trade in these areas. While exclusive or special rights have been almost completely eliminated in telecommunications, in the electricity sector the process of removing local monopoly franchises has just begun. Its progress depends significantly on the co-operation of local governments in those countries where local governments have licensing authority. At this stage, even domestic trade of electricity is constrained in many countries.

49. Once entry is liberalised, securing competitive conduct by vertically integrated firms becomes crucial in network industries such as electricity and telecommunications. A firm that operates both in the provision of a network service and in liberalised markets has the incentive and ability to discriminate

23. Excessively low regulated prices in the local network due to insufficient rate-rebalancing can cause sustained dominance of an incumbent by discouraging entry in the local network.

against competing firms in the access to the network, and to shift costs from the unregulated market to the regulated market when the price of network services is subject to cost-based regulation. In addition, in the telecommunications sector where network externalities are significant, the incumbent has an incentive to deny interconnection, in order to maintain its competitive advantage due to larger size of its network, even though consumers gain from interconnection. An effective enforcement of competition rules against incumbents' conduct aimed at raising rivals' costs is therefore crucial for facilitating entry of both domestic and foreign competitors. A key regulatory intervention in this respect is to require the incumbent vertically integrated firm to offer non-discriminatory access to its network, in both price[24] and non-price dimensions, including access to information on the network service. Moreover, separation of the monopoly and competitive segments removes the incentive facing the network operator to discriminate among firms in the competitive segments. Separation also facilitates the remaining regulation of the network operator.

50. In the agriculture sector, lowering the very high bound tariffs could have the effect of lowering domestic prices, and might have a positive effect on international trade and competition, particularly if monopoly importers are unable to revert to non-tariff restrictions. Similarly, ending exclusive export rights could afford a greater role to market forces in determining production and trade patterns. However, in the view of some Delegations, ultimately, these potential gains would have to be assessed in the context of a fuller analysis of the competitive conditions and industry characteristics prevalent in international agricultural markets.

International issues

51. Gains from trade are likely to be large in the electricity and telecommunications sectors. In network industries, international trade will enhance the gain due to the expansion of interconnected networks, as is clear in the case of telecommunications and many electricity markets. International trade and investment will enhance competition in sectors where the incumbent often maintains a dominant position, due to the legacy of exclusive rights.

52. In network industries, the speed of external market liberalisation seems to be slower than domestic market liberalisation. One sign of this is the higher price-cost margin for international telecommunications relative to domestic telecommunications. Besides the standard concerns over the impact of external liberalisation on domestic industry, there are also concerns specific to enterprises with exclusive or special rights.

53. One such concern is the impact of liberalisation on international bargaining power. In the telecommunications industry, asymmetric liberalisation between countries may weaken the bargaining power of a domestic operator relative to the foreign monopoly operator in international settlement agreements. In some cases, this has led to the introduction of conduct regulation such as a proportionate return requirement or a uniformity requirement in negotiated accounting rates. These national concerns, however, may slow liberalisation and cause high international prices to be maintained. A similar concern is observed in agriculture too. One of the arguments for maintaining export-oriented state trading enterprises

24. When a firm supplying bottleneck network service is vertically integrated, defining non-discriminatory access price itself is complicated, because access price for internal use of the network service may be merely a transfer price within the vertically integrated structure. When such firm perceives incremental cost of access as the true cost of access, only (two-part) pricing with the incremental access price being equal to its incremental cost will guarantee non-discrimination [See Armstrong et al. (1994)]. Thus, cost-orientation may be necessary for ensuring non-discrimination under such circumstances.

is to strengthen bargaining power to secure higher export prices, especially in markets where imports are controlled by monopolies.

54. Another source of concern arising from asymmetric liberalisation is the impact on stranded costs. In the electricity industry, asymmetric liberalisation is regarded by the US regulatory authority as worsening the problem of stranded costs in a liberalised area, since the utility from that area would not be able to export its electricity to a non-liberalised area.[25] Reciprocity clauses are allowed in both the United States and the EU as a condition for access. The direct effect of the reciprocity requirement, however, is the restriction of competition and international trade. These concerns about bargaining power or stranded costs highlight the importance of internationally co-ordinated efforts at market liberalisation.

55. There is also a concern that asymmetric investment liberalisation may allow a greater exercise of market power by a foreign monopoly enterprise. In telecommunications, there is a concern over anti-competitive bypass of an existing settlement agreement by a foreign monopoly enterprise through the establishment of an overseas subsidiary. If entry liberalisation is symmetric, such opportunities for bypassing the accounting rate system would be available in both countries and this would promote end-to-end competition. If not, asymmetric liberalisation could allow a greater exercise of market power by a firm with a protected market. Such concerns led to the introduction in the United States of a licensing policy for foreign investment based on the benchmark accounting rate.

56. There is also a risk of international collusion. When national firms have exclusive rights to provide a bottleneck network service in their respective countries, an international service can be provided only co-operatively by such national firms, since each firm needs the network service of another. Even if exclusive rights were removed, such would be the case as long as the national firm controls *de facto* the network service. Such a co-operative relation can lead to collusion, preventing the emergence of international competition. In telecommunications, national firms may agree to impose high interconnection charge on each other, so as to maintain a high price for international calls. In electricity, national vertically integrated firms may refrain from investment in international interconnections, in order to avoid creating international competition.

Application of competition policy

Phasing out exclusive or special rights

57. When a government creates a monopoly or duopoly by restrictive licensing, that market structure itself is generally not subject to the structural remedy based on competition policy. A major exception in this regard applies in the EU. EU member governments cannot provide exclusive or special rights to enterprises, inconsistent with other EU rules, including competition rules, according to Article 90(1) of the EC Treaty. In particular, if a firm with an exclusive right cannot avoid abusing its dominant position by merely exercising its right, the existence of an exclusive right itself can be regarded as a violation of Article 90 in combination with Article 86.[26] In addition, EU member states cannot establish or maintain a monopoly enterprise that will restrict intra-community trade of goods, according to Article 37 of the EC

25. However, in early liberalising States, utilities have been able to sell assets at prices well above book value.

26. See the EU submission to the WTO(WT/WGTCP/W/78), and Mavroidis and Messerlin (1997). Examples of the abuse of dominance in this context are excessive pricing (Port of Genoa, Case C-179/90) and inability to satisfy demand (Hofner, C-41/90).

Treaty .[27] But even in the case of the EU, competition rules do not apply to enterprises providing services of general economic interest or to revenue-producing monopolies, when their enforcement obstructs the performance of the particular tasks assigned to such enterprises (Article 90(2)). In particular, if the introduction of competition endangers the financial capability of the firm with an exclusive right to provide a universal service, the exclusive right could justified.

Securing competitive conduct[28]

58. While (central or local) governments often own enterprises with exclusive or special rights in electricity and other public utilities,[29] in most countries state ownership does not provide a justification for exempting or excluding such enterprises from the application of competition rules. In most continental European countries and in Canada, Japan, Australia and New Zealand competition law applies to the commercial activities of every enterprise, including those with state ownership. Competition law does not apply to government-owned and controlled firms in the United States and the United Kingdom. On the other hand, state ownership is relatively limited in these countries even in regulated industries, including electricity and telecommunications.

59. As for conduct, although some regulated conduct is exempted or excluded by legislation from the application of competition law, anti-competitive exclusionary practices by a dominant firm are typically not exempted in electricity, telecommunications and agriculture. Thus, in electricity, an unjustified refusal to provide access to a transmission network by a dominant incumbent can be prosecuted as an abuse of dominance. Competition law can also address predatory practices by a dominant firm in a liberalised market, which take advantage of the possibility of cost-shifting between the market for which it has an exclusive right and the liberalised market. Addressing market structure, i.e., separating the competitive and monopoly segments, can reduce the incentives of the monopoly supplier to engage in such anti-competitive practices in the first instance.

60. Cartels in the agricultural sector are exempted from competition law prohibitions in some countries [30]. Such cartels may negatively affect international trade, if they have market power to engage in exclusionary practices or to raise price above a competitive level. However, cartel exemptions typically do not extend to exclusionary cartels or joint boycotts.[31] For example, in the United States, while agricultural co-operatives are not subject to antitrust law, case law has established that an agricultural association exceeds that exemption when it excludes from the market all persons not buying or selling in accordance

27. Recently the European Court of Justice delivered a series of judgements with respect to exclusive import (and export) rights for electricity and natural gas in several European states, including France, the Netherlands, and Italy (cases: C-157/94, C-158/94, C-159/94, C-160/94). It ruled that exclusive import or export rights give rise to the violation of EU article 37. However, it also ruled that the European Commission did not provide enough evidence to establish that such exclusive rights could not be justified by Article 90(2).

28. See Hawk (1996) and the OECD roundtable on the relationship between regulation and competition (1998) http://www.oecd.org/daf/clp/Roundtables/relat00.htm.

29. See the Table A.4 in the Statistical Appendix. In the electricity industry, private industry is dominant only in 3 OECD economies, while state industry is dominant in 10 OECD economies and a mixture of ownership in 6 economies [see OECD (1997) on Regulatory Reform: Volume I].

30. See Hawk (1996) and OECD (1996).

31. There are exceptions in some regulated industries. In the maritime shipping industry a cartel agreement can include the dual rate provision for tariffs, under which shippers not agreeing to use cartel vessels will be charged a higher price.

with its fixed prices.[32] Exemptions can cover only producers. In the case of Japan, Article 24 of the Anti-monopoly law, which allows exemptions for co-operatives, makes it clear that their membership has to be voluntary. Moreover, unfair business conduct or substantial restraint of competition does not enjoy exemption. As for the impact on the international market, competition in the world market may prevent a national cartel from acquiring" before "international market power.

61. Given that anti-competitive exclusionary conduct is subject to prohibitions under competition laws, effective competition law enforcement can significantly facilitate the expansion of international trade once entry is liberalised. It would also be important to prevent the use of any national cartel exemptions or exclusive export right in agriculture to facilitate international cartels.

62. Sector-specific regulators have become increasingly involved in promoting competition, as entry is liberalised. In particular, they typically mandate non-discriminatory access to a dominant network service at a cost-oriented price in infrastructure sectors such as telecommunications and electricity. The regulatory principles as stipulated in the Reference Paper of the Basic Telecommunication Agreement are a good example. Regulation can play an important role in ensuring competitive conduct of a dominant firm on an ex ante basis in such areas as developing interconnection rules. Thus, securing consistency between regulatory interventions and competition policy in market definition and in identifying market power and anti-competitive conduct has become important.

Application of WTO rules

Phasing out exclusive or special rights

63. The GATT provisions do not oblige governments to phase out exclusive or special rights granted to enterprises, including those directly bearing on international trade.[33] However, exclusive import rights inevitably result in discrimination by preventing a foreign supplier from promoting sales directly to domestic consumers. In addition, once an enterprise is established for the purpose of protecting domestic industry and obtains exclusive import rights, there is no assured incentive for such a firm to expand imports even when the domestic price becomes substantially higher than the tariff-inclusive international price. Thus, a behavioural rule for securing non-discriminatory conduct of such an enterprise is generally hard to enforce. Similarly, the GATS provisions do not oblige governments to phase out exclusive right, unless liberalisation is specifically committed.

Securing competitive conduct

64. As the following discussions show, the WTO provisions oblige member governments to avoid taking measures that can undermine the non-discrimination principles of the WTO or liberalisation commitments by governments. They also oblige member governments to prevent an import monopoly or a monopoly service supplier from undermining these principles or commitments, although there exist some gaps. Thus, while WTO provisions place ultimate responsibility only on governments, they cover both government measures and autonomous enterprise conduct.

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32. See Areeda and Kaplow (1997).

33. GATT Article XVII recognises the right of member governments to grant such rights, while imposing behavioural constraints on the enterprises with such rights. In contrast, the EC Treaty (Article 37 of The Treaty of EC) is interpreted to require its member states to phase out exclusive import or export rights for goods on intra-EC trade. (see the EU submission to the WTO, WT/WGTCP/W/78)

65. The first important provision directly applying to a government measure is GATT Article III on national treatment in regulation. In the case of electricity the government typically regulates access terms to the transmission grid after liberalisation of wholesale and/or retail competition. Thus, national treatment in regulation obliges governments to ensure that the terms and conditions of access to the grid subject to government approval do not treat imported electricity in a discriminatory manner.

66. The second important provision is GATT Article II.4, which obliges governments to prevent import monopoly firms from undermining the tariff commitment. In the case of electricity, the tariff is bound to zero in most OECD economies. This obligation would seem to imply that, once entry in generation is liberalised domestically, a domestic vertically integrated electricity firm with an import monopoly for electricity has to provide no less favourable treatment to imported electricity than to domestically generated electricity in access to transmission. It is important to note that GATT Article II.4 is applicable, even when an exclusive right is provided in effect, as would be the case when the electricity firm is given only an exclusive right to domestic sales. This provision thus obliges the government to ensure non-discriminatory conduct of an enterprise that is established or authorised as an import monopoly formally or in effect. When a tariff is prohibitive as for some agricultural products , this Article has no additional constraint on the conduct of an import monopoly. Although Article 4.2 of the Agreement on Agriculture does generally proscribe the maintenance of non-tariff measures by state-trading enterprises.

67. A third provision complementary to the above provision is GATT Article XI**,** which prohibits quantitative restrictions on trade made effective through state trading enterprises (Ad Article XI). Moreover, such prohibitions can cover not only trade restrictions but also domestic restrictions by such enterprises, such as imposition of more restrictive distribution requirements on imports.[34] Thus, discriminatory restriction of imports through a non-price domestic means, such as discrimination in access terms to the network, by a state trading enterprise (including an enterprise with an exclusive right) would be contrary to the requirement of GATT Article XI. In this sense GATT Article XI complements GATT Article II.4. This provision applies both to import and export.

68. In addition to GATT Article II.4 obligations not to exceed bound commitments, GATT Article XVII provisions prohibit discriminatory mark-ups or discriminatory treatment by an import monopoly. Nevertheless, the ability of import monopolies to charge import mark-ups can reduce the demand on the domestic market.

69. In the case of services, the first important provision is GATS Article XVII on national treatment in government measures. In telecommunications, as in electricity, the government typically regulates access terms to the dominant transmission network. Thus, national treatment obliges governments to ensure that the terms and conditions of access to the network subject to government approval do not discriminate against foreign services or foreign service suppliers.

70. GATS Article VIII applies to a monopoly supplier of a service, which is authorised or established formally or in effect by a government. It obliges a government to ensure that it's the supplier's conduct respects MFN[35] and the specific commitments made by the WTO Member government (which could

34. See Adopted Report of the Panel on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies on 22 March 1988. According to the panel "in the case of enterprises enjoying a monopoly of both importation and distribution in the domestic market, the distinction normally made in the General Agreement between restrictions affecting the importation of products and restrictions affecting imported products lost much of its significance since both types of restriction could be made effective through decision by the monopoly."

35. Since GATS does not cover service supplied in the exercise of government authority (Article 1), even the MFN obligation does not apply to such service. However, a "service supplied in the exercise of

include national treatment). That is, GATS Article VIII requires a government to ensure non-discriminatory treatment by a monopoly service supplier only to the foreign services or service suppliers in the market that is liberalised. In addition, GATS Article VIII obliges a government to prevent the abuse of its monopoly position in the liberalised market that is subject to specific commitments. The exact coverage of the abuse subject to this obligation has not yet been addressed by WTO panels or the Appellate Body. But, as discussed earlier, it is possible that a vertically integrated monopoly could abuse its monopoly position by discriminating against competing firms in supplying the monopoly network service, and by shifting costs from the liberalised market to the monopoly market when the latter price is regulated based on cost. In the telecommunications sector where market entry has been fully liberalised, Article VIII would not apply, since the article depends on the presence of an exclusive right.

71. However, in telecommunications, the pro-competitive regulatory principles, as stipulated by the Reference Paper[36] of the Basic Telecommunication Agreement, address competition issues beyond those covered by Article VIII. That is, the Reference Paper obliges the government to ensure not only that the conduct of major suppliers in public telephony is non-discriminatory, but also that mandated access at a cost-oriented price to its network by competitors is guaranteed. The effective control of market power by an incumbent vertically integrated firm will substantially reduce the risk of anti-competitive exclusionary conduct. In addition, the non-discrimination provision on interconnection of the Reference Paper requires that a major supplier has to charge the same cost-oriented price for terminating a call from a foreign telephone operator as it charges for domestic calls, once the Reference Paper becomes applicable to the accounting rate. It indicates the necessity of major reform of the current accounting rate system.

72. Before unbundling,[37] a vertically integrated firm purchases goods from foreign suppliers and then transmits and distributes them to consumers. Both GATT Article II.4 and Article XI apply to such a firm (i.e. the government is obliged by these provisions to prevent such a firm from discriminating against foreign goods in purchase or in re-sales). Unbundling transforms the firm from a monopsony purchaser of goods into a supplier of network services to competing foreign producers. Neither GATT Article II.4 nor GATT Article XI is applicable to such network service supplied by the vertically integrated firm, since the GATT applies only to goods. The GATS provisions are applicable to the supply of network services by the vertically integrated monopoly supplier to foreign services or service suppliers. Thus, as wholesale and/or retail competition is liberalised, one potential question arises in the case of electricity. Once a vertically integrated firm is transformed from a monopsony buyer of electricity to a monopoly transmission service seller, do the GATT provisions for a monopoly importer or the GATS provisions for a monopoly supplier apply to the network services supplied to foreign electricity generators. Nonetheless, if unbundling is a part of ownership separation,[38] as in the separation of generation from transmission, the incentive and ability of the network operator to discriminate against new entrants in generation may be mitigated.

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government authority" does not include a commercial service, since it is defined as "any service, which is supplied neither on a commercial basis nor in competition with one or more service suppliers".

36. The Reference Paper is an additional commitment under Article XVIII of the GATS.

37 Unbundling takes place when a firm gives up the practice of bundling, i.e. selling two potentially separable goods (or services) only in a package. In the context of electricity supply, unbundling takes place when a vertically integrated electricity supplier starts selling transmission service independently of its sales of electricity.

38 Ownership separation takes place when the ownership of the entity supplying one part of the package of goods (or services) will be separated from that of the entity supplying the rest of the package. In the context of electricity supply a vertically integrated electricity firm may be vertically separated into two firms: one for generating electricity and another for transmission service.

IV. Assessment

To what extent do WTO rules ensure effective non-discrimination principles for enterprises with exclusive or special rights?

73. WTO rules do not address directly the existence of exclusive or special rights that limit market entry. Even though WTO has provisions against discriminatory conduct by a firm with exclusive or special right, they may not effectively prevent their discriminatory conduct. In particular, although GATT has provisions against discriminatory conduct by an import monopoly, the existence of the import monopoly itself is likely to provide more protection than the tariff by prohibiting direct marketing by a foreign supplier. Moreover, an import monopoly has no incentive to keep domestic prices within the tariff-inclusive international prices.

74. WTO rules have non-discrimination disciplines both on government measures applied to enterprises with exclusive or special rights and on their autonomous conduct, even though only governments are ultimately responsible. That is, a government is obliged not only to avoid adopting measures forcing these enterprises to discriminate against imports but also to prevent discriminatory conduct by such firms against imports (see the following table).

Table 3. **General non-discrimination disciplines of WTO for enterprises with exclusive or special rights**

	Autonomous conduct by a firm		**Government measure**	
	Goods (Import monopoly/Domestic monopoly)	Services (Monopoly supplier)	Goods	Services
Main Applicable WTO disciplines	GATT Article II.4 and GATT Article XI	GATS VIII	GATT III	GATS XVII
Competition discipline	Non-discrimination in the purchase and re-sales of goods	1)Non-discrimination in the provision of services 2)Prohibition of the abuse of a monopoly position in a liberalised market	Non-discrimination in regulation with respect to enterprises in purchasing foreign goods or in providing services	
Constraints	Not-applicable once unbundling takes place	Applicable only to services subject to specific commitments 1) not-applicable to goods 2) not-applicable to goods production	Government has to regulate access terms.	

75. However, there may exist some important potential gaps. First, GATS Article VIII requires a government to ensure non-discriminatory conduct by a monopoly service supplier only with respect to foreign services or service suppliers in the markets that are subject to liberalisation commitments.

76. Second, although a firm with an exclusive right can have market power on both the supply and the demand side, WTO provisions may effectively cover only one of them. For goods, although GATT Article XVII covers both purchases and sales involving either imports or exports and calls for MFN treatment in both, it has not yet been clearly established by WTO panels or the Appellate Body whether it obliges national treatment as well.[39] GATT Article II.4 covers discrimination between domestic goods and goods imported by the domestic import monopoly. For services, GATS Article VIII covers the supply of services by a monopoly supplier of a service, and does not *necessarily* cover its purchasing practices in the absence of specific commitments made or Article II MFN obligations.

77. Third, it has not yet been tested how effectively WTO provisions such as GATT Article II.4 apply to local public utilities whose exclusive rights are granted by local governments, given the very small number of notifications concerning such enterprises. The small number of notifications may reflect the fact that entry has been heavily regulated until recently, so that opportunities for international trade have been limited.[40]

78. Fourth, GATS does not provide extensive disciplines for important service sectors such as aviation and international shipping, in which international trade is 10 times larger than in communications (see Table A-1). Aviation is explicitly out of the scope of GATS, and negotiations over liberalisation of maritime transport services have not yet been completed.

How does competition policy support the non-discrimination principle of the WTO for enterprises with exclusive or special rights?

79. The basic principle of the WTO provisions concerning enterprises with exclusive or special rights is that member governments have to ensure that these enterprises do not undermine the WTO non-discrimination principles (national and MFN treatment). On the other hand, the main focus of competition and pro-competitive regulatory policies in network industries, such as electricity and telecommunications, is prohibit anti-competitive denial of network services. Prohibiting such anti-competitive conduct in the latter sense will contribute to an effective enforcement of non-discrimination in the first sense (see Figure 1). Thus, competition policy has an important role to play in ensuring that WTO non-discrimination principles apply to these enterprises.

80. However, it is important to recognise the limits to competition and regulatory policies in ensuring non-discrimination through conduct regulation. Close monitoring of all relevant access terms and conditions requires very complex and costly work from both regulators and competition agencies, and deterrence against exclusionary conduct may not be fully effective. These considerations highlight the importance of limiting exclusive or special rights to truly justifiable areas, as well as the role of structural

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39 Some scholars and panels see only the MFN obligation in GATT Article XVII. Jackson (1969) states that "what is meant by non-discriminatory treatment is a Most-Favored-Nation principle tempered by commercial considerations." See the 1984 GATT Panel Report on Canada-Administration of the Foreign Investment Review Act.

40. GATT Article XXIV.12 and GATS Article I stipulate that each contracting party will take reasonable measures as may be available to it to ensure the observance of GATT/GATS provisions by regional and local governments.

policies, e.g., the separation of the monopoly from the competitive segments, for promoting non-discrimination and the transition from monopoly to competition.

What are the major competition policy issues, which are not covered effectively by WTO non-discrimination principles? Are they important from a trade perspective?

81. The extent of mark-up over costs is not subject to multilateral rules unless it is discriminatory, or in excess of bound commitments as per GATT Article II:4, even though high mark-ups will reduce demand (for both domestic and foreign products) and increase the cost of access to local services for both domestic and foreign service suppliers. An important exception is the Reference Paper of the Basic Telecommunication Agreement, which calls for cost-oriented interconnection pricing.

82. On the other hand, a national regulator typically seeks to prevent monopoly profits. Thus, as long as non-discrimination is effectively secured, we might expect that monopoly pricing against foreign goods and services is substantially controlled.

83. GATT non-discrimination rules do not appear to cover cost shifting from unregulated to regulated markets. When cost shifting results in predatory practices in unregulated markets, it may restrict competitive entry by both foreign and domestic firms. In services GATS Article VIII addresses such a possibility in the context of abuse of dominance by a monopoly supplier, but only in the domestic market.

Are there important gaps in national competition law for these enterprises?

84. To the extent that national competition laws exist, national competition laws do not directly address the existence of exclusive or special rights granted by governments, with certain exceptions in the EU, although competition authorities indirectly address that through competition advocacy in some countries.

85. On the other hand, anti-competitive exclusionary conduct by a dominant firm as well as exclusionary cartels are not exempted in most sectors, and state ownership does not provide justification for exemption in most countries. Competition rules typically apply to the commercial activities of enterprises authorised by local governments as well. Thus, an effective enforcement of competition law against anti-competitive exclusionary conducts could facilitate both domestic and foreign entry, once entry is liberalised. In addition, it would be particularly important to remove standing exemptions in some sectors such as maritime transportation, which have anti-competitive exclusionary effects, since the risk that they restrict competition and trade is very high.

86. Cartels in the agricultural sector are exempted from competition law prohibitions in some countries , although cartel exemptions typically do not extend to exclusionary cartels or joint boycotts. It would be important to prevent these cartel exemptions or exclusive export rights to result in international cartels.

87. Finally, it is also important to ensure coherence between regulatory and competition policies. Regulatory policy has increasingly played an important role in promoting competition, in particular, in the enforcement of non-discriminatory access to dominant network services. Sector-specific competition rules or competition enforcement by sector-specific regulators should be based on standards consistent with those of general competition policies in market definition and in identifying market power and anti-competitive conduct.

Will the recent move toward entry liberalisation in major regulated industries necessitate re-definition of the enterprises subject to the provisions of the WTO based on exclusive rights toward those based on market power?

88. Many governments are liberalising entry in what were formerly natural monopoly industries such as telecommunications, postal service and electricity. However, liberalising entry will not bring about competitive outcome quickly. As has been seen in the case of telecommunications and electricity, a vertically integrated incumbent firm will often remain dominant for a considerable time after market liberalisation in the market in local network service. On the other hand, once entry is liberalised, the WTO provisions such as GATT Article II.4 and the GATS Article VIII cease to be applicable to the conduct of such firms. Thus, there is a danger that the current WTO disciplines may become increasingly inadequate as entry liberalisation takes place.

89. In this respect, the reference paper of the Basic Telecommunications Agreement may provide important lessons. First, it complements the WTO provisions on enterprises with exclusive or special rights by including provisions based on a standard similar to market power.[41] Second, it makes explicit the obligation of providing mandatory access to a network service of a major supplier on non-discriminatory and cost-oriented terms.

What would be the appropriate response to concerns over the anti-competitive consequences of asymmetric liberalisation of exclusive rights between nations? Would liberalisation result in vigorous international competition?

90. First, it is important to note that unilateral liberalisation may well benefit the liberalising country even if it suffers the loss of international bargaining power. In addition, a non-discriminatory charge to cover stranded cost would generally be more efficient than the complete ban of import from a specific country, in order to address the problem of stranded cost.

91. Second, internationally co-ordinated efforts at market liberalisation would substantially neutralise changes in the international bargaining power. The Basic Telecommunication Agreement can be seen as an example of this principle.

92. Third, the control of the conduct of a foreign monopoly firm by a foreign competition or regulatory authority will help to reduce concerns over the loss of international bargaining power as well as the abuse of market power such as through anti-competitive bypass.

93. Fourth, domestic competition law can be applicable to certain aspects of the abuse of market power by a foreign firm on an *ex-post* basis, such as anti-competitive conduct through the home subsidiary of such a firm.

94. To ensure that liberalisation results in active international competition will require competition law enforcement to prevent international collusion, given that many international services have been provided co-operatively by national firms with exclusive rights. Since international services often require reciprocal access to the bottleneck network in each country, which is *de facto* or *de jure* exclusively controlled by a national firm, there may be a significant risk of national firms co-operating to prevent the emergence of vigorous international competition.

41. A major supplier for which the Basic Telecommunications Agreement applies is defined to be a supplier with the ability to affect the terms of participation in the relevant market as a result of its control over essential facilities or its position in the market.

STATISTICAL APPENDIX

Table A.1. **International trade in electricity, transport and communication in OECD economies (1995, B$)**

	Export (B $)	**Import (B$)**	Total	**%**
Electricity	6.3	4.2	10.5	2.0
Transport	235.3	258.6	493.9	92.1
Sea	64.9	95.1	160.0	29.8
Air	77.4	74.8	152.2	28.4
Other	51.4	45.2	96.6	18.0
Unclassified	41.6	43.5	85.1	15.9
Communication	13.0	18.7	31.7	5.9
Subtotal	254.6	281.5	536.1	100.0
% (Excluding electricity) of services trade	25.9	29.9	27.9	
% of goods & services trade	5.5	6.2	5.9	
Other selected service trade				
Insurance	31.2	35.9	67.0	
Finance	41.3	24.5	65.8	
Royalties & License fees	47.9	42.0	89.8	

Note: Some countries do not report the sub-sector breakdown figures of the transport sector, so that the value of sea transportation, for example, is underestimated.
Source: Constructed from IMF Balance of Payments Statistics and Foreign Trade Statistics of OECD

Table A.2. **Market shares of formerly monopoly firms in telecommunications**

	Local	Domestic long distance	International	Year
USA	99	55	55	1996
UK	84	74	52	1998
Japan	98	64	68	1996

Source: *(i)* For the United States the market share for domestic long distance is that for inter-state toll. Data are from FCC, Trends in Telephone Service; *(ii)* For Japan, the number for the local market is that for the calls within prefectures and that for domestic long distance is for the calls across prefectures. Data are from the Report of the Economic Council (1997); *(iii)* For the United Kingdom, the numbers are for 4th Quarter 1997/98 and from OFTEL. The main competitors to the incumbent telephone company in the local exchange are cable telephone companies.

Table A.3. **Export and import market shares of the largest state trading enterprises (1996, estimates)**

Export-oriented STE	World export share	Production share	Import-oriented STE	World import share	Production share
Canadian Wheat Board	14% (wheat)	5.1%	China (Cofco)	11% (wheat)	18.9%
Australian Wheat Board	12% (wheat)	4.0%	Japanese food agency	5.2% (wheat)	0.1%
The New Zealand Dairy Board	11% (skimmed milk) 13% (cheese)	5.9% (skimmed milk) 1.6%(cheese)	Indonesia (Bulog)	6.4% (rice)	9.0%

Note. Based on the FAO yearbook (1997) for production, and on the World Agricultural Outlook Board of the United States, the Foreign Trade Statistics of Japan and the GAO of the United States (1996) for imports and exports. Production share refers to the share of each country's production in world production. The export shares for New Zealand are estimates for 1993.

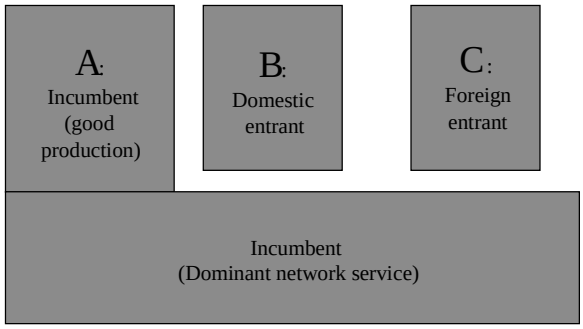
Table A.4. **Public enterprise intensity in economic sectors (%)**

	Energy	Transport	Communication	Finance and insurance	Manufacturing	Commerce
EU(91)	55.0	58.0		20.0	3.4	NA
Japan (95)	2.3	1.7	62.0	0.8	0.1	0.3
USA(96)	(18.7)	NA	NA	NA	NA	NA

Note: Shares are in terms of employment for EU and Japan. Such information is not available for the United States. The US figure for energy is the percentage of electricity generated by publicly or federally owned electricity companies. Public enterprises in Japan include those owned by local governments.

Source: CEEP (1994) for Europe, Establishment survey (1998) for Japan, and Energy Information Administration (The Restructuring of the Electric Power Industry) for the United States.

Figure 1. Two concepts of non-discrimination



Non-discrimination in **competition policy** requires equal treatment in the access to network between A on the one hand, and B and C on the other

WTO non-discrimination requires equal treatment in the access to network between C on the one hand, and A and B on the other.

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