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REGULATION OF COMPETITION IN REGIONAL TRADE AGREEMENTS; HOW THIS CAN BE BEST ACHIEVED FOR THE BENEFIT OF AN EXPANDED MARKET

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ABSTRACT

The paper departs from the premise that trade and competition are two sides of the same coin and that the benefits arising from them are intertwined. Then, an analysis focused on how competition policy influenced (or not) the European Union, the Andean Pact, the Mercosur and the NAFTA, by looking into how these free trade areas evolved. The paper shows how diplomatic and political priorities in the Andean Pact, the Mercosur and the NAFTA prevented competition policy from performing the pivotal role in economic integration as it had in the EU. After that, a roadmap is suggested to bring trade and competition into harmony in regional trade agreements. In spite of the recognized benefits arising from regulating trade and competition together, the

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implementation of regional trade areas has been far less effective than many would consider desirable. Based on the analysis of the historical background, the paper draws some conclusions about how negotiations should evolve in order to reach a favorable outcome.

LA REGULACIÓN DE LA COMPETENCIA EN LOS ACUERDOS COMERCIALES REGIONALES; LA MEJOR MANERA DE ALCANZARLA PARA EL BENEFICIO DE UN MERCADO AMPLIADO

RESUMEN

Este ensayo parte de la premisa según la cual el comercio y la competencia son dos lados de la misma moneda y adicionalmente que los beneficios que éstos generan están entrelazados. El documento analiza cómo las políticas de competencia influenciaron (o no) a la Unión Europea, el Pacto Andino, el MERCOSUR, el NAFTA, en particular mediante el examen de la evolución de estas áreas de libre comercio. Este estudio revela cómo las prioridades diplomáticas y políticas en el Pacto Andino, el MERCOSUR y el NAFTA impidieron que las políticas de competencia desempeñaran un rol determinante en la integración económica como lo tuvo en la Unión Europea. Posteriormente, una hoja de ruta es sugerida para que el comercio y la competencia entren en armonía con los acuerdos regionales de comercio. A pesar de los reconocidos beneficios que genera la regulación conjunta del comercio y de la competencia, la implementación de las áreas regionales de comercio ha sido menos efectiva con respecto a lo que muchos considerarían como deseable. Basado en el análisis del trasfondo histórico, este ensayo

contiene conclusiones sobre la manera como las negociaciones deberían evolucionar con el fin de alcanzar un resultado favorable.

1. INTRODUCTION

Trade and competition are a topic which has been recently added to the agenda of the World Trade Organization (WTO) for discussion to be held from the Millenium Round on. In spite of the difficulties to reach an agreement at world level[1], regional trade agreements have been pursuing the incorporation of regulations on competition due to the benefits that an effectively expanded market may bring to national economies. This scenario leads to the question of how to reconcile trade with competition in regional trade agreements.

2. UNDERSTANDING WHY TRADE AND COMPETITION ARE COMPLEMENTARY AND AT SAME TIMES OPPOSITES

Regional trade agreements are seen as a mechanism that allows trade to flow in a more efficient way across the national borders by removing governmental restrictions[2], since the markets are quite often not limited by political divisions. The focus on economic efficiency is provided by competition whereas its main targets are private agents. The incorporation of competition into regional trade agreements is part of a process, in which it has been widely accepted that even after the establishment of

1 For a summary of the difficulties in the negotiation, see HUFBAUER, G. C.; KIM, JISUN, *International Competition Policy and the WTO*, Paper presented at The Antitrust Modernization Commission's Report and the Challenges that Await Antitrust. 2008.

2 Some argue that regional trade agreements cause trade diversion and therefore, are not necessarily the best way of increasing efficiency. This could be best achieved at world level before WTO. For a summary of the debate, see Matsushita, Schoenbaum and Mavroidis, 2002, 342-345.

a trade agreement, private agents may restrain the trade flow with the use of anticompetitive practices.

This is particularly true when one looks at several examples of how competition policy played a pivotal role in building an effective free trade flow in the European Union (EU). Since the Treaty of Rome in 1957, competition policy has been responsible for fostering the implementation of a common market to an extent which has surprised many experts on the subject.

However, there is a great difference when competition and governmental restrictions to trade are negotiated. Although both lead ultimately to an abdication of part of the national sovereignty, competition policy can be much more pervasive than the mere lowering of trade tariffs. Competition policy remains as one of the last available tools of economic and industrial policies – see the leniency of some competition authorities in relation to national champions. Furthermore, its effects spread over specific and identifiable economic agents rather than broad economic sectors. Hence, as Wilson (1980:371-2) argues, from the perspective of the impacted industry, the organizational cost of lobbying can be compensated *vis-à-vis* the possible damages suffered if competition policy is adopted in the regional trade agreements.

While States control (or believe to) directly their competition policies and their outcomes, the same does not automatically occur in the regional trade agreements. The latter are subject to factors which are quite often beyond the governments' control (natural competitive advantages and disadvantages, world economic scenario etc) and because of that, are not so easily accepted.

Clearly, the existing relationship between trade and competition is tense, which is probably one of the reasons why there has not been an agreement at world level so far. National perceptions will reflect national evaluations about the perspectives of abdicating the right to enforce their national competition policies and hence, will be subject to a more detailed cost-benefit analysis. The knowledge of this tension may help to design tools which can lead to a consensus about how to reconcile the different interests.

3. LOOKING INTO THE PAST TO LEARN FROM PREVIOUS EXPERIENCES

Taking for granted that nations are reticent to abdicate their control over competition policy and that the same nations are looking forward to obtaining the benefits of an expanded market, it is useful to look at how institutions evolved. The EU, the Andean Pact, the Mercosur and the NAFTA are used as examples in this task.

1) The *EU*

In the early 1950's, the six founding European state members agreed only on the inter-state trade regulation of coal and steel – in spite of some antitrust provisions, the fear of a renewed German dominance over these markets prevailed and the treaty was embedded with rules which suffered from a strong regulatory influence (GERBER, 2001: 335-6).

In 1957, after a shared learning process, the same state members agreed to create a customs union, which later led to the common market. In other words, prior to the establishment of a customs union, the EU had an agreement for a sector specific taught the countries what the economic integration process should be like. When the customs union was created, a common competition policy was considered necessary to achieve the proposed objectives (GERBER, 2001: 342-3).

In view of that, competition was brought into the agenda, as the removal of interstate trade barriers could be fostered by antitrust measures. This is particularly true, when one takes into account that dominant corporations may want to bar competition from abroad by using their market power (GERBER, 2001: xi).

The "competition agency" of the European Commission (EC) – known at that time as DG Comp and reasonably independent from national governments – slowly began to implement an active competition policy. This happend exactly when the EU menbers were implementing industrial policies supported by nationalisation and creation of nacional champions. Such was the reaction to the DG Comp's actions that, for instance, Italy tried to challenge it alleging that the EC had overstepped its powers based on the doctrine of *détournement de pouvoir* (GOYDER, 2003:

49-51). However, state members continued to occupy substantial role in implementing their own competition policies, mainly when these had an impact only within the national borders. This is a good example of how to minimize frictions at earlier stages of economic integration.

In 2004, in a surprising movement, the EC decided to grant the National Competition Authorities more power in implementing the European competition policy. Although the EC continues to hold substantial powers, mainly focused on policy-making, its role has changed: now, the EC has transferred much of the hard work to the National Competition Authorities.

2) Andean Pact

The Andean Pact was originally constituted in 1969 by Bolivia, Colombia, Ecuador, Peru and Venezuela and it was widely inspired by the European experience. As a matter of fact, the signatory countries were aware of their vulnerability, for their main export products, which were basically agricultural and mineral raw-materials, were very sensitive to price fluctuations. The Andean Pact program consisted of a complex body of taxes exemption, as well as the Common External Tariff (CET), which was adopted according to sector programs for fostering industrialization.

By that time, the signatory countries adopted such an industrialization policy because they were deeply inspired by ECLAC's model[3]. According to ECLAC, the volatile prices of raw materials would suggest the adoption of a particular strategy to overcome the underdevelopment problems: the substitution of imports. Thus, the Andean Pact was designed to be an effective strategy to vanquish underdevelopment, rather than a mere plan of action made to direct economic integration.

In this context of serious economic handicaps, especially those related to the integration and development of the country members' industrial

3 ECLAC stands for Economic Commission for Latin America and the Caribbean, which is an United Nations body created in 1948. ECLAC's works influenced many Latin American countries which adopted development and industrialization policies based on the substitution of imports.

sector, the fact that competition policy has been driven to a second level of priorities becomes understandable. As a matter of fact, the Cartagena Agreement barely mentions competition policy in articles 93 and 94, but one specialist in that subject will assuredly recognize the existence of a trend that leads toward commercial defense (BRUSICK, ALVAREZ and CERNAT, 2005: 301). The policy regarding competition defense was not acknowledged as an instrument to achieve integration by the way, – such integration, was a goal established through the industrial development policy.

On the other hand, the 1990's were characterized by new arrangements that were thought to strengthen the Andean Community. Such a strengthening would be crucial to cause the group to become an active player in the global economy. At the same time, both political and economic environment of the country members was qualified by the rise of free trade policies. After the abandonment of the policies based on ECLAC, competition policy was expected to start playing a major role in the regional integration. Many of the country members were implementing or considering to competition laws. In 1996, the Trujillo Protocol outlined the creation of a common market: that was supposed to take place until 1995.

A consistent series of specific norms to regulate competition were approved, such as: (i) Decision 283 (Rules for preventing or correcting distortions in competition caused by dumping or subsidy practices); (ii) Decision 284 (Rules and regulations for preventing or correcting distortions in competition caused by restrictions on exports); and (iii) the wide Decision 285 (Rules and regulations for preventing or correcting distortions in competition caused by practices that restrict free competition). As a result, it is no longer possible to state that there was no legal framework. Some cases were indeed commenced.

Nevertheless, the implementation of coordination among the signatory countries was very difficult to be put into practice. In fact, the signatory countries failed and the hopes brought up by the Trujillo Protocol were not materialized in 2005. Therefore, it turns unnecessary to mention that the implementation of a common competition policy in the Andean Pact remains mostly as a mere theoretic reference.

3) Mercosur

To a certain extent, the origins of Mercosur are similar to those of the EU. All the four original state members had just become democratic governments and Mercosur was a response to the end of old military rivalries in South America. Moreover, the four state members were about to abandon ECLAC's development policies, which were also largely followed in the Andean Pact.

The Treaty of Asunción: thebasic documenst which established MERCOSUR in 1991, called for creation of a common market with "the free circulation of goods, services and production factors" within member countries, plus "an external common tariff and a commercial common policy regarding other states or group of states and the coordination of positions in international and regional commercial economic forums."[4]

After 15 years, the customs area proved to be very successful, but the integration process needs a new impetus to go ahead, possibly through the use of an active competition policy to expand the market. However, Mercosur's basic document regulating competition, the Fortaleza protocol signed in 1996[5], which has not been implemented, is too ambitious[6]. For this reason, the Fortaleza protocol prevents competition from being used as an integration tool.

This situation does not surprise one who carefully observes the South Cone's reality. As HURREL and GÓMEZ-MERA (2003) emphasize, even

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4 http://www.realtor.org/intupdt.nsf/pages/MERCOSURE?OpenDocument

5 Fortaleza protocol, article 3. It is the exclusive competence of each State Party the regulation of the acts committed on their territory by person or legal entity of public or private law or other entity domiciled there and whose effects on competition are restricted to the Parties.

6 BRUSICK, ÁLVAREZ and CERNAT, "One questionnaire response from Uruguay commented that the MERCOSUR Protocol for the Defence of Competition (also known as the Fortaleza Protocol) was too ambitious and not considered a genuine tool to solve issues of competition policy as it was too trade centred. A similar response from a Latin American respondent stated that there was a coordination problem between the trade negotiators and the competition negotiators during the process of creating the RTA, leaving the competition authority of the respondent's country dissatisfied with the end result", 2005, 134-135.

before the Fortaleza protocol, the "new strategy based on a programme of linear and automatic tariff liberalization was aimed at accelerating and deepening the process of economic integration. The Ouro Preto Protocol, signed in December 1994, brought integration a step forward with the establishment of a common external tariff, and the launch of the customs union. Regional trade and investment grew rapidly in the second half of the 1990s".

First, the Fortaleza protocol would partially withdraw functions performed by national independent competition agencies and transfer them to a supra-national body, composed of representatives appointed by each member state, i.e. the regulation of competition would be made by an essentially political body rather than a technical one. Second, the Fortaleza protocol has not defined precisely what is to be performed by the national competition agencies and by Mercosur's supra-national body. This blurred distinction has caused fear that larger economies (Brazil accounts for more than 50% of the region's GDP) would lose too much power comparatively. Additionally, the appeal to supra-regional dispute resolution bodies continues to be the preferred way to resolve disputes, even when these are closely related to competition, which is the case of several incidents related to antidumping before WTO involving Brazil and Argentina.

4) NAFTA

The North American Free Trade Agreement (NAFTA) is a comprehensive trade agreement signed in 1994 among Canada, the United States, and Mexico regulating not only trade, but also investment and intellectual rights. NAFTA's main purpose was to create a free trade area by removing tariff barriers. Moreover, differently from the other two experiences in the American continent, NAFTA' state members also signed two side agreements: the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC). The NAFTA is also the second largest trade bloc in the world. Thus, one can perceive a different

approach towards economic integration, since these two matters are not the usual ones for supporters of industrial policies.

Competition is one major issue regulated in the NAFTA: Chapter 15 regards Competition Policy, Monopolies and State Enterprises. Article 1501, item 1, determines that "each Party shall adopt or maintain measures to proscribe anticompetitive business conduct". Thus, each state member shall put in force an effective competition policy, which creates a level playing field among them.

Similarly to Mercosur, the NAFTA is plagued with major economic asymmetries between its members. The United States accounts for most of NAFTA's economy and its vigorous antitrust agenda has been exported to its partners. However, quite differently from the European Union, competition policy is not a tool for economic integration but rather a means of leveling the playing field.

5) Historical inference

Different approaches to competition policy at the free trade agreements revealed the importance that institutions play in the integration process. While in the competition policy evolved as an efficient tool for the integration of the regional trade in the EU, the same did not take place in the Mercosur and in the Andean Community, let alone the NAFTA, in which it is a means of leveling the playing field. The efforts to move ahead with the Mercosur and the Andean Pact continue to come exclusively from the will of governments and hence, they vary according to political convenience.

Such a history of successes and failures showed that building up institutions to implement the regulation of competition is more difficult than it looks at first. When competition is brought into the agenda of regional trade agreements, appropriate institutions should be chosen or even designed in order to avoid sabotaging the integration process.

4. SUGGESTING A ROADMAP TO RECONCILE TRADE WITH COMPETITION IN REGIONAL TRADE AGREEMENTS

In this complex context, nations have already accepted that free trade can have positive effects but the same is not yet widely recognized in relation to competition. Take the example of several developed countries which have been refusing to enforce competition rules for various reasons.

Some recent academic papers stress out the difference between competition policy and competition law. As NKELEBE (2006: 6) points out, "competition policy refers to those government measures that directly affect the behavior of enterprises and the structure of industry. An appropriate competition policy includes the following: i. Micro-economic policies that enhance competition in local and national markets, such as trade liberalization policy, relaxed foreign investment and ownership requirements, economic deregulation and privatization; and ii. Competition law (also referred to as anti-trust, anti-monopoly law or restrictive business legislation in some countries) designed to prevent anti-competitive business practices by firms and unnecessary government interventions in market place". Besides encompassing competition law, the concept of competition policy is broader than the one of competition law.

However, not every country must necessarily have a competition law. Sometimes, it can cost too much for a small economy to burden the costs of competition enforcement. More than that, the total benefits can be neglectable vis-à-vis the total costs. This certainly places a challenge for policy-makers, since not always the mere enactment of a competition law is the best regulatory policy. Sometimes, a vigorous competition policy may not need an antitrust watchdog. As a result, the refusal to pass or enforce competition laws does not necessarily lead to an unfavorable economic outcome. This statement is particularly true for many small Latin American and Caribbean economies.

These considerations show that each country has its tools for safeguarding its own interests or what it believes to be its own interests (BRAITHWAITE and DRAHOS, 2000: 571). A difference in the competition

policy illustrates this statement: while small economies may not want to have competition agencies due to the high costs and may have more interest in a global competition watchdog, large economies may want to obtain a relative insulation from outer pressures in order to protect what they consider to be legitimate commercial policies, such as export cartels. How can these contradictory views be reconciled?

First, it is advisable to negotiate the agreement's terms focusing on principles rather than on rules. As a matter of fact, "conflicts at the level of principle are sharper, clearer, and more accessible than at the level of systems of rules" (Braithwaite and Drahos, 2000: 572). The Treaty of Rome determined that "the following shall be prohibited (..): (a) directly or indirectly fix purchase or selling prices (...); (b) limit or control production (...); (c) share markets or sources of supply (...)". These are principles on which there is little disagreement in most nations. Even so, how to apply them may be controversial: What are the criteria used to determine whether an economic group holds dominant position? Should financial institutions be subject to the exclusive competition control of central banks? As the reader perceives, negotiating details may be time-consuming and lead to endless discussions[7].

Furthermore, these principles should be contested by all the actors which may have interests affected (BRAITHWAITE and DRAHOS, 2000: 572). This is particularly appropriate when different nations do not share a common view about competition, so that attempts to undermine the effectiveness in the application of the agreed principles can be avoided. Many industrialists believed that the regulation of competition in the Treaty of Rome would only be applied to cartel cases (GOYDER, 2003: 53). In fact, the growth of the European competition policy towards merger control would not have been possible were it not for the support

7 To avoid detailing how competition should be implemented in the regional trade agreement does not necessarily mean that countries should not debate key issues related to trade and competition. Mercosur's experience shows that the lack of an appropriate regulation of antidumping within the regional trade agreement caused excessive and extenuating litigation among the member states before WTO. Antidumping could have been discussed together with competition but the state members preferred to avoid this matter.

from other actors like the European Court of Justice. The positive outcome of contestability in relation to legitimacy endorses the view that non-governmental organizations (NGOs) of lawyers, consumerists and industrialists should be granted access to the debate about how to incorporate competition rules into regional trade agreements.

Nevertheless, the mere formal access of NGOs to the negotiation process is not enough. There must be a commitment to lowering the barriers to contest the principles established (BRAITHWAITE and DRAHOS, 2000: 572-3). The participation of NGOs is fundamental to convince civil society that it is worth abdicating part of sovereignty to gain greater benefits. The perception of the benefits is an important persuasive tool for convincing the actors to include competition rules into regional trade agreements.

Also, trade and competition should be discussed in a broad context and not as an isolated system. When negotiations occur simultaneously, the parties tend to accept a less favourable agreement in one occasion as long as this apparently negative outcome can be compensated in another manner (TSEBELIS, 1990: 240). The theory of nested games may facilitate the negotiations about the competition and trade, when the interests involved disagree about key issues. For instance, one party may be deeply interested in a specific aspect of competition policy being incorporated into the regional trade agreement, but the other party, which has strong interests in the agricultural markets, refuses it categorically. The latter may cede to the former as long as some concession to liberalize the agricultural markets is made.

Of course, the existence of nested games does not preclude the fact that several proposals must be left on the table. To play for the tout and to ignore that there may be alternatives is risky and counter-productive. See that there are at least four different proposals for trade and competition under discussion at WTO[8].

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8 According to Matsushita, Schoenbaum and Mavroidis, the proposals are (i) "a declaration that competition policy is an integral part of the WTO regime", (ii) the negotiation of a plurilateral agreement with implementation in two phases, (iii) "a non-binding multilateral framework for cooperation in competition policy" and (iv) "a partly binding multilateral framework", 2002, 584-587.

Moreover, trade and competition should be slowly and gradually incorporated into the agenda. Apparently ambitious attempts to skip steps in the shared learning process may lead to the abortion of competition policy being regulated in a regional trade agreement. In this sense, the EU gradualism which took decades to set up a common competition policy contrasts clearly with the approach taken by Mercosur' state members. Mercosur tried to skip phases in the process of integration of competition policy – when the Fortaleza protocol was signed, not even every state member had competition agencies. To make things worse, the dialogue between the existing competition agencies was nonexistent, even in matters of cartel fight or cross-border merger control.

To avoid these difficulties, it is recommendable to "escalate" negotiations. The idea is to start with mutual cooperation agreements in order to create a comity among the state members. Later, when a certain maturity and mutual trust is reached, it is possible to move towards a more substantial competition policy.

5. CONCLUSION

Based on the historical experience, each region's diplomatic and political background plays an important role which must be taken into account and should not be disregarded when designing a regional trade agreement that incorporates competition.

The paper shows there are certain "golden rules" which may be pointed out: (i) negotiation of principles rather than specific rules; (ii) participation of actors who can contest the negotiation process; (iii) lowering entry barriers to NGOs in the negotiation process; (iv) adoption of nested games in order to allow bargains among different negotiation games; (v) existence of several proposals to incorporate different levels of commitment to competition policy into the regional trade agreement and (vi) use of gradualism in the incorporation of competition into regional trade agreements.

Thus, the best strategy to incorporate the regulation of competition policy into negotiations of a regional trade agreement for the benefit of an expanded market should follow a non-confrontational approach.

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