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Introduction

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SYMPOSIUM

SECOND ANNUAL LATIN AMERICAN COMPETITION AND TRADE ROUND TABLE

INTRODUCTION

*Russell W. Pittman**

Competition law enforcers in Latin America face a variety of special challenges as they seek to establish their credibility in their early enforcement experience. Some of these challenges stem from the importance of international trade in the Latin economies: exports account for thirty percent of GDP in Mexico but less than twelve percent in the United States.[1] Some stem from the lack of an established regulatory structure in these countries. In this Introduction, I focus on three such issues that are considered at some length in the Symposium: free trade as a substitute for competition law, competition policy toward domestic investment by multinational enterprises, and competition law as a complement to regulation.

I. FREE TRADE

A maxim that contains a good deal of truth is that "open borders are the best competition policy." A small economy has no need to try to support three plants manufacturing (say) aluminum in order to create the competition so important to

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1. *See* INTERNATIONAL MONETARY FUND, INTERNATIONAL FINANCIAL STATISTICS YEARBOOK 627 (1998).

purchasers of aluminum. As long as there is free international trade and products are not very expensive to transport (relative to their value), purchasers may enjoy the competition provided by two foreign and one domestic supplier, or even by three foreign suppliers. In this case the most important task of the authorities regarding the aluminum market may be to prevent a domestic supplier from creating barriers to the import of aluminum, thus creating his own monopoly.

However, it is quite a step to go from this maxim to the conclusion that small countries are better off without competition laws.[2] There are at least three reasons to believe that this conclusion does not follow. First, not all goods are tradeable, and even those which are tradeable may trade on regional rather than world markets. For many goods it is *not* the case, as described above, that "products are not very expensive to transport"; furthermore, there are other factors besides simple transport costs, such as responsiveness to changes in local conditions, that may give a competitive advantage to suppliers who are closer to purchasers. The extent of the geographic market for a particular good is determined by a variety of such factors.[3] All in all, the fact that a particular good is sometimes imported and exported and is produced by many firms around the world may or may not serve to provide effective competition for purchasers at a particular time at a particular location.

Second, as discussed in the articles throughout this Symposium, competition authorities may play a critical role as protectors of the very freedom of international trade upon which buyers rely. Local enterprises may seek to use their political influence to effect the erection of barriers to international trade, and ministries of industry may be persuaded to assist them in this effort. As the Symposium Essay by John

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2. This is the leap made by Paul E. Godek, *One U.S. Export Eastern Europe Does Not Need*, 13 INT'L MERGER L. 2 (1991), *reprinted in* 15 REG. 20 (1992). *See also* Armando E. Rodriguez & Mark D. Williams, *The Effectiveness of Proposed Antitrust Programs for Developing Countries*, 19 N.C. J. INT'L L. & COM. REG. 209 (1994); Mark Williams & Armando Rodriguez, *Antitrust and Liberalization in Developing Countries*, 9 INT'L TRADE J. 495 (1995).

3. I discuss this point further in *Some Practical Considerations in Geographic Market Definition* (visited Aug. 15, 1999) <http://www.antitrust.org/economics/mergers/geomkt.html> (remarks presented at a Department of Justice/Federal Trade Commission Conference on Competition Law Enforcement in Transition Economies in Vienna, 1995).

Clark emphasizes, state and local governments may erect barriers to the import or export of goods as well, if they believe it will benefit local industry. It is typically left to the competition authorities to speak on behalf of consumers in the councils of government, to demonstrate that trade barriers, while indeed benefitting some local industry, may cause great harm to consumers as well as to other local industries (those who purchase the protected good). This "competition advocacy" role may be one of the most important roles that a competition authority plays.

Finally, even in cases where borders are formally open to the importation of goods, local producers may succeed in using anticompetitive agreements to prevent or disadvantage foreign competitors. A prospective seller who manufactures abroad will need local distribution, and a dominant local producer may force exclusive distribution agreements upon such distributors. A prospective seller who wishes to set up local manufacturing may need local suppliers, and a dominant local producer may force exclusive supply agreements on such suppliers. Some may argue that the local distributors and suppliers would not find it in their best interest to participate in such agreements, but a dominant local producer may have the market power to force participation, or it may provide a sufficient share of the monopoly rents that force is unnecessary. Shanker Singham argues in his Symposium Article for multilateral enforcement agencies to curb these kinds of anticompetitive agreements imposed by dominant local producers, but for now we must rely mostly on domestic competition law enforcers.

II. DOMESTIC INVESTMENT BY MULTINATIONAL ENTERPRISES

Developing countries throughout the world compete for direct investments by multinational enterprises (MNEs). Scholars attempt to determine what conditions in developing countries may be most attractive to MNE investors.[4] Such invest-

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4. Not surprisingly, transparency and predictability of business law enforcement are high on the list. For two interesting recent treatments, see Aymo Brunetti et al., *Institutions in Transition: Reliability of Rules and Economic Performance in Former Socialist Countries* (Policy Research Working Paper No. 1809, World Bank, Aug. 1997), and Yuko Kinoshita, *Firm Size and Determinants of Foreign Direct Investment* (CERGE-EI Working Paper No. 135, Dec. 1998) (visited Aug. 15, 1999) <http://papers.ssrn.com/paper.taf?ABSTRACT_ID=154611.html>.

ments are valued for creating jobs and for providing new technology and experienced management to domestic enterprises. Nevertheless, they may come at a cost to competition in domestic markets. How are these potential benefits and costs to be evaluated and compared?

Although it provides no great benefit in terms of exactness, the methodology used by competition authorities for the evaluation of merger proposals is quite applicable to this issue. In particular, the fact that competition authorities evaluating a merger proposal must seek to determine what the effect of the merger *will or would be* on competition in particular markets calls attention to the need both to predict the future and to evaluate the counterfactual situation: what will or would competition look like in this market absent the proposed merger?

Thus, as with a domestic merger proposal, the competition authority evaluating an alliance or joint venture or merger between a local enterprise and an MNE must define product and geographic markets, examine competition in those markets, and evaluate the effect of the MNE investment on such competition. An alliance between a foreign manufacturer and a local input supplier or distributor must be examined for the possibility that such a vertical agreement will foreclose access to the market by other enterprises. An alliance between a foreign manufacturer and a local manufacturer of the same or a competing product must be examined for the possibility that such a horizontal agreement will reduce competition in the market. Just as in domestic merger enforcement, a horizontal agreement may harm either actual or potential competition.

A recent example of the complex issues—and sensitive political considerations—involved is provided by the experience of the Brazilian competition tribunal, the Conselho Administrativo de Defesa Econômica (CADE), in considering the proposed alliances of Anheuser-Busch with Antarctica Paulista and of Miller Brewing (a subsidiary of Phillip Morris) with Cervejaria Brahma: the two largest American brewers with the two largest Brazilian brewers.

Both alliances promised the usual benefits of foreign direct investment: modernized capital stock, knowhow, jobs, and increased exports (in this case, of Brazilian beer). Yet both created the possibility of reducing competition with accompanying price increases for beer in Brazil (likely a quite regressive "tax"). Both Anheuser and Miller had very small presences in the Brazilian beer market, so the alliances were evaluated under the rubric of potential competition.[5]

Under U.S. law, which was used as a framework for analysis by CADE, a merger may be harmful to potential competition in either of two ways:

> Under the perceived potential competition theory, competitors in a concentrated market are currently constrained from engaging in anticompetitive behavior by the perceived threat of entry by a nonparticipant. Absorption of the potential entrant through merger may eliminate that threat, reducing pricing pressure on existing competitors. Thus, the market may become less competitive. Under the actual potential competition theory, a market not behaving in a competitive manner would become more competitive through the impending entry of the acquiring or acquired firm but for the merger. The injury to competition stems from this preemption of actual entry.[6]

Either theory requires for its applicability that a market be concentrated, with significant barriers to the entry of other firms, and that the acquiring or acquired firm being eliminated from the market (in this case, Anheuser and Miller) be one of a very small number of potential entrants, otherwise its removal would not cause a significant reduction in potential competition. After extensive analysis, CADE determined that these conditions were indeed met in these two cases, and ordered both transactions undone. The resulting controversy—including the dissenting CADE chairman's warning against "xenophobia"[7]—was followed by negotiations among the enterprises and

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5. *See* BOARD MEMBER LUCIA HELENA SALGADO E SILVA, MINISTRY OF JUSTICE OF BRAZIL, ANALYSIS OF CONCENTRATION NO. 83/96, 15, 28 (June 18, 1997).

6. ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 342 (4th ed. 1997).

7. One investment analyst was concerned that "[t]he decision seems to be a political one, against foreign capital in general." Jonathan Wheatley, *Miller Ordered to End Brazilian Joint Venture*, FIN. TIMES, June 13, 1997, at 29. *Business Week* noted that these decisions, combined with an earlier decision imposing conditions on the purchase of Brazilian toothpaste-manufacturer Kolynos by Colgate-Palmolive, were "raising questions about Brazil's openness to investment from abroad. Privately, officials of President Fernando Henrique Cardoso's government have criticized the rulings, which are at odds with Cardoso's encouragement of foreign direct investment." Ian Katz & Richard A. Melcher, *Is Brazil Antitrust—or Anti-Foreigner?*, BUS. WK., July 21, 1997, at 330. *See also* Nely Caixeta, *Um Acesso do Xenofobia no CADE?*, EXAME, July 16, 1997, at 38.

CADE and an eventual agreement that the alliances would be permitted with increased investment guarantees by the U.S. firms.[8]

Whether these decisions were the "right" ones is not the issue here, though the CADE report does list five international brewers besides Anheuser and Miller that are larger than Brahma (Heineken, Kirin, Forester's, South African Breweries, and Carlsberg) and six others smaller than Brahma but larger than Antarctica (Danone, Modelo, Santo Domino, Coors, Guinness, and FEMSA), thus creating at least prima facie doubt on the uniqueness of Anheuser and Miller as market entrants.[9] If CADE was seeking to balance the benefits to competition (or, more broadly, the benefits to Brazil) from the alliances with their harms, it succeeded in increasing the benefits side of the balance by hundreds of millions of dollars.[10] What is notable and commendable is that CADE used an internationally accepted methodology of competition analysis to evaluate the desirability of these proposed alliances between powerful Brazilian manufacturers and MNEs, and that the use of this methodology was described to the public in a way that made the enforcement actions transparent and understandable.

What is perhaps not so commendable is the use by CADE of an increasingly popular type of merger enforcement decision in developing countries, the conditional approval. The acquisition of Kolynos by Colgate-Palmolive, mentioned above, was also approved by CADE with conditions, in this case severe restrictions on the future use of the Kolynos brand name.[11] Certainly there is nothing wrong or unusual about a merger approval with conditions as such; this happens all the time. There are at least two kinds of conditions, however, that raise serious concerns when they are imposed:

1. Conditions that are not closely related to the competitive harm caused by the merger. One may argue that

8. *See* Jonathan Wheatley, *Brazil Watchdog Sets Conditions for Brewing Link-Up*, FIN. TIMES, Dec. 12, 1997, at 27; Jonathan Wheatley, *Miller's Brazil Venture Approved*, FIN. TIMES, May 15, 1998, at 29.

9. *See* SALGADO E SILVA, *supra* note 5, at 56.

10. *See* Wheatley, *Miller's Brazil Venture Approved*, *supra* note 8, at 29.

11. *See* Katz & Melcher, *supra* note 7, at 330; *Brazil's Pit Bulls*, EIU BUS. LATIN AM., June 23, 1997.

CADE's requirements that Brahma provide technical and distribution assistance to four small brewers and that Anheuser dramatically increase the size of its investment in Antarctica will increase competition in the Brazilian beer market, but the nature of the conditions required raises questions as to whether what was really going on was the charging of a "toll" in exchange for permission for MNEs to invest and operate in Brazil.[12]

2. Conditions that will require future monitoring and enforcement by the competition tribunal. Investment guarantees are one popular condition for merger approval in developing countries; price guarantees are another. Either may place the tribunal in the position of a long-term regulator of the business. What is CADE (or the Ministry of Justice or the Ministry of Finance) to do if Antarctica comes before it in 2002 and says that "conditions have changed," and the planned investments are no longer affordable? And what if, as seems likely, "conditions" HAVE "changed"? Competition authorities in developing (or developed, for that matter) countries do not have the resources to devote to long-term regulation of particular sectors of the economy.

In general, "structural" remedies, where one of the merging parties divests certain assets in order to prevent harm to competition, are preferable to "behavioral" remedies, where the merged enterprise promises to behave in a certain way in the future. (A more common behavioral remedy than investment or price guarantees in most developed economies is a commitment not to discriminate against certain competitors.) Structural remedies, where they are feasible, attack the root of the problem and do not require long-term monitoring to assure their effectiveness. Behavioral remedies accept the existence of the competitive problem but seek assurances that the merged firm will not behave anticompetitively. Partly because behavioral

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12. *See* Wheatley, *Brazil Watchdog Sets Conditions for Brewing Link-Up, supra* note 8, at 27; *Brazil's Pit Bulls, supra* note 11. One respondent to a survey by the *Latin America Advisor* suggested that the decisions demonstrated that "potential anti-trust implications can be made to miraculously disappear in the face of investment pledges;" another advised that CADE "leave investment policy and economic planning to more competent agencies." *Today's Question*, LATIN AM. ADVISOR, Jan. 16, 1998, at 1.

remedies leave the root problem in place, they may be more likely to be thwarted by the merged enterprise engaging in different but equally harmful anticompetitive behavior; thus they tend to require long-term monitoring by the competition agency and/or the court.

III. COMPETITION AND REGULATION

However, what about those industries that by their nature require some economic regulation? What is the proper role of the competition authorities in such industries? The Symposium Articles by Gesner Oliveira and Shanker Singham address this important topic.[13]

Note first that in many countries, competition authorities have been formed before the creation of regulatory authorities. In the course of economic liberalization, infrastructure enterprises may be partially or completely privatized, with no effective regulator to protect customers from the exercise of market power. Under such circumstances, it may be advisable for the competition authority to act as a "backstop" regulator, protecting the public from the worst abuses by using the abuse-of-dominance provisions of the competition law.[14]

There are drawbacks to this course of action. As noted above, competition authorities do not have the resources to act as day-to-day economic regulators. Perhaps more important, competition authorities are in the business of creating and protecting the conditions for competition to thrive and to determine economic outcomes in the marketplace; they should not be getting into the habit of regulating prices. On balance, however, the competition authority acting as regulator of last resort would seem the lesser of evils.

When there are both competition authorities and regulatory authorities active in the economy, a new set of issues arises. What is the best way to structure the responsibilities of each and the relationship between the two? Should regulated industries be exempt from the competition law? If not, should regulators enforce the competition law in regulated industries, or

13. *See also* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, THE RELATIONSHIP BETWEEN REGULATORS AND COMPETITION AUTHORITIES (1998).

14. This is the position taken by Janusz A. Ordover et al., in *Competition Policy for Natural Monopolies in a Developing Market Economy*, 2 ECON. TRANSITION 317 (1994).

should the competition authority (or both?)? It should be emphasized that there is no single right answer to questions like these, that different countries have different histories and institutional structures that suggest different "best practices."[15]

Nevertheless, there are certain principles to be kept in mind when designing such institutions. A competition agency is probably less susceptible to regulatory "capture" than is a regulatory institution devoted to only one or a few sectors. The staff of a competition agency may become more flexible and better informed as they study a variety of different kinds of markets. On the other hand, the regulatory agency staff gains experience in a particular sector over a long period of specialization. Oliveira discusses these and other issues in his article in this Symposium.

A second and important set of issues in the competition/regulation area has to do with the application of substantive competition principles in regulated sectors. Some such issues (such as merger enforcement) may be important in general, but others are most important in the current context of liberalization and deregulation. In particular, most market economies, regardless of their state of development, are now in the process of deregulating portions of sectors that were traditionally regulated, either because they were considered "natural monopolies" or because they were considered so important that their operation could not be trusted to the market.[16] Typically, however, it is only *portions* of these sectors that are deregulated; other portions remain under monopoly control and some form of regulation. Some examples are the following:

- Electricity generation may be opened to competition while long-distance electricity transmission and local electricity distribution remain regulated monopolies.

15. *See generally* Brian Levy & Pablo T. Spiller, *The Institutional Foundations of Regulatory Commitment: A Comparative Analysis of Telecommunications Regulation*, 10 J.L. ECON. & ORG. 201 (1994); Pablo T. Spiller, *Institutions and Regulatory Commitment in Utilities' Privatization*, 2 INDUS. & CORP. CHANGE 387 (1993).

16. See the discussion in Ordover, *supra* note 14.

- Natural gas production may be opened to competition while natural gas pipelines and local natural gas distribution remain regulated monopolies.

- Long-distance telephone service and the provision of household telephone equipment may be opened to competition while local telephone service remains a regulated monopoly.

Experiments are under way to expand this trend to other sectors as well. For example, in the UK and Sweden, private train operating companies may operate competing train service over a regulated monopoly track system, and many other countries are considering this option.[17]

This separation of the old, vertically integrated natural monopoly into a competitive sector and a remaining monopoly sector raises a crucial competitive issue, however: is the monopoly owner of the "bottleneck" asset to be allowed to participate in the related competitive sector? One's first reaction may be "of course," as to prevent this would in many cases keep from the competitive sector the very enterprise that is most expert in it, and the one that could most effectively coordinate its operations with those of the remaining monopoly. But "of course not" may be an equally defensible reaction, as the entrance by the bottleneck provider into the competitive sector will likely create the incentive and ability for that enterprise to discriminate in favor of its own competitive company in the provision of the monopoly service. Remaining regulation of price may be ineffective in combatting this discrimination, since in infrastructure sectors (as in many other sectors) the quality and reliability of service may be just as important as the price, and it may be very difficult for regulators to prevent discrimination in those areas.[18]

As with other issues in competition and regulation, there

17. *See* Janusz Ordover & Russell Pittman, *Restructuring the Railway for Competition*, *in* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CONFERENCE ON COMPETITION AND REGULATION IN NETWORK INFRASTRUCTURE INDUSTRIES 273-84 (1994).

18. For a host of examples in the electricity area, see Notice of Proposed Rulemaking, 18 C.F.R. pt. 35 (1999) (proposed May 13, 1999).

is probably no single correct solution to this dilemma; the answer may vary not only from country to country, but also from sector to sector. Even though infrastructure sectors tend to be capital intensive, there is still a good deal of variation in the importance of bottleneck-asset-related costs to total costs in different sectors. For example, among investor-owned electric utilities in the United States in 1996, power production and power purchases accounted for 74% of annual operation and maintenance expenses, while transmission made up only 2% of expenses.[19] On the other hand, for Class I railroads in the United States, while expenditures on transportation and equipment accounted for 70.5% of annual operating expenses in 1997, expenditures on the maintenance of way and structures (including roadway depreciation) accounted for fully 17% of annual expenses.[20] Thus one might expect that a policy that threatened to impose extra transmission costs upon certain electricity generation enterprises would be less potentially harmful to competition than a policy that threatened to impose extra track costs upon certain train operating enterprises.

Finally, and regardless of whether the owner of the bottleneck assets is allowed to operate in the competitive sector, use of the natural monopoly network by independent enterprises raises the issue of the price to be charged for access. What is the most efficient price from the point of view of public welfare, and what is the fair price to compensate the monopolist for past investments, are topics that have not been satisfactorily resolved. The debate ranges from those who would have the users of the network pay only the short-run marginal costs imposed by their operations to those who would have the users compensate the network owner for the profits foregone from allowing this use. This gap in charges may be quite wide in practice, and there are numerous arguments (and some experience) favoring prices in between these two extremes. This "access price" question will certainly be one of the most important competitive issues facing regulators and competition enforcers in the future.[21]

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19. *See* FRC, ANN. REP. OF MAJOR ELECTRIC UTILITIES, LICENSEES, AND OTHERS, FERC FORM 1 (visited Aug. 16, 1999) <http://www.eia.doe.gov/cneaf/electricity/page/fercl.html>.

20. *See* SURFACE TRANSPORTATION BOARD, 1997 ANN. REP. FORM R-1, (visited Aug. 16, 1999) <httm://www.stb.dot.gov/Publications/AnnRpt.htm#_1_49.html>.

21. *See generally* Mark Armstrong et al., *The Access Pricing Problem: A Syn-*

IV. CONCLUSION

Important challenges remain ahead for competition law enforcers in Latin America (as well as other countries). There are industry demands, political demands, and regulatory agency demands for particular courses of action. A young agency must establish its credibility both within the government and among the population. All of this calls for careful case selection, transparent and predictable enforcement, and public explanation of decisions. The articles in this Symposium issue address these and other issues that are important to the success of economic liberalization.

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thesis, 4 J. INDUS. ECON. 131 (1996); Jean-Jacques Laffont et. al., *Network Competition: I. Overview and Nondiscriminatory Pricing*, 29 RAND J. ECON. 38 (1998); Michael Carter & Julian Wright, *Interconnection in Network Industries*, 14 REV. INDUS. ORG. 1 (1999).