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INSTITUTIONAL FOUNDATIONS FOR ECONOMIC LEGAL  
REFORM IN TRANSITION ECONOMIES: THE CASE OF  
COMPETITION POLICY AND ANTITRUST ENFORCEMENT

WILLIAM E. KOVACIC\*

INTRODUCTION

The modern progression toward market processes in nations once committed to comprehensive central economic planning is one of the most extraordinary events of our time. Since the mid-1970s, many communist or socialist nations have undertaken market-oriented reforms of varied intensity and scope.<sup>1</sup> There is no assurance that this attempted transformation will succeed in all or most cases, as economic and political turmoil today besets many countries seeking to rely more extensively on market systems.<sup>2</sup> Yet, despite enormous uncertainty and upheaval in the transition from planning to markets, economic liberalization still remains the strategy of choice for boosting growth.<sup>3</sup>

Competition policy laws that prohibit various restraints of trade and create public or private rights of action to enforce such prohibitions have become remarkably common elements of market-

\* General Counsel, Federal Trade Commission. Professor Kovacic is on leave from the George Washington University Law School. The views expressed in this Article are the author's and not necessarily the views of the Federal Trade Commission or any of its individual members. The author thanks Kathryn Fenton, Geraldine Foster, Michal Gal, Michael Trebilcock, and Frederic Vissi, and participants in conferences or workshops at the University of Canterbury, Chicago-Kent College of Law, Fordham University, George Washington University, and the University of Toronto for many useful comments and discussions. The author owes a special debt to the editorial staff of the Chicago-Kent Law Review.

1. Extensive treatments of modern economic reform in communist and socialist countries include THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE (Christopher Clague & Gordon C. Rausser eds., 1992); FOREIGN ECONOMIC LIBERALIZATION (Andras Koves & Paul Marer eds., 1991); INSTITUTIONS AND ECONOMIC DEVELOPMENT (Christopher Clague ed., 1997).

2. See, e.g., Stephen Fidler, *World Bank Lifts Growth Forecasts*, FIN. TIMES, Dec. 8, 1999, at 19 (describing economic vulnerabilities of emerging market economies).

3. See Joseph E. Stiglitz, *Knowledge for Development: Economic Science, Economic Policy, and Economic Advice*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1998, at 9, 14 (Boris Pleskovic & Joseph E. Stiglitz eds., 1999) ("In most countries, there is almost universal agreement that markets should be at the center of any vital economy.").

oriented, economic law reform in the transition environment.<sup>4</sup> Over forty formerly communist or socialist states have enacted new competition laws or augmented older competition statutes since 1975.<sup>5</sup> Considerable additional activity in the competition policy field is underway. Within the next decade, as many as twenty additional transition economies are likely to establish competition policy systems.<sup>6</sup> The adoption of new laws in transition countries is a vital element in a process of competition policy globalization that has seen the number of nations with antitrust systems grow to over ninety.<sup>7</sup>

The proliferation of new systems raises questions about the proper scope and form of competition policy in transition economies and, more generally, about the design of legal reforms in emerging markets.<sup>8</sup> Individual Western countries and multinational bodies actively have encouraged emerging markets to establish new competition laws.<sup>9</sup> Western advisors sometimes have pressed

4. See Clive S. Gray & Anthony A. Davis, *Competition Policy in Developing Countries Undergoing Structural Adjustment*, 38 ANTITRUST BULL. 425, 427–28 (1993) (describing adoption of antitrust legislation as a component of structural adjustment programs in developing economies); William E. Kovacic, *Getting Started: Creating New Competition Policy Institutions in Transition Economies*, 23 BROOK. J. INT'L L. 403, 403–08 (1997) (describing creation of competition policy systems as a component of economic law reform).

This Article uses the term “competition law” to describe a statute of general national applicability that prohibits specific forms of anticompetitive conduct and creates public or private rights of action to redress misconduct. This definition omits laws adopted by local or regional government authorities that do not apply to the nation as a whole. This definition excludes countries that have general antimonopoly provisions in their constitutions but have yet to adopt legislation that translates these general provisions into operation principles and creates a mechanism for their enforcement. It also omits consumer protection measures that broadly forbid “unfair competition”—a term that could be interpreted to proscribe price fixing among competitors.

5. See Kovacic, *supra* note 4, at 403–04 (discussing the adoption of new competition systems since the late 1970s).

6. See William E. Kovacic, *Developing Competition Policy in Transition Economies: Milestones in 2000*, 4 INT'L ANTITRUST BULL. 40, 41 (2000) (discussing perspectives for new competition systems).

7. *Id.* Identifying nations with competition laws in the transition environment can be an uncertain process. In some instances, the collection of information is relatively easy. The competition regimes of a number of countries have been the subject of extensive study and published commentary. A growing collection of transition economies maintains highly informative web sites about their competition systems. In many cases, however, current, reliable information is difficult to come by, if only because new competition laws are being adopted at a relatively rapid pace. The best source of information sometimes will be an advisor who by word of mouth reports the establishment of a new system.

8. See Jean-Jacques Laffont, *Competition, Information, and Development*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1998, *supra* note 3, at 237 (analyzing hazards associated with transplanting sophisticated Western antitrust systems into a transition economy environment).

9. See United Nations Conference on Trade and Development, *Report by the UNCTAD Secretariat, Empirical Evidence of the Benefits from Applying Competition Law and Policy Principles to Economic Development in Order to Attain Greater Efficiency in International Trade*

transition governments to adopt close replicas of competition laws typically found in mature market economies.<sup>10</sup> In the field of medicine, the bases for prescribing a sound regime of care include formulating an accurate diagnosis, selecting the correct treatment, monitoring results, and making adjustments over time. Only in extreme circumstances would a physician treat a complex affliction with a standardized, off-the-shelf solution on the basis of a snap diagnosis.

The development of new competition policy systems and the promulgation of other economic legal reforms have important consequences reaching beyond the borders of the emerging markets that have enacted new laws. For business managers accustomed to focusing on the competition systems of a few Western nations, the new transition economy competition systems will require ever greater attention in the preparation of business plans that affect commerce in such economies. Many emerging market antitrust systems require pre-merger notification of certain transactions.<sup>11</sup> Such mechanisms are common elements of modern antitrust practice in Western economies, and they reflect a consensus that, in principle, meaningful remedies frequently will be unattainable if antitrust intervention occurs after a transaction is completed and the operations of the merging parties are combined. Though the application of pre-merger oversight in Western countries is not lacking for controversy, such

*and Development 2*, TD/B/COM.2/EM/10/Rev.1 (May 25, 1998) (finding that “there would be substantial benefits to be obtained from strengthening the application of competition law and policy principles in developing and least developed countries in transition in terms of greater production, allocative and dynamic efficiency, welfare and growth”).

10. See JOHN FINGLETON ET AL., *COMPETITION POLICY AND THE TRANSFORMATION OF CENTRAL EUROPE* 54–57 (1996) (discussing the EU’s influence on antitrust laws in the Czech Republic, Hungary, Poland, and Romania); Mark R.A. Palim, *The Worldwide Growth of Competition Law*, 43 *ANTITRUST BULL.* 105 (1998) (documenting how the EU has induced countries in Central and Eastern Europe to modify their antitrust laws to copy the EU model); Carolyn Brzezinski, *Competition and Antitrust Law in Central Europe: Poland, the Czech Republic, Slovakia, and Hungary*, 15 *MICH. J. INT’L L.* 1129, 1149–56 (1994) (describing how the prospect of EU membership has reshaped competition laws in Central Europe); Eleanor M. Fox, *The Central European Nations and the EU Waiting Room—Why Must the Central European Nations Adopt the Competition Law of the European Union?*, 23 *BROOK. J. INT’L L.* 351, 352–56 (1997) (describing how the European Union requires candidates for accession to the EU from Central and Eastern Europe to approximate EU law, including competition law).

11. See Roger Alan Boner, *Competition Policy and Institutions in Reforming Economies*, in *REGULATORY POLICIES AND REFORM: A COMPARATIVE PERSPECTIVE* 38, 45 (Claudio R. Frischtak ed., 1995) (discussing merger notification requirements in transition economy antitrust laws); Michael J. Cicero, *Overview: International Merger Control*, 15 *ANTITRUST* 15 (2001) (summarizing national merger control systems); WHITE & CASE LLP, *SURVEY OF WORLDWIDE ANTITRUST MERGER NOTIFICATION REQUIREMENTS* (2001) (reviewing merger control regimes).

mechanisms are noticeably harder to design and administer in transition economies than in the Western environments in which the concepts were first devised. Transition economy enforcement actions in applying mechanisms modeled on Western practice show that new competition laws can have a substantial impact on specific transactions in emerging markets and can dictate adjustments in the way firms plan arrangements such as mergers and joint ventures.<sup>12</sup>

This Article uses the development of competition systems to examine economic law reform in transition economies. The Article provides a context for the development of transition economy competition policy by presenting the modern debate about the proper approach to economic development and law reform in emerging markets. Part II defines the concept of “competition policy” and emphasizes how nations can achieve important competition policy goals by a mix of strategies that includes antitrust enforcement. Part III addresses conceptual rationales for and against making competition policy a component of reform efforts. Part IV discusses the initial conditions that typically confront a transition economy seeking to develop a competition policy system and identifies the implications of such initial conditions for designing and implementing a new system of law. Part V considers the implications of modern experience for the proper design of technical assistance programs.

#### I. COMPETITION POLICY, ANTITRUST ENFORCEMENT, AND LAW REFORM

The decision to adopt a competition law, or promote the adoption of a competition law, as an element of economic development raises a number of issues about the appropriate approach to law reform in transition environments and the possible contributions of competition policy to economic progress. Since the mid-1980s, multinational donors and individual Western countries have expended substantial resources advising countries with centralized economic and political systems about legal reforms designed to promote economic and political liberalization.<sup>13</sup> The principal targets

12. See William E. Kovacic, *Merger Enforcement in Transition: Antitrust Controls on Acquisitions in Emerging Economies*, 66 U. CIN. L. REV. 1075, 1106–08 (1998) (discussing a challenge in 1996 by Venezuela’s competition authority, Pro Competencia, to Coca-Cola’s joint venture with the Cisneros Group).

13. For an overview of contributions of foreign donors to economic development, see WORLD BANK, *ASSESSING AID: WHAT WORKS, WHAT DOESN’T, AND WHY* (1998).

of assistance have been the countries of the former Soviet Union and the socialist states of Central and Eastern Europe, although donors have undertaken significant projects in Africa, Asia, and Latin America as well. Recent technical assistance programs are the latest chapter of post–World War II efforts by Western countries with democratic political structures and market systems to export their institutions to states with totalitarian governments and planned economies.<sup>14</sup> The most recent period of technical assistance has inspired extensive discussion about the appropriate design and phasing of law reforms to promote economic and political liberalization.<sup>15</sup> This Section summarizes some major focal points of recent debate about transition economy law reform initiatives.

#### A. *Setting Priorities for Economic and Legal Reforms*

Efforts to establish market systems in planned economies confront a number of difficult choices. The choices are forced by three basic conditions of scarcity. One form of scarcity involves human capital. Transition economies ordinarily feature a comparatively small number of individuals with formal training in disciplines relevant to a market economy or experience in market-oriented institutions. The second condition of scarcity involves political capital. A government committed to reform does not enjoy infinite good will or political power as it undertakes departures from past practices that endanger beneficiaries of the status quo. A third form of scarcity involves the level of foreign assistance. Donor assistance programs have limited resources and cannot support the full range of possible reform initiatives.

Scarcity dictates that advocates of economic law reform rank specific measures by their importance and choose assistance strategies that focus chiefly on the greatest needs. Modern commentary on economic reform has tended to emphasize five law reform prerequisites for economic development:<sup>16</sup>

14. Post–World War II trends in development work and the philosophy that animated specific foreign assistance programs are traced in Vernon Ruttan, *Participation and Development*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 217, 217–20.

15. See Jeffrey Sachs, *Poland and Eastern Europe: What Is to Be Done?*, in FOREIGN ECONOMIC LIBERALIZATION, *supra* note 1, at 235, 235 (“The main debate in economic reform should . . . be about the means of transition, not the ends.”).

16. See Charles Cadwell, *Implementing Legal Reform in Transition Economies*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 251, 260 (“The key institutions of a market economy are property rights, mechanisms for enforcement of contracts, and reliable and peaceful ways of organizing political debate.”); Christopher Clague et al., *Institutions and*

1. Creating and defining private property rights and creating systems for recording and transferring such rights.
2. Establishing contract principles and enforcement mechanisms to facilitate exchange.
3. Recognizing the formation of business enterprises in the form of partnerships, corporations, and sole proprietorships and specifying the means for governing such bodies.
4. Promoting capital formation through the sale of securities, issuance of debt, and pledging of assets.
5. Facilitating the exit of assets and their redeployment through bankruptcy procedures.

Pursuit of these aims would not come at the exclusion of other measures, such as adopting laws to control pollution, prohibiting restrictive business practices, and addressing other market failures.

### B. *The Importance of Supporting Institutions*

The recent literature on law and economic development shows a growing recognition that the effectiveness of economic and legal reforms depends on the quality of numerous supporting institutions inside and outside the government.<sup>17</sup> Much of the modern emphasis

*Economic Performance: Property Rights and Contract Enforcement*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT *supra* note 1, at 67, 74 (“[P]oorer countries as a group have grown somewhat less rapidly than rich countries, not because they are inevitably doomed to fall further behind but because the majority of them have failed to establish mechanisms for securing rights to property, for enforcing contracts, and for establishing efficient public bureaucracies.”); Peter Murrell, *Evolution in Economics and in the Economic Reform of Centrally Planned Economies*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE, *supra* note 1, at 35, 49 (describing key legal institutions underpinning market systems); Mancur Olson, *The Hidden Path to a Successful Economy*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE, *supra* note 1, at 55, 65. Olson writes:

To realize all the gains from trade, . . . there has to be a legal system and political order that enforces contracts, protects property rights, carries out mortgage agreements, provides for limited liability corporations, and facilitates a lasting and widely used capital market that makes the investments and loans more liquid than they would otherwise be. These arrangements must also be thought likely to last for some time.

*Id.* See also Gordon C. Rausser, *Lessons from Emerging Market Economies in Eastern Europe*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE, *supra* note 1, at 311, 318–21 (describing essential elements of the “legal and regulatory infrastructure” for a market economy in transition economies).

17. See Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1731, 1797 (2000).

We have learned that Western-style capitalism is more fragile than we thought. It will not emerge—certainly not quickly, perhaps not at all—if seeds are simply scattered widely through mass privatization, to grow in the thin soil of an institutionally impoverished country. Instead, the institutions that control theft in its myriad forms,

on institutions results from the work of scholars, such as Douglass North, who have contributed to what is known as the New Institutional Economics (“NIE”) and applied its insights to explain the process of economic development.<sup>18</sup> “Institutions” in the NIE literature encompass a broad collection of “socially devised constraints on individual action.”<sup>19</sup> Christopher Clague suggests the wide range of phenomena that might be characterized as institutions:

They can be organizations or sets of rules within organizations. They can be markets or particular rules about the way a market operates. They can refer to the set of property rights and rules governing exchanges in a society. They may include cultural norms of behavior. The rules can be either formally written down and enforced by government officials or unwritten and informally sanctioned.<sup>20</sup>

In the field of law reform, among the most important government institutions are a well-functioning judiciary and other mechanisms for resolving disputes arising from the enforcement of the law. To some degree, private parties can rely on nongovernment dispute resolution methods, such as arbitration, to compensate for weaknesses in the judicial process. For the longer term, a country’s inability to create courts that are regarded as competent, impartial fora for resolving commercial disputes will seriously restrict growth. A second essential government institution consists of principles of

especially self-dealing by managers and controlling shareholders, are an essential fertilizer.

*Id.* See also Paul L. Joskow, *Regulatory Priorities for Infrastructure Sector Reform in Developing Countries*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1998, *supra* note 3, at 69 (“These regulatory institutions should be created as an integral component of the entire reform program, not as an afterthought.”); Steven Knack & Philip Keefer, *Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures*, 7 ECON. & POL. 207 (1995) (demonstrating links between institutional quality and economic growth in emerging markets); Laffont, *supra* note 8, at 30 (“[L]ittle can be expected in countries where the political willingness is lacking and that in others international aid for institution building is essential to exit vicious circles of underdevelopment.”); Mancur Olson, *Why Are Differences in Per Capita Incomes So Large and Persistent?*, in ECONOMIC GROWTH IN THE WORLD ECONOMY 193 (Horst Siebert ed., 1993) (describing the value of institutional improvements in raising living standards); Stiglitz, *supra* note 3, at 10 (identifying, as a flaw of some economic reform proposals for transition economies, “the lack of emphasis on institutional infrastructure, including not only competition policy, but also legal structures that enforce contracts, implement bankruptcy, and ensure sound financial institutions”); WORLD BANK, *supra* note 13, at 3 (“Improvements in economic institutions and policies in the developing world are the key to a quantum leap in poverty reduction.”).

18. See DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE (1990); Douglass C. North, *Economic Performance Through Time*, 84 AM. ECON. REV. 359 (1994).

19. Christopher Clague, *The New Institutional Economics and Economic Development*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 13, 17.

20. *Id.* at 18.

public administration that compel government bodies to operate honestly and transparently. Achieving economic growth in transition economies often demands simultaneous efforts to weaken the state's capacity to control economic activity and to increase its ability to execute public functions necessary to the operation of a market system. The latter category of activities includes the honest administration of mechanisms to dispense justice, to raise revenue by taxing individuals and businesses, and to execute proper regulatory responsibilities.

The effectiveness of government bodies in turn rests upon the vitality of a number of supporting institutions, both public and private, that provide resources essential to the operation of the law.<sup>21</sup> Prominent among these are universities, which contribute major inputs to the process of economic and political liberalization. Universities train specialists in business administration, economics, law, and public administration. Graduates from such programs take positions in the government agencies that carry out the new laws or work outside the government advising those whose interests are affected by the legal regime. University faculties also conduct research that informs judgments about existing public policies and the need for further adjustments. Building a self-sustaining indigenous capacity in universities and other institutions to collect data and perform policy research is a key step toward improving the quality of public policy.<sup>22</sup>

Most legal regimes also rely on a variety of nongovernmental organizations to explain the content of various laws to affected groups.<sup>23</sup> Professional associations provide networks through which lawyers and others who advise business operators can learn about new policy developments. Media organizations disseminate information about rights and responsibilities created by law, report on economic trends and the activities of individual business operators, and monitor the performance of government bodies responsible for

21. See Kovacic, *supra* note 4, at 440–41 (describing how “collateral institutions” influence the effectiveness of new competition policy systems).

22. See Peter Murrell, *Missed Policy Opportunities During Mongolian Privatization: Should Aid Target Policy Research Institutions?*, in *INSTITUTIONS AND ECONOMIC DEVELOPMENT*, *supra* note 1, at 235, 236 (recommending that foreign assistance programs “aim to create a capacity for information gathering, research, and analysis”).

23. See William E. Kovacic, *Creating Competition Policy: Betty Bock and the Development of Antitrust Institutions*, 66 *ANTITRUST L.J.* 231, 234–45 (1997) (describing Betty Bock's role in building nongovernment institutions that facilitate antitrust enforcement in the United States).



enforcing legal commands. Consumer groups inform citizens about their legal rights and collect complaints about alleged violations.

### C. *The Sequence of Economic, Legal, and Institutional Reforms*

Studies of the interaction between economic reforms, new laws, and implementing institutions demonstrate the importance of ensuring that the development of implementing institutions receives careful attention at the beginning of the economic liberalization and law reform processes. Liberalization measures are prone to fail unless preceded (or at least accompanied) by the creation of appropriate regulatory frameworks.<sup>24</sup> The massive privatization of assets without the creation of mechanisms for ensuring competition and effective shareholder governance may enable company managers during the era of planning to loot the productive core of the newly private enterprises.<sup>25</sup> Institutional improvements—such as the establishment of effective judicial systems—must precede or be undertaken in parallel with substantive law reforms, such as the establishment of a company’s law or the creation of private property rights in land.

### D. *Pre-reform Study of Initial Conditions*

It has become increasingly apparent to Western donors that the selection of law reform priorities and the design of a process for their implementation are prone to fail unless it emerges from a careful initial assessment of existing conditions. One recent assessment of privatization in Russia suggests that a careful, pre-reform evaluation of initial conditions might have raised serious doubts about the wisdom of adopting a strategy that immediately transferred vast amounts of state holdings into private hands. The study observes:

[I]n the early 1990s, Russia wholly lacked the institutional infrastructure to control self-dealing by managers of private firms.

24. See Jean-Jacques Laffont, *Regulation, Privatization and Incentives in Developing Countries*, in CURRENT ISSUES IN ECONOMIC DEVELOPMENT 164 (M.G. Quibria & J. Malcolm Dowling eds., 1996) (explaining how decontrol of natural monopolies requires establishment of regulatory framework).

25. See Black et al., *supra* note 17, at 1735 (stating that to prevent business managers from stealing the assets of their firms, “development of a decent legal and enforcement infrastructure must precede or at least accompany privatization of large firms”); Stiglitz, *supra* note 3, at 10 (“The experience in Russia shows that, without the appropriate institutional infrastructure, privatization provides incentives for asset stripping—and shipping wealth abroad—rather than for wealth creation.”).

Prosecutors, judges, and lawyers had no experience in untangling complex corporate transactions or understanding of the indirect ways in which company insiders can siphon off profits. Legal concepts of fiduciary duty and proscriptions against self-dealing didn't exist.<sup>26</sup>

The requisite initial assessment is unlikely to succeed if undertaken by outsiders alone. Early and continuing participation by host country specialists and indigenous research institutions is vital to develop an understanding of the status quo and to formulate a strategy for changes.<sup>27</sup>

### E. Determining the Rate of Change

A focus of extensive debate within the reform community is the appropriate rate of change.<sup>28</sup> Many donor-supported efforts at law reform in the early 1990s emphasized a "big bang" or "shock therapy" approach involving, among other measures, rapid decontrol of prices, trade liberalization, and swift privatization of government-owned assets.<sup>29</sup> The essential logic of shock therapy is that the swift divestiture of the state's economic holdings and relinquishment of other forms of economic control would best stimulate the development of market processes and create a constituency for the establishment of a legal regime to ensure its growth over time. The urgency to

26. See Black et al., *supra* note 17, at 1752.

27. See Murrell, *supra* note 22, at 237:

Each new institution interacts with a larger preexisting structure. Therefore, the effectiveness of each new institutional brick crucially depends on its fit with the existing institutional foundation. As a consequence, if it is to be effective, the generation of information on the effects of existing policies and the formulation of new policies needs to reflect the deep characteristics of a society. To know how a policy will work, one must understand the concurrent processes occurring in the economy. A model imported from the West is useful only to the extent that it provides a disciplining pedagogical device, not a magic key that will fit any door.

*Id.* at 237. See also Georges Korsun & Peter Murrell, *Ownership and Governance on the Morning After: The Initial Results of Privatization in Mongolia* (Univ. of Md. Ctr. for Institutional Reform and the Informal Sector (IRIS), Working Paper No. 95, Jan. 1994) (reviewing effects of the failure, in drafting Mongolia's Economic Entities Act, to account for the existing Mongolian economic environment).

28. See Paul Starobin, *What Went Wrong*, 31 NAT'L J. 3450 (1999) (describing the debate in the economic reform community about the causes of failed efforts to promote capitalism in the former Soviet Union).

29. For an extensive discussion of the rationale for shock therapy by one of its leading architects, see JEFFREY SACHS, *POLAND'S JUMP TO THE MARKET ECONOMY* (1994). See also Armeane M. Choksi et al., *The Design of Successful Trade Liberalization Policies*, in FOREIGN ECONOMIC LIBERALIZATION, *supra* note 1, at 37, 55 (proposing that a transition economy's trade liberalization program "should be bold and it should start with a bang"); Sachs, *supra* note 15, at 236 (explaining the need for "rapid transformation" and quoting a Polish economist as saying, "You don't try to cross a chasm in two jumps").

implement broad-based adjustments swiftly reflected the concern that reformers faced only a narrow window of opportunity and that an incremental process of reform would falter as political opposition to market liberalization mobilized.

Other commentators proposed evolutionary approaches that would introduce market-oriented economic reforms and related laws more gradually.<sup>30</sup> The evolutionary model cautions that some big bang strategies—such as the immediate, large-scale privatization of state-owned firms—may retard the growth of a vital private sector in ways that actually extend the length of the transition from planning to markets. Advocates of the more gradual, evolutionary approach offer two specific recommendations about the content and timing of law reform efforts. The first is that the design of wise reform measures demands extensive preliminary study of initial conditions. The second is that technical assistance programs should promote the establishment of implementing institutions as precursors or complements to adopting new legal commands. In a number of national settings, these measures may provide a more effective path to durable reforms.

#### F. Popularizing Reforms

To have positive long-lived effects, reforms ultimately must command the assent and support of the general public.<sup>31</sup> Gaining public acceptance for market-oriented legal reforms is a tremendous challenge in countries accustomed to comprehensive government intervention and conditioned to view private institutions with suspicion. The common path of reform efforts is to engage the host country's elites—public sector and private sector professionals who often have gained formal training in Western universities or held positions that provide extensive contact with Western market institutions.

Extending participation in and support for the reform process beyond the elites, to the larger body of citizens who live in extreme poverty or are politically disaffected, requires conscious efforts to increase public awareness of the rationales for reform and the

30. See Murrell, *supra* note 16, at 37–40 (describing the evolutionary model of law reform in transition economies); Peter Murrell, *What is Shock Therapy? What Did It Do in Poland and Russia?*, 9 POST-SOVIET AFF. 111 (1993) (analyzing early results of rapid privatization).

31. See Clague et al., *supra* note 16, at 88 (“[S]ociety has to accept the new [economic reform] policies, and this is not simply a matter of changing directions at the top.”).

encouragement of public participation in the design and implementation of specific measures.<sup>32</sup> Where specific structural adjustment initiatives (such as the removal of price controls) can cause short-term upheaval, sustaining broad public support may require the expansion of social insurance programs and recourse to other redistribution measures.<sup>33</sup>

### G. *Introducing Democracy*

There is a substantial debate among commentators about the relationship between economic reform and political liberalization.<sup>34</sup> A number of American foreign assistance programs have sought to spur the development of democratic institutions by, among other means, supporting free and honest elections, building political institutions such as constitutions, courts, and legislatures, and stimulating the creation of nongovernment civic bodies such as professional societies.<sup>35</sup>

Programs to promote political liberalization have stimulated debate about whether the promotion of democracy is a necessary or desirable element of efforts to increase reliance on market processes. The literature on development emphasizes that generalizations about links between autocracy or democracy and economic growth are especially difficult.<sup>36</sup> It is nonetheless possible to identify a number of distinct perspectives in the commentary. One perspective suggests

32. See WORLD BANK, *supra* note 13, at 86–87 (discussing the value of “beneficiary participation” in ensuring the success of economic reform projects); Elinor Ostrom, *Investing in Capital, Institutions, and Incentives*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 153, 177 (analyzing investments in local health and irrigation projects; observing that foreign assistance programs that “build little at the ground level are a poor investment from the donor’s perspective”).

33. See David M. Newbery, *The Safety Net During Transformation: Hungary*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE, *supra* note 1, at 197 (describing strategies for protecting vulnerable groups during the transition process).

34. A valuable starting point for analyzing the impact of different forms of political organization on economic growth is Mancur Olson, *The New Institutional Economics: The Collective Choice Approach to Economic Development*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 37.

35. See THOMAS CAROTHERS, *AIDING DEMOCRACY ABROAD* (2000) (examining modern US efforts to promote development of democratic institutions).

36. See, e.g., Christopher Clague et al., *Democracy, Autocracy, and the Institutions Supportive of Economic Growth*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 91, 111 (observing that “democratic regimes differ in their economic effectiveness”); Stephan Haggard, *Democratic Institutions, Economic Policy, and Development*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 121, 121 (“Cross-national empirical evidence on the relationship between regime type and economic performance remains highly contested.”).

that economic reform progresses most swiftly in countries with comparatively authoritarian structures. By this view, one needs a strong national leader to design and impose the package of reforms. Some commentators point to modern experience in Chile, China, Peru, South Korea, and Taiwan to support this interpretation. At least in the short- to middle-term, a durable autocracy may have greater success in establishing conditions conducive to growth than an unstable democracy.<sup>37</sup> A corollary point is that market decentralization eventually will create social conditions that foster political liberalization. From this perspective, measures to promote growth by the decentralization of economic decision making tend to require a decentralization of political power and the establishment of a more politically astute and active middle class.<sup>38</sup>

A number of scholars have concluded that, compared to a condition of anarchy, autocratic forms of government increase the possibilities for growth.<sup>39</sup> These observers caution that autocratic systems ultimately provide comparatively weak assurance that mechanisms necessary for long-term prosperity—such as the protecting of property and contract rights—will be sustained. Research on the long-term stabilizing influence of democracy has generated a second perspective on the role of democracy in economic development—namely, that the adoption of democratic political institutions ultimately is necessary to ensure that economic reforms are enduring.<sup>40</sup> Without a broad perception that rules affecting

37. See Clague et al., *supra* note 36, at 114 (“For a country for which stable democracy is not a feasible option, a durable autocracy with a leader who is rationally maximizing his long-term tax extraction may be, among the available political arrangements, the one most favorable to property rights.”).

38. An early influential statement of this thesis appears in Seymour Martin Lipset, *Some Social Requisites of Democracy: Economic Development and Political Legitimacy*, 53 AM. POL. SCI. REV. 69 (1959). Later empirical verifications of Lipset’s thesis include Robert Barro, *Democracy and Growth*, 1 J. ECON. GROWTH 1 (Mar. 1996), available at <http://kapis.wkap.nl/oasis.htm/10643>; Ross E. Burkhardt & Michael S. Lewis-Beck, *Comparative Democracy: The Economic Development Thesis*, 88 AM. POL. SCI. REV. 903 (1994); see also Ruttan, *supra* note 14, at 229 (“[P]olitical liberalization is more sustainable when it is preceded by a successful program of economic liberalization.”).

39. See Olson, *supra* note 34, at 42–54 (describing how “roving bandits” and “stationary bandits” have different incentives to establish an environment that induces individuals to create wealth).

40. See Clague et al., *supra* note 36, at 114 (reporting empirical evidence that “long-lasting democracies provide better property rights than long-duration autocracies or short-duration regimes of either type”); Olson, *supra* note 34, at 60 (“It is no accident that the only societies that have enjoyed high levels of capital accumulation across successive generations are the durable democracies. Every society with autocratic rulers sooner or later is victimized by roving banditry from the top. Thus, there are compelling and normally neglected practical as well as moral reasons why the United States should make the promotion of democracy a priority.”).

economic activity are legitimate and without political safeguards against arbitrary state interference in the economy, the impact of economic reforms may be short-lived. A corollary proposition is that a commitment to protect civil liberties is necessary to attract and sustain investment from domestic and foreign sources.<sup>41</sup>

Commentators who have endorsed the development of democracy as an element of foreign assistance have cautioned that establishing democratic institutions and cultures will require a sustained, substantial commitment of foreign support and cannot be done with short-term intervention or external political pressure alone.<sup>42</sup> Though democratic systems tend to ensure the emergence of a superior environment for economic growth in the longer term, new democracies may feature significant periods of instability that impede investment and growth.<sup>43</sup> Experience with individual democracies also may vary considerably according to the specific design of the country's democratic institutions, such as the choice between parliamentary and presidential rule, the definition of executive authority, and the establishment of rules that affect the level of fragmentation in a party system.<sup>44</sup>

A third noteworthy perspective is that the effect of adopting democratic reforms depends heavily on initial economic, political, and social conditions. Some observers have warned that the adoption of democratic reforms in countries with strongly disfavored ethnic

41. See WORLD BANK, *supra* note 13, at 87 (describing the positive impact on investment projects of a political environment in which citizens enjoy civil liberties, particularly those related to free expression); Jonathan Isham et al., *Civil Liberties, Democracy, and the Performance of Government Projects*, in 11 WORLD BANK ECON. REV. 219 (1997).

42. Olson comments that, in promoting democracy in transition environments, the United States "should either devote the considerable investment of resources and patience needed to make the effort succeed, or else not intervene at all." Olson, *supra* note 34, at 61. Olson adds that "the promotion of democracy is in large part an educational problem: it requires giving elites in countries without democracy an appreciation of the extraordinary practical value of the secure contract, property, and other individual rights that lasting democracies provide." *Id.*

43. See Clague et al., *supra* note 36:

[N]ewly established democracies may require time to consolidate the mosaic of institutions that characterize successful democratic polities. Executive branch adherence to the rulings of a supreme court, the education of voters, and the modalities of transparent administrative procedures do not emerge instantly. Rather, the multiple sources of authority that underpin successful democracies might in the early years, when decision-making procedures are underdeveloped and not well understood or accepted, create substantial uncertainties regarding property rights.

*Id.* at 94.

44. See Cadwell, *supra* note 16, at 255-60 (describing implications for executing law reforms of the distribution of authority between national and local authorities and within the executive branch of the national government); Haggard, *supra* note 36, at 129-41 (analyzing implications of various models of democratic governance).

minorities may increase the ability of majority groups to oppress minority interests, particularly where the disfavored minority accounts for a disproportionate share of economic activity.<sup>45</sup>

A fourth perspective emphasizes the importance of decentralizing political power from central government authorities to political subdivisions such as regional and local administrations. Democracy development programs sponsored by the United States and other foreign donors have attempted to strengthen the capacity of local and regional government institutions.<sup>46</sup> Among other effects, political decentralization is seen as a partial antidote to unprincipled decision making and corruption by central government authorities, which otherwise are shielded from effective monitoring by nontransparent administrative processes.<sup>47</sup> An unresolved issue is whether decentralization of power diminishes the ability of interest groups to manipulate government processes and allocate the state's resources in ways that disadvantage the public as a whole.

#### H. Role of the Government in Carrying Out Reforms

The move from centralized power to dispersed authority requires a basic decision about what role the government should play in executing reforms. Two basic models of government involvement have received attention in commentary about economic development. The first is what Robert Cooter calls "political modernization" of the law.<sup>48</sup> In this model, the state plays the leading role in law reform by enacting comprehensive statutes and regulations. Foreign advisors make significant contributions to this process by drafting models,

45. See Amy L. Chua, *Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development*, 108 YALE L.J. 1 (1998) (considering how market liberalization and democratic reforms in transition economies can increase ethnic tensions).

46. See Ruttan, *supra* note 14, at 220 ("An important theme in the democratization agenda has been the design of local institutions of governance to empower communities to mobilize their own resources for development.").

47. Transition economies often have resisted decentralization measures that would give political subdivisions more control over economic and political resources. Vernon Ruttan observes that "the strengthening of local governance is often viewed as a threat to political stability rather than as a resource for development by the national political leadership and the central bureaucracies." *Id.* at 228. Ruttan adds that national government attitudes disfavoring political decentralization "have sometimes been reinforced by the staffs of development assistance agencies, who often have little historical insight into the evolution of rural development institutions in the currently developed countries." *Id.*

48. See Robert D. Cooter, *Market Modernization of Law: Economic Development Through Decentralized Law*, in ECONOMIC DIMENSIONS IN INTERNATIONAL LAW 275, 276 (Jagdeep S. Bhandari & Alan O. Sykes eds., 1997).

which draw principally upon Western solutions and rely on variants of Western institutions for their implementation.

The chief alternative to this approach is what Cooter terms “market modernization” of the law.<sup>49</sup> In this framework, the state establishes initial conditions, such as recognizing private property rights and liberalizing trade, necessary to promote the evolution of a market economy, but it looks mainly to private individuals, firms, and institutions (e.g., trade associations) to devise specific legal principles that the state ultimately will embrace. The market modernization approach de-emphasizes state efforts to conceive comprehensive legal frameworks at the beginning of the reform process and stresses gradual, piecemeal approval by courts and legislatures of privately created norms.

Compared to a political modernization approach, the market modernization model channels more effort by host country reformers and their foreign advisors to studying indigenous economic and social conditions as a predicate for the state’s recognition of new legal rules. Unlike “top-down” law reform, “bottom-up” initiatives place a premium on identifying and understanding customs and norms that promote market processes. The bottom up orientation would discourage rote application of Western legal models in ways that fail to account for crucial differences in local circumstances and would force host country policy makers and foreign advisors to study more carefully, and improve, the apparatus for translating widely accepted norms into binding legal rules.

Executing a market modernization strategy can raise special problems of its own.<sup>50</sup> The first obstacle concerns the state’s role in creating the initial conditions that permit the emergence and evolution of private norms, which form the basis of future legal rules. One cannot underestimate the difficulty of accomplishing these foundational tasks, which include creating and defining private property rights, lifting price controls, liberalizing trade, and removing unnecessary legal barriers to the entry of new firms. These reforms will not emerge spontaneously and will demand extensive effort by the national government (and close monitoring by external donors) to ensure their implementation.

49. *See id.*

50. *See* William E. Kovacic, *Comments on Chapter 7, in* ECONOMIC DIMENSIONS IN INTERNATIONAL LAW, *supra* note 48, at 317 (reviewing limitations of Robert Cooter’s market modernization model).



A second problem involves the process by which courts and legislatures ultimately endorse private norms. This requires that judges and legislators have the ability and incentive to identify private norms that enhance efficiency and forms that reduce it. For example, a court must be able to make distinctions between a variety of contractual restrictions—to approve a restrictive covenant because such covenants enhance efficiency by increasing an employer’s incentive to share proprietary data and commercial know-how with her employees, but to forbid an agreement among direct competitors not to make sales in the traditional home market of each. Both types of restrictions might be widely used, customary norms, but each type has significantly different efficiency effects. Judges must have the expertise to tell the difference, and the judicial system must have sufficient integrity to ensure that parties cannot purchase the outcome they wish.

The third problem deals with the proper residual role of the state in addressing market failures. Even a system that relies heavily on the government’s approval of privately generated norms will find instances in which the operation of the private norms reduces economic welfare. At least some regulatory apparatus may be necessary to identify and address such market failures.

## II. FORMS OF COMPETITION POLICY: ANTITRUST AND OTHER POLICY INSTRUMENTS

In discussions among Western commentators about economic law reform, there is a tendency to equate “competition policy” with enforcing prohibitions against restrictive business practices. This might be called an antitrust-centric view of competition policy. Properly understood, competition policy encompasses a large collection of policy instruments by which a country can promote business rivalry.<sup>51</sup> A sound competition policy program need not invariably place antitrust enforcement at the top of its agenda. A transition economy might use a variety of techniques to increase the role of competition as a means for governing economic activity. In the full set of possible competition policy tools, antitrust enforcement might not always be the principal instrument.

51. See R. Shyam Khemani & Mark A. Dutz, *The Instruments of Competition Policy and Their Relevance for Economic Development*, in REGULATORY POLICIES AND REFORM: A COMPARATIVE PERSPECTIVE, *supra* note 11, at 16 (describing policy tools by which countries can achieve competition aims).

### A. *Advocacy*

There is widespread recognition that one of the most important contributions of a competition policy system is to serve as an advocate within the government and the country at large for reliance on market processes and business rivalry to organize economy activity.<sup>52</sup> Government regulations that restrict entry, pricing, and trade often curb new business development and distort the competitive process. Though most countries feature such phenomena, the dangers of government regulation assume special significance in emerging markets where public policies and cultural perceptions often reflect a basic suspicion of capitalism and a preference for statist solutions to economic problems. In emerging markets, the competition agency can discourage the adoption or maintenance of competition-suppressing measures by unmasking their social costs and pressing public officials to justify the restriction of business rivalry.

### B. *Education and Constituency Development*

One important role for a competition agency is to educate business officials, consumers, and government policymakers about the merits of market processes.<sup>53</sup> The competition policy authority can be a catalyst for debate about the appropriate role of government intervention in the economy and the correct choice of strategies for promoting growth.<sup>54</sup> Performing the education function can help the

52. See Malcolm B. Coate et al., *Antitrust in Latin America: Regulating Government and Business*, 24 U. MIAMI INTER-AM. L. REV. 37, 58 (1992) ("In any economy, the antitrust agency can act as a useful watchdog to protect the market economy from excessive regulation. In effect, the antitrust agency should attempt to regulate bureaucracy and minimize the burden of government on society."); Ana Julia Jatar, *Comment on "Competition, Information, and Development" by Jean-Jacques Laffont*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1998, *supra* note 3, at 258, 259 ("A competition agency should have the legal authority to challenge other government agencies' decisions that conflict with competitive principles."); Ben Slay, *Industrial De-monopolization and Competition Policy in Poland*, in DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES 123, 143 (Ben Slay ed., 1996) ("Perhaps the [Polish] Antimonopoly Office's most important (and least-discussed) function has been the advocacy of liberal, pro-competitive solutions to economic policy problems during the Polish transition.").

53. See Ana Julia Jatar, *Competition Policy in Latin-America: The Promotion of a Social Change* 13 (1995) (paper presented at the Annual Meeting of the American Economic Association) (on file with author) (observing that "[c]hanges in conduct and attitudes must be considered one of the major goals in competition policy" in transition economies). Ana Julia Jatar is the former head of Venezuela's competition authority.

54. A focus of donor assistance can be to assist competition authorities in stimulating public discussion of economic organization. *Cf.* Cadwell, *supra* note 16, at 263 ("[D]onors can

competition agency can build a political constituency for market-oriented policies. Building a political constituency for competition and other market-oriented solutions may be as vital to the competition system's effectiveness as "technocratic" measures (such as raising salaries and increasing expertise through training) that seek to build the system's stature and influence.<sup>55</sup>

### C. Research and Studies

A competition agency can establish a research capability that permits it to analyze impediments to competition. The results of the competition agency's research can inform its competition advocacy activities and the selection of possible subjects for law enforcement. Publication of studies can help educate government agencies and the public generally about the sources of poor economic performance. One model for such research is Hernando de Soto's formative study of the informal sector in Peru.<sup>56</sup> De Soto and a team of researchers examined the impact of public regulations involving housing, transportation, and retailing in Lima. The study suggested how adjustments in various government regulatory policies discouraged entrepreneurs from making the type of "sunk" investments that often are instrumental in spurring growth. De Soto and his colleagues documented how a more austere regulatory regime would reduce entry barriers and improve public administration by reducing the number of opportunities for public officials to accept bribes for giving necessary approvals.

Similar work by competition authorities in other countries would provide highly informative perspectives on domestic obstacles to competition. In many instances, the barriers to rivalry might not be immediately apparent. A number of transition economies have taxation mechanisms that feature high marginal rates, poor success in making collections, and extraordinarily complex codes that confer tremendous discretion on individual tax officials and create

contribute to broadening of public debate, especially among the idea elites who lead opinion in democracies: journalists, academics and researchers, and officials in competing centers of power."); WORLD BANK, *supra* note 13, at 57 ("Stimulating debate in civil society about policy is an intangible way for development assistance to influence policy reform.").

55. See Haggard, *supra* note 36, at 144 ("For agencies to sustain themselves over time, they must also build on bases of constituent support.").

56. HERNANDO DE SOTO, *THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD* (1989).

compelling temptations for corruption.<sup>57</sup> The operation of such systems deters new business entry and expansion by existing entrepreneurs. As identified by a competition agency's study, reform of the taxation system—reducing rates, improving collections, and imposing integrity-related administrative safeguards—could enhance competition by encouraging entry.<sup>58</sup>

A second possible focal point for attention could be preferences that some economies confer upon state-owned enterprises (“SOEs”). In a number of countries, SOEs have special access to cheap land and favorable credit. Private entrepreneurs can face substantial cost disadvantages in seeking to compete with public enterprises. Foreign investors sometimes cannot purchase land directly but must engage in joint ventures with SOEs to build and operate facilities.

In many countries, deficiencies in the financial services market discourage entry. Where the state prevents the establishment or growth of private commercial banks, individual entrepreneurs often must raise capital by saving net revenues and seeking loans from customers, family members, and friends. Such loans might enable a small business operator to amass modest amounts of money, but recourse to these devices precludes assembling the sums needed to undertake a significant expansion of operations.

In other settings, frailties in the mechanism for registering and recognizing business enterprises can discourage entry.<sup>59</sup> In Vietnam, entrepreneurs must prepare a registration form that requires them, among other information, to specify their business plan. Various government officials review the application and have authority to reject the applicant if they believe the business plan is deficient. One possible deficiency is that the applicant seeks to enter a field already occupied by an SOE or otherwise wishes to do business in a sector with “excess” capacity. Simplification of the registration process and elimination of reviews of business plans as elements of the reforming Vietnam's companies law would promote entry.

57. See *infra* notes 115–17 and accompanying text (describing difficulties with taxation systems in transition economies).

58. See Vito Tanzi & Anthony Pellechio, *The Reform of Tax Administration, in INSTITUTIONS AND ECONOMIC DEVELOPMENT*, *supra* note 1, at 273 (describing recent experience with technical assistance programs to improve tax administration in transition economies).

59. See *Report on Recommendations on Building and Improving Economic Legal Framework in Vietnam*, U.N. Development Programme, at 155–58, U.N. Doc. VIE/94/110 (1998) (recommending reducing legal obstacles to the creation of new enterprises).

#### D. Antitrust Enforcement

A fourth component of competition policy is the one that appears most prominently in discussions about competition and law reform: the enforcement of prohibitions against restrictive business practices. There is considerable room for variation in determining which commands a transition country should adopt and in deciding the sequence of efforts to apply them. A country reasonably could choose a strategy that begins with enacting basic prohibitions on hard core horizontal restraints, such as collusive tendering, and gradually adds a fuller collection of prohibitions.<sup>60</sup> Alternatively, a country could adopt a more elaborate set of antitrust measures, but with an express commitment to focus on simpler enforcement tasks at first and expand its operations to apply more conceptually complex and resource-intensive commands over time as the institution's capability grows.

A good case can be made for including some level of law enforcement in the competition agency's initial package of responsibilities. It will be impossible for the competition agency to become proficient in antitrust enforcement if it does not gain experience in investigating and prosecuting cases.<sup>61</sup> Yet a decision to undertake some enforcement measures does not mean that a nation must attempt everything. There is no principle of sound implementation that compels a country to make law enforcement the central component of its early competition policy strategy or to adopt a full collection of Western-style prohibitions as part of its initial competition policy regime.

#### E. Implications

Discussions about the desirability of competition policy as a component of economic development need not automatically assume that a competition policy system will consist exclusively, or even chiefly, of enforcing antitrust prohibitions. Nations can tailor

60. See Coate et al., *supra* note 52, at 81–82 (recommending that in Latin American countries “prohibitions on price fixing should represent the core antitrust policy”; concluding that enforcement priorities should not include non-price horizontal agreements, vertical restraints, or price discrimination); Jatar, *supra* note 52, at 259 (observing that competition rules in recently liberalized economies “should prohibit horizontal agreements among competitors, including price cartels”).

61. Cf. Black et al., *supra* note 17, at 1735 (observing, in the context of discussing privatization and corporate governance in Russia, that “to learn to prosecute fraud and self-dealing, regulators need some fraud and self-dealing to practice on”).

competition policy systems to suit their unique needs and capabilities through their initial choice of tools (e.g., advocacy, education, research, and law enforcement) for promoting market rivalry, through the relative emphasis that the new competition agency gives to these tools as it begins operations and matures, and through adjustments to the agency's powers over time to alter the initial collection of policy tools. There is considerable room to account for specific national circumstances and changing capabilities through the initial definition of responsibilities and creation of policymaking instruments, the sequencing of activities, and the adjustment of powers over time.

### III. COMPETITION POLICY AS AN ELEMENT OF LAW REFORM

The design of a competition policy program can follow various approaches that involve different combinations of policy instruments. Despite the widely acclaimed benefits of competition in promoting economic progress, the inclusion of competition policy on the transition economy reform agenda has stimulated controversy. This Section examines arguments for and against making competition policy an ingredient of reform and offers a synthesis of these views that emphasizes possibilities for varying the content of competition policy according to the institutional capabilities of the transition economy.

#### A. *The Critique of Competition Policy as an Element of Reform*

The widespread adoption of new competition policy systems in transition economies has not attracted unqualified praise. A number of commentators have criticized efforts by Western governments and multinational donors to adopt competition statutes or make competition laws a high priority for law reform.<sup>62</sup> The major themes of this literature are presented below.

62. Notable contributions to the critical literature include: Cooter, *supra* note 48; Paul E. Godek, *A Chicago-School Approach to Antitrust for Developing Economies*, 43 ANTITRUST BULL. 261 (1998); Paul E. Godek, *One U.S. Export Eastern Europe Does Not Need*, 15 REGULATION 20 (1992) [hereinafter Godek, *One U.S. Export*]; Laffont, *supra* note 8; A.E. Rodriguez & Mark D. Williams, *The Effectiveness of Proposed Antitrust Programs for Developing Economies*, 19 N.C. J. INT'L L. & COM. REG. 209 (1994); Armando E. Rodriguez & Malcolm B. Coate, *Limits to Antitrust Policy for Reforming Economies*, 18 HOUS. J. INT'L L. 311 (1996); Paul H. Rubin, *Growing a Legal System in the Post-Communist Economies*, 27 CORNELL INT'L L.J. 1, 45-46 (1994).

### 1. The Foreign Trade Liberalization Alternative

Some commentators address the competition policy issue by arguing that transition economies seeking to improve competition will achieve far more by liberalizing trade than by creating laws to attack private trade restraints. The core of such a policy would be to dismantle tariff and nontariff barriers to imports of foreign goods. The trade liberalization advocates suggest that removing obstacles to imports will supply an effective means for disciplining domestic producers of tradable goods, particularly in smaller economies.<sup>63</sup>

### 2. Facilitating Domestic Trade

A second criticism of creating programs to challenge trade restraints is that a transition economy's public resources are better invested in initiatives to improve the flow of goods and the provision of services within its own borders. One focus of such a program would be to eliminate government regulations that restrict the shipment of goods outside of specific regions or otherwise induce producers to sell their output to local purchasers only.<sup>64</sup> A second strategy would be to invest more public funds in airports, communications systems, highways, port facilities, railroads, and other infrastructure assets whose improvement could give consumers access to a wider range of potential sellers.<sup>65</sup>

### 3. Dangers of Misguided Competition Law Enforcement

Critics of antimonopoly enforcement as a law reform element contend that transition economy officials too often will misapply competition policy commands and retard the development of free

63. See Cooter, *supra* note 48, at 306 ("The pressure of international competition is more reliable and relentlessly procompetitive than the activities of antitrust officials. Developing nations can accomplish many goals of antitrust policy through free trade without the state creating an enforcement bureaucracy. . . . Free trade is, consequently, the best antitrust policy."); Godek, *One U.S. Export*, *supra* note 62, at 20 ("Free trade stimulates wealth creation and development, and in a small country it makes antitrust concerns largely irrelevant.").

64. See ANNETTE W. BROWN ET AL., *THE MYTH OF MONOPOLY: A NEW VIEW OF INDUSTRIAL STRUCTURE IN RUSSIA* 38–39 (World Bank, Policy Research Paper No. 1331, 1993) (discussing how reducing regional and local limits on entry and shipments of goods could improve Russia's distribution system).

65. See Laffont, *supra* note 8, at 245 ("Beyond institutional weaknesses, competition is weak in developing countries because transactions are localized as a result of poor communications systems and inefficient trading organizations. Focusing attention on these areas should be useful, but these problems call even more for investments in infrastructure than for better competition policy.").

markets and the decentralization of political power.<sup>66</sup> In this perspective, antitrust is excessively prone to become another instrument of central government control that hinders the growth of a relatively fragile private sector. Excesses in enforcement that might be acceptable in wealthy Western countries can be especially damaging in emerging markets. In countries with a deep-seated culture of rent-seeking and weak or corrupt systems of public administration, well-established political and economic interests may readily subvert the competition policy system to protect the existing distribution of wealth and privilege in society. Possibilities for faulty enforcement increase where transition economy competition agencies lack adequate expertise and physical resources.<sup>67</sup> In nations where disfavored ethnic minorities account for an especially high share of activity in certain industries or functional areas (such as distribution), antimonopoly prohibitions on “abusive” conduct by “dominant” firms might serve as tools by which the majority oppresses the minority.

#### 4. High Opportunity Costs in the Reform Process

Nations undertaking the transition from central planning to reliance on markets typically face a daunting collection of reform needs. These include enhancing the protection of private property rights, privatizing publicly owned enterprises, building a regime of contract enforcement, creating a legal framework for the founding and dissolution of business entities, and forming legal institutions

66. See Godek, *One U.S. Export*, *supra* note 62, at 21 (“The potential harm of misguided antitrust policy to newly emerging economies should not be discounted.”); Laffont, *supra* note 8, at 252 (“Poorly designed and applied competition laws can even discourage trade and foreign investment.”); Rubin, *supra* note 62, at 45–46 (describing ineffectiveness and frailties of antitrust enforcement in developing economies).

67. Some commentators who approve transition economies’ adoption of antimonopoly statutes point out how some controls—particularly those designed to address the abuse of a dominant market position—are particularly vulnerable to misuse. See Robert D. Willig, *Anti-Monopoly Policies and Institutions*, in *THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE*, *supra* note 1, at 187, 195 (“Anti-monopoly laws with broad provisions permitting intervention against dominant-firm behavior and ‘price gouging’ pose the danger of chilling the very investment and entrepreneurship that emerging economies sorely need.”). *But see* Ross C. Singleton, *Competition Policy for Developing Countries: A Long-Run, Entry-Based Approach*, 15 *CONTEMP. ECON. POL’Y* 1, 7 (1997) (maintaining that transition economy antitrust systems should give competition authorities “substantial discretion in challenging the business practices of dominant firms”; law should treat various practices as *prima facie* evidence of violation and require dominant firms to offer efficiency justifications; behavior that “could be specified and scrutinized in this manner likely would include exclusive dealing arrangements, refusal to deal, predation, access to essential facilities, vertical mergers, and perhaps horizontal and even conglomerate mergers”).



(such as laws allowing securing lending) to promote the formation of capital.<sup>68</sup> Some scholars observe that establishing competition policy and antitrust enforcement mechanisms can divert scarce transition economy resources away from achieving higher reform priorities.<sup>69</sup> In this view, competition policy and antitrust enforcement warrant attention only after a transition economy has made considerable progress toward laying other foundations for a market system.

Concerns about the sequencing of reforms rest partly on the awareness that many transition economies have a relatively small pool of public officials with expertise in market-related economics available to administer economic law reform efforts.<sup>70</sup> The limited number of officials with such expertise often must manage demanding, diverse portfolios of economic reform initiatives. Time consumed in overseeing the pursuit of one reform initiative—drafting laws, meeting with foreign advisors, consulting with government and nongovernmental constituencies inside the country, and participating in the creation of new government bodies—comes at the expense of completing other projects. The opportunity costs in the transition environment of allocating scarce resources to inferior priorities are substantial.

##### 5. Summary: A Skeptics' Consensus for a Modest Competition System?

Many commentators who have criticized efforts to transplant elaborate replicas of Western antimonopoly systems into transition economies appear to see benefits in establishing properly limited competition policy mechanisms and giving a government agency at least some enforcement powers. Critics of elaborate Western-based

68. See William E. Kovacic, *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine, and Zimbabwe*, 44 DEPAUL L. REV. 1197, 1200–01 (1995) (describing obstacles to entrepreneurship in Ukraine due to a lack of well-defined property rights and a reliable contract enforcement mechanism).

69. Paul Godek casts the argument in these terms:

East Europeans have limited resources and much more important things to worry about at this precarious stage in their development. Worrying about antitrust issues shows an unhealthy anxiety about the imagined ills of capitalism. Exporting antitrust to Eastern Europe is like giving a silk tie to a starving man. It is superfluous; a starving man has much more immediate needs. And if the tie is knotted too tightly he won't be able to eat what little there is available to him.

Godek, *One U.S. Export*, *supra* note 62, at 21.

70. See Kovacic, *supra* note 68, at 1213 (discussing limited availability in many transition economies of indigenous expertise in market-oriented economics or law).

transplants appear to see a useful role for a national competition agency to perform advocacy and education functions.<sup>71</sup> Some skeptics also seem to endorse the establishment and enforcement of antitrust controls on cartels and perhaps other forms of trade restraints.<sup>72</sup> To sum up their views, the critics would accept a competition policy system that emphasized advocacy and enforced prohibitions on naked trade restraints. They would not establish competition laws that prohibit the full range of behavior—abuse of a dominant position, mergers, vertical restraints, and price discrimination—commonly subject to antitrust oversight in older Western competition systems.<sup>73</sup> While acknowledging a potentially useful role for competition policy programs that entail advocacy, education, and carefully delimited enforcement duties, these observers predict that the immediate gains to transition economies are likely to be modest, at best, and warn against efforts by Western advisors to make heroic claims about the impact of adopting new systems.<sup>74</sup>

#### *B. Rationales for Competition Policy and Antitrust Enforcement*

Many participants in the debate about economic law reform take a sanguine view about the contributions of competition policy, including enforcement of prohibitions against trade restraints, to economic growth.<sup>75</sup> Commentators who favor making competition

71. See Laffont, *supra* note 8, at 245 (noting that “a competition agency can play a valuable educational role in advocating the social benefits of fair competition.”).

72. See Cooter, *supra* note 48, at 309 (“Free trade . . . may not be enough to destabilize cartels created by overt agreements. Courts should not enforce such agreements and the antitrust authorities should undermine them.”); Laffont, *supra* note 8, at 244–45 (“[D]esigning simple and transparent rules for developing countries, particularly to prevent horizontal collusion and abuse of dominant position, remains a worthy task.”).

73. See Laffont, *supra* note 8, at 244 (concluding that “U.S.-style competition policy—with its armada of lawyers and economists—is neither affordable nor implementable”).

74. Laffont offers a representative statement of this assessment:

[T]he benefits that can be expected from competition policy in very poor countries will be quite small for the foreseeable future, for several reasons. Complexities and ambiguities remain in the economic analysis of predatory behavior and vertical restraints. Emerging industries will necessarily be highly monopolistic, yet competition agencies lack expertise and information, and interest groups have considerable discretion and potential for interference.

*Id.* at 245.

75. See Black et al., *supra* note 17, at 1800 (calling competition policy one of the “essential accompaniments” in the privatization process); James Langenfeld & Marsha W. Blitzer, *Is Competition Policy the Last Thing Central and Eastern Europe Need?*, 6 AM. U. INT’L L. REV. 347, 367–76 (1991) (discussing the impact of antitrust laws in creating competition in Central and Eastern Europe); Sachs, *supra* note 15, at 238 (stating that state-owned enterprises in transition economies “must be subjected to real market disciplines” by, among other means, “antitrust policies to break up industrial giants”); Richard Schmalensee, *Comment on*

policy a central element of law reform in transition economies offer the following justifications.

### 1. Catalyst for Market Reforms

Many reforms proposed as alternatives to antimonopoly enforcement—including trade liberalization and other forms of deregulation—require government institutions to surrender power and contradict the preferences of powerful economic interests that benefit from the regulatory status quo. There is little reason to believe, either, that reform measures will arise spontaneously within government institutions that have spawned and profited from competition-suppressing policies. Beneficiaries of the *ancien regime* are unlikely to surrender power passively.<sup>76</sup> Even when donors elicit reform commitments as conditions for approving financial assistance, governments have proven themselves adept at subverting the impact of nominal reforms through outright neglect or subtle forms of resistance in implementation.<sup>77</sup>

A competition policy agency can supply an institutional counterweight within the government to promote liberalization measures and resist overt or subtle efforts to sabotage market-oriented reforms. Through a variety of advocacy and education activities, the competition agency can provide valuable support for policy measures, such as trade liberalization, that some observers have advanced as alternatives to antitrust enforcement. Specific focal points of activity

*“Competition, Information, and Development,”* by Jean-Jacques Laffont, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1998, *supra* note 3, at 262, 265 (“I contend that a competition policy focused on blatant cartel behavior and mergers to monopoly would be relatively cheap and could have substantial benefits in developing countries.”); Spencer Weber Waller & Rafael Munte, *Competition Law for Developing Countries: A Proposal for an Antitrust Regime in Peru*, 21 CASE W. RES. J. INT’L L. 159 (1989) (maintaining that competition law can be vital to developing an effective national economy); Willig, *supra* note 67, at 195 (stating that emerging markets correctly recognize that “anti-monopoly policy is integral to the process of transition”).

76. See Jeffrey Sachs, *In Defense of Russia’s Reformers*, WALL ST. J., Dec. 30, 1993, at A8 (describing “hand-to-hand political combat” between economic reformers and the “communist old guard” in Russia).

77. See Ana Julia Jatar, *supra* note 53, at 2–3 (discussing how despite nominal programs to encourage economic liberalization, Latin American governments continue to restrict competition through use of price controls, limits on entry, and public ownership of various industries); PETER MURRELL ET AL., THE CULTURE OF POLICYMAKING IN THE TRANSITION FROM SOCIALISM: PRICE POLICY IN MONGOLIA 7 (Univ. of Md. Ctr. for Institutional Reform and the Informal Sector (IRIS), Working Paper No. 32, 1992) (examining how, despite economic liberalization measures, the Mongolian government continued to implement earlier centralization policies, including price controls).

include participation in developing privatization programs,<sup>78</sup> advising legislators on drafting economic reform legislation,<sup>79</sup> and participating in regulatory proceedings conducted by other government institutions (such as public utility regulatory commissions) with authority to determine competition policy in specific economic sectors.

## 2. Preserving the Benefits of Privatization

Foreign assistance programs commonly emphasize the need for transition economies to privatize a wide range of state-owned assets. Privatization programs often raise significant competition policy issues. Without adequate attention to competition concerns, the strategy and methods chosen to alienate assets may simply reincarnate obdurate state-owned monopolies as durable privately held monopolies.<sup>80</sup> A number of commentators have concluded that measures designed to promote competition are a vital predicate to the success of privatization.<sup>81</sup>

As part of a competition policy program, the host country might design the privatization process to transform the state enterprise monopolist into two or more viable successor firms. A competition policy agency—either acting solely in an advocacy capacity within the government or exercising authority to veto certain privatization plans—can promote the achievement of privatization results that increase future prospects for competition.<sup>82</sup>

Competition policy oversight in the post-privatization period also can serve to ensure that the public reaps the benefits of creating private property rights.<sup>83</sup> Where the government dissolves a

78. See *infra* notes 80–84 and accompanying text (reviewing possible contributions of a competition policy program to the privatization process).

79. See Kovacic, *supra* note 68, at 1204–05 (describing possible contributions of a competition agency in reforming the legal structure governing the regulation of natural monopolies).

80. See Stiglitz, *supra* note 3, at 10 (“Turning a state monopoly into a private monopoly . . . is unlikely to help create a more dynamic market economy.”).

81. See Laffont, *supra* note 8, at 253 (“Privatization and formal liberalization are likely to lead to private monopolies, which will generate resources for interest groups apt to resist further development of authentic competition. Efforts to impose these reforms before a credible set of institutions—for regulation, competition policy, financial regulation—has been designed will yield disappointing results.”); Stiglitz, *supra* note 3, at 10 (“[C]ompetition remains thwarted in many of the former socialist economies that pursued privatization first.”).

82. See Vladimir Capelik & Ben Slay, *Antimonopoly Policy and Monopoly Regulation in Russia*, in DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES, *supra* note 52, at 57 (describing the role of Russia’s antimonopoly authority in promoting disaggregation of the construction industry as part of the privatization process).

83. See Black et al., *supra* note 17, at 1800 (“Just as it helps to install controls on self-

monolithic public enterprise into a number of privately-owned successor firms, the successors may seek to use mergers, holding companies, or other institutional arrangements to re-establish the monopoly structure of the public ownership era. Some forms of consolidation or cooperation will increase efficiency by enabling the participants, for example, to realize scale economies or link complementary assets. Competition policy oversight of outright consolidations or cooperation by contract can help ensure that such measures are not mere efforts to create a private variant of the predecessor public monopoly.<sup>84</sup>

### 3. Redressing Private Trade Restraints

Even with extensive efforts to liberalize foreign and domestic trade, transition economies still may remain vulnerable to harmful private trade restraints.<sup>85</sup> Consider four scenarios involving horizontal collusion. Trade liberalization may do little to improve competition in various services and local goods markets.<sup>86</sup> In many developed and developing countries, service sectors feature collusive efforts by incumbent sellers to raise prices by setting fees, allocating sales opportunities, and restricting entry. Although entry into some services might seem relatively easy and capable of destroying cartel discipline,<sup>87</sup> incumbent suppliers nonetheless may succeed in jointly restricting output. This is particularly true where incumbents coordinate their affairs through trade associations or other institutions that the government previously has recognized as legitimate

dealing together with privatization, lest the managers of privatized firms defeat subsequent efforts to install these controls, so too with competition and trade policy, lest the private owners defeat efforts to reduce their monopoly rents.”).

84. See Rausser, *supra* note 16, at 329–30 (describing the rationale for antitrust oversight of holding companies that may take shape in the wake of privatization measures).

85. For an extensive overview of possibilities for harmful private trade restraints in developing nations, see PATRICK REY, *COMPETITION POLICY AND DEVELOPMENT* (1997) (on file with author).

86. See Jatar, *supra* note 52, at 259 (reporting on experience with competition systems in transition economies and finding that “many competition agencies have found it useful to give high priority to nontradable sectors and quasi-nontradable products such as perishables and those with low price-volume ratios (paints, beverages), since potential foreign competition will have little or no impact on local firm behavior”); Anne O. Krueger, *Institutions for the New Private Sector*, in *THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE*, *supra* note 1, at 219, 223 (stating that “preventing anti-competitive practices among domestic producers of nontradable goods” poses “major challenges” to “the governments of Eastern European countries”); Willig, *supra* note 67, at 190–91 (describing limited capacity of free trade to stimulate competition in local goods and services markets).

87. Godek points to ease of entry as a reason for emerging markets to forego establishing statutory prohibitions on cartels. Godek, *One U.S. Export*, *supra* note 62, at 21.

fora for orchestrating sectoral activity.<sup>88</sup> A statutory prohibition on cartels could include a clear statement forbidding output restrictions through trade associations or similar instrumentalities and withholding immunity where the government previously has acquiesced in the private ordering of output.

A second rationale for anti-cartel enforcement is to prevent the continuation of patterns of inter-firm relationships that flourished during the period of planning. Central planning, with its regime of production quotas and price controls, ingrained in the managers of individual firms an ethic of cooperation that may persist even when an emerging market has formally liberalized the economy.<sup>89</sup> Even when a government enacts laws that allow enterprises to set their own production levels and choose their own prices, the cooperation ethic will not disappear instantaneously. Business operators might continue privately to abide by conduct norms that the state once mandated.<sup>90</sup> An anticollusion measure in a competition law could serve a useful purpose by making clear that the government will not tolerate private efforts to recreate collective planning techniques that the country has abandoned.

The third scenario concerns public procurement. Public purchasing authorities are common targets for collusive schemes throughout the world.<sup>91</sup> Collusive tendering poses especially grave dangers in transition economies where public purchasing accounts for a substantial part of national economic activity and public projects, such as transportation infrastructure development, are vital to economic growth. An anti-cartel measure in a competition law could

88. See Kovacic, *supra* note 68, at 1206 (discussing the use of trade associations to set prices and control bidding for construction projects in Zimbabwe).

89. See Paul L. Joskow et al., *Competition Policy in Russia During and After Privatization*, in *BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS* 301, 306–24 (Martin N. Baily et al. eds., 1994) (reviewing the extent and methods of state oversight of business units in Russia during the Soviet era).

90. See Karen Turner Dunn et al., *The Meat Processing Sector in Mongolia*, in *DEMONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES*, *supra* note 52, at 107, 110 (finding that despite economic liberalization measures, Mongolian meat producers continued to use private agreements to determine what prices they would bid for livestock and to delineate territories in which their meat would be sold).

91. See ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, *COMPETITION POLICY AND PROCUREMENT MARKETS* 7 (1999) (on file with author) (“There is general agreement, though it is not unanimous, that certain characteristics of public buyers render them to become more likely to be the victims of collusion.”); Kara L. Haberbush, Note, *Limiting the Government’s Exposure to Bid-Rigging Schemes: A Critical Look at the Sealed Bidding Regime*, 30 *PUB. CONT. L.J.* 97, 98 (2000) (“[C]ertain aspects of the government procurement process may be particularly vulnerable to antitrust abuses, especially bid-rigging.”).

provide a valuable tool for punishing and deterring efforts to rig public tenders.

The fourth possible setting for anti-cartel enforcement involves international collusive schemes. In recent years, the exposure of international price-fixing cartels involving food additives and vitamins has demonstrated the ability of multinational enterprises to carry out global schemes to allocate territories and curb production.<sup>92</sup> It is likely that the cartels in question have raised prices to consumers and industrial purchasers in transition economies. An anti-cartel mechanism would enable the transition economy to seek redress for injuries imposed by international cartels and to cooperate with foreign competition authorities in prosecuting cross-border collusive arrangements.<sup>93</sup>

The emphasis upon collusion enforcement scenarios above reflects a general view among those who favor antitrust intervention as an element of transition economy competition policy that “clear and tough” rules against hard-core horizontal restraints supply the appropriate core of law enforcement.<sup>94</sup> Anti-cartel enforcement, however, does not necessarily exhaust the range of desirable applications of antitrust enforcement in the transition process. Scrutiny of exclusionary behavior by dominant incumbent firms may

92. The prosecution of the international food additives and vitamins cartels is discussed in Harry First, *The Vitamins Case: Cartel Prosecutions and the Coming of International Competition Law*, 68 ANTITRUST L.J. 711 (2001).

93. Laffont describes the threat that international producer cartels pose to economic growth in transition economies:

In developing countries lacking technical, management, and government expertise, it may be that only foreign investment can help development, because it brings new technologies and the credibility needed to borrow on international capital markets. Such investments should be welcomed if they help build local capacity. But when international cartels engage in anticompetitive practices, foreign investment can undermine economic development in developing countries. For this reason it is clearly desirable to make progress in global competition policy to discipline international cartels.

Laffont, *supra* note 8, at 245–46 (citation omitted). The establishment of a competition policy authority could provide the transition economy government with a necessary platform for cooperating with foreign competition agencies in policing international cartels.

94. See Willig, *supra* note 67, at 195; see also Jatar, *supra* note 52, at 259 (competition rules in transition economies “must be simple and straightforward” and “should prohibit horizontal agreements among competitors, including price cartels”). *But see* Singleton, *supra* note 67, at 6–8 (discouraging reliance on per se rules to address horizontal restraints in transition economies and suggesting that antitrust statutes simply deny enforcement of “naked price fixing provisions” due to doubtful persistence and adverse consequences of such arrangements and “limited judicial and bureaucratic abilities that characterize most developing countries”; proposing that transition economy statutes instead emphasize control of dominant firm exclusionary behavior by giving the competition agency broad power to challenge a wide array of entry-deterring conduct).

be necessary where, for example, the state previously has created or permitted monopolies to control the distribution of goods. The operation of a distribution monopoly will retard expansion of trade within the country and diminish the capacity of imported goods to press domestic producers to improve performance.<sup>95</sup>

#### 4. Deterring Corruption

The corruption of government officials is a serious problem in many transition economies, especially in nations that have relied heavily on central economic planning.<sup>96</sup> In transition economies, government bodies have tremendous power to affect the competitive process when they issue licenses, permits, franchises, and subsidies. For poorly paid and weakly monitored civil servants, the authority to dispense entitlements and privileges creates countless opportunities to solicit bribes.<sup>97</sup> Where traditional safeguards to ensure transparency and integrity in public administration are feeble, individual business operators may enjoy great success in bribing public officials to obtain special benefits or deny privileges to their opponents.

A competition policy system could help undermine corrupt agreements between government officials and business managers.<sup>98</sup> A number of transition economy competition laws directly limit the ability of government agencies to diminish competition.<sup>99</sup> Some measures forbid government bodies to restrict entry by, for example,

95. See Black et al., *supra* note 17, at 1764 (discussing impediments to successful privatization in the former Soviet Union and observing that “poor transportation and state-owned local distribution monopolies often limited import and interregional competition”); Jatar, *supra* note 52, at 259 (“In Latin America the enforcement of competition since liberalization has been instrumental in lowering entry barriers to foreign competition, particularly where dominant local firms have used vertical mechanisms to control distribution channels.”).

96. See Rick Stapenhurst & Shahrzad Sedigh, *Introduction: An Overview of the Costs of Corruption and Strategies to Deal with It*, in *CURBING CORRUPTION* 1 (Rick Stapenhurst & Sahr J. Kpundeh eds., 1999) (describing the pervasiveness of corruption in many transition economies); Samantha Marshall, *Vietnam Puts a Price Tag on Corruption*, *ASIAN WALL ST. J.*, May 27, 1999, at 1 (describing the results of a Vietnamese government study that documents massive corruption by public officials).

97. See Daniel Kaufmann, *Economic Reforms: Necessary but Not Sufficient to Curb Corruption?*, in *CURBING CORRUPTION*, *supra* note 96, at 89, 94–95 (describing regulatory and entitlement-related functions that create opportunities for corruption in transition environments).

98. See Kovacic, *supra* note 4, at 442 (discussing the use of a competition policy system as an anticorruption device).

99. See Roger Alan Boner & William E. Kovacic, *Antitrust Policy in Ukraine*, 31 *GEO. WASH. J. INT'L L. & ECON.* 1, 23–25 (1997) (discussing limits in Ukraine’s antitrust system upon anticompetitive government intervention).



imposing licensing requirements, unless the national legislation expressly grants such authority. Other provisions bar public officials from granting exclusive franchise rights or otherwise discriminating improperly against entrepreneurs that seek access to the market.

Enforcement of these and similar measures can complicate the formation and execution of corrupt agreements between public officials and private individuals. The competition policy mechanism essentially prevents the public official (the seller) from fulfilling her promise to the payer of the bribe (the buyer) to provide an illicit economic privilege. The competition law does not directly sanction the payer or recipient of the bribe by subjecting them to civil or criminal punishment. Rather, it diminishes the gains from improper bargains by impeding the execution of the promises that form the core of any single corrupt agreement and diminishes the maintenance of stable buyer-seller relationships that characterize corruption in many settings.<sup>100</sup> By raising the costs of conceiving and executing corrupt arrangements, the competition policy system can help prevent their creation.

### C. *Facilitating the Transition from Planning to Markets*

Extensive, long-lived reliance on central planning can create a pervasive suspicion of capitalism. Comprehensive planning limits the exposure of citizens to market mechanisms, and government policies continually reinforce the notion that the state is the sole appropriate conservator and manager of the nation's economic resources. In many countries, efforts to decentralize the economy take place in a political and social context that is wary of markets and fearful that the state's retreat from its traditional role as producer and protector will endanger consumer interests.

In such environments, it may be unrealistic to expect that the government will commit itself to economic liberalization without establishing a mechanism to address market failures.<sup>101</sup> Without the creation of a competition policy system (and other measures such as a

100. See Susan Rose-Ackerman, *Corruption and the Global Economy*, in CORRUPTION AND INTEGRITY IMPROVEMENT INITIATIVES IN DEVELOPING COUNTRIES 25, 25 (1998) (analyzing patterns in corruption and noting how “[c]orrupt buyers and sellers frequently develop systems that are mutually reinforcing and persist over time”).

101. See William E. Kovacic & Robert S. Thorpe, *Antitrust and the Evolution of a Market Economy in Mongolia*, in DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES, *supra* note 52, at 89, 92 (describing the role of an antitrust system in facilitating the political transition to a market system).

consumer protection regime and environmental protection mechanisms), a nation may choose not to undertake measures such as decontrolling prices or privatizing state-owned enterprises. Viewed in this light, a competition policy system can facilitate the transition from planning to markets by demonstrating the government's commitment to address serious market failures. The competition policy system becomes an outward symbol of a basic change in the government's role from planner and producer to referee.

*D. Synthesis: The Link between Competition Policy and Capability*

Discussions about competition policy in emerging markets sometimes suggest that the policy choice confronting transition governments and their foreign advisors is between establishing no competition statute or competition policy bureau on the one hand, or immediately adopting a competition law with the full array of provisions found in wealthy market economies. Posing the question this way ignores a host of intermediate options that might be desirable for a number of countries. The "do nothing" and "do everything" solutions are neither the exclusive competition policy options nor, in most countries, are they sensible formulas.

1. Phasing Reforms

The all-or-nothing solution set obscures important intermediate possibilities. One alternative is to vary the initial design of a competition policy system according to the host country's existing capabilities and resources and the strength of commitments by foreign advisors to provide implementation assistance.<sup>102</sup> A country with weak initial capabilities and uncertain assurances of foreign assistance sensibly might choose to begin with a more austere

102. In the context of discussing possible strategies for pollution control in transition environments, Laffont addresses the importance of accounting for institutional capabilities in designing policy commands:

[W]hat if the agency in charge of the environment is nonexistent, poorly staffed, or captured by the industry, or if the pollution is diffuse and cannot be measured at the individual level? A barrier to entry, such as a license to operate, may then be the only way to limit production and therefore pollution, at least if this policy can be implemented and is not a pretext for rent seeking. The right policy answer should take into consideration many aspects of the problem that are not easily measured or even modeled. Thus it is not surprising that the right answers may differ by industry or country, particularly between industrial and developing countries.

Laffont, *supra* note 8, at 238-39; see also William E. Kovacic, *Capitalism, Socialism, and Competition Policy in Vietnam*, ANTI-TRUST, Summer 1999, at 59, 61 (arguing for the use of strategies that gradually phase in competition policy as implementation capacity increases).

competition policy system that emphasized advocacy and education and forbade a narrow range of behavior, such as hard-core horizontal restraints. As capabilities and implementation resources increase, the host country could augment its law. An alternative is to enact a relatively elaborate law but expressly phase in the implementation of certain operative provisions over time as the country's capabilities grow. There are many examples from the history of competition law in transition economies and mature market systems to rebut the notion that a nation gets a single chance to formulate a competition law and therefore must pack every conceivable power or responsibility into the original statute.<sup>103</sup>

It would also be reasonable to begin with a more ambitious competition policy system—with fuller advocacy and law enforcement powers—in emerging markets with strong institutional foundations and substantial resource commitments from foreign advisors. Countries with greater capabilities and resources stand a stronger chance of making good use of an ambitious competition policy system than countries with weak institutions and few resources. There is a great difference between Jamaica, which appears to have received \$9 million in the early 1990s from the US Agency for International Development to create its competition mechanism,<sup>104</sup> and many other transition economies that will be fortunate to receive even a tenth of that amount from foreign sources to build their own systems. The point to keep in mind is that a decision to move from a more austere competition policy system to a more complex design should be justified by showing that there are measures in place to ensure effective implementation.

Two examples from other areas of law reform suggest how the design of a reform strategy and the emphasis of different reform elements might vary from country to country, depending upon one's evaluation of initial conditions. The first example involves privatization in Russia in the 1990s. Privatization reformers had to decide the relative importance to be given to privatizing small firms and large firms, respectively, and to building the institutional framework for ensuring sound corporate governance.<sup>105</sup> The strategy actually

103. Examples in mature antitrust systems include Australia, Canada, and the United States. Transition economy examples include Brazil, South Africa, and South Korea.

104. See Geraldine Foster, *Antitrust in Transition Economies*, in 2000 FORDHAM CORP. L. INST. 563, 564 (B. Hawk ed.) (containing remarks made at the Fordham Corporate Law Institute on International Antitrust Law & Policy in New York City on October 14–15, 1999).

105. Black et al., *supra* note 17, at 1797–1800.

chosen gave primary emphasis to rapidly privatizing small and large firms and to making the establishment of the legal framework, in effect, a secondary priority. A more effective approach might have involved rapidly privatizing small enterprises, undertaking a slower “staged privatization” of large firms, reallocating some of the efforts actually devoted to large firm privatization into creating the supporting institutional infrastructure, and focusing greater attention to establishing a “friendlier business climate,” mainly through reforms in the tax system. Such an approach does not dispute the elements of the reform agenda pursued by the “big bang” privatization advocates, but it suggests changes in the relative emphasis given to specific elements.<sup>106</sup>

The second example involves the choice of policies for reforming infrastructure sectors such as energy and telecommunications in transition economies. As described by Paul Joskow, one reform model is a “‘big bang’ approach” in which “privatization, restructuring, and the introduction of competition occur at the same time.”<sup>107</sup> The alternative “gradualism” approach “is to provide for a relatively long transition period, during which the industrial organization and associated regulatory institutions are allowed to evolve according to a planned transition program.”<sup>108</sup> Joskow concludes that the suitability of either approach—big bang or gradualism—depends on six factors:

[T]he performance of the existing system, the complexity of implementing a big bang approach given pricing and other imperfections that cannot be fixed instantly, the capacity of legal and political institutions to support competitive markets for infrastructure services, the speed with which reasonably competitive markets can evolve, the time required to create effective regulatory institutions, and the government’s ability to credibly commit to a restructuring framework that supports private investment and competitive entry.<sup>109</sup>

Among other considerations, Joskow’s factors directly account for the quality of institutions whose efficacy will determine the impact of the infrastructure privatization and deregulation program. Differences in such conditions across countries would dictate different strategies in the continuum of approaches between an immediate big bang and protracted gradualism. Joskow concludes that infrastructure “regulatory agencies may do best by starting with simple regulatory

106. *Id.* at 1778 (describing the content of introducing privatization in stages).

107. Joskow, *supra* note 17, at 198.

108. *Id.*

109. *Id.*

rules and procedures and refining them as they gain information and experience.”<sup>110</sup>

The framework for analyzing the timing and content of privatization and infrastructure reforms can be applied to competition policy as well. The correct dosage of individual competition policy reform elements would depend on a country’s initial conditions and the need for donors and the host country to make choices in how to use scarce technical assistance resources. There is no particular reason to think that the competition policy reform strategy for each nation would be identical in its content or the timing of its implementation.

## 2. Shared Tasks

A second basis for variation is to consider possibilities for multinational regional cooperation in building competition policy institutions. Consider the case of neighboring states whose institutions are weak and whose prospects for obtaining substantial foreign assistance for implementing new measures are poor. Rather than individually attempting to construct elaborate competition policy institutions, such countries might seek to develop regional alliances through which members delegate certain functions (such as the adjudication of disputes) to a common instrumentality.<sup>111</sup>

## IV. COMMON INITIAL CONDITIONS AND THEIR IMPLICATION FOR LAW DESIGN AND IMPLEMENTATION

A common theme in the foregoing analysis of competition system design possibilities is the centrality of initial conditions and implementation. To be effective, competition policy law reform strategies require careful pre-reform analysis of existing conditions in the host country and rigorous attention to how the host country will implement nominal competition policy commands. Accounting properly for these concerns is a vital ingredient of effective reforms.

Transition economy antitrust agencies confront implementation challenges that are largely alien to their Western counterparts. Decisions about the appropriate design of antitrust systems in emerging economies must acknowledge the distinctive features of the

110. *Id.* at 220.

111. *See* Kovacic, *supra* note 6, at 42–43 (describing possibilities for regional cooperation in the “Caribbean Community”).

transition environment. Western antitrust systems benefit from a number of favorable circumstances, including access to substantial financial resources, wide availability of expertise in antitrust economics and law, broad acceptance of administrative safeguards to restrict the discretion of public decision makers, and reliance on well-established market processes. These conditions rarely characterize the transition economy experience. Approaches that have proven effective in Western countries are hardly assured of success when transplanted into a transition economy setting.

*A. Durability of Public Policies That Impede Competition*

Despite adoption of various economic liberalization measures, many transition economies continue to feature substantial resistance to market-oriented reforms inside and outside the government. Such resistance often is manifest in the maintenance of substantial government-imposed barriers to entry and exit. In many instances, competition-suppressing policies persist at all levels of government despite nominal measures by the national legislature to encourage private entrepreneurship and new business development.<sup>112</sup>

1. Barriers to Imports and Foreign Investment

A number of transition economies maintain significant barriers to participation by foreign companies in their domestic market. In some cases, obstacles to trade take the form of substantial tariffs and quotas. Countries that formally have reduced tariffs and quotas sometimes replace these measures with nontariff trade barriers that eliminate or severely curb competition from imports.<sup>113</sup> National regulatory regimes also place cumbersome limits on the ability of foreign firms to enter the market directly by constructing new facilities or investing in existing domestic enterprises.

112. See Irina Starodubrovskaya, *The Nature of Monopoly and Barriers to Entry in Russia*, 6 COMMUNIST ECON. & ECON. TRANSFORMATION 3, 13 (1994) (discussing techniques used by local government authorities in Russia to control commercial activity and limit competition despite efforts by the national government to promote economic liberalization).

113. See Andras Nagy, *Institutions and the Transition to a Market Economy*, in THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE, *supra* note 1, at 301, 305 (“It is luckily difficult for the new [transition economy] governments formally to resist formal trade liberalization, but—under the influence of the big lobbies behind them—they learn quickly how to build non-tariff barriers.”).

## 2. Restrictions on New Business Development

Transition economy governments maintain a variety of barriers to entry and exit. Some transition economies impede entry by imposing significant burdens on firms seeking to incorporate or otherwise register to do business. In Vietnam, firms seeking to register must satisfy formidable initial capital requirements and must present a business plan that is subject to review and approval by government officials.<sup>114</sup> In reviewing business plans, government overseers often take account of whether there is “sufficient capacity” in the business sector into which the business operator wants to enter. This screen is a frequently used tool to deny approvals to private firms whose operations might threaten sales of incumbent state-owned enterprises.

## 3. Complex and Arbitrary Taxation Systems

A second common impediment to entry and expansion by private firms is the tax system. Tax codes in many transition economies discourage legitimate private sector development. One pathology is to set rates at extraordinarily high levels and closely monitor the bank accounts of business operators to determine whether taxable cash balances are available for confiscation. The use of high marginal tax rates and the monitoring of bank account or balance sheet surpluses as taxation points create a host of perverse incentives for small and large enterprises alike. Many entrepreneurs choose to forego ordinary registration requirements and operate outside the bounds of the law as “informal” enterprises, denying the state any tax revenues from their operations and precluding the informal firms from availing themselves of mechanisms, such as judicial enforcement of contracts, that properly registered enterprises can use to undertake substantial investments and reduce operating costs. Companies may refuse to pay workers or suppliers to avoid giving tax authorities the impression that they have funds available to pay additional taxes.<sup>115</sup> Other

114. See NGUYEN DINH CUNG, SOME REMARKS OF THE MARKET STATE IN VIETNAM (1997) (on file with author) (describing how business formation and registration formalities curb competition by raising barriers to entry by new firms).

115. One study describes how the tax system induces company managers in Russia to hide income and engage in barter transactions. Black et al., *supra* note 17, at 1757–60. In evaluating the causes of failure for the Russian privatization program in the 1990s, the study concludes that “perhaps the single most important regulatory obstacle to earning an honest profit is the Russian tax system.” Tax rules all but compelled managers to hide profits from tax inspectors and shareholders alike. *Id.* at 1758.

enterprises refuse to deposit significant amounts of cash in banks. Instead they take costly precautions to keep cash in private safes or increase reliance on barter transactions.<sup>116</sup> The fear of revealing liquidity also induces companies to publish untruthful financial statements, thus impeding efforts by investors to make well-informed judgments about the firm's condition.<sup>117</sup>

Transition economy tax codes also tend to be extremely complex and subject to continuous, selective adjustment. One form of ad hoc adjustment consists of conceiving special assessments, sometimes applied retroactively, to business operators who appear to be profitable. The details of the codes seldom are widely available to affected business operators, and many operational provisions are promulgated in the form of regulations or interpretations held exclusively within the offices of the taxation authority. Governments frequently delegate enforcement of these measures to public officials, who use their expansive enforcement discretion to "discover" violations and gather bribes under the guise of "settling" tax claims. Taxpayers rarely have recourse to an appeals mechanism, much less a system of review that affords swift, impartial analysis of tax claims.

#### 4. Price Controls

The abandonment of price controls is a common element of economic liberalization in the transition environment. Multinational financial institutions such as the International Monetary Fund and the World Bank often insist on price decontrol as a condition for providing loans or other forms of assistance. Researchers have documented a number of instances where price control regimes persist despite a government's formal adoption of decontrol measures. Reforms undertaken at the national level lack significance when individual national ministries, regional government bodies, or local public officials establish surrogate mechanisms whose operation is more difficult for external institutions to monitor.<sup>118</sup>

116. See Clifford G. Gaddy & Barry W. Ickes, *Russia's Virtual Economy*, 77 FOREIGN AFF. 53 (1998) (describing an increased reliance in Russia on cashless barter transactions because maintenance of cash in bank accounts attracts the attention of tax authorities).

117. See Black et al., *supra* note 17, at 1758 ("Companies that can't report income honestly to the tax inspectors also can't report honestly to investors. Investors therefore can't use a company's financial statements to check on management honesty and skill.").

118. See MURRELL ET AL., *supra* note 77, at 7 (discussing how local governments in Mongolia regulated prices despite the national government's abandonment of price controls).



## 5. Restrictive Labor Laws

A number of transition economies have labor laws that severely restrict the ability of an employer to adjust the size of its workforce.<sup>119</sup> One common form of control is to forbid layoffs or make termination decisions very costly. By limiting the firm's flexibility to reduce employment when demand for its products sags, the labor regime can discourage companies from expanding capacity. The adoption of more flexible retention and termination policies could encourage new business development.

### *B. Fragile Political Foundations*

New competition authorities often begin with weak political foundations. In some countries, the new agencies represent institutional innovations, such as the creation of an independent regulatory body in a country that has no history of such agencies. In other nations, the new competition authority has been given a familiar, widely accepted institutional form. Even if the agency is created within an existing ministry or established as a new entity similar in form to other government bodies, it usually will begin operating without the political ties and power base that its adversaries inside and outside the government will enjoy. New competition bodies continually must ask whether the exercise of nominally significant powers will arouse debilitating political opposition.

### *C. Weak Indigenous Competition Policy Expertise*

Most transition economies begin implementing new competition policy systems and other types of market-oriented legal reforms with relatively little indigenous expertise in competition law or industrial organization economics.<sup>120</sup> This condition is one dimension of a general deficiency that afflicts economic law reform programs in transition economies. In examining reform efforts in former command economies, Michael Trebilcock points to "the critical

119. See Black et al., *supra* note 17, at 1761–62 (describing restricting labor laws in Russia).

120. See James Langenfeld & Dennis A. Yao, *Competition Policy and Privatization: An Organizational Perspective*, in GOVERNMENTS AND MARKETS 195, 205–07 (Hendrikus J. Blommestein & Bernard Steunenberg eds., 1994) (discussing human resource problems confronting new antitrust agencies); William E. Kovacic, *The Competition Policy Entrepreneur and Law Reform in Formerly Communist and Socialist Countries*, 11 AM. U. INT'L L. REV. 437, 452–60 (1996) (discussing the limited pool of transition economy individuals who are expert in antitrust economics or law).

shortage of what might be called ‘the human capital of capitalism’—legal, managerial, economic, accounting, statistical, and so on—required to effectuate and operate a market economy and, from a public sector perspective, to regulate or otherwise address its dysfunctions or limitations effectively.”<sup>121</sup> Laffont warns that human capital “shortcomings are usually underestimated, despite their dramatic implications for many areas of public policy.”<sup>122</sup>

In the short term, antitrust agencies and other government agents of market reform must rely heavily on a handful of individuals who either have studied or worked in Western universities, or have participated extensively in training programs through which foreign experts provide instruction in the fundamental economic and legal underpinnings on competition policy. Over time, the pool of indigenous experts may expand as university programs in business, economics, law, and public administration reformulate their curricula to teach courses relevant to developing a market economy. Transition economy agencies often find that professionals who have become expert in antitrust economics or law become extremely attractive to private sector employers. Rapid turnover in personnel is common.

#### D. Dysfunctional Courts

In many transition economies, the courts are ill suited to adjudicate antitrust disputes, either as tribunals of the first instance or as appellate overseers of administrative competition policy bureaus. Few judges have even a rudimentary understanding of market processes, let alone comprehension of the basic rationale for and elements of an antitrust system. Corruption and delay deeply infect many transition economy court systems, denying the judiciary legitimacy as a forum for resolving business disputes.<sup>123</sup>

121. Michael J. Trebilcock, *What Makes Poor Countries Poor?: The Role of Institutional Capital in Economic Development*, in *THE LAW AND ECONOMICS OF DEVELOPMENT* 15, 50 (Edgardo Buscaglia et al. eds., 1997).

122. Laffont, *supra* note 8, at 242.

123. See Edgardo Buscaglia, *Corruption and Judicial Reform in Latin America*, 17 *POL’Y STUD. J.* 273 (1996); Sergio Garcia-Rodriguez, *Mexico’s New Institutional Framework for Antitrust Enforcement*, 44 *DEPAUL L. REV.* 1149, 1177 (1995) (stating that Mexico’s “judicial system is perceived by many as plagued with considerable delays, institutional corruption and a lack of independence”). One recent study describes how weaknesses in the Russian judicial system prevent effective enforcement of laws designed to ensure honest corporate governance:

[A] shareholder who sues a major company will usually lose at trial and first-level appeal, because of home-court bias, judicial corruption, or both. A shareholder with a strong case has a decent chance of getting an honest decision on further appeal, but

### *E. Frail Transparency Safeguards and Vulnerability to Corruption*

Few transition economies have adopted mechanisms for ensuring transparency in operations of government ministries, including competition authorities. Most countries lack basic controls on bureaucratic discretion, such as requirements that policy adjustments be promptly and widely publicized (or subject to comment and debate before their enactment). Procedures for ensuring the confidentiality of business records or preserving the integrity of settlements of disputes are uncommon. Effective mechanisms for obtaining expeditious review of agency decisions are rare. The lack of transparency creates frequent opportunities for corruption and deprives the legal system of the clarity needed to provide meaningful guidance for business operators.<sup>124</sup>

A number of transition economies recognize that developing new competition agencies presents an opportunity to establish models for improving public administration. In transition economies such as Mexico and Ukraine, for example, the new competition agencies present possibilities for significant improvements over existing administrative structures. Means to this end include the promulgation of rules that insulate competition authorities from political interference, compel disclosure of the content of and rationale for agency decisions, and permit affected parties to challenge deviations from procedural requirements.

### *F. Resource Shortages*

Most transition economy competition agencies labor under oppressive resource shortages. Civil servants often are paid minuscule wages, making it difficult for the competition agency to retain capable professional staff and creating temptations for employees to accept bribes in return for relaxing nominal regulatory

that will take years. And judgments must be enforced (or, often, not enforced) by the same biased or corrupt lower court where the case began.

Black et al., *supra* note 17, at 1755.

124. See Clague et al., *supra* note 16, at 80 (“Fair and transparent procedures for property, contracts, and government regulation of business facilitate the entry of low- and middle-income people into many areas of economic life. They also promote the accumulation of physical and human capital, which raises wages.”); Garcia-Rodriguez, *supra* note 123, at 1178 (“In the not-too-distant past, Mexican administrative entities enjoyed unbridled discretionary power selectively to enforce legal requirements against individuals or firms. The bureaucratic structure for administrative enforcement in Mexico was tailor-made for the extension of political favors and other forms of corruption.”).

requirements. Many agencies struggle with little success to obtain minimally adequate quarters, office equipment, and reference materials.

### G. *Data Shortcomings*

Transition economy antitrust agencies typically must operate with limited access to data that offers an accurate view of existing market conditions and the competitive significance of individual firms.<sup>125</sup> Competition authorities often rely on official government statistical records that use classification schemes that correspond poorly with the economic concept of an antitrust relevant market.<sup>126</sup> Government data sets also may fail to reflect important categories of activity, such as imports, or the contributions of important groups of market participants, such as operators in the informal sector who do not formally register as business enterprises.<sup>127</sup> Calculating market shares without accurate data on the identity of market participants and the size of their activities is treacherous.

Gaining direct access to company records may be difficult or fruitless, at least for some period of time. Especially in the early period of a new competition agency's operations, business managers may resist requests for records until the country's courts have validated the agency's authority to obtain data and demonstrated their willingness to enforce compulsory process. Where public law enforcement institutions are weak, business managers may threaten government antitrust officials with violence if such officials insist on collecting company documents or interviewing employees. Even where competition authorities obtain company records, such data may provide an uninformative view of the firm's significance. Many firms in formerly planned economies maintain data that reveals little about the true economic value of their assets, the size of their sales, or their profitability.

125. See Ben Slay, *From Monopoly Socialism to Market Capitalism*, in DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES, *supra* note 52, at 1, 8–9 (describing methodological difficulties in defining markets and measuring concentration in transition economies).

126. See Adam Torok, *Competition Policy and De-monopolization in Hungary After 1990*, in DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES, *supra* note 52, at 24, 31 (discussing problems with official government statistical records in Hungary).

127. Georges Korsun and I traveled to Benin in March 1998 to perform research on competition policy under a project sponsored by the US Agency for International Development. In interviews with participants in the trucking industry, we discovered that roughly 80 percent of all trucking industry operators in Benin are "informals."

Official records and internal company data also may fail to give a clear view of ownership patterns. Privatization and economic liberalization blur the boundaries of individual firms and complicate the analysis of inter-firm relations as existing companies are bought and sold, as firms form joint ventures, and as new enterprises are created. In some countries, government and company records may not account for inter-firm connections that take shape through family relationships or personal friendships. Such relationships have great economic significance in some settings, as they serve to unify the operation of seemingly independent economic entities.<sup>128</sup>

#### H. Implications

The design of a competition policy system must account for initial conditions that will determine the effects of enforcement. A thoughtful assessment of initial conditions not only will influence decisions about the content of the statute but also will force foreign advisors to identify weaknesses in supporting institutions and offer plans to enhance their capability. It should be clear to donors that the real measure of a law reform initiative is not simply the quality of the original statutes but the strength of programs to build the institutional capacity to apply them effectively.<sup>129</sup>

The interplay between initial conditions and institutional design is evident in two illustrations. The first concerns the decision about whether to create private rights of action to enforce a competition law. In principle, decentralizing enforcement authority to private citizens can act as a valuable safeguard against default—for reasons of inadequate resources, sloth, or corruption—by a public prosecutor. In practice, the value of a private right of action depends crucially on the quality of the tribunal that will adjudicate cases initiated by private parties. In a country with dysfunctional courts, it makes little sense to create a private right of action and do nothing more than channel lawsuits through the existing judicial process.<sup>130</sup> A decision to create a private right of action requires an immediate commitment of

128. See Jatar, *supra* note 53, at 19–20 (describing the significance for competition policy of family relationships in Latin America).

129. See Laffont, *supra* note 8, at 253 (“Because competition is not an automatic outcome of deregulation, simply conditioning loans on the existence of competition laws will not ensure the creation of proper institutions for effective competition. Only a strong state can implement competition.”).

130. See Coate et al., *supra* note 52, at 53 (“Unless a well-developed and experienced court system exists, [private] civil suits would not be advisable.”).

resources to rehabilitate existing tribunals or create new judicial bodies to hear the cases that private entities invoking the competition law are likely to file. The second illustration involves merger control. One element of establishing a merger control regime is to determine the thresholds of activity that will trigger the obligation of merging firms to report their transactions to the competition authority.<sup>131</sup> The wisdom of a specific threshold for any single competition agency depends heavily on the agency's resources. Merger analysis has proven to be the most resource-intensive activity for new competition agencies. Agencies that set reporting thresholds too low will find themselves swamped with reviewable transactions, including a substantial number of mergers with no conceivable competitive significance. Establishing comparatively high thresholds may be the only means that impoverished agencies can use to focus scarce resources on matters of the highest importance.

## V. IMPLICATIONS FOR TECHNICAL ASSISTANCE

A careful assessment of the predicates for successful competition law reforms and of the initial conditions in transition economies has basic implications for how countries with older antitrust systems provide technical assistance. Perhaps the most fundamental lesson is that the successful development of competition policy institutions in transition environments will require extensive, sustained contributions from foreign governments in the form of human and physical capital. It is irresponsible for Western governments and multinational donors to promote the establishment of antitrust laws or the adoption of other economic law reforms without providing extensive assistance in preparing and implementing the new legal mechanisms.<sup>132</sup>

### A. *Building Foundations for Creating New Competition Systems*

The possibilities for success in preparing new legislation or designing new institutions are likely to increase if such initiatives are

131. See Boner & Kovacic, *supra* note 99, at 37–40 (discussing the importance of defining reporting requirements in the context of Ukraine's antimonopoly law); Kovacic, *supra* note 12, at 1097–99 (describing the selection of reporting thresholds).

132. See Laffont, *supra* note 8, at 250 (discussing economic liberalization and financial services reform and observing that “the most effective aid is aid that helps to design those regulatory institutions”; concluding that “it is irresponsible to advocate liberalization without providing such aid”).

informed by careful study of the host country's existing conditions. This involves analyzing the economic, legal, political, and social context in which reforms will take place. An accurate diagnosis of initial conditions requires collaboration by foreign advisors with host country specialists.

A thoughtful pre-reform analysis serves four major purposes. The first is to guide the assessment of how to draft the original competition policy statute. The pre-reform assessment will help identify the types of public and private competitive restraints that warrant attention and indicate what types of institutions the competition law should create or augment. No sensible system of law reform would try to draft legal commands or design institutions without such an evaluation of initial conditions.

The second purpose is to formulate possible priorities and competition policy strategies for the new competition policy institution. The initial assessment can assist in diagnosing the obstacles to effective competition and proposing their cures. Case studies of specific industry sectors might reveal that the chief impediment to new business development is a government policy that would be an appropriate target for advocacy efforts (or direct prohibition in the competition statute). Industry analysis also might reveal common practices—such as the tendency of various trade associations to adopt bylaws that set fee levels or control bidding—which the competition agency might challenge.

The third objective is to identify implementation needs and formulate a plan for building the competition agency and enhancing the capability of institutions—such as courts and universities—on which the agency will depend to function effectively.

The fourth reason to perform an extensive pre-reform assessment is to identify existing institutions that the competition authority can draw upon or adapt to execute its responsibilities.<sup>133</sup> For example, an existing social network might provide a conduit for communicating information about the operation of the new competition policy regime and performing educational programs. Indigenous organizations might play a role in detecting deviations from competition policy norms or assist in resolving community-level disputes.

133. See Melinda Smale & Vernon Ruttan, *Social Capital and Technical Change: The Groupements Naam of Burkina Faso*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 182, 183 (describing how existing indigenous cultural and social endowments can facilitate the development process).

### B. Sustained Assistance During Implementation

The best assistance programs are anchored by the presence of long-term advisors who reside within the country and work directly with the host country's competition policy officials. There is a growing recognition that short-term initiatives, while useful in limited respects, do little to improve conditions for the longer term.<sup>134</sup> Charles Cadwell makes this point in reflecting upon his experiences as one of the principal managers of the University of Maryland's Center for Institutional Reform and the Informal Sector, a major technical assistance provider:

While assistance such as short-term training and study tours are helpful if conducted as part of a longer term interaction, IRIS experience in Russia, Poland, Nepal, Chad, and Mongolia suggests that, absent sustained interaction, one ought to have limited expectations about the effect of such activities. As frustrating as it is for us to host study tours that generate much interest but only a brief exchange without a chance to plumb the details of issues, it is similarly frustrating for local officials and others to host a series of short-term "development tourists."<sup>135</sup>

The cost of supporting such operations is trivial compared to the potential gains in the form of improved institutional capability and sensible policy making.

### C. Regional Cooperation

For many transition economies, regional cooperation can supply a valuable means for developing new implementation capabilities and reducing the cost of building new competition policy institutions. Multinational initiatives such as Mercosur and the Andean Pact provide opportunities for transition economies to cooperate in developing enforcement strategies, to harmonize procedures and substantive standards, and to share best practices.<sup>136</sup> In some instances, regional alliances may permit transition economies to

134. See Robert Picciotto, *Putting Institutional Economics to Work: From Participation to Governance*, in INSTITUTIONS AND ECONOMIC DEVELOPMENT, *supra* note 1, at 343, 363 ("It is no accident that, where development has failed, basic governance and institutions have usually been weak. Enhancement of domestic capacities simply cannot be handled within reasonable time frames without sustained international cooperation and development assistance.").

135. Cadwell, *supra* note 16, at 267.

136. See Jose Tavares de Araujo, Jr. & Luis Tineo, *The Harmonization of Competition Policies Among the Mercosur Countries* (June 1997) (paper presented to the Organization of American States Trade Unit) (on file with author) (discussing possible use of Mercosur competition policy protocol to achieve common competition policy approaches).



reduce the costs of implementation by consolidating certain functions, such as the investigation of region-wide trade restraints or the adjudication of cases, in the regional authority. Multinational bodies whose members include developed and developing economies, such as ASEAN, APEC, and NAFTA, also can provide useful conduits for transferring information and know-how from well-established Western competition systems to newer regimes.<sup>137</sup>

#### *D. Transferring Knowledge and Investing in Human Capital*

In most transition environments, the long-term success of new competition policy institutions will require considerable effort to transfer information and expand the pool of individuals with professional training in market-oriented economics and law.<sup>138</sup> Donors can and must provide some of this training on a short-term basis in the form of seminars for competition agency enforcement officials, judges, academics, and members of the private sector. The more important task is to build a self-sustaining intellectual infrastructure.<sup>139</sup> Constructing the requisite infrastructure will require longer-term investments that may not have an immediate tangible payoff. Such investments include improving university departments of business administration, economics, law, and public administration and providing assistance for promising students to obtain graduate training in Western universities.<sup>140</sup>

#### *E. Continuing Efforts to Evaluate Results*

The successful execution of competition policy programs requires a continuing commitment by donor agencies and host country competition authorities to assess the impact of efforts to design and

137. See Garcia-Rodriguez, *supra* note 123, at 1193–95 (discussing the use of NAFTA to coordinate the antitrust policies of Canada, Mexico, and the United States).

138. See WORLD BANK, *supra* note 13, at 5 (stating that “[foreign assistance] projects need to focus on creating and transmitting knowledge and capacity”).

139. See *id.* at 83 (“Creating knowledge does not mean that donor agencies (or the experts they hire) have chunks of technical or engineering information that they simply transmit to aid recipients”; observing that the knowledge that matters “must be created locally and internalized”).

140. See Black et al., *supra* note 17, at 1801–02 (discussing the possible value to market reforms in Russia of foreign aid investments in building Russian business and law schools and paying for Russian students to study in foreign graduate programs); WORLD BANK, *supra* note 13, at 17, 55 (describing the positive impact of donor funding for future transition economy policy makers’ overseas study).

implement the competition policy system.<sup>141</sup> Continuing assessment of implementation experience is a necessary ingredient of any competition policy program.<sup>142</sup>

### CONCLUSION

The extraordinary pace of creation of competition policy systems in emerging markets raises a series of interrelated issues about law reform. The first issue is whether competition policy deserves a high priority on the agenda of economic reform measures. The answer that commentators give to this question depends on how we define competition policy. There seems to be a universal consensus that transition economies should take affirmative measures to increase business rivalry as a tool for promoting growth. Most observers appear to agree that creating an institution to advocate pro-market solutions, to educate business leaders, public officials, and citizens about the merits of a market system, to perform industrial organization research, and to undertake an antitrust enforcement program against collusion among competitors is appropriate. The sharpest point of disagreement involves the wisdom of establishing the full panoply of antitrust commands found in mature competition policy systems.

In encouraging transition economies to create competition policy systems, Western nations and multinational bodies have tended to slight grave problems that emerging markets will encounter in implementing the new statutes. In most transition countries, there is a significant mismatch between national implementation capabilities and the demands of new competition laws, especially where statutes dictate enforcement of the elaborate commands found in experienced Western antitrust systems.

To decide about the correct measure of completeness and complexity in transition economy competition policy systems, one must confront the mismatch between well-developed conceptions from Western experience about the optimal design of laws and the existing institutional capacity of emerging markets to implement them. As Jean-Jacques Laffont has observed, the potential mismatch between

141. See WORLD BANK, *supra* note 13, at 27 (“[Donor] agencies should be asking themselves continually: Why do we do what we do? And what is the impact?”).

142. See William E. Kovacic, *Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy*, 9 GEO. MASON L. REV. 843 (2001) (making a case for evaluating the outcomes of competition policy programs).

legal commands and institutional capabilities forces one to make a fundamental choice: “Do we take a purely normative view or do we take into account political and administrative constraints?”<sup>143</sup> Many modern law reform programs, including competition policy projects, have tended to begin by creating the conceptually ideal legal regime on the assumption that political and administrative constraints that will influence the application of the law can be resolved later. There is a growing awareness among commentators, including many participants in the foreign assistance process, that issues of institutional capability deserve far greater attention in designing laws and timing their application. The modern literature identifies a number of possibilities for adjusting the sequence of law reforms to ensure that host countries attain the institutional capacity to implement nominal legal commands.

The expanded emphasis on institutional capability has significant implications for technical assistance. Law reform projects are more likely to succeed in promoting economic development when donors satisfy certain conditions. Law drafting and institutional design should build upon careful pre-reform analysis of economic, political, and social conditions conducted by indigenous specialists and foreign advisors. Successful reform measures require close attention to enhancing the capacity of a wide variety of institutions—among them, universities, research institutions, professional societies, and courts—whose effectiveness is vital to the operation of the legal regime. The key to setting the proper institutional foundation and encouraging sensible application of new laws is a durable commitment to provide assistance, anchored by a sustained, in-country presence of foreign advisors.

143. Laffont, *supra* note 8, at 238.