



The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND INVESTMENT SYSTEM  
FOR SUSTAINABLE DEVELOPMENT



## Antitrust, Regulatory Capture, and Economic Integration

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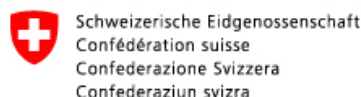
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# INTRODUCTION: ANTITRUST GOALS AND THE RISK OF CAPTURE

Effective competition constrains the exercise of market power: it efficiently allocates goods and services to consumers, rewards productive firms that have lower costs of production and increases incentives to invest in new technologies. These claims are supported by a large body of evidence<sup>1</sup>.

The design of competition laws and institutions to promote competition should consider the constraints that imperfect information imposes on actual policy implementation and should explicitly consider the cost of failing to prevent inefficient conduct/transactions (type II errors) against the cost of misguided intervention (type I errors), which might reduce the incentive to compete and thereby compromise the ultimate objective of competition laws<sup>2</sup>. Great care is thus required in designing competition regimes in terms, *inter alia*, of the scope of their intervention, the standards that they implement, the powers granted to them, the procedures under which they operate and the objectives that are assigned to them.

While most economists agree that the ultimate and only goal of antitrust should be to maximise total welfare, which aggregates consumer welfare and firms' profits (or producers' surplus)<sup>3</sup>, not everyone agrees on how to achieve that goal. In particular, many economists believe that total welfare is likely to be greater when competition authorities are instructed to intervene in order to maximise consumer welfare. In other words, when they are required to ignore the impact of their decisions on firms' profits (at least in a static sense and acknowledging that incentives to further innovate may have to be preserved to ensure dynamic efficiency). These economists fear *inter alia* that the adoption of a total welfare standard will lead to enforcement in which the interests of firms are given greater weight than the interests of consumers, in part because the firms have a greater capability to influence decisions, while consumers face collective action limitations<sup>4</sup>.

In practice, competition regimes typically consider a series of competition and non-competition goals and make no explicit reference to any welfare measure. Competition laws may thus be used to achieve political objectives other than the protection of competition. In the EU, for example, competition law is meant to contribute to the creation of a single market. A number of jurisdictions allow for a 'public interest' test, with few constraints on the considerations that can be appealed to in the implementation of the test and little guidance on the relative weight that should be given to these considerations.

The risk that competition provisions can be used to pursue different goals is also increased by the effectiveness of the remedies that they can mobilise (including hefty fines and structural remedies with significant effects on markets). Accordingly, there is a temptation to use competition instruments to reinforce weaker instruments, for example by imposing restrictions that would alter market structure, protect certain companies, preserve employment or otherwise affect the welfare of a well-identified set of market players. There is a number of illustrations of this from the EU. For instance, provisions on abuse of dominance have arguably been used to address the failure to properly regulate access to essential facilities in telecoms and energy. The cumbersome and fragmented decision-making process involving a multiplicity of participants (the European Commission, the European Parliament and the Council of the EU representing 28 member states) in the introduction of new regulation can trigger calls for a more active and prompt intervention by the Commission in its role of antitrust authority, possibly imposing remedies going beyond what is necessary to terminate an antitrust abuse. The public debate surrounding the Google case and the call for drastic measures, including break up, from various constituencies (including the European Parliament and some national competition authorities) is a case in point.

The multiplicity of goals and objectives, and in particular the adoption of non-competition goals, opens the door to discretionary decisions, political intervention and more generally the capture of enforcement decisions by particular interests. For example, in a world with many competing goals, competition authorities might be more easily 'persuaded' to prioritise non-competition goals, such as improving the competitiveness of domestic firms, over and above the protection of effective competition and the interests of consumers<sup>5</sup>. It might be easier for affected parties to convince competition authorities to adopt a decision that favours their interests when the criteria for the decision are fuzzy. Short of making monetary transfers (which would be regarded as corruption in many jurisdictions), companies involved may raise the prospect of a revolving door and lucrative positions

1 | See for instance, Carlton and Perloff (2005).

2 | Using the terminology of decision theory, a type I error occurs when a business practice is found to be anticompetitive when it is in fact procompetitive, and a type II error occurs when a business practice is regarded as legitimate when in fact it is anticompetitive.

3 | Farrell and Katz (2006).

4 | See Neven and Röller (2005). A consumer welfare standard might also lead to a higher level of total welfare because of a selection effect (transactions that are proposed with a consumer surplus standard might actually yield a higher total welfare) and the commitment effect (an agency announcing a policy might not find it optimal *ex post* to apply it given the transactions proposed by the parties). For the former, see Lyons (2002). For the latter, see Besanko and Spulber (1993).

5 | For a discussion of the difficulty in enforcing a regime with a broad (public interest) objective, see for instance Chisholm and Jung (2014).

in the future. They might simply impress knowledge and competence that the decision maker is unable to challenge, or more subtly influence the priors that will affect the judgments that the decision makers will have to make (this is referred to as cognitive capture). Making decisions inevitably involves judgments that rely on priors, which to some extent reflect ideology. Third parties can affect these beliefs<sup>6</sup>. Fuzzy criteria might also make it easier for civil servants to take decisions which serve their own interests. This is known as bureaucratic capture. Civil servants in charge of an investigation will pursue their own career goals and may accordingly bias the investigations in order to best achieve these goals (see Dewatripont and Tirole, 1999, for a discussion<sup>7</sup>) and third parties can take advantage of this.

The risk of capture is lower when competition law is meant to protect competition and nothing else, and especially when competition enforcement is guided by consumer welfare only. Hence, reforms aimed at limiting the scope of antitrust intervention to control behaviour that harms consumer welfare are likely to reduce the risk of political intervention and regulatory capture<sup>8</sup>.

A debate of this sort is currently being held in the United States. Section 5 of the Federal Trade Commission (FTC) Act provides that *“unfair methods of competition in or affecting commerce ... are hereby declared unlawful”*. The statute is framed in general terms because any list of unfair methods of competition necessarily would be incomplete. FTC Commissioner Joshua Wright issued in 2013 a proposal to clarify the standards and the limits the FTC will adhere to in exercising its authority to prosecute unfair methods of competition under Section 5<sup>9</sup>. The ultimate goal of such proposal is to tie the hands of the FTC so that the enforcement of Section 5 is limited to the attainment of competition goals.

Besides the multiplicity (or fuzziness) of objectives, the legal standard against which the effect of transactions or the effect of particular conduct is assessed might allow for significant deviation from what the protection of effective competition would dictate. For instance, in some jurisdictions, protecting competition does not mean protecting consumers by preserving the integrity of the competitive process, but can mean protecting competitors, especially SMEs and other vulnerable (possibly inefficient) firms. In those jurisdictions, competition law is used to achieve non-competition goals even when those goals are not explicitly stated.

This is not a concern that is limited to emerging competition law regimes<sup>10</sup>. In a 2014 paper, Wouter Wils, Hearing Officer of the European Commission, stated: *“The EU competition rules no doubt have positive effects on consumer welfare and on efficiency, but the EU Treaties do not allow these effects to substituted for the objective of a system of undistorted competition, to the exclusion of the other benefits of undistorted competition... such as variety and consumer choice, the right to compete on the merits, and equality of opportunity between economic operators”* (Wils, 2014; emphasis added). What amounts to a system of undistorted competition is however

ill defined and this concept does not provide a discipline on enforcement, thereby allowing for discretionary decisions<sup>11</sup>.

Besides the multiplicity of objectives and the scope of the legal standards, the design of the institutions in charge of enforcement can greatly affect the scope for capture. Even if one should be wary of making generalisations across countries (as the performance of an institutional design depends on the environment in which it is integrated), a number of key principles stand out. First, capture will be easier when accountability is limited. If authorities do not have to justify their decisions in detail, it will be easier for them to favour particular interests. In turn, accountability will require some degree of transparency both with respect to the outcomes (for instance through detailed published decisions) and with respect to the process<sup>12</sup>. Second, capture will be easier when the decision maker is not independent. For instance, if the head of an agency can be dismissed by the government without much public justification, it will be easier for the government to affect particular decisions<sup>13</sup>.

6 For a discussion of the role of ideology and beliefs, see Lao (2014).

7 For instance, civil servants who are supposed to evaluate all aspects of a transaction might turn into prosecutors simply because the improvements in career prospects triggered by a high profile negative decision might exceed those triggered by a clearance after a balanced in-depth investigation.

8 However, the enforcement of antitrust laws can generate distortions in the global economy even when competition enforcement is guided by consumer welfare only in all jurisdictions. See Guzman (2001). For criticisms of this theory, see Elhauge and Geradin (2007); Trebilcock and Iacobucci (2004); McGinnis (2004) and Bradford (2007). In addition, the effects doctrine implies that at least in the absence of country-specific remedies, the strictest national antitrust jurisdiction will prevail in case of jurisdictional conflict, which will naturally lead to global overregulation. See Bradford (2012).

9 Statement of Commissioner Joshua D. Wright, 'Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act', 19 June 2013.

10 For a discussion in relation to the US, see Edlin and Farrell (2015).

11 In addition, some of the concepts associated with a system of undistorted competition as understood by those rejecting a welfaristic interpretation seem to be in contradiction with effective competition. For instance, the principle of equality of opportunity could be applied to mitigate the selective forces of the market, providing a shelter to those operators that are unable to compete with more efficient rivals, at the ultimate expense of consumers.

12 Accountability is not only a matter a transparency. It will be harder to achieve when civil servants have to perform potentially conflicting tasks. For instance, it is difficult to make the civil service accountable in a system in which it investigates cases but also decides in first instance.

13 In this regard, there is some empirical evidence supporting the view that agencies that lack independence perform poorly. See for instance, Borrell and Jimenez (2008), Voight (2009) and Guidi (2015). It is naturally difficult to measure to the performance of agencies, to measure their independence and to control for the other factors that affect their performance. Results should thus be interpreted cautiously.

The debate about the effects of regulatory capture on antitrust intervention and its implications for competition law design has thus far been conducted largely in a closed-economy setting. As we will explain in what follows, competition law design and enforcement issues are also relevant in an open economy, because competition law might be used in unorthodox ways in order to favour domestic firms competing in global markets, at the expense of foreign competitors, domestic consumers and economic integration.

## DOMESTIC BIAS IN ANTITRUST ENFORCEMENT

The concern of a strategic use of antitrust enforcement often refers to merger control<sup>14</sup>. Merger control is being used in some countries to promote local employment and/or to favour certain population groups, including local SMEs, at the expense of foreign competitors. The Chinese public body in charge of merger control (Ministry of Commerce or MOFCOM), for example, has been blamed for imposing conditions on foreign companies involved in M&A with the specific aim of shielding domestic companies from the merged entities' potential increase in competitiveness. In *Inbev/Anheuser-Busch and Wal-Mart/Niu Hai*, the parties were prohibited from entering into a specific line of business. In *Novartis/Alcon*, the parties were required not to relaunch a Novartis product. In *Marubeni/Gavilon*, the parties were prohibited from exploiting synergies that would reduce wholesale costs and increase Marubeni's competitiveness in the supply of soya beans to the Chinese market. Synergies and efficiency gains might allow merged companies to outperform Chinese competitors. China's competition authorities appear to want to limit this negative externality on domestic firms, rather than to enable market conditions that will result in lower prices and better quality products for Chinese consumers<sup>15</sup>.

More generally, Mariniello (2013) finds that all Chinese conditional clearance decisions until October 2013 involved foreign companies. This is surprising. The rate of merger activity in China is comparable to that in Europe, but the majority (about 60 percent) of the mergers cleared with conditions by the European Commission involve only European companies. A potential explanation for such an outcome is that Chinese authorities do not enforce notification requirements against domestic companies and, hence, relatively few scrutinised mergers involve only Chinese companies: only 15 percent of the decisions dealt with by MOFCOM concern domestic deals, compared to 47 percent in the case of the European Commission. It should also be pointed out that the protection of 'the national economic development' is one of the factors Chinese

authorities are required to consider when performing their merger reviews according to the Chinese Anti-Monopoly Law. This is an example of a fuzzy objective that can be abused to favour particular interests at the expense of competition.

Recent examples of regulatory capture in merger control are to be found also in economies with established merger-control policies and where antitrust authorities have longer experience of enforcement. A recent consolidation wave in national mobile markets in Europe, for example, has been accompanied by an extraordinary number of public statements by political leaders from several EU member states supporting the adoption of a lenient approach by the European Commission in favour of a reduction in the number of market players<sup>16</sup>. There are good indications that such political pressure led the Commission to impose milder clearance conditions that it would have otherwise. For example, the Commission was heavily criticised by national regulators over the *Telefonica/E-Plus* merger in Germany<sup>17</sup>. In that case, the Commission identified a significant potential harm because of the removal of an aggressive network operator from the market, particularly for the lower-end pre-paid segment. The Commission however cleared the merger with an apparently weak remedy: the parties had to grant access to less than half of the capacity that was previously used by E-Plus to exert a competitive constraint on Telefonica, raising doubts about the ability of the virtual operator to replicate the competitive pressure exerted by E-Plus before the merger.

Other examples of political capture of antitrust in Europe involve national government interventions in cases of foreign takeovers of national champions. National concerns are

<sup>14</sup> See also Bradford (2012) and Gerber (2010).

<sup>15</sup> It should be stressed however that a full-fledged Chinese antitrust framework (the Anti-Monopoly Law) was first introduced in China in 2008, marking progress in limiting the likelihood of abusive conduct in Chinese markets and arguably improving the attractiveness of the Chinese investment environment. That is to say progress has been made but practice is still lacking in some respect. It is interesting to draw a parallel between the evolution of the Chinese approach to competition policy and Chinese policies with effects on inward foreign direct investment (FDI). The OECD FDI restrictiveness index provides an indication of a country's openness to foreign investors (the index include all discriminatory measures affecting foreign investors, including market access restrictions and departures from national treatment – it ranges from 0 to 1, with one being most restrictive; see <http://www.oecd.org/investment/fdiindex.htm>). According to the OECD index, China became much more open to FDI in recent years: the index for primary and tertiary sectors dropped from 0.65 – 0.75 in 1997 to below 0.5 from 2010 onwards, and for the secondary sector it dropped from above 0.4 to below 0.3. However, China still remains much less open to FDI than the average OECD economy (below 0.10 in all sectors in 2013).

<sup>16</sup> See, for example, 'Merkel backs EU telco consolidation', *Financial Times*, 8 May 2014.

<sup>17</sup> See 'Regulators revolt against Telefonica and E-Plus merger', *Financial Times*, 20 June 2014.

often of a presumed economic nature. There is a general perception that a foreign investor would be less physically or psychologically attached to the host economy, that it would be easier for the foreign investor to close down the headquarters of the acquired company, that the foreign investor could have an interest in downgrading national brands that compete on the same markets or that it would be less sensitive to trades unions or to political pressure to preserve jobs in the country. Such views can become even more prevalent in times of economic crisis. The European Union Merger Regulation (EUMR) allows national states to derogate normal merger control whenever specific “public interests” are endangered (Art. 21(4) EUMR). However, the definition of public interest has not been clarified and in the past governments have attempted to stretch the meaning of Art. 21(4) EUMR to pre-empt the action of EU antitrust authorities and impose conditions on mergers to pursue broader goals than the protection of competition (see Neven, 2014). Mariniello (2014) shows that in 14 out of 22 cases of major attempted cross-border deals in the EU in the period 1999-2014 in which the buyer’s nationality prompted government intervention, economic concerns other than consumer interests, such as fears about job cuts or productivity losses, played a significant role in the final outcome of the merger review. In most cases over which economic concerns were expressed, the merger ultimately did not take place.

As explained by Jones and Davies (2014), where the EUMR does not apply to a merger transaction, “there appears to be no EU barrier to Member States exercising regulatory approval of mergers between domestic companies on public interest grounds”. This has been used by some member states, such as Germany in connection with the *E.ON/Ruhrgas* merger, to approve mergers that raised clear competition concerns domestically and internationally in order to facilitate the emergence of national champions<sup>18</sup>.

Merger control might also be conditioned by foreign political pressure. This could be the case for Oracle acquisition of Sun/MySQL, which was cleared by the European Commission in January 2010. On 24 November 2009, 59 US senators wrote to the Commission asking for the merger to be allowed. In the letter, the senators stressed that “*Sun Microsystems’ financial position has become more precarious and the Commission’s inquiry has continued. Some [senators] have raised concerns over the company’s ability to continue to employ its thousands of workers*”. First signatory Senator John F. Kerry declared: “*this transaction has been thoroughly reviewed by the United States Department of Justice, which has decided to take no action. Therefore, I hope the [Commission] will quickly conclude their investigation into this transaction*”<sup>19</sup>.

The strategic use of competition policy does not seem to be restricted to merger control. Antitrust policy and, in particular, the laws against abusive conduct by dominant firms might also be used opportunistically. Companies selling key inputs, or licensing their valuable intellectual property (IP) to domestic manufacturers have been accused

of charging excessive prices in order to grant domestic manufacturers a competitive advantage over their foreign counterparts, both domestically and in foreign markets. Some companies have been forced to reduce their prices arbitrarily; others have been compelled to license their IP at rates that are disproportionately low.

In August 2010, the Competition Commission of South Africa alleged that Sasol Chemical Industries (Pty) Ltd (SCI) had contravened the South African Competition Act by charging excessive prices for propylene and polypropylene to its domestic customers from 2004 to 2007<sup>20</sup>. The matter was referred to the Competition Tribunal, which in 2014 found that SCI had charged excessive prices for these products. This intervention was justified as a way of protecting the competitive position of domestic converters – companies manufacturing different plastic products for domestic and industrial consumption – relative to their rivals from Brazil and South-East Asia, which were penetrating the South African markets taking advantage of their superior scale<sup>21</sup>.

In February 2015, US chipmaker Qualcomm paid \$975m to Chinese authorities to end a 14 month antitrust investigation into its patent licensing practices<sup>22</sup>. The fine is the largest in China’s corporate history. The settlement will require the firm to reduce the royalty rates on its standard essential patents applied to sales of mobile phone made in China by Chinese smartphone makers, such as Xiaomi, Lenovo and Huawei. The move could in our opinion help Chinese manufacturers compete against market leaders Apple and Samsung in the growing Chinese mobile phone market. More recently, the Korean FTC has published revised IP guidelines

18 The merger was initially prohibited by the Bundeskartellamt. This decision was subsequently overturned by the Ministry of the Economy, partly because the merger would “enhance the international competitiveness” of Ruhrgas (see <http://www.eon.com/en/media>)

19 See ‘Hatch, Kerry Lead 59 Senators in Defending U.S. Business Abroad’, 24 November 2009, available at <http://www.hatch.senate.gov/public/index.cfm/2009/11/hatch-kerry-lead-59-senators-in-defending-u.s.-business-abroad>.

20 See Competition Commission v Sasol Chemical Industries, Case 011502, Decision, available at [http://www.comptrib.co.za/cases/complaint/retrieve\\_case/1722](http://www.comptrib.co.za/cases/complaint/retrieve_case/1722).

21 “The Tribunal concluded that SCI’s exercise of market power and its excessive prices have resulted in a missed opportunity for innovation and development for the domestic manufacture of downstream plastic goods. Cheaper polypropylene prices for local plastic converters could enhance local production thereby enabling them to compete more effectively with imported final plastic products, manufacture locally rather than overseas and introduce new products to South African consumers adding to their choice of product through greater innovation”. See <http://www.comptrib.co.za/publications/press-releases/outcome-of-the-sasol-case/>. Sasol appealed the Tribunal’s ruling to the Competition Appeal Court of South Africa, which overturned the Tribunal’s decision in June 2015. See [http://comptrib.co.za/cases/appeal/retrieve\\_case/1925](http://comptrib.co.za/cases/appeal/retrieve_case/1925).

22 See ‘Qualcomm Settlement With China’s NDRC Removes Major Speedbump’, *Forbes*, 10 February 2015, available at <http://www.forbes.com/sites/patrickmoorhead/2015/02/10/qualcomm-settlement-with-chinas-ndrc-removes-major-speedbump/>.

which state that it will regard as dominant companies that own technologies that are not standardised by standard-setting organisations, but that are widely used as de-facto standard technologies. By virtue of being classified as dominant, such companies would be bound by law to license their technologies on fair, reasonable and non-discriminatory (FRAND) terms<sup>23</sup>. This move could be seen as an attempt to restore or improve the competitive position of Samsung and other Korean manufacturers such as LG, in the wake of China's intervention against Qualcomm.

In November 2014, the European Parliament approved a motion calling for tougher regulation of internet search engines, including a suggestion that Google should be broken up as a solution to its dominance in Europe. The resolution calls on the European Commission "to prevent any abuse in the marketing of interlinked services by operators of search engines" and "to consider proposals with the aim of unbundling search engines from other commercial services" in the long run<sup>24</sup>. In February 2015, US President, Barack Obama, suggested that investigations by the European Union into companies like Google and Facebook were "commercially driven". In an interview with *Recode*, the president claimed that European "service providers who... can't compete with ours, are essentially trying to set up some roadblocks for our companies to operate effectively there"<sup>25</sup>. All these political and/or strategic interventions could distort competition at the expense of consumers, who will be forced to pay higher prices for lower quality products.

In our view, the problem of bias in enforcement, if unchecked, is bound to grow in importance in a world where economic activity is increasingly globalised (mergers and acquisitions with a cross-border dimension have increased about 250-350 percent since 1990), almost every country in the world possess a competition policy toolkit (the number of jurisdictions with competition law enforcement has increased 600 percent since the 1990s<sup>26</sup>), and the jurisdictional reach of most domestic antitrust laws is determined by the 'effects doctrine', according to which a state can apply its antitrust laws to any anticompetitive conduct that has an effect on its domestic market.

## EFFECTS OF CAPTURE ON TRADE AND INVESTMENT

The types of regulatory capture in the enforcement of competition law that we have illustrated in the previous section could cause significant distributional effects, shifting rents from innovative and efficient firms, and from local and foreign consumers, to less efficient companies. This reallocation of rents could distort incentives to invest and innovate and, hence, reduce the overall growth potential of the global economy. The risk of domestic bias on the part of antitrust authorities also creates regulatory and legal uncertainty, thus reducing the incentives of foreign companies to invest both domestically and overall.

Generally speaking, exports and production in host countries, the location of future investments and the incentive to innovate can be affected by regulatory capture. In particular, foreign firms might find it unattractive to produce, invest in and/or export to countries where antitrust policy is used strategically in order to favour their domestic competitors.

One can distinguish between four channels through which these decisions can be affected.

First, regulatory capture increases uncertainty: political interference in the enforcement process makes it more difficult to predict the final outcome of antitrust investigations. Regardless of what that outcome could be, the mere inability to anticipate it reduces the incentive to invest. Julio and Yook (2012) investigate the relationship between cross-border capital flows and host economies' political uncertainty. They find that the capital flow from US companies to their foreign affiliates drops by 12 percent during election years in host economies. Investment is lower when investors find it more difficult to anticipate future government policy.

23 | *Review Guidelines on Unfair Exercise of Intellectual Property Rights*, 17 December 2014, available at [http://eng.ftc.go.kr/bbs.do?command=getList&type\\_cd=62&pageld=0401](http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=62&pageld=0401).

24 | See 'European parliament votes yes on "Google breakup" motion', *The Guardian*, 27 November 2014, available at <http://www.theguardian.com/technology/2014/nov/27/european-parliament-votes-yes-google-breakup-motion>.

25 | See 'Obama Says Europe's Aggressiveness Toward Google Comes From Protecting Lesser Competitors', the *Re/code* Interview, available at <http://recode.net/2015/02/13/obama-says-europes-aggressiveness-towards-google-comes-from-protecting-lesser-competitors/>.

26 | See Capobianco *et al* (2014).



The second channel is through direct distorting effects: these arise if the main objective of political intervention is to protect domestic companies (eg blocking a cross-border merger that is expected to enhance the ability of the merged entities to compete with domestic competitors). The *Oracle/Sun-MySQL* case also illustrates that foreign interests can sometimes attempt to capture domestic authorities. Political pressure can be exerted by a (powerful) foreign country in order to get a favourable treatment for investors originating in that country at the expense of domestic consumers and (possibly) other firms. The intervention in favour of domestic firms might also involve the absence of enforcement, as in the celebrated *Kodak/Fuji* case, in which Japanese authorities were accused of protecting Fuji by failing to challenge vertical restraints that acted as a barrier against Kodak<sup>27</sup>.

More generally, with regulatory capture that directly favours domestic firms, foreign companies face a higher risk of being convicted when innocent (type I error), receiving a disproportionate sanction (for example, the imposition of a remedy which goes beyond what is necessary to halt an abuse, or the imposition of conditions unrelated to antitrust concerns such as a requirement to retain a certain amount of the workforce after a merger takes place), or a greater probability of being investigated by the antitrust authority. Research points out that even an independent arbitrator can be subject to a domestic bias. Bhattacharya *et al* (2007), for example, show that there is a lower probability of adverse US court judgements for US domestic companies compared to foreign companies.

Political intervention that biases antitrust enforcement in favour of local players might in particular have effects on the competitiveness of foreign companies that are already present in the domestic market. Politically motivated antitrust intervention might increase the costs of foreign firms, which undermines their competitive position in domestic and international markets. Countries can also enforce their competition laws to reduce costs for domestic firms and, therefore to improve their competitive position in global markets.

Biased antitrust intervention might also force foreign companies to revise downwards their expectations about future profits from innovation. This could reduce their incentives to invest and innovate. The magnitude of these dynamic effects is difficult to calibrate, because it depends on the market size and industrial specialisation of the country with a biased antitrust policy.

A small country, or a country in which new technologies are mostly used as inputs by domestic manufacturers, might find it optimal to adopt a pro-implementer bias and, hence, use competition law to reduce the cost of IP. Lower IP prices need not have negative effects on that country's economy if the incentives of high-tech multinationals supplying domestic manufacturers to develop new technologies are warranted by bigger markets in other countries. Issues pertaining to innovation are particularly tricky for the

interaction between developed and developing countries. Over-enforcement of antitrust could entail a transfer of surplus from the former to the latter.

The third channel is through indirect effects if the distortions introduced by political interference in the enforcement of competition law affect domestic markets in such a way that it is less appealing for foreign investors to produce or invest in that country. This could be the case if an anticompetitive merger between domestic upstream companies is cleared, making downstream markets which depend on inputs from the upstream market where the merger took place less attractive to foreign investors.

Finally, there are potential dynamic effects: strategic trade theory suggests that the more leeway countries have in using antitrust to pursue protectionist goals, the greater the risk that penalised companies' countries of origin will retaliate by implementing equally distorting measures. The end result is a reduction of the inflow and outflow of trade for all jurisdictions involved<sup>28</sup>.

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## COMPETITION LAW IN A GLOBALISED WORLD

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In the long term, sub-optimal antitrust decisions allocating rents to domestic companies for reasons other than the promotion and protection of effective competition are likely to generate negative effects for everybody. Any short-term advantages conferred on domestic firms by the strategic use of domestic competition law will evaporate once trading partners respond to those abuses and retaliate. A well-functioning global economy requires competition laws designed and enforced without bias. And yet the world economy may find itself, once again, in a prisoners' dilemma situation, in which competition laws around the world are designed and/or enforced to promote local industry interests.

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27 Durling (2000). The Telmex case can be also be seen as one in which the US authorities were challenging the lack of enforcement of the Mexican competition law (even if it was not formulated in this way). See Mavroidis and Neven (2005).

28 See Brander and Spencer (1985). See also Gal and Padilla (2010). As pointed by Horn and Levinsohn (2001), the strategic use of competition policy will also affect the optimal use of other instruments (in particular export subsidies).

# WHAT COULD BE DONE?

## POLICY COORDINATION

Some of the distortions described above could be resolved if governments converged on an understanding that the sole objective of competition policy ought to be the protection of consumer welfare or, in other words, if all non-competition goals were abandoned and/or if institutions that would protect enforcers of competition laws against capture were put in place. This would prevent the abusive use of competition policy to favour certain domestic stakeholders, such as small entrepreneurs, employees and domestic firms competing in global markets, at the expense of foreign competitors, consumers and economic efficiency<sup>29</sup>.

The question is how to achieve such an outcome. In order to escape from the prisoner's dilemma, governments need to commit to not allow their competition enforcement to be captured in return for other governments making similar commitments. In order to achieve this, governments should internalise the risks for their own economies of the generalised enforcement of biased competition laws. International organisations, such as the International Competition Network (ICN), OECD, the United Nations Conference on Trade and Development and the World Trade Organisation, can certainly promote greater awareness of the domestic costs of the strategic use of competition policy. More importantly, however, the domestic firms affected by biased enforcement abroad need to lobby their government in order to obtain unbiased enforcement abroad. This lobbying will balance the influence of the domestic constituencies protected by a biased enforcement at home and prompt the government to enter into a mutual commitment with the foreign governments not to interfere with competition enforcement.

Such an exchange of market-access commitments as a mechanism to achieve policy coordination has arguably worked well when the effects of the instrument at stake are straightforward and the implementation of the commitment is transparent (for instance, with respect to commitments to bind import tariffs below their optimal level, as in the 'mutual market access' theory of the WTO contract, see Bagwell and Staiger, 2002). But the matter is more delicate when the implementation is difficult to observe and when the instrument is more complex. For instance, governments might want to retain some discretion over the objective of competition enforcement for legitimate public policy reasons that are unrelated to mercantilist motives. In many jurisdictions, including the EU, there is considerable controversy about the adoption of consumer welfare as the appropriate standard for antitrust intervention even in the

absence of international spill-overs. In addition, it will be difficult to detect on the basis of simple indicators whether enforcement decisions have been captured by protectionist or mercantilist motives. In those circumstances, policy coordination will be more difficult to achieve.

## IN WHAT FORUM?

Soft coordination, like that achieved by the ICN or the OECD, could help governments that are willing to limit the opportunistic use of competition laws to achieve some convergence in competition policy goals or institutional design. However, it would seem desirable to achieve a greater degree of commitment than soft mechanisms of convergence can provide.

If one accepts that it is unrealistic in the current circumstances to negotiate a discipline on competition enforcement in the context of the WTO (given the failure of the last attempt), bilateral free trade agreements (FTAs) may offer some potential in this respect.

As documented by Laprévotte *et al* (2015), an increasing number of FTAs include specific provisions or chapters on competition-related matters. Laprévotte *et al* calculate that almost 90 percent of current FTAs included in the WTO's Regional Database agreement contain such clauses. However, they also find that FTAs very rarely tackle the issue of independence of enforcement of competition law by national antitrust authorities or the goals of antitrust intervention.

A number of clauses could be considered. While explicit coordination on competition law goals is likely to prove overly ambitious, governments could find it easier to coordinate their policies in other ways. For example, a provision aimed to ensure procedural fairness and non-discrimination in the judicial review of potentially anti-competitive practices could be included in an FTA with the explicit purpose of ensuring that misplaced enforcement of competition law does not undermine the benefits of trade liberalisation. More ambitiously, governments could agree to tie their hands by designing their competition laws and institutions in a way that will limit the scope for capture. For example, they could commit to adjust their laws so that they explicitly (a) identify the set of non-competition goals that competition agencies can legitimately take into consideration (such as, for example, public and military security, plurality of the media and prudential rules in financial markets) and (b) specify the criteria according to which those goals are to be assessed and weighed. They could also commit to delegate the assessment

29 As noted above, there may be a case for the coordination of competition enforcement across jurisdictions even if all agencies were pursuing the objective of consumers welfare and were immune to capture. This case may be particularly compelling when trade is organised along value chains. See for instance, Antras and Staiger (2012).

of non-competition goals to independent competition authorities, thus removing governments from the business of competition law enforcement.

In our view, those clauses should be adopted more frequently. However, implementation costs would undoubtedly depend on the level of institutional development of the parties involved: clauses that would in principle entail a substantial redesign of domestic institutions might be exceptionally burdensome for the party required to 'catch-up', and are therefore unlikely to be welcomed in the text of an FTA (and even less likely to be implemented). The asymmetry in the institutional setting between the parties to the agreement should therefore be reflected in the choice of the right balance between clauses that aim to affect enforcement directly (arguably more burdensome), advocacy clauses promoting improvements to the institutional framework, and clauses that promote capacity-building initiatives and foster agency-to-agency cooperation on antitrust matters.

As noted by Lapr votte *et al*, dispute-resolution mechanisms implemented by FTAs have never so far covered competition provisions. It would be desirable to extend dispute-resolution mechanisms to competition. It is not clear that allowing firms to challenge governments (as in the case of investment disputes) would be desirable, because it involves delicate issues of discrimination between domestic and foreign firms (in favour of the latter, because foreign firms would have additional means to challenge a competition decision). By contrast, a state-to-state dispute-settlement mechanism through which a member of the FTA could challenge specific legal provisions and possibly their implementation would seem more appropriate<sup>30</sup>.

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What we have in mind is a clause that specifies that any party that considers that any benefit accruing to it directly or indirectly under the FTA is being nullified or impaired as the result of the application by the other contracting party of an antitrust measure may have the recourse to the dispute resolution process specified in the FTA. This clause parallels the regulation of 'non-violation' complaints under Article XXIII(1)(b) of the original GATT and Article 26 of the WTO Dispute Settlement Understanding. See Staiger and Sykes (2013).

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