

The Role of Competition Policy in Emerging Economies Comments

Tetsushi Sonobe
Professor, National Graduate Institute
for Policy Studies

Perspective of development economics

- My major is development economics.
- We, development economists, are almost the same as other economists.
- But development economists appreciate the importance of competition policy probably more than other economists. I think the reason is as follows:
- Development economists deal with bad political and economic institutions.
- Under bad institutions, power, wealth, and opportunity are concentrated in the hands of a few elites.
- Bad institutions are characterized by the lack of the rule of law and check and balance. Bad institutions allow entry barriers and economic controls to proliferate, which prevent markets from functioning and limit economic opportunities for people.
- Let's refer to such bad institutions as **extractive institutions**, following the lead of Acemogru (MIT) and James Robinson (Harvard).

Institutions and sustained economic growth

- By contrast, good institutions allow broad participation, create a level playing field, and provide economic opportunities for the majority of people. Such institutions are called **inclusive institutions**.
- **Most development economists agree on the following:**
 1. **A country's economic growth and its institutions are closely associated.**
 2. **Economic growth is brought about by the expansion of markets and the improvement of production technology and management.**
 - **Market or commerce expands under the rule of law.**
 - **Technology (including management) is improved through innovation and imitation. For developing countries, learning from abroad (technology catch-up or borrowing) is the key.**
 3. **Although economic growth is possible even under extractive institutions, **sustainable economic growth** is most likely to occur under inclusive institutions.**

Institutional changes in India, China, and Brazil

- India has had inclusive political institutions, but her political institutions were rather extractive until 1991. Now India has inclusive political institutions and inclusive economic institutions.
- Before the Reform and Opening Up began in 1978, China had extractive institutions, both politically and economically. Today, China has inclusive economic institutions even though political institutions remain extractive.
- From 1964 to 1985, Brazil had military regime. Political institution became inclusive in 1985, but economic institutions remain extractive until the middle of the 1990s. Now Brazil enjoys inclusive economic and political institutions.
- It could be said that the movement away from extractive institutions to inclusive institutions have brought about economic growth to these countries.

Importance of Antitrust and Competition Policy (1)

- Market is an indispensable element of the inclusive institution.
- Market, however, can cease to be inclusive, but it can be dominated by a small number of economically and politically powerful people.
 - In the United States after the Civil War, Cornelius Vanderbilt, John D. Rockefeller, John Pierpont Morgan, Andrew Carnegie, among others made fortunes. They used their wealth to consolidate their monopolies. As a result, more wealth was concentrated in their hands, and it became easy for them to buy political power. This would be a very dangerous vicious circle leading to extractive institutions similar to those observed in Latin America and other regions of the world.
- Such backslides away from inclusive markets were stopped by Interstate Commerce Act of 1887, Sherman Antitrust Act of 1890, Clayton Antitrust Act of 1914, and other antitrust measures and policies.
- **Competition policy plays a critically important role in maintaining inclusive society, in addition to the well-recognized role in reducing inefficiency or dead weight loss.**

Importance of Antitrust and Competition Policy (2)

- Brazilian exports are booming and creating a new generation of tycoons.
- Similarly in other emerging economies, extremely large firms and rich people are emerging.
- The question arises as to whether they are being checked by the antitrust authority.
- The US government had kept Bill Gates under surveillance for many years, even though it was obvious to everyone that his company, Microsoft, had grown large because of its innovations.
- Probably we should follow this aggressive attitude of the US Justice Department and FTC, which is likely to be the one of the major sources of the energy, dynamism, and long-term prosperity of the US economy.

Challenges

- The antitrust authorities in the emerging economies are still in their infancy and have only small staff with limited experience.
- Nonetheless, they have to handle complicated problems as Dr. Geeta Gori just pointed out.
- In order to increase the staff and build up their capacity, the antitrust authority needs more support from the government and civil society, as Dr. Wu Hanhong has just pointed out.
- I think that these organizations (including JFTC) should pay more attention to boosting the general awareness of the vital importance of antitrust and competition policy through media as well as this kind of symposiums.

Four issues raised by Prof. Okada

1. Industrial policy vs. competition policy
2. State-owned enterprises backed by favoritism and cronyism
3. International mergers and acquisition
4. Promotion of technological catch-up and competition policy

1. Industrial policy vs. competition policy

Industrial policy type 1 is Infant Industry Protection.

The existing empirical studies indicate that industrial development is successful only when firms learn actively from abroad. Protection does not facilitate learning from abroad. Hence it is meaningless and should be abolished. Instead industrial policy should address the market failure problems that make it difficult for firms to learn from abroad. Real industrial policy in this sense is perfectly consistent with competition policy.

Industrial policy type 2 is Industrial Adjustment.

In emerging economies, industrial structure changes rapidly because of sharp increase in wage rates and the resulting change in comparative advantage. How to buy time for reallocation of labor and capital from declining industries to emerging industries? It is not a good idea to use antitrust law exemptions. Rather than helping declining industries, it is more appropriate to provide vocational training for workers so that they can move to new industries.

2. State-owned enterprises (backed by favoritism and cronyism)

- Clearly, state-owned enterprises, favoritism, cronyism and so on are typical extractive institutions and should be eliminated.
- Dr. Victor Gomes has just presented his empirical study showing that productivity of the SOC can increase drastically if it is exposed to competitive pressure.
- But I am sorry I have no answer to the question of who can tie a bell to the neck of the Cat.

3. International mergers and acquisition

- Foreign direct investments by multinationals will be useful for emerging economies if they bring about new technologies (in a broad sense), and if they engage in neither predatory nor exclusionary conducts.
- It seems appropriate to design a policy that facilitates the inflow of foreign direct investments on the one hand and prevent multinationals from engaging in anti-competitive conducts on the other hand.

4. Promotion of technological catch-up and competition policy

- Technological catch-up, technological borrowing, technology transfer and adoption (and dissemination), and learning from abroad are about the same thing. They are vitally important for economic development.
- Two major market failure problems:
 - Information spillovers (or rampant imitation) reduces private benefit from learning from abroad relative to social benefits (the problem of externalities).
 - Those who should learn tend to be unaware of the value of learning (asymmetric information problem).
- It is important for the government to encourage the first movers in some ways other than antitrust law exemptions.