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Karl P. Sauvant, Columbia University

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BOOK REVIEWS


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The *World Investment Report 1997* (WIR 97) sheds new light on one of the most important issues of the current international agenda: the relationship between foreign direct investment (FDI) and competition policy. Besides the useful information about the major trends of FDI and competition legislation, the essential issues of the discussion are addressed in this UNCTAD publication.

The evidence presented suggests that two extreme and simplistic views should be rejected: first, the naive notion that FDI by itself would assure competitive markets in developing countries; second, the opposite and xenophobic stand that the entry of transnational corporations (TNCs) in the various national domestic markets of the developing world would necessarily lead to economic dominance and/or abuse of market power.

As underlined in the overview of the study, FDI may have an ambivalent impact upon market contestability:

*A foreign-direct-investment liberalization, by removing formal barriers to the entry of FDI, can increase the contestability of national markets and inject greater competition into them. However, because of the ownership-specific assets of TNCs, their transnational organizational structures and the relatively greater competitive strengths that they often have vis-à-vis domestic firms, FDI could also increase concentration, and TNCs could indulge, like dominant firms generally, in restrictive and anticompetitive practices* (p. xxv).

And again, at the end of the overview:

*A while FDI liberalization can increase competition in markets and thereby contribute to economic efficiency, growth, development and ultimately, consumer welfare, there are limitations to competition. They arise in particular when markets tend naturally towards high level of concentration and when market outcomes conflict with other policy objectives* (p. xxxiv).

However, a general proposition of particular interest for the policy maker can be derived from *WIR 97*: *the more foreign direct policies are liberalized, the more important competition policy becomes.*

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The argument can be divided into two points. First, FDI liberalization, extensively documented in *WIR 96* (UNCTAD, 1996) and also in table 1.4 of *WIR 97*, has succeeded to a great extent because a set of other liberalization policies has been implemented, such as trade liberalization, privatization and deregulation. Competition policy, in turn, is an essential ingredient for those liberalization policies. Indeed, none of the above processes can be fully undertaken without the implementation of competition law and policy. In order to reap all the benefits from economic reform, it is necessary to have a global approach in which competition policy has a role of increasing importance. As stated in *WIR 97*:

A. to the extent that contestability and competition considerations gain in importance in shaping policies, and the more liberal trade and FDI policies become -- but at the same time do not always lead to contestable markets -- competition policy becomes primus inter pares among policy instruments used to maintain contestability and competition (p. 211).

Furthermore, sound competition policy may be by itself an attraction for FDI. Therefore, *competition policy is an essential factor for the success of FDI liberalization.*

Second, FDI liberalization provokes structural changes in national economies, which require particular attention on the part of competition authorities. According to the study, nearly half of the FDI inflow of developing countries occurred through mergers and acquisitions. It is useful to recall some of the typical scenarios involving horizontal cross-border raised by *WIR 97* in this respect (pp. 196-200):

C A foreign firm makes an acquisition in a market to which it has already been exporting;

C Two foreign firms agree to merge their facilities in the market where they operate in the development country;

C A foreign firm enter in a market by means of a joint venture with a local firm, but is likely to have entered it separately and competed with the local firm had it not had the opportunity to buy the domestic dominant firm;

C A parent firm acquires or makes an alliance with an enterprise abroad which is a source of competition for the domestic market;

C A foreign investor assumes control of an essential facility.

A number of interesting policy issues and challenges can be derived from the above scenarios. First is the need for a meticulous merger review mechanism. But many developing countries, which are at the early stages of implementation of competition policy, still do not have such a mechanism. Some authorities have even argued that due to the cost of merger control it would be appropriate for
competition agencies to concentrate exclusively on conduct.\textsuperscript{1} While the concern with the scarcity of resources is a legitimate one, most of the scenarios presented by \textit{WIR 97} could be dealt with appropriately only if the country in question had some kind of merger review. Consideration of the international flows of capital requires a more careful and precise definition of the relevant markets in both the product and the geographic dimensions. It also has implications for the evaluation of entry barriers.

The discussion of the possibility of independent entry by a foreign firm instead of its acquiring a domestic company is a relevant one, although it does raise considerable challenges for the analysis. As the United States jurisprudence on the potential competition doctrine suggests, it is not a trivial matter to prove that without the opportunity of acquiring a domestic firm or at least having a local partner, a foreign company would in fact undertake the investment.\textsuperscript{2} The standard of proof required by the courts in such cases has been a very rigorous one in the United States, and it is likely (and desirable) to be the same elsewhere.

Furthermore, the fact that a high percentage of FDI is derived from M&As should be interpreted carefully. Although the association of TNCs with domestic enterprises may, in some instances, lessen competition, it is also true that it is this possibility that often makes entry easier since it reduces the cost differential between the incumbents and the potential entrants in terms of the available information about the national market. If domestic firms resort to associations with foreign partners to improve their competitive capacity, the final result may be increased rivalry and not the contrary.

As correctly underlined in \textit{WIR 97}, international cooperation among competition authorities becomes particularly important as international production becomes a more significant element in the world economy. Indeed, there has been an increase in transactions, which affect several jurisdictions; technical cooperation and consistency are essential for solid decisions in such cases.

Market-power inducements by host countries may have negative effects. One should balance different policy objectives without giving exclusive attention to anyone of them. Although FDI is desirable, it is important to avoid restrictions to trade and competitive behaviour of firms. Anti-competitive behaviour becomes more likely if the Government grants privileges that restrict entry.

The above discussion should lead to the conclusion that \textit{the more FDI policies are liberalized, the more important competition policy becomes}. Indeed, without competition policy:

\begin{itemize}
  \item The pace of liberalizing reforms, including FDI liberalization, could be reduced;
\end{itemize}

\textsuperscript{1} Such an argument has been put forward by Beatriz Boza, the president of INDECOPI, the Peruvian competition authority.

\textsuperscript{2} The recent discussion about CADE's decisions on two alliances between Brazilian breweries and leading United States breweries illustrates the point. For more details, see CADE's Internet homepage at http://www.mj.gov.br/cade.
FDI liberalization could have welfare reducing effects under certain circumstances, especially those associated with anticompetitive M&As;

The lack of stable and well-known competition rules could inhibit foreign investors in search of simple and transparent rules.

The challenges to building up a sound competition policy are enormous, and the gap between developing and developed countries remains large. Indeed, although there has been a dissemination of competition laws around the world (as shown in figure V.1 of WIR 97), the degree of enforcement of such laws in many new jurisdictions is far from satisfactory. Eliminating this institutional under-investment in competition policy should therefore be a priority of an adequate development strategy.

**Gesner Oliveira**

Professor

Getulio Vargas Foundation, São Paulo, and

President

Administrative Council for Economic Defence (CADE),

Brasília, Brazil
Reference
