

# COMPETITION POLICY AND ECONOMIC DEVELOPMENT IN EAST ASIA

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## I. INTRODUCTION

East Asia experienced rapid economic growth for several decades before the economic crisis of the late 1990s. In the mid-1990s, a massive amount of capital flowed into East Asia against the backdrop of an enormous increase in transnational capital transactions aided by financial liberalization and innovation. Foreigners invested in East Asia with an expectation that it would continue to register rapid economic growth. Additional investors followed this trend without carefully examining the expected return on their investments. When it became apparent to investors that the Thai baht could not maintain its value, they quickly withdrew their investments, leading to a sharp depreciation in the markets. This dramatic decline marked the beginning of the financial crisis in Thailand in July 1997, which subsequently spread to other countries.

Both external and internal factors played a role in creating the East Asian financial crisis. Externally, the international financial system could not control the overt speculation of foreign investors. Internally, weak financial and corporate governance systems plagued many countries. Domestic firms, especially large firms with significant market power, invested heavily not only in their particular line of business but also in those of other firms. Like foreign investors, domestic firms expressed overwhelming optimism about the future of their particular economy and business. They borrowed heavily from banks and other financial institutions to make investments, and the weak financial sector responded without hesitation to finance the purchases. However, the currency crisis that destabilized East Asian economies left firms with huge debts and financial institutions with non-performing loans.

One can attribute the internal problems directly to the lack of a well-established market mechanism. Specifically, the lack of both transparency in transactions and accountability in corporate, financial, and government systems created massive problems in the crisis-stricken economies. Cronyism and nepotism rather than market forces set the rules of the game in making transactions. Indeed, one could say that these countries lacked

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true competition. Recognizing these defects in their economic systems, policymakers and researchers in East Asia discovered the importance of competition policy in developing a competitive environment, which in turn ultimately would promote economic growth.

This Article examines competition, competition policy, and economic development in developing countries in East Asia. The term “competition policy” is defined broadly to include not only competition law but also other measures such as regulation, trade, and foreign direct investment (FDI) policies that influence competition. Part II examines how competition influences economic development from both a theoretical and empirical perspective. Part III examines several policies that impact competition, namely, competition law, regulation, trade, and FDI policies. The discussion of each policy begins with theoretical examinations and then turns to empirical findings. Part IV presents some concluding remarks.

## II. COMPETITION AND ECONOMIC DEVELOPMENT

Improving the competitiveness of a firm or industry is an important factor in achieving economic development. Economic development progresses as competitive firms displace non-competitive firms, thereby enabling an economy to utilize resources efficiently. Indeed, an examination of economic development patterns reveals that changes in industrial structures accompanied economic development, which reflects the changes in the patterns of industrial competitiveness. In the early stages of economic development, an economy tends to compete most effectively in labor-intensive industries like the textiles industry. As a result of economic development, which typically is accompanied by both capital accumulation and improvements in human resources, the economy tends to possess competitiveness in more capital intensive and human-capital intensive industries like the machinery products industry.

The previous discussion points to the importance of improving the competitiveness of a firm or industry in achieving economic development. An important query in the discussion of competition policy in this context concerns whether increased competition—which may result from an application of competition law, deregulation, liberalization of trade, and FDI—would improve competitiveness. This part discusses the impact of greater competition on the competitiveness of firms and industries.

A key factor in the discussion on the level of competition and competitiveness is the presence (or absence) of economies of scale in production. When economies of scale are present, many argue that

competition impairs the ability of firms to improve competitiveness. This results from competition's failure to allow firms to expand production to a level where they can realize a minimum efficient scale of production. Critics often present this argument in the case of small developing economies, where domestic markets allegedly can accommodate only a small number of firms.

One may question the validity of the presence of economies of scale theoretically and empirically. Theoretically, a domestic market in a small developing country may be too small to maintain many firms, but this constraint no longer applies once overseas markets are taken into account, especially considering that many East Asian economies have increased their volume of exports successfully. Empirically, a number of researchers examined the relationship between technical efficiency and firm/plant size, and while many of the studies found the relationship to be positive, others were unable to find only evidence of a relationship between firm size and technical efficiency. Most studies have examined cases only in the United States and other developed countries, so it would be beneficial to examine the empirical findings of studies conducted on developing economies in East Asia.<sup>1</sup>

Jeffrey Nugent and Seung-Jae Yhee found no evidence of a strong relationship between firm size and levels of technical efficiency in their study of 920 firms possessing anywhere between 5 and 299 employees in the Korean manufacturing sector.<sup>2</sup> However, Yueping Wang and Yang Yao,<sup>3</sup> and Albert Berry and Edgard Rodriguez<sup>4</sup> found a positive correlation between firm size and productivity in their studies of manufacturing sectors in China and the Philippines, respectively. Both studies found a higher rate of productivity increase for small firms as compared to large firms, even though the overall level of productivity is lower for smaller firms. Furthermore, Berry and Rodriguez also found

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1. See Richard E. Caves, *International Differences in Industrial Organization*, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 1230-35 (Richard Schmalensee & Robert D. Willig eds., 1989) (citing examples of studies performed on developed countries).

2. See JEFFREY B. NUGENT & SEUNG-JAE YHEE, SMALL AND MEDIUM ENTERPRISES IN KOREA: ACHIEVEMENTS, CONSTRAINTS AND POLICY ISSUES 9-10 (World Bank Institute, Working Paper No. 37190, 2000) (forthcoming 2002 in SMALL BUSINESS ECONOMICS: AN INTERNATIONAL JOURNAL).

3. See YUEPING WANG & YANG YAO, MARKET REFORMS, TECHNOLOGICAL CAPABILITIES AND THE PERFORMANCE OF SMALL ENTERPRISES IN CHINA 6-8 (World Bank Institute, Working Paper No. 37187, 2001) (forthcoming 2002 in SMALL BUSINESS ECONOMICS: AN INTERNATIONAL JOURNAL).

4. See ALBERT BERRY & EDGARD RODRIGUEZ, DYNAMICS OF SMALL AND MEDIUM ENTERPRISES IN A SLOW-GROWTH ECONOMY: THE PHILIPPINES IN THE 1990S 7-8 (World Bank Institute, Working Paper No. 37181, 2001) (forthcoming 2002 in SMALL BUSINESS ECONOMICS: AN INTERNATIONAL JOURNAL).

comparatively wide variations in productivity among small and medium-sized enterprises (SMEs).<sup>5</sup>

These observations illustrate the importance of the dynamic aspects of the relationship between firm size and technical efficiency. Bee Yan Aw examined the relationship between firm size and technical efficiency in Taiwan from the dynamic perspective.<sup>6</sup> Using total factor productivity (TFP) as a measure of technical efficiency, Aw found that TFP correlates with firm size.<sup>7</sup> However, by tracking firms over time using the panel data, Aw found that the observed relationship between TFP and firm size reflects the fact that highly productive firms survive and grow over time, regardless of their size.<sup>8</sup> Indeed, the analysis shows that it is the market selection process rather than the size of the firm that has led to the development of highly productive SMEs in Taiwan. Aw's finding is significant for East Asian competition policy: it is beneficial for countries to develop a highly competitive business environment, under which the active entry of new firms and the exit of inefficient firms take place, to improve technical efficiency.

Innovation provides a source of competitiveness for a firm. As such, it is important to examine the impact of both competition and firm size on innovation. The general consensus is that large firms with market power tend to engage in research and development more than small firms because innovation is risky and subject to economies of scale. In order to finance risky investments, firms therefore must possess sufficient financial resources. In addition, research and development costs are not dependent upon the level of production, purportedly giving large firms an advantage over small firms in conducting research and development.

The disparity between firms indicates the harmful impact of competition on innovation. However, one may make the contrary assertion that competition leads to innovation, whereby competitive pressures force firms to develop new technologies to survive in the market. Firms with comfortable profits resulting from market power possess little incentive to conduct risky research and development.

Theoretically, it is unclear whether competition promotes or deters innovation. Empirical evidence does not completely support the view that

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5. *Id.* at 9.

6. BEE YAN AW, PRODUCTIVITY DYNAMICS OF SMALL AND MEDIUM ENTERPRISES IN TAIWAN (CHINA) 5-6 (World Bank Institute, Working Paper No. 37188, 2001) (forthcoming 2002 in SMALL BUSINESS ECONOMICS: AN INTERNATIONAL JOURNAL).

7. *Id.* at 13-14.

8. *Id.*

either firm size or market power positively impact innovation. Indeed, many studies show that small firms without market power actively participate in innovation similar to large firms. In their study of firms in the Chinese manufacturing sector, Wang and Yao discovered that small firms are particularly active in both the acquisition of technologies and commercialization of new products.<sup>9</sup> David Audretsch reports that while large firms introduced only a slightly greater number of significant new innovations than small firms, small firms employed roughly half as many employees as large firms, yielding an average small firm innovation rate in manufacturing of 0.309 (compared to a large firm innovation rate of 0.202).<sup>10</sup>

Strong competitive pressures are very important for the diffusion of foreign technologies. Developing countries with a limited capability to develop new technologies may benefit substantially from absorbing and assimilating imported technologies. Indeed, Japan, Korea, and other countries can attribute substantial economic development and improvement to the successful assimilation of imported technologies.<sup>11</sup>

Competition is important for economic development because it imposes competitive pressures that improve technical efficiency and active innovations. Indeed, the aforementioned benefits of strong competition appear to outweigh the benefits of large firm size and market power in realizing economies of scale and engaging in risky innovation. Rapid advances in information technology likely will reduce the benefits of large firm size in the future. Advances in information technology will allow firms to concentrate on their competitive activities or core competence while obtaining other necessary services either from other firms or via outsourcing.

Largely attributing both the remarkable performance of the U.S. economy and the resilience of the Taiwanese economy during the Asian economic crisis to dynamic SMEs, business and policy circles now emphasize the importance of dynamic SMEs in a competitive business environment in promoting economic growth. It therefore follows that an

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9. WANG & YAO, *supra* note 3, at 10-14.

10. DAVID B. AUDRETSCH, THE ECONOMIC ROLE OF SMALL- AND MEDIUM-SIZED ENTERPRISES: THE UNITED STATES 123-35 (World Bank Institute, Working Paper No. 37180, 1999) (forthcoming 2002 in SMALL BUSINESS ECONOMICS: AN INTERNATIONAL JOURNAL).

11. Shujiro Urata discusses technology diffusion in the Japanese textile industry, where competitive pressures from potential entrants forced textile producers to assimilate imported technologies as quickly as possible. See Shujiro Urata, *The Impact of Imported Technologies on Japan's Economic Development*, in THE ECONOMIC DEVELOPMENT OF JAPAN AND KOREA: A PARALLEL WITH LESSONS 73, 75-82 (Chung H. Lee & Ippei Yamazawa eds., 1990).

effective application of competition policy promotes economic growth and development.

### III. POLICIES TO ENHANCE COMPETITION

Realizing the importance of competition for achieving economic growth and increasing economic welfare, governments have pursued various measures to stimulate competition, including competition law, deregulation, trade and FDI liberalization, and privatization. This part focuses on competition law, deregulation, and trade and FDI liberalization policies, and examines and evaluates the current situations faced by the selected developing members of the Asia-Pacific Economic Cooperation (APEC) community.

#### *A. Competition Law*

The purpose of competition law is to maintain and enhance competition in order to achieve economic growth and enhance consumer welfare. A typical competition law addresses issues such as the abuse of a dominant position, restrictive agreements, mergers and acquisitions, and unfair competition. No universal definition of the phrase “abuse of a dominant position” exists, but in many countries, the term “dominant position” refers to a situation where a firm’s market share exceeds a certain level.

Competition law prevents a firm from abusing its dominant position. For example, a firm cannot increase prices to limit competition through practices like predatory pricing, tying, and exclusive dealing. Restrictive agreements, including cartel, horizontal, and vertical agreements, may reduce competition, but they also may increase economic efficiency. For example, subcontracting, which may be a type of vertical agreement is likely to increase technical efficiency through cooperation between firms in developing new products and technologies. Mergers and acquisitions also may come under scrutiny when deemed to limit competition. Furthermore, unfair competition encompasses the distribution of false or misleading information that harms another firm’s business interests.

Alan Bollard’s and Kerrin Vautier’s seven concept framework is helpful when evaluating the current competition environment under competition law/ policy in developing APEC economies: (1) merger regimes, (2) abuse of dominant power, (3) horizontal agreements, (4) vertical restraints, (5) jurisdiction exceptions, (6) unfair trade practices,

and (7) roles, enforcement, and powers.<sup>12</sup> Based on the information from Bollard and Vautier, we evaluate the competition environment by using the following scoring system: a full score of ten for each area that explicitly indicates the rules concerning the noncompetitive behavior in question, zero points when such rules are not stipulated, and a score of five for rules that do exist but suffer from a lack of clarity.

Table 1: Competition Policy in APEC Members<sup>13</sup>

	Merger regime	Abuse of Dominant Power	Horizontal Agreements	Vertical Restraints	Jurisdiction exceptions	Unfair trade practices	Enforcement	Total
Full score	10	10	10	10	10	10	10	70
Australia	10	10	10	5	0	10	10	55
Brunei						10		10
Canada	10	10	10	5	0	10	10	55
Chile	10	10	5	5	0	10		50
China		5		5		10	5	25
Hong Kong	10							10
Indonesia								0
Japan	10	10	10	5	0	10	10	55
Korea	10	10	5	5	0	10	5	45
Malaysia						5		5
Mexico	10	10	10	5	0		10	45
New Zealand	10	10	5	5	0	10	10	50
PNG								0
Philippines		10			0	10	5	25
Singapore								0
Taipei	10	10	5	5	0	10	5	45
Thailand	10		5	5	0	5	5	30
U.S.A.	10	10	10	5	0	10	10	55

12. See Alan Bollard & Kerrin M. Vautier, *The Convergence of Competition Law within APEC and the CER Agreement*, in *BUSINESS, MARKETS AND GOVERNMENT IN THE ASIA-PACIFIC: COMPETITION POLICY, CONVERGENCE AND PLURALISM* 126-34 (Rong-I Wu & Yun-Peng Chu eds., 1998).

13. Data collected from Ipppei Yamazawa & Shujiro Urata, *Trade and Investment Liberalization and Facilitation*, in *ASIA PACIFIC ECONOMIC COOPERATION (APEC): CHALLENGES AND TASKS FOR THE TWENTY-FIRST CENTURY* 64-67 (Ipppei Yamazawa ed., 2000).

Table 1 illustrates the results of this evaluation. The highest achievable score is seventy. As Table 1 shows, developed APEC members (included for comparative purposes) score high marks exceeding fifty. By contrast, developing APEC members score much lower. Among them, Korea and Taipei score relatively high at forty-five. Behind them rank Thailand (thirty), the Philippines (twenty-five), and Hong Kong (ten). Indonesia and Singapore scored the lowest with zero. For many developing APEC members, mergers and the abuse of dominant power are monitored while horizontal agreements, vertical restraints, and unfair competitive practices are not. In addition to this incongruity, these countries appear to suffer from weak enforcement of these rules.

As far as the results are concerned, a few points should be explained. First, among developing APEC members in Asia, only four economies (Korea, Malaysia, the Philippines, and Thailand) regulate competition. The other developing APEC members regulate noncompetitive behavior using alternative means. Second, Hong Kong and Singapore, which both scored low, promote competition by introducing foreign competition under liberalized trade and FDI regimes. One then might argue that liberalized trade and FDI regimes alone cannot ensure strong competition, and that competition law can serve as a supplement rather than simply as a substitute. Third, many APEC members are considering introducing competition law or competition policies. Fourth, important differences exist not only in the types of rules but also in the basic design and type of enforcement arrangements among APEC members. According to Bollard and Vautier, competition law in the United States, the Philippines, Thailand, and China is predominantly structure-based, while competition law in New Zealand, Mexico, Korea, Canada, and Australia is predominantly outcome-based.<sup>14</sup> They further note that China, Thailand, and Korea rely more on administration-based enforcement, while the United States, Canada, New Zealand, Australia, and Mexico rely more on judicially-based enforcement.<sup>15</sup>

### *B. Deregulation*

Deregulation covers a wide range of measures, for the term “regulation” encompasses any government measures that affect activities in the private sector. State-owned enterprises constitute a typical form of regulated activity, though they are by no means exclusive. Regulations generally fall into one of two categories: economic regulations (including

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14. *Id.* at 135-36.

15. *Id.*



agricultural price restrictions and restrictions on entry into certain sectors like the telecommunications sector) and social regulations (including environmental and sanitary requirements for certain products). Generally, economic regulations incur efficiency costs, while social regulations are considered beneficial to the public welfare. However, while the differences between these two types of regulations seem unmistakable, their characterization and classification are not always so clear-cut. The dividing line can become blurry, for even social regulations can be created for, and used to provide, industry protection.

This analysis uses three factors to evaluate the performance of developing APEC members on deregulation: (1) privatization, (2) market access, and (3) transparency.

Privatization is a necessary condition for deregulation.<sup>16</sup> Naturally, the lower the share of state-owned enterprises in gross domestic investment, the greater the extent of privatization. However, while privatization constitutes a necessary condition for deregulation, it may be insufficient. Even after privatization, regulators may impose various restrictions, including those on entry and price. In the absence of necessary information on those restrictions, this analysis considers “market access” for foreign firms as a proxy for the extent of regulations applied to these economies. On our scale, the highest score for market access is forty.<sup>17</sup> Transparency (with twenty points) is evaluated by the information presented in APEC members’ individual action plans (IAPs).

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16. The extent of privatization achieved by selected economies is evaluated using information on the share of state-owned enterprises in gross domestic investment compiled by the World Bank. See *World Development Indicators 1998*, World Bank (1998).

17. Because various restrictions are not considered due to the unavailability of necessary information, scores tend to overestimate the extent of deregulation achieved by these economies.

Table 2: Deregulation in APEC Members<sup>18</sup>

	Privatization	Market access	Transparency	Total
Full score	40	40	20	100
Australia	30	30	10	70
Brunei	15	20	0	35
Canada	30	35	10	75
Chile	35	25	0	60
China	25	25	0	50
Hong Kong, China	35	35	10	80
Indonesia	30	20	0	50
Japan	35	35	10	80
Korea	30	30	0	60
Malaysia	25	30	0	55
Mexico	30	30	10	70
New Zealand	38	35	15	88
PNG	35	25	0	60
Philippines	35	25	10	70
Singapore	30	35	0	65
Chinese Taipei	30	30	10	70
Thailand	30	30	0	60
U.S.A.	38	35	10	83
Average	30.9	29.4	5.3	65.6

The estimated results shown in Table 2 indicate good performance among many developing APEC members, although it is clear that developed APEC members perform relatively better than developing members. Among developing members, the Philippines and Chinese Taipei earn high scores of seventy, while Brunei registers the lowest score at thirty-five. China (fifty points), Korea (sixty points), and Malaysia (fifty-five points) possess scores in-between. APEC members generally have achieved a relatively high level of privatization, with the exception of a few members such as Brunei, China, and Malaysia. Many members performed favorably in the area of market access, thanks to active FDI liberalization in recent years. Regarding transparency, members with low scores on privatization and market access generally scored low on

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18. Data modified from data collected by Yamazawa & Urata, *supra* note 13.

transparency, which appears to reflect member attitudes toward deregulation.

### *C. Trade Liberalization*

Countries often restrict imports to protect domestic producers. A popular argument in favor of protection in developing economies is the “infant industry” argument,<sup>19</sup> which proffers that developing countries possess a potential comparative advantage in manufacturing industries, but that manufacturing industries in the early stages of development cannot compete with well-established competitive manufacturing firms in developed countries. Fledgling manufacturing industries need time and experience to become competitive. Accordingly, this justifies the temporary protection of manufacturing industries in developing countries from imports. Indeed many countries, including the United States, Germany, Japan, and Korea use import protection to develop local manufacturing industries.

The infant industry argument seems highly plausible, but it raises several objections. First, many cases exist where “temporary” infant industry-protective regulations ultimately resulted in “permanent” protection because protected industries never became competitive. Within protected markets, firms do not possess incentives to improve their efficiency. Inefficient infant firms will ask for the maintenance of protection that, if granted, may reduce their competitiveness. Second, the fact that nurturing competitive firms takes time and resources does not justify government protection. If an investor identifies an infant firm with potential, the investor will invest in that firm. Naturally, import protection or any other kinds of protection benefit infant firms, but that does not mean that such protection is necessary. Indeed, if an infant firm encounters difficulty in raising funds or finding investors, it is likely the result of a poor financial market, which is responsible for providing long-term funding. Ideally, government policymakers should aim to develop financial markets for long-term funding and not to provide import protection.

While temporary protection of an infant industry may be justified in some situations, the reality is that protection prevents the infant industry from becoming competitive. A lack of competitive pressures from both imports and other local firms impedes the competitiveness of infant

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19. For a detailed explanation of the infant industry argument, see PAUL R. KRUGMAN & MAURICE OBSTFELD, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 257-59 (2d ed. 1991).

industries. Indeed, protecting infant industries often produces lower rates of both allocative and technical efficiency, which in turn impose costs on the economy.

The following studies examined the impact of import protection on allocative and technical efficiency, with most finding that import protection lowers both. In their study of industry in the United States, Louis Esposito and Frances Esposito found that industries with low import penetration tend to have a high rate of profitability.<sup>20</sup> Studies of developing countries produced similar findings: Jaime de Melo and Shujiro Urata,<sup>21</sup> Tein-Chen Chou<sup>22</sup> and Kyu Uck Lee<sup>23</sup> all found similar relationships in their studies of Chile, Taiwan, and Korea, respectively. Few have studied empirically the impact of import protection on technical efficiency. Hiroki Kawai examined the relationship between the degree of openness and productivity at the macroeconomic level for twenty-eight countries and found that greater openness improves technical efficiency measured by TFP.<sup>24</sup> Shujiro Urata and Kazuhiko Yokota examined the impact of import protection on TFP for Thai manufacturing industries and found that extensive import protection yields low productivity while lowering protectionist measures increases productivity.<sup>25</sup> These studies clearly indicate that import protection reduces both allocative and technical efficiency and does not contribute to economic welfare and growth.

20. Louis Esposito & Frances Ferguson Esposito, *Foreign Competition and Domestic Industry Profitability*, 53 REV. ECON. & STAT. 343, 345 (1971).

21. Jaime de Melo & Shujiro Urata, *The Influence of Increased Foreign Competition on Industrial Concentration and Profitability*, 4 INT'L J. INDUS. ORG. 287, 287-304 (1986).

22. Tein-Chen Chou, *Concentration and Profitability in a Dichotomous Economy: The Case of Taiwan*, 6 INT'L J. INDUS. ORG. 409, 409-28 (1988).

23. Kyu Uck Lee et al., *Industrial Organization: Issues and Recent Developments*, in STRUCTURAL ADJUSTMENT IN A NEWLY INDUSTRIALIZED COUNTRY: THE KOREAN EXPERIENCE 204, 216-22 (Vittorio Corbo & Sang-Mok Suh eds., 1992).

24. Hiroki Kawai, *International Comparative Analysis of Economic Growth: Trade Liberalization and Productivity*, 32 THE DEVELOPING ECONOMIES 373, 373-97 (1994).

25. Shujiro Urata & Kazuhiko Yokota, *Trade Liberalization and Productivity Growth in Thailand*, 32 THE DEVELOPING ECONOMIES 444, 444-59 (1994).

Table 3: Tariff and Non-Tariff Barriers for Selected East Asian Economies<sup>26</sup>

		Primary products	Manuf. products	All products			Primary products	Manuf. products	All products
China					Malaysia				
Mean tariffs	1980-83	46.5	50.5	49.5	Mean tariffs	1980-83	4.3	12.7	10.6
	1984-87	33.1	41.9	39.5		1984-87	8.6	15.4	13.6
	1988-90	34.1	42.7	40.3		1988-90	7.7	14.8	13.0
	1991-93	31.7	39.7	37.5		1991-93	7.3	14.7	12.8
NTB incidence	1984-87	17.8	7.9	10.6	NTB incidence	1984-87	4.5	3.2	3.7
	1988-90	27.2	21.9	23.2		1988-90	1.6	3.0	2.8
	1991-93	11.5	11.3	11.3		1991-93	1.2	2.4	2.1
Hong Kong					Singapore				
Mean tariffs	1984-87	0.0	0.0	0.0	Mean tariffs	1980-83	0.1	0.4	0.3
	1988-90	0.0	0.0	0.0		1984-87	0.1	0.4	0.3
	1991-93	0.0	0.0	0.0		1988-90	0.2	0.4	0.4
NTB incidence	1984-87	6.9	2.1	3.4	NTB incidence	1991-93	0.3	0.4	0.4
	1988-90	0.8	0.3	0.5		1984-87	15.3	14.1	14.7
	1991-93	0.8	0.3	0.5		1988-90	3.0	0.2	1.0
					1991-93	1.2	0.0	0.3	
Indonesia					Thailand				
Mean tariffs	1980-83	23.0	31.3	29.0	Mean tariffs	1980-83	26.3	34.6	32.3
	1984-87	14.7	19.4	18.1		1984-87	28.0	32.5	31.2
	1988-90	14.8	22.5	20.3		1988-90	33.4	43.7	40.8
	1991-93	13.6	18.3	17.0		1991-93	26.2	41.8	37.8
NTB incidence	1984-87	98.9	93.1	94.7	NTB incidence	1984-87	24.4	7.8	12.4
	1988-90	15.7	7.0	9.4		1988-90	7.9	8.8	8.5
	1991-93	4.6	2.0	2.7		1991-93	8.8	4.2	5.5

The focus now shifts to the patterns of import protection for developing APEC members in East Asia. As Table 3 clearly illustrates, developing APEC members in East Asia (with the exceptions of Hong Kong and Singapore, which adopted virtually free trade regimes) liberalized their import regimes by lowering both tariff rates and non-tariff barriers from the early 1980s through the early 1990s. Regarding tariff barriers, China and Indonesia registered significant reductions in their average tariff rates from the early 1980s through the early 1990s, while Malaysia and Thailand increased their average tariff rates only slightly.

The incidence of non-tariff barriers declined in many East Asian economies. Indeed, only China increased the incidence of non-tariff barriers during the period under study. Indonesia represents the most surprising decline, as it reduced the incidence of non-tariff barriers from 94.7% in the period from 1984-87 to 2.7% in the period from 1991-93. Although not included in the table due to a lack of comparable data, Korea

26. Data collected from PACIFIC ECONOMIC COOPERATION COUNCIL, SURVEY OF IMPEDIMENTS TO TRADE AND INVESTMENT IN THE APEC REGION (1995).

reportedly also reduced its tariff rates and the incidence of non-tariff barriers in the period from 1988 to 1993.<sup>27</sup> An analysis of import regimes in more recent years by Ipppei Yamazawa and Shujiro Urata indicates the continued trade liberalization by many APEC members.<sup>28</sup> Although the economic crisis slowed the pace of trade liberalization, only a few cases of backtracking exist.

#### *D. FDI Liberalization*

Inward FDI arguably contributes to the economic development of the recipient or host country through various channels. FDI provides a conduit for financial resources and technological and management know-how to pass from the multinationals to the FDI host country. Financial resources stimulate economic growth by expanding productive capacity, while technological and management know-how contribute by improving technical efficiency. Furthermore, FDI contributes to improvements in the technical efficiency of local firms by introducing competitive pressures.

Despite the wealth of literature regarding the impact of inward FDI on the host country, no readily available study has examined the impact of inward FDI on promoting either competition or technical efficiency through increased competition. Many studies have investigated the impact of FDI on the technical efficiency of the host country's firms, but they focus on the transfer of technology and not on enhanced competition. Many argue that "technology spillover"—transfers of technology from multinationals to local firms—occur through various channels. Local workers that acquire technologies by working at multinational firms may transfer those technologies to local firms as they move from the multinational firms to the local firms. Local firms may acquire technologies possessed by multinationals by imitating the production and other processes conducted by multinational firms. Although studies on the impact of multinationals on the technological efficiency of the host country focus on the transfer of technology, it is likely that the presence of multinationals would improve the technical efficiency of the host by promoting competition in the host country.

While the empirical studies on the impact of FDI specifically examine the presence or absence of technology spillovers, in light of FDI's possible

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27. For Korea the unweighted average of tariff rates declined from 19.2% to 11.6% between 1988 and 1993, while the incidence of non-tariff barriers declined from 9.0% to 1.7% during the same period. *Id.* at 8.

28. Yamazawa & Urata, *supra* note 13, at 64-67.

impact on competitive pressures affecting local firms, these studies also may reflect the presence or absence of competitive pressures from multinationals on local firms. The results of the analyses on the presence of technology spillover are mixed. Using industry-level data, Richard Caves found the presence of technology spillover in his study of the Australian manufacturing sector but not in his study of the Canadian manufacturing sector.<sup>29</sup> Using similar methodology, Steven Globerman identified the spillover effect of FDI in the Canadian manufacturing sector.<sup>30</sup> Both Magnus Blomström and Hakan Persson,<sup>31</sup> and Blomström and Edward Wolff<sup>32</sup> detected technology spillover in their studies of the Mexican manufacturing sector.

These earlier studies exhibited one common shortcoming: they failed to account for differences in productivity across domestic industries. Controlling differences in productivity across industries by utilizing firm-level data, Mona Haddad and Ann Harrison,<sup>33</sup> and Brian Aitken and Harrison<sup>34</sup> found no technological spillover in their respective studies of Morocco and Venezuela. The limited presence of foreign firms in these countries may explain their inability to detect technology spillover.

Recognizing that multinational firms play an important role in promoting competition in host economies shifts the focus to the openness of FDI regimes of the developing APEC member economies, which I examined by using the following twelve policy areas: (1) right of establishment; (2) screening and examination; (3) most favored nation (MFN) treatment; (4) profit repatriation; (5) work permits; (6) taxation; (7) performance requirements; (8) investor behavior; (9) investor protection; (10) dispute settlement; (11) investment incentives; and (12) capital exports.

These policy areas may be divided into three groups. The first group consists of policies that restrict investment by foreign firms, which

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29. Richard E. Caves, *Multinational Firms, Competition, and Productivity in Host-Country Industries*, 41 *ECONOMICA* 176, 176-93 (1974).

30. Steven Globerman, *Foreign Direct Investment and 'Spillover' Efficiency Benefits in Canadian Manufacturing Industries*, 12 *CAN. J. ECON.* 42, 53 (1979).

31. Magnus Blomström & Hakan Persson, *Foreign Investment and Spillover Efficiency in an Underdeveloped Economy: Evidence from the Mexican Manufacturing Industry*, 11 *WORLD DEV.* 493, 493-501 (1983).

32. Magnus Blomström & Edward N. Wolff, *Multinational Corporations and Productivity Convergence in Mexico*, in *CONVERGENCE OF PRODUCTIVITY: CROSS-NATIONAL STUDIES AND HISTORICAL EVIDENCE* 274-75 (William J. Baumol et al. eds., 1994).

33. Mona Haddad & Ann Harrison, *Are There Positive Spillovers from Direct Foreign Investment? Evidence from Panel Data for Morocco*, 42 *J. DEV. ECON.* 51, 60-70 (1993).

34. Brian J. Aitken & Ann E. Harrison, *Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela*, 89 *AM. ECON. REV.* 605 (1999).

includes the right of establishment, screening and examination, and MFN treatment. The right of establishment remains the largest potential impediment, as the denial of this right prevents foreign multinationals from undertaking FDI. The second group consists of policies that restrict the behavior of multinationals in the host country after they undertake FDI, namely profit repatriation, work permits, taxation, performance requirements, investor behavior, investor protection, and dispute settlement. The third group, which consists of investment incentives and capital exports, influences FDI by distorting the decisions and behavior of multinationals. For example, investment incentives may cause “round tripping” of FDI, as domestic investors seek to take advantage of such incentive measures by making it appear as if FDI originates from outside the host economy.



Table 4: Assessment of FDI Regimes<sup>35</sup>

	Right of Establishment	Screening and Examination	MFN Treatment	Profit Repatriation	Work Permit	Taxation	Performance Requirement	Investor Behavior	Protection of Investors	Dispute Settlement	Investment Incentives	Capital Exports
Full score	10	10	10	10	10	10	10	10	10	10	10	10
Australia	6	8	10	10	8	10	10	10	0	10	10	10
Brunei	4	6	0	10	8	10	10	0	0	0	0	10
Canada	8	8	0	10	10	10	0	10	8	10	10	10
Chile	4	6	10	6	8	8	8	10	8	10	10	10
China	2	6	10	2	6	6	8	10	8	8	8	6
Hong Kong	8	10	10	10	10	10	10	10	0	10	10	10
Indonesia	2	6	10	0	6	10	8	8	8	8	6	0
Japan	6	8	10	10	8	10	10	10	8	10	8	10
Korea	4	6	10	8	8	10	10	10	8	10	6	8
Malaysia	4	6	10	8	8	10	8	0	8	10	6	10
Mexico	4	6	8	10	8	10	8	10	8	10	8	10
New Zealand	8	8	10	10	8	10	10	10	10	10	10	10
PNG	6	8	10	8	6	10	8	0	8	8	10	8
Philippines	6	8	0	10	6	8	6	0	8	8	8	0
Taipei	6	8	8	8	8	8	8	10	8	8	6	8
Thailand	4	8	8	10	8	8	6	10	8	8	10	8
U.S.A	8	10	8	8	8	10	10	0	8	10	8	10
Average	5.4	7.6	7.9	8.2	7.8	9.3	8.2	7.1	6.8	8.7	7.9	8.2

Notes: 1) Scoring takes the values from 0 to 10, with 10 being full liberalization and 0 being "not mentioned" in the sources used for the analysis.  
2) Total is obtained by summing all the scores with the "right of establishment" having 10 as a weight and other items having 1 as a weight.

Table 4 reports the results of the assessment of the FDI regimes for developing Asian APEC member economies as compared to other selected APEC member economies. For each policy area, the full score is ten. Considering the extreme importance of the right of establishment in influencing FDI, the score for the right of establishment receives the weight of ten.<sup>36</sup> Among developing Asian APEC member economies, Singapore and Hong Kong exhibit high total scores, which both exceed eighty points. Indeed, developing APEC members possess more open FDI

35. Data collected from APEC Committee on Trade and Investment, Guide to the Investment Regime of the APEC Member Economies (3d ed. 1996).

36. Note that in Table 4, for the economies that did not report the characteristics of particular FDI policy items regimes, the score has a value of zero.

regimes than developed members. Indonesia and China scored the lowest, while the scores for the other developing economies lie in-between these two groups. The right of establishment accounts for much of this difference in scores. China and Indonesia score as low as two points because they close off a substantial portion of their economies to FDI. In addition to the right of establishment, performance requirements also account for some variations among the sample economies.

This assessment of APEC's FDI regimes shows that significant impediments to FDI still exist for a number of developing economies. This remains true despite evidence that APEC members exerted significant liberalization efforts in FDI regimes.<sup>37</sup>

In discussing the favorable impact of FDI on its recipient country, this analysis examines impediments to FDI with a view that such impediments produce inefficiency in the host country. However, FDI may yield undesirable consequences if a multinational firm with market power exercises anticompetitive practices. Indeed, this is exactly why countries need competition policies to deal with anticompetitive behavior of competitive multinational firms.

#### IV. CONCLUSION

Based on the recognition that competition is an important mechanism for promoting economic development, this analysis examined the current status of pro-competitive policies within selected developing APEC members in East Asia, including competition law, deregulation, and trade and FDI liberalization. This study discovered an encouraging policy trend toward greater competition in the countries under study, but the need to strengthen pro-competitive policies remains. In addition, substantial differences exist in the content of these countries' policies, thereby reflecting diversity in both the levels of economic development and the social and historical backgrounds.

Despite the importance of promoting competition for achieving economic development, it is difficult and undesirable for APEC members to adopt a uniform set of competition rules to achieve the goal of greater competition due to a wide diversity in their levels of economic development. It therefore is important for these countries to adopt a broad, flexible approach to formulating and implementing competition policies that consists solely of basic principles. In response to this need, the Pacific

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37. See Yamazawa & Urata, *supra* note 13, at 67.

Economic Cooperation Council (PECC) developed its Competition Principles, which APEC leaders endorsed in Auckland in 1999.<sup>38</sup>

The core axioms in the PECC Competition Principles are comprehensiveness, transparency, accountability, and non-discrimination. Comprehensiveness indicates the importance of a competition dimension to all policymaking that affects economic activities, while transparency ensures clarity in the application of the Competition Principles. Members should account for any departure from the Competition Principles, which they should apply in a non-discriminatory manner once a transition period is complete.

Several basic measures would give effect to these core principles, including both reevaluating all relevant government legislation and regulations to ascertain the extent to which they distort competition and promoting competition by minimizing the risk of anticompetitive conduct through appropriate competition discipline on business conduct. The Competition Principles also emphasize the importance of international cooperation among both competition agencies and authorities for dealing with ever-increasing cross-border issues and capacity building in developing APEC members.

The Competition Principles should serve an important role in formulating and implementing competition policies. However, their non-binding nature remains problematic. Although non-binding principles are consistent with APEC's voluntarism in pursuing competitive environments, they may prove ineffective. In order for APEC members to promote voluntarily competition and set binding principles, it is important to discern the impact of increased competition on economies, which is a task that remains the responsibility of researchers.

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38. PACIFIC ECONOMIC COOPERATION COUNCIL, PECC PRINCIPLES FOR GUIDING THE DEVELOPMENT OF A COMPETITION-DRIVEN POLICY FRAMEWORK FOR APEC ECONOMIES (1999).