



Institut Européen
d'Administration Publique

European Institute
of Public Administration

Competition Policy and the WTO:

Is there a need for a multilateral agreement?

**Sanoussi Bilal
Marcelo Olarreaga**

**Working
Paper
98/W/02**

Competition Policy and the WTO:
Is there a need for multilateral agreement?

98/W/02

© 1998, European Institute of Public Administration.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, or otherwise, without prior written permission of the publisher, European Institute of Public Administration, O.L. Vrouweplein 22, P.O. Box 1229, 6201 BE Maastricht, the Netherlands.

Typeset and printed by the Publications Service, EIPA, the Netherlands.

This working paper has not been language checked by EIPA's Linguistic Services.

Competition Policy and the WTO: Is there a need for a multilateral agreement?*

Sanoussi Bilal^{**}
Marcelo Olarreaga^{***}

September 1998

Abstract

This paper discusses the arguments in favour of an International Competition Policy Agreement (ICPA) within the WTO framework. We argue that the only clear justification for an ICPA is in the presence of cross-border policy spillovers in competition policy. However, it is shown that such an agreement may lead both to a less competitive world trading system and, more importantly, to a lower level of world welfare. While recognizing the potential benefits that may arise from an ICPA, we recommend a cautious approach that acknowledges these drawbacks and other potential holes in such an agreement.

(JEL F13, L40)

Key Words: competition policy, trade negotiations, World Trade Organization.

* We gratefully acknowledge comments by Marc Bacchetta, Henrik Horn and Jaime de Melo. An earlier version of this paper was presented at the CEFIR-EIPA seminar on *Competition Policy and Regional Integration* held in Montevideo on the 8-10 of September 1997. The views expressed here are those of the authors solely and do not necessarily reflect those of the institution with which they are associated.

** European Institute of Public Administration, P.O. Box 1229, 6201 BE Maastricht, The Netherlands, e-mail: sbi@eipa.nl

*** Development Economic Research Group, The World Bank, 1818 H Street, Washington DC 20433, USA; e-mail: molarreaga@worldbank.org

1. INTRODUCTION

The first regular biennial Ministerial meeting of the World Trade Organization (WTO) held in Singapore in December 1996 gave birth to a working group which will study the interaction between trade and competition policies.¹ This was not the first time that the subject was considered in the WTO/GATT.² Already in 1948, the Havana Charter for the creation of an International Trade Organization (ITO) included a Restrictive Business Practices chapter (Chapter V) whose objective was to prevent business practices that restrain competition and adversely affect international trade. However, the Havana Charter never entered into force due to the refusal by the US Congress to ratify it, probably of its fear of losing some of its sovereignty (see Jackson, 1969).

The failure to create the ITO resulted into the incorporation of a 'best-efforts' clause in Article XXIX of the General Agreement on Trade and Tariffs GATT to account for the agreement reached on Articles I to VI of the Havana Charter. However, Article XXIX of GATT and other later provisions (discussed below in section 2) are seen by some authors as insufficient (see Matsushita, 1997). On the contrary, others argue that reinterpretation of existing rules may suffice to ensure a fair-competitive world trading system (see, for example, Bacchetta, Horn and Mavroidis, 1997.)

Those authors who see existing rules as insufficient often urge for negotiations on an agreement on competition policy to be undertaken within the WTO. This is the approach supported for instance by the European Union (EU). Several arguments are advanced. First, the on-going trade liberalization through successive rounds of negotiations (and other agreements such as the General Agreements on Trade and Services (GATS)) implies that competition policy, as an instrument to restrict market access, becomes more visible as traditional trade barriers vanish. Second, as trade policy becomes constrained by WTO rules, governments may be tempted to substitute trade restrictions by competition policy barriers to trade. Third, conflicts over competition issues may trigger trade wars (as could have been the case with the US-EU dispute over the Boeing-

¹ The working group will have to report by the end of 1998 to the General Council of the WTO.

² Note that the WTO is not the only international forum on which the relation between trade and competition policies are discussed. Developed countries have been discussing this issue within the OECD and developing countries have pursued this topic within UNCTAD. The advantage of the WTO over OECD and UNCTAD is that the former has an enforcement mechanism through the dispute settlement process. This paper focuses exclusively on the WTO.

McDonnell Douglas merger).³ More generally, this implies that to fully capture gains from trade liberalization countries should also remove impediments to trade induced by competition policy.

The paper is organised as follows. Section 2 gives a brief summary of provisions against anti-competitive behaviour in WTO. Arguments for the creation of an International Competition Policy Agreement (ICPA) are discussed in section 3 where it is argued that the only robust case for an ICPA is linked to the presence of competition policy spillovers (i.e., the decision of a national competition policy authority affects rest-of-the-world welfare).

However, as discussed in section 4, the case for an ICPA, based on competition policy spillovers, would be damped by the difficulties that a hasty implementation could entail. A major hurdle is that it is not clear how large would be the gains and costs from such an agreement. Moreover, it is difficult to determine, *a priori*, whether the creation of an ICPA would result in a more or less competitive world, as shown in section 5. Besides, if one introduces endogenous determination of competition policy into the analysis, as we do in section 6, then the scope for such an agreement to improve economic efficiency tends to shrink, as lobbying inherently gives a second-best nature to any policy decision.

Finally, section 7 explores the costs of such an agreement within the WTO, whereas section 8 provides some concluding remarks.

2. PROVISIONS AGAINST ANTI-COMPETITIVE BEHAVIOUR IN WTO

This section focuses on provisions against anti-competitive behaviour in the GATT and WTO framework.⁴

³ As argued by Sir Leon Brittan: 'I have long believed that we need an international agreement on competition rules and smoother cooperation between national competition jurisdictions. Otherwise there are bound to be more and more clashes when powerful competition authorities seek to deal with the same case, applying different rules.' (Financial Times, 25/07/97).

⁴ The discussion below extensively relies on World Trade Organization (1997).

2.1 A brief history

Provisions for restrictive business practices were first introduced in the GATT through Article XXIX:1. This Article required contracting parties to observe the general principles of Chapter V (among others) of the Havana Charter while expecting ratification of the Havana Charter by all contracting parties. The objective of Chapter V was to 'prevent, on the part of private or public commercial enterprises, business practices affecting international trade which restraint competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade...'. Deletion of Article XXIX of the GATT was voted in 1955 when it became clear that the Havana Charter would not enter into force,⁵ and a working party considered proposals to include in the GATT provisions along the lines of those of Chapter V of the Havana Charter. However, it was agreed to postpone further considerations on this matter pending the outcome of discussions on related issues in the Economic and Social Council of the United Nations.

In 1958, a *Group of Experts* was created to study whether and to what extent the GATT should include provisions on trade-related competition issues. Building on the report of the Group of Experts, a Decision on Arrangements for Consultations on Restrictive Business Practices was adopted in 1960. The Decision 'recommends that, at the request of any contracting party, a contracting party should enter into consultations on Restrictive Business Practices on a bilateral or a multilateral basis as appropriate...and if it agrees that such harmful effects are present it should take such measures as it deems appropriate to eliminate these effects.' These arrangements have been invoked on only three occasions, all during 1996, in regard to disputes submitted by the United States against Japan concerning the Kodak vs. Fuji case.

The abuse of dominant positions through international price-dumping is condemned in Article VI of GATT and countries are allowed to introduce countervailing duties when injured by dumping by foreign firms. Obviously, the solution proposed by Article VI has a second-best nature, as it does not tackle the problem directly. This could be corrected with the adoption of an ICPA.⁶

⁵ Failure by one contracting party to ratify this change result in continuous inclusion of Article XXIX in GATT. However, as suggested by Bacchetta *et al.* (1997), it is not clear 'whether Members (of the GATT/WTO) are still bound by obligations contained in Chapter V of the Havana Charter'.

⁶ Some authors, e.g., Hoekman and Mavroidis (1996), argue that with the successful conclusion of the Uruguay Round and the resulting prohibition of VERs, lobbying for protection has further shifted towards anti-dumping given the inherent protectionist bias of

The inclusion of competition policy rules in GATT was also considered during the preliminary negotiations for the Uruguay Round, but was later dismissed in 1986 when launching the Round in Punta del Este.

anti-dumping rules. Vosgereau (1995) argues that the second-best nature of anti-dumping duties raise a case for an ICPA. However, while in theory an ICPA would be a first-best choice, its practical relevance depends on the rules and implementation of these rules within the ICPA. In other words, depending on its design, an ICPA could fail to correct for the protectionist bias of anti-dumping duties.

2.2 Provisions against anti-competitive behaviour in post-Uruguay Round agreements

As internationalisation of production is progressing worldwide, the WTO approach differs from the GATT-1947 by focusing on broader and integrated market access guarantees. This has translated into inclusion of several provisions concerning private anti-competitive behaviour in the new WTO agreements. These new agreements are the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related aspects of Intellectual Property Rights (TRIPS), and the Agreement on Trade-Related Investment Measures (TRIMS).

All these agreements recognize the need for including provisions against anti-competitive behaviour. Concerns about private anti-competitive behaviour in the service sectors seem particularly relevant when noting that this sector includes telecommunications and financial services which are characterised by important dominant positions by incumbent firms or mergers and where contestability of markets is relatively limited because of large fixed costs. Intellectual property rights have an inherent anti-competitive nature as they provide monopoly rights to their owners. Investment abroad, especially Foreign Direct Investment, generally occurs in imperfectly competitive markets. Thus, the importance of considering anti-competitive behaviour in all these agreements. However, none of the agreements goes beyond the recommendation of entering into consultations whenever anti-competitive business practices may have a serious impact on competition and thereby restrain trade.⁷

Other agreements and articles of GATT 1994 address implicitly or explicitly the question of anti-competitive behaviour. These include, for example, the agreement on safeguards, Article xvii of GATT 1994 on state trading enterprises, the agreement on technical barriers to trade, the agreement on the application of sanitary and phytosanitary measures, the agreement on preshipment inspection, and the agreement on trade in civil aircraft. To describe these goes beyond the scope of this paper. The interested reader can refer to Petersmann (1996) who gives a clear and detailed lists of provision for anti-competitive behaviour in all these agreements and articles.

Most authors agree that there exists several holes and loopholes in existing WTO rules concerning private anti-competitive behaviour. Take the

⁷ This is the case in article IX:2 of GATS and Article 40 of TRIPS. Article 9 of TRIMS requires the Council of Trade in Goods to consider the introduction into the agreement of provisions for competition policy before 1999.

following examples. First, the recent Boeing-McDonnell Douglas merger was clearly out of reach of WTO rules and the application of extra-territoriality clauses may lead to a trade war without an international dispute settlement mechanism. The second-best nature of anti-dumping duties provide a second example. The question, however, is not only whether existing provisions should be seen as sufficient, but whether negotiations for a multilateral agreement on competition policy can be justified on a cost and benefit analysis.

In the next section we discuss arguments in favour of an ICPA.

3. ARGUMENTS FOR AN INTERNATIONAL COMPETITION POLICY AGREEMENT (ICPA)

Several arguments can be put forward in favour of an international approach towards competition rules. These are discussed in turn below and some counter arguments are advanced.

First, international trade is distorted by private anti-competitive behaviour. In this case, some form of transnational competition cooperation may be necessary to insure that trade agreements are not circumvented by business practices restricting competition and therefore reducing the gains from trade liberalisation and market access.⁸

Moreover, if restrictive business practices affect trade, then national competition policies affect rest-of-the-world welfare. If we assume that the prime objective of competition policy is to prevent departures from competition (i.e. 'endogenous market distortions' in Bhagwati's (1971) terminology) that would reduce welfare, then national competition authorities will attempt to maximise national welfare. Under partial equilibrium, this implies that the focus of a benevolent government is, from an economic perspective, to prevent 'market distortion' whose net effects on total national consumer *and* producer surplus are negative. Thus, as discussed in section 4, it neglects the international externalities associated with its competition policy, i.e., the effects on rest-of-the-world welfare. To

⁸ The beneficial effects of an ICPA may be limited for small countries where a liberal trade and foreign investment policy may suffice to ensure relatively competitive markets. Indeed, Singapore and Hong Kong have no national competition policy authorities as they believe that their open trade and investment policies largely substitute for competition regulation. Note, however, that small countries may be 'victims' of foreign countries laxist competition policies and therefore support the idea of an ICPA.

illustrate this, consider a monopolist which sells all its production abroad or the common situation of an export cartel. In this case, the national competition authority (even a social welfare maximising one) has no incentives to control the potential abuse of dominant position, as all the costs are borne by foreign consumers (i.e. the negative externality) and all the 'benefits' go to national producers.

This, in turn, may imply that national competition policies can be used in a strategic way to maximise national welfare at the expense of foreign countries, much as strategic trade policies does, by backing the market power of domestic firms. Obviously, such considerations come into play for instance when the European and US authorities address the Boeing-Airbus competition issue. The scope for an ICPA in the presence of such spillovers is discussed in the next section.⁹

Second, an ICPA could enhance the credibility of national governments in their enforcement of an effective competition policy, as trade agreements may solve the 'time-inconsistency' problem¹⁰ with respect to trade policy decisions. That is, an ICPA could help national government to commit to a strict application of competition policy when governments face credibility problems. Note, however, that solving the competition policy credibility issue through an international agreement is more tricky than with trade, as the latter inherently has an international dimension that lacks in the former in the absence of cross-country welfare effects.

Third, it has been sometimes suggested that in a global world where multinational companies become more predominant, national political authorities are no longer able to control or simply regulate transnational economic activities. This current trend is exemplified by the surge of foreign direct investments and international mergers and acquisitions over the recent years.¹¹ The lax or no enforcement of competition principles may also be favoured by the prospect of attracting foreign companies into the domestic market. This may in turn trigger a 'race to the bottom' between countries' competition policies.

⁹ The counter-argument is that an ICPA is very likely to raise sovereignty tensions as well, as countries will have to submit their decisions to supra-national supervision. This is discussed in section 6.

¹⁰ The 'time-inconsistency' problem arises when the optimal ex-ante policy is different from the optimal ex-post policy raising the problem of credibility.

¹¹ During the last ten years, foreign direct investment has increased three times faster than international trade, while the value of announced mergers and acquisitions worldwide has more than tripled.

This line of reasoning can be challenged on several grounds. Firstly, a strong competition authority may provide a healthy environment and efficiency in factor market which could be seen as a relative comparative advantage for a host country from the multinational perspective. Thus, governments willing to attract FDI may instead engage in a 'race to the top' with respect to competition policy. Secondly, it is doubtful that multinational decisions to invest lay on comparative *national* competition policy analysis. As multinationals tend to trade worldwide from one location, they are certainly subject to extra-territoriality clauses. Thus, the competition rules in the exporting markets may be as relevant (or even more) than the rules in the country of production. Moreover, the existence of extra-territoriality clauses implies that a 'race to the top' is more likely. Indeed, multinationals subject to extra-territoriality may prefer to locate in a country with a strong competition policy, so that decisions by the strong national authority take into account the changes in their profits (if the firm is domestically based, its profits enter national welfare), whereas if it is located in a foreign country, the decision linked to the extra-territoriality clause will not consider changes in their profits. Finally, it is not clear why countries should care about multinational competitive behaviour in other parts of the world as long as this has no influence on national welfare. If it has some effect, then we are in the presence of policy spillovers which are to be analysed in the next section.

Fourth, it has been sometimes argued that the laxist Japanese anti-trust law has allowed Japanese firms to benefit from higher monopolist profits which could be invested in research and development (R&D), hence 'artificially' boosting their relative competitiveness. An harmonisation of international competition rules could prevent such behaviour. However, if monopolistic rents are invested in R&D which allow for future price falls, quality improvement and increased diversity, then competition policy authorities should maximise welfare inter-temporally before taking any decision.

Fifth, an international harmonisation of competition rules will lead to a reduction in transaction costs for firms. The coexistence of numerous, sometimes conflicting, national competition rules entails private cost in terms of information, requirement and uncertainty. At present, an international merger has to comply to the competition rules of each country of origin (and possibly of activity) of the merger parties. The issue, then, is whether transaction costs are high enough to give scope for an international agreement which also involves significant costs. Indeed, not only negotiation costs may be high (recall that the Uruguay Round lasted eight years), but also the dispute settlement mechanism at the international level may involve higher costs than at the national level. Thus, more empirical work is needed before concluding on the potential gains from an ICPA

based on the reduction of transaction costs. Besides, differences in competition policy rules may just reflect differences in preferences across countries. This, through the effects on relative prices, certainly makes trade more attractive, which in turn maximises world welfare while respecting countries preferences. Harmonisation of rules not only neglects country preferences but reduces the scope for beneficial trade.¹²

The above arguments suggest that the only convincing case for an ICPA boils down to the presence of competition policy spillovers.¹³ Arguably, cross-border externalities may be internalised by unilateral or bilateral extension of national jurisdiction to foreign countries. However, the extra-territorial reach of a national competition policy may generate sovereignty tensions which jeopardise the globalised world. Thus, as discussed in the next section, to internalise such cross-country welfare effects it may be necessary to adopt an international perspective.

4. COMPETITION POLICY SPILLOVERS: A CASE FOR AN ICPA?

The existence of anti-competitive behaviour does not justify in itself the need for an ICPA.¹⁴ A necessary condition (though not sufficient) to justify the creation of an ICPA is the existence of spillovers (i.e., cross-border externalities): that is, restrictive business practices in one country affect agents (consumers, firms) in other countries. This condition is certainly fulfilled in the case of export cartels. In theory, this necessary condition is almost always fulfilled. Indeed, even in the case of a national competition policy decision in a non-tradeable sector in country *A*, there may be effects on consumers or firms in country *B*, through general equilibrium effects in country *A* (such as production and factor price adjustments which may affect international markets). In practice, however, these indirect effects are likely to be relatively small. More direct effects could be of larger concern. In general, policy spillovers may be larger when national competition policy decisions are taken in sectors which trade a large share of their production.

¹² See Krugman (1997) for a similar line of reasoning with respect to environment and labour standards. Note also that, as argued by Bacchetta *et al* (1997), harmonisation of trade policies do not solve the competition policy spillover dilemma. Indeed, two countries may have identical competition policy rules but may still hurt a trading partner's interest through policy spillovers as rest-of-the-world welfare is not considered by the national competition policy authority.

¹³ Gatsios and Seabright (1989) and Neven (1992) previously argued that policy spillovers are the key issue in deciding which policies should be subject to international negotiation or assigned to the top-tier in a multi-level governmental structure.

¹⁴ This section draws largely on Bacchetta, Horn and Mavroidis (1997).

However, the fact that national competition policy decisions may affect international markets does not necessarily imply that an ICPA is required to account for the interests of consumers and producers in other countries. Indeed, as long as the national competition policy decision does not change when taking into account the rest-of-the-world interests, policy spillovers do not justify an ICPA. Clearly, if the decision taken by the national authority is the same as the one that would have been taken by a international authority within an ICPA, then there is no justification to create such an agreement. This type of situation arises whenever the domestic gains related to the national competition policy authority decision are larger than the neglected spillovers to foreign firms and consumers. In such a case, internalising the spillovers through an ICPA would not change the decision of the national authority given that world welfare increases (i.e., the increase in national welfare is larger than the fall in rest-of-the-world welfare). Note that the fact that internalisation of an externality does not affect the optimal decision is due to the fact that competition policy decision are often discrete choices, as for example, allow or not a merger. If the competition policy decision were a continuous variable, then the international optimal decision would be different from the national optimal decision.

Then, an ICPA would be justified in the presence of a ‘prisoner’s dilemma’, that is whenever the optimal choice that each rational agent takes individually differs from the choice that is taken when individuals cooperate *and* if the cooperative choice implies a higher payoff for all agents than the payoff in the non-cooperative equilibrium.

To summarise, spillovers from nationally-pursued competition policies provide a case for an ICPA only to the extent that the spillovers are sufficiently large to change the decision taken by a national authority and that there are welfare gains for the world when this decision is taken within an ICPA.

5. PRO- AND ANTI-COMPETITIVE SPILLOVERS

Spillovers can have different effects on competition: they could either enhance competition, i.e., be *pro-competitive*, or reduce it, i.e., be *anti-competitive*.

Spillovers are anti-competitive when, for instance, a national competition authority allows a merger between two domestic firms that sell a large share of their output in foreign markets.¹⁵ The national competition authority does not take into account foreign consumers' interests in its decision to allow the merger. The price increase in foreign markets that may result from the merger, and the resulting loss for foreign consumers, is of no concern to the national authority.¹⁶ However, had an international authority taken the decision, foreign consumers' interests would have been considered and the merger may have been forbidden. Clearly, in this case, the spillovers are anti-competitive as the national authority takes a more laxist attitude towards anti-competitive behaviour.

Pro-competitive spillovers exist when, for example, the national competition policy authority does not allow a merger between two domestic firms that compete in the national market *only* with foreign firms. The national authority refuses the merger because of the presumed price increase that would hurt national consumers interests by more than the increase in the merged firms profits. However, under a large set of circumstances,¹⁷ the foreign firms would benefit from the domestic merger. This is the case if the final domestic price is higher after the merger and if the two merged firms sufficiently internalise their strategic interaction, so that they restrict their total market share.¹⁸ The international authority which will include foreign firms' profits in its objective function may decide to allow the merger if the increase in foreign firms profits outweighs the fall in national welfare.¹⁹ Thus, spillovers in this case are clearly pro-competitive as their elimination through internalisation in an ICPA will lead to a less competitive trading system.

Hence, spillovers could be pro-competitive or anti-competitive and their internalisation through an ICPA may lead to a more or a less competitive world. Therefore, the creation of an international competition policy authority is not unambiguously conducive to a more competitive world. Moreover, if it is generally possible to identify situations where spillovers exist, it may be extremely difficult to conclude *a priori* whether the spillovers are pro- or anti-competitive. For instance, consider the case of pro-competitive spillovers discussed above. If we had assumed instead that efficiency gains (i.e., cost reductions) from the merger were sufficiently

¹⁵ The level of competition in this example depends on the number of firms operating in the world market. Competition increases with the number of firms.

¹⁶ Note that this holds regardless of whether markets are segmented or integrated.

¹⁷ See Salant *et al.* (1983) for the conditions under Cournot behaviour and Deneckere and Davidson (1985) for Bertrand competition.

¹⁸ Recall that in oligopolistic markets the perceived marginal revenue for a given firm is above its true marginal revenue.

¹⁹ A similar result is obtained by Barros and Cabral (1994), though in a different context.

large to decrease the domestic price, then foreign firms' profits would have fallen. In this case, spillovers would have been anti-competitive since the merger might have been accepted by the national authority but refused by the international authority once foreign firms' profits are accounted for. To summarise, whether the ICPA would have pro- or anti-competitive effects on the world trading system remains an open question.²⁰ So far, we have assumed that competition authorities seek to maximise social welfare in a direct way. However, they may have different objective functions. Competition policy authorities may be subject to lobbying. In this case, its objective function will also differ from social welfare maximisation as discussed in the next section.

6. ENDOGENOUS DETERMINATION OF COMPETITION POLICY AND WORLD WELFARE

Competition policy, as any redistributive policy, is subject to lobbying by industry groups which may try to influence the competition authority's decision in their favour.²¹ Assume that, as in the endogenous trade policy literature, this translates into a higher weight put on producer surplus (i.e., firms' profits) in the competition authority's objective than on consumer surplus.²² Thus, producers' interests are over-represented in the decision process.

Consider the same setup as in the discussion of pro-competitive spillovers in the previous section, taking into account that both the national and the international competition policy authority are subject to industry lobbying.²³ Then, both authorities will be more likely to accept the merger, as firms' profits increase in this case. For the sake of illustration, consider the case where both national and world welfare would fall following the merger (which would have implied with a benevolent government as in the previous section that both the national and international authorities would have rejected the merger). In spite of industry lobbying by national firms, it is

²⁰ This may recall the discussion over the pro or anti-competitive effects of anti-dumping rules (see Hoekman and Mavroidis (1996) for an illustration).

²¹ To illustrate this, let us quote Hans Krakauer, senior vice president of the International Airline Passengers Association, on the Boeing-McDonnell Douglas and European Commission struggle in Summer 1997: 'What you've got here is a power play, and anyone who says it's being done in the interest of passengers is a liar' (Wall Street Journal, 23 July 1997).

²² For a recent formal justification of this result with microeconomics basis in the context of trade policy, see e.g., Grossman and Helpman (1994).

²³ Note that the same logic applies to anti-competitive spillovers, and perhaps surprisingly to the case of positive spillovers.

possible that the national authority still refuses the merger. It may be the case, however, that the international competition authority which is subject to industry lobbying by both national and foreign firms accepts the merger since foreign firms' profits, which increase with the merger, are over-represented in its objective function.

In such a situation, the authorisation of the merger by the international authority does not only decrease the level of competition, as the merger is allowed and price-markups increase, but it also decreases national and world welfare. Note that these are potential risks, rather than likely outcomes, as this depends on the institutional setting prevailing in the decision-making process.

7. FURTHER CONSIDERATIONS: AN ICPA IN THE WTO?

The desirability of an ICPA also rests on the institutional form that would be adopted. It is sometimes suggested that an agreement in the WTO may consist of a minimum set of competition policies to be introduced in each member country and which would be regulated by a national authority. Though desirable in itself, as it may improve institutional aspects in developing countries, this would not address the main rationale identified in sections 3 and 4 for an agreement, i.e. the presence of competition policy spillovers. To solve this some form of coordination mechanism should be implemented. In this section we outline factors that may prevent the coordination of national competition policies within the existing WTO framework.

An important issue is the question of sovereignty. An overseeing body responsible for competition policy (within the WTO) would automatically imply some abandon of sovereignty from the part of national authorities (to the WTO dispute settlement mechanism for example). Although many countries may find it in their interest to coordinate competition policies in the presence of spillovers, they may not be willing to delegate their authority to an international agency. This problem is further heightened by the fact that contrary to other economic policies, such as tariff barriers for instance, deviation from the rules cannot be assessed in a general way. With anti-competitive behaviour each case has to be assessed individually. Hence, to be efficient, an international cooperation on competition policy has to involve a significant delegation of national sovereignty over competition rules and implementation.

Second, because of national and cultural differences regarding the appropriate characterisation of competition policy, international coordination may prove to be very tedious, and more importantly, very costly. At the initial stage, high negotiating costs are to be expected since long negotiations involving a significant amount of bargaining among negotiating partners will probably be required to reach an international agreement. Moreover, the setting of international competition rules is doomed to attract fierce lobbying activities, in particular from the large companies and industries, in order to influence the design and implementation of competition policies, thus further increasing the social costs of negotiating an agreement.²⁴

Third, an agreement on the set of competition rules that should be adopted is likely to prove controversial. One of the major dilemmas concerns the constraints imposed by international competition rules: should they be binding or not? And if they are, what should be the enforcement mechanism? Another similar dilemma rests on the nature of international competition laws. On the one hand, rules *per se* would provide a very clear framework, removing most of the uncertainty associated with competition decisions. The drawback, however, would be the arbitrary nature of such competition rules reinforced by the absence of consensus on competition standards. Moreover, rules *per se* lack flexibility, and therefore may result in the condemnation of very efficient practices. On the other hand, an international competition law based on the *rule of reason* could be adopted. This would have the advantage of providing a greater flexibility in assessing anti-competitive behaviour, albeit at the cost of greater uncertainty. That is, although general rules *per se* can be set as guidelines, each case must be judged on its own merit, which implies some scope for *rule of reason*.

The implication of a more discretionary ruling, apart from greater uncertainty, is that it would require some forms of judicial process. Obviously, this could become problematic at the international level since it would require an international authority. The question of whether the WTO dispute settlement mechanism is the right place arises. The resources that such an approach would require are very likely to overtake WTO capacities. The cases raised to the dispute settlement mechanism risk to be much more tedious and complex than the ones concerning trade issues. As a comparison, Blackhurst (1996) notes that the International Court of Justice in The Hague, which heard an average of two cases a year, has a budget and

²⁴ Other negotiations, such as in agriculture, may also be subject to high negotiating costs. The main difference is that gains from an agreement on the liberalization of agriculture markets have been already quantified whereas those from an ICPA still need to be identified and quantified.

staff which is almost three times the budget and staff of the Legal Affairs Division of the WTO.

Fourth, international cooperation on competition could be plagued by information problems. In particular, investigations on anti-competitive behaviour often involve the communication to competition authorities of confidential information. A firm in one country may then be very reluctant to disclose sensitive information regarding its economic activities to a foreign or international competition authority (see for instance, Van Miert, 1996). Besides, due to high information costs, it is arguably preferable to implement competition policies in the most decentralised way (i.e., at the national level), rather than by a central, remote international trade authority.²⁵

Fifth, if the ICPA is going to be negotiated within the WTO and related to trade issues, negotiators should be careful not to introduce a protectionist bias in the agreement. Indeed, it is well recognised by economists that Article VI of GATT concerning international dumping has a protectionist bias and this may extend to an agreement on competition policy if not carefully elaborated. As other forms of trade protection tend to be banned by GATT, industries may request their governments to protect their domestic market based on competition policy agreements.

8. CONCLUDING REMARKS

Claims for the need for an International Competition Policy Agreement (ICPA) are often raised. This paper takes a cost-benefit approach in assessing it. Thus, the existence of potential benefits from such an agreement in the presence of cross-border competition policy spillovers that lead to a 'prisoners dilemma' situation must be balanced against the risks that may emerge from the hasty adoption of an agreement that may be subject to capture.

In particular, this paper shows that an ICPA can potentially lead to both a less competitive world trading system and, more importantly, a lower level of world welfare. The nature of the impact of an ICPA depends on the

²⁵ This may explain why the EU has adopted the principle of subsidiarity in its competition policy: member states are responsible for competition policy unless it concerns practices that distort competition in the common market (and not simply in one member state).

objective pursued by national and international competition authorities and the influence of specific interest groups in the design and implementation of competition policies.

Concerning the creation of an ICPA within the WTO framework, this process could entail long and tedious negotiations and may not fulfil expectations. An agreement on a minimum set of competition rules for member countries (as suggested by the EU and to some extent by the US), while desirable for institutional reasons, does not correct for the main rationale for an international agreement discussed in section 4, i.e. competition policy spillovers. On the other hand, if the agreement tries to solve the spillover problem by introducing some sort of supra-national authority or inter-government cooperation, it is yet not clear from a cost/benefit perspective that this is worth pursuing (especially if supra-national authorities are subject to capture). Further study on the costs and benefits from such an agreement is needed. Moreover, if the ICPA is going to be related to trade issues within the WTO, negotiators should be careful not to introduce a protectionist bias in the agreement.

BIBLIOGRAPHY

BACCHETTA, M., H. HORN and P. MAVROIDIS (1997), 'Do Negative Spill-Overs from Nationally Pursued Competition Policies Provide a Case for Multilateral Competition Rules?', mimeo, WTO.

BHAGWATI, J. (1971), 'The Generalized Theory of Distortions and Welfare', in J. Bhagwati, R. Jones, R. Mundell and J. Vanek, eds.: *Trade, Balance of Payments and Growth: Papers in International Economics in Honor of Charles P. Kindleberger*, North Holland.

BLACKHURST, R. (1996), 'The Capacity of the WTO to Fulfil Its Mandate', paper presented at the *Institutional Aspects of World Trade Organization's Effectiveness* conference, Stanford.

CRAMPTON, P. (1994), 'Alternative Approaches to Competition Law: Consumers' Surplus, Total Welfare and Non-Efficiency Goals', *World Competition* 17, pp. 55-86.

DENECKERE, R. and C. DAVIDSON (1985), 'Incentives to Form Coalitions with Bertrand Competition', *Rand Journal of Economics* 16, pp. 473-485.

GATSIOS, K. and P. SEABRIGHT (1989), 'Regulation in the European Community', *Oxford Review of Economic Policy* 5, pp. 37-60.

GROSSMAN, G and E. HELPMAN (1994), 'Protection for Sale', *American Economic Review* 84, pp. 833-850.

HOEKMAN, B. and P. MAVROIDIS (1996), 'Dumping, Antidumping and Antitrust', *Journal of World Trade*, 30, pp. 28-52.

HOEKMAN, B. (1997), 'Competition Policy and the Global Trading System', *World Economy*, 20, pp. 383-406.

JACKSON, (1969), *World Trade and the Law of the GATT*, Bobbs Merrill, Indianapolis.

JACQUEMIN, A. (1995), 'Internationalisation of Competition Policy', *World Economy* 18, pp. 781-789.

JENNY, F. (1994), 'Competition and Efficiency' in: B. Hawk, ed. *Antitrust in a Global Economy*, Fordham Corporate Law Institute.

KRUGMAN, P. (1997), 'What Should Trade Negotiators Negotiate About?', *Journal of Economic Perspectives* 35, pp. 113-120.

KÜHN, K., P. SEABRIGHT and A. SMITH, 'Competition Policy Research: Where Do We Stand?', CEPR Occasional Paper # 8.

MATSUSHITA, M. (1997), 'Competition Policy within the Framework of the WTO', mimeo.

MAVROIDIS, P. and S. VAN SICLEN (1997), 'The Application of the GATT/WTO Dispute Resolution System to Competition Issues', mimeo, University of Neuchatel, Switzerland.

MESSERLIN, P. (1995), 'Politiques commerciale et de la concurrence', *Revue économique* 46, pp. 717-726.

MIERT, K. van (1996), 'EU Competition Policy in the New Trade Order', paper presented at the Oslo Conference on Competition Policies for an Integrated World Economy, 14 June 1996.

MOTTA, M. and F. ONIDA (1996), 'Trade Policy and Competition Policy', CESPRI working paper #86.

NEVEN, D. (1992), 'Regulatory Reform in the European Community', *American Economic Review*, Papers and Proceedings, 82, pp. 98-103.

NICOLAIDES, P. (1996), 'For a World Competition Authority', *Journal of World Trade* 30, pp. 131-145.

PETERSMANN, E. (1996), 'The Need for Integrating Trade and Competition Rules in the WTO World Trade and Legal System', PSIO Occasional Paper # 3.

SALANT, S.W., S. SWITZER and R. REYNOLDS (1983), 'Losses from Horizontal Mergers: The Effects of an Exogenous Change in Industry Structure on Cournot-Nash Equilibrium', *Quarterly Journal of Economics* 98, pp. 185-199.

VOSGEREAU, H. (1995), 'Towards an International Coordination of Competition Policies', paper presented at the International Conference on *Recent Development in International Economics*, Aix-en-Provence, 14-16 June.

WOOD, D. (1996), 'International Standards for Competition Law: An Idea whose Time Has Not Come', PSIO Occasional Paper #2.

WORLD TRADE ORGANIZATION (1997), 'Trade and Competition Policy', *Annual Report*, Special Topic, vol. I.