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## Considerations on international rules for competition policy in the case of high-technology products and services

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**Considerations on International Rules for Competition Policy in the Case of High-Technology Products and Services**

by

Ernst-Jürgen Horn

March 1996



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## **Considerations on International Rules for Competition Policy in the Case of High-Technology Products and Services\***

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## **Abstract**

Issues in high-technology development, production and trade have been a major cause for frictions in international economic relations in recent years. A future change for the better is not yet in sight, notwithstanding the accomplishments of the Uruguay Round of multilateral trade negotiations. In order to contain or to reduce the conflict potential evidently existing in the field of international competition in high technology, it is widely held that it seems necessary to reshape the existing global framework for high-technology competition. Taking into account the lessons from the protectionist races during the inter-war period, the conclusion is that only an adequate advance in international economic law can, at least in principle, be considered as a promising route towards any kind of problem resolution.

In the case of globalizing markets and mutually integrating national economies, the question is becoming increasingly irresistible of why global economic relations should be subdued to a different set of rules than national economies - as expressed in the respective national competition laws. There is in fact every reason to treat foreign subjects always in the same manner as domestic subjects („national treatment“ in the GATT-language). This would have far-reaching consequences. And there is a for-rider for all this institutional change, namely the Government Procurement Agreement. If the disciplines embodied in the GPA were to be generalised, one would in fact end up in a more or less world-wide internal market where any economic agent of whatever country's origin would be entitled to sue against any other country's undue government behaviour in commercial policies.

## **I. Introductory Remarks**

Popular sports aside, high-technology competition among industrial countries, older and newer ones, seems to be one of the most interesting games of our times for the public audience. However, while winners in sports generally tend to be accepted as the fitter, or at least as the luckier, players winning in the technologies race among nations (or firms?) tend to be suspected of having played foul, or it is suspected that the rules of the game have been unfair from the very beginning [Bhagwati, 1995]. The consequence in the latter cases is that political frictions in international economic relations can be expected to arise.

As a matter of fact, issues in high-technology development, production and trade have been a major cause for frictions in international economic relations in recent years. A future change for the better is not yet in sight, notwithstanding the accomplishments of the Uruguay Round of multilateral trade negotiations [Blackhurst, 1994]. In order to contain or to reduce the conflict potential evidently existing in the field of international competition in high technology, it is widely held that it seems necessary to reshape the existing global framework for high-technology competition [Ehlersmann, 1995]. Taking into account the lessons from the protectionist races during the inter-war period, the conclusion is that only an adequate advance in international economic law can, at least in principle, be considered as a promising route towards any kind of problem resolution [European Commission, 1995].

## **II. On the Causes of Frictions in International Trade Policy**

As far as the nature of „desirable“ changes in the global framework for high-technology competition is concerned, the causes of current frictions in international economic relations for which a remedy in this area is sought, can be taken as point of departure [Fikentscher, 1994]. These causes include in particular that

- national governments have a strong interest in the development of domestic high-technology activities (for reasons of growth potential, defence, prestige or else);
- international competition in high-technology development, production and trade (often in the presence of high entry costs and increasing returns) is in many instances suspected to lead to outcomes where „the winner takes it all“ [Fox, 1995];
- national high-technology development and production is therefore widely considered as an essential base for furthering national wealth [Fricke, Zimmer, 1994];
- national governments themselves tend to be deeply involved in national high-technology development, production, and frequently even in trade, by means of R&D subsidies, procurement policies, export promotion, etc.;
- the determinants of success and failure of nations in high-technology competition seem essentially to rest with „domestic“ competition conditions (e.g. factor endowments, economic institutions, government

policies) which to a large extent are not, or at least not explicitly so, regulated by present international economic law.

All in all, the problem of political peace-keeping in the international technologies race seems to concentrate on the issue, whether and to what extent national governments are prepared to accept rules of international economic law in domestic conduct, and to what extent national governments are prepared to accept the legitimacy of other countries' economic structures, economic institutions, and of traditionally grown „styles“ of capitalism in general [Stern, Hoekman, 1987].

Current trade-policy frictions in the area of high-technology products and services do just reflect the fact that the evolution of international economic law has not kept track with problems that have evolved in the process of increasing openness of industrial economies. The international trading order as defined in the GATT (General Agreement on Tariffs and Trade) [GATT, 1993, 1994], for instance, was originally and essentially meant to cope with trade policy problems „at the border“, concerning mainly tariffs, quantitative restrictions, dumping, export subsidies, and escape clauses from contractually defined obligations [Schott, 1994]. Over the past decades, the international trading order has increasingly evolved into the direction of an international order of competition conditions, widening its scope from border rules for trade relations towards rules for the legitimacy of domestic economic policy measures of member states [Graham, 1995]. A new global framework for high-technology competition would in various respects require the transformation of the existing trading order into an international



order of competition conditions<sup>1</sup>, in which the conduct of national governments and of private firms would underlie restraints defined by international economic law. Correspondingly, national sovereignty in conducting „domestic“ economic policies would be constrained [Hauser, 1994; Herrmann and Laumer, 1994].

The problems to be dealt with in the pursuit of such an approach can be demonstrated by simply quoting a recent publication on these issues in the USA. Tyson [1992, pp. 11 sq.] states „I believe that what we as a nation make and what we trade matter. The composition of our production and trade does influence our economic well-being. Technology-intensive industries, in particular, make special contributions to the long-term health of the American economy“. One problem with statements of this kind is that governments of all trading nations can be expected to think along quite similar lines. If one just substitutes Japan or Britain for „we“ [i.e. the United States] in Tyson's statement, it becomes clear that there exists a clash between likewise legitimate interests of the various trading nations which is hard to be reconciled [Immenga, 1995]. Taking into account that a major rationale of the post-war multilateral trading system was to tame unilateral action and retaliation, to discipline it, and to keep it within bounds [Hudec, 1990, especially p. 40], existing international trade frictions in the area of high-technology products and services indicate a need for establishing new rules in the international and multilateral framework for high-technology competition [Ostry, Nelson, 1994].

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<sup>1</sup> „Extending international trade rules to cover competition policy would produce better anti-trust laws - and better trade rules too.“ The Economist, December 17th, 1994, p. 68. - See also in this context Scherer [1994].

The definition of the „sins“ that contracting parties of GATT might commit, and the procedures for an enforcement of the rules, make up the core of the multilateral trade order [Jackson, 1994]. Before embarking on a discussion of new dimensions for international trade regulation in high-technology competition, however, it seems appropriate to reconsider past experience with the rules and obligations of the multilateral trading system [Wolff, 1995]. The legal basis for the enforcement of rules is basically given in Article XXIII (1) of GATT, where it is stated:

„1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

- (a) the failure of another contracting party to carry out its obligations under this Agreement, or
- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
- (c) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be considered. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.“

The basic message included in Art. XXIII is that not only a breach of formal obligations (so-called violation cases) does count, but that also the actual

effects of measures by governments of contracting parties (so-called non-violation cases) can count as a „sin“ under the Agreement.<sup>2</sup> Enforcement of the rules against any such malpractice by another contracting party is left, however, to counter-measures of the affected party, and therefore heavily dependent on the retaliation power of this party. Nevertheless, these provisions seem to entail far-reaching obligations of contracting parties, and be it simply because not only the letter of existing international rules, but also the results of actual conduct have to be taken into account [Jacquemin, 1995]. In this respect, one has also to consider that there seems to exist a mutual understanding among the nations participating in international trade negotiations that trade agreement obligations are generally not meant to be enforced to the letter [Hudec, 1990]. International trade law tends to be considered as a kind of grey zone, where compliance with existing obligations of contracting parties under the Agreement might well be once and again be challenged in order to achieve further concessions from other contracting parties.

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<sup>2</sup> It is quite interesting to note that, according to the final design for the International Trade Organisation (being the core of the Havana Charter) which did not enter into force as planned after the Second World War, "sins" in trade policy matters could not only be committed by government actions, but also by restrictive practices of private businesses. A remainder of this approach is still to be found in Art. XXIX of GATT, stating in paragraph (1) that "The contracting parties undertake to observe to the fullest extent of their executive authority the general principles of Chapters I to VI inclusive and of Chapter IX of the Havana Charter pending their acceptance of it in accordance with their constitutional procedures." Chapter V of the Havana Charter deals with Restrictive Business Practices. Art. XXIX does still exist, notwithstanding an attempt to abolish it in 1955 which did not succeed due to the failure of just one contracting party to ratify this change. Leading opinion is, however, that, as established in past GATT case-law, contracting parties are not bound by obligations contained in Chapter V of the Havana Charter.

Given this somewhat muddled state of affairs in international economic law, as it is existing at present, the most important question is, then, whether and to what extent a renewal of international economic law could really serve the purpose of reducing international frictions in high-technology competition [Kaell, Ireland, Sadeque, 1995]. The answer to this question can be expected to be found mainly in two directions:

- Firstly, past experience shows that trading nations can hardly afford to breach continuously and systematically the existing legal obligations that were signed by them, short-term emergency situations apart. This delineates a case for establishing new international rules for the resolution of controversial issues in the behaviour of trading nations.
- Secondly, past experience also shows that international trade negotiations on matters like these tend as such to sharpen the awareness of national governments about the subject matters in question. Therefore, it stands to reason that only if these topics become the explicit objective of multilateral trade negotiations, a reasonable resolution of these problems can be achieved [Lloyd, Sampson, 1995].

Some key elements, such new international agreements would have to deal with, will be discussed in the following parts of this paper. As it is always the case in matters of trade policies as well as in matters of competition policies, one has to distinguish among the types of rules that seem desirable. These rules may range from per-se prohibitions over case-by-case rulings („actionable“ cases) to per-se allowances („non-actionable“ measures).

### III. Access to Markets and „Fair“ Competition

High-technology industries may be fairly well described as activities which are characterised [Tyson, 1992] by high returns (regarding profits as well as wages) for themselves and by beneficial externalities for the overall economy.<sup>3</sup> It follows from this that almost any government of any trading nation can be expected to try to further domestic high-technology activities. Any such national ambition will produce international externalities. The question is, then, how to define a set of international rules restraining the ambitions of national governments that are detrimental to the prevalence of an international trading system mutually agreed upon by the respective trading powers.

It would seem that all trading powers should share a common interest in order to contain this threat for the international trading system. The problem is, however, that the first sinner may have a good chance to get away with it. Under such conditions, governments of all countries capable to do so can be expected to try to go it alone in the technologies race. If all relevant governments of the international trading system are behaving in such a manner, no country can achieve a gain in this game. Competing high-technology policies would simply match one another rewarding potential benefits mainly to third parties not involved in this policy competition race. In the prevalence of the suspicion that any other government may apply unfair practices, the case for new and internationally binding rules of the game is compelling. In this respect, the players in the international trade

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<sup>3</sup> In more technical terms, high-technology activities are said to be different from the rest of the lot, in that they are operating under conditions of increasing returns, technological externalities, and imperfect competition.

policy game would have to start again at the point, where their forefathers drew their conclusions from the experiences of the inter-war period immediately after the Second World War. The basic issues discussed at those times have gained more relevance than ever before: The issues of market access, and in relation to this, of restrictive business practices, are once again on the forefront of the debate on international trade regulation [OECD, 1994(a)]. This is in fact an important aspect in modern international trade relations: Restrictive business practices (alleged ones or real ones) and restrictive government practices are likewise to be considered as being relevant for international trade relations.

But what is fair market access and fair competition to mean in reality? A look at the political compromise, as expressed in a recent OECD paper [OECD, 1994(b)], gives some hints on what political decision makers may have in mind when talking about such things. First of all, it is interesting to note how much space has been devoted to certain subjects in this paper that are meant to reflect the present degree of consensus among OECD member countries. The impression is conveyed, however, that there seems to be at least a growing awareness of the need for a closer convergence of competition law and policy, on the one hand, and of international trade law and policy, on the other hand. The rationale of bringing closer together these two policy areas which are primarily concerned with issues of market access and market competition, appears simple: Competition is assumed to foster economic welfare, in the national context as well as in the international context. So it is quite reasonable that competition policy should not only hold in check restrictive business practices on respective national markets, but also on international markets. On the other hand, government market interventions in external trade or in other policy areas may in many instances

have anti-competitive effects on national and international markets. Any measure impeding imports and thus raising domestic prices tends to have, for example, quite similar effects as a domestic cartel (not contested by external competition); only the latter is, however, normally to be prosecuted by the respective national cartel office.

To sum up, there are free areas for restrictions of competition such as with respect to certain international restrictive business practices (e.g. export cartels), and there are contradicting means and contradicting ends in the pursuit of national competition policies and of national trade and industrial policies. Furthermore, national trade policy authorities regularly include a competition policy branch of their own dealing with alleged or real unfair trade practices by foreigners, such as (predatory) dumping or foreign subsidies not compatible with the obligations under the international trading order. „Strategic“ export controls as applied by most industrial countries - after the end of the Cold War mainly intended to prevent that „evil“ countries, such as currently Libya or Iraq, can get access to critical technologies - may also severely impede international competition, and bear a high potential for international trade policy frictions. Such provisions tend to include the demand for extra-territorial application of domestic regulations, and export controls as such possibly could at least be intentionally used in order to exclude foreigners from the use of domestic advanced technologies [Thomson, 1995].

Traditionally, national governments of industrial countries seem to have been rather reluctant to apply the rules and stated objectives of their competition policies also likewise in the pursuit of their trade and industrial policies. Restrictive business practices, on the other hand, have been a much

discussed issue of international conferences and of other international fora, without leading to little more than unbinding communiqués and declarations. Nevertheless, activities of the latter kind have led to a clarification of the main issues involved; in most cases it seems sufficient to extend the application of already existing national competition rules towards international economic relations. Three examples:

- As concerns issues of vertical relationships and market access, vertical price restraints (essentially real price maintenance) tend to be per se prohibited by national law. Vertical non-price restraints - such as exclusive territories or exclusive dealing - are usually considered to be worth weighing for their pro- and anti-competitive effects. The outcome of such a weighing procedure may differ across countries, and may as well differ when undertaken from a national competition policy perspective or from an international trade perspective.
- With respect to horizontal agreements, „hard core cartels“, or so-called „naked restraints“, or mergers and acquisitions which are conflicting with critical values concerning company size and market share, are usually per se prohibited by national law. There are, however, in many countries provisions allowing for „case-by-case“ or „rule of reason“ examinations; or there exist special guidelines, regulations, or block exemptions (e.g. referring to standard setting, joint R&D, joint ventures, joint purchasing or selling).
- The competition effects of officially sanctioned or officially concluded international agreements are almost by definition treated as exemptions to



standard national competition regulations.<sup>4</sup> There is no problem with this in areas such as defence which are exempted from trade and competition law anyhow [Office of Technology Assessment, 1989, 1991, 1992]. But when it comes to „normal“ products, such as textiles, automobiles, or semiconductors, international arrangements may well have quite detrimental effects on international competition. The only reasonable case for international arrangements conducive to foster international competition is given when the aim of such an undertaking is to contest a monopolistic market position of a third party.

Restrictive business practices may be part of the problem when international frictions in high-technology competition occur, but they are hardly at the core of this matter. The most important variable in this context is the actual conduct of national governments in trade and industrial policies. This is not to denounce attitudes of this or that government as selfish or as pursuing a beggar-your-neighbour approach, along mercantilistic prescriptions for economic policies. What really matters is, instead, whether and to what extent it seems possible to establish „... an agreed framework of multilateral rules covering access to markets and fair competition“.<sup>5</sup> One may well contemplate on the term „fair“ in this statement. Nevertheless it seems to show into the right direction. It is tempting to suggest that the evolution of an „agreed framework of multilateral rules“ should rest on principles, which

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<sup>4</sup> Note, however, that in the international perspective after the Uruguay Round officially sanctioned voluntary export restraints are per se prohibited (after a transition period of some years). Interestingly enough, the new measure of officially sanctioned „voluntary“ import expansion arrangements was not covered at all during these negotiations.

<sup>5</sup> Paragraph 10 of the Ministerial Communiqué C (93)87 adopted by the OECD Council at its 806th Session on 3 June 1993.

are since long established in domestic competition law and policies of the trading nations, the major difference (or innovation) in relation to previous practices being that the conduct of national governments in the international arena would be subdued to the same principles, these governments have used to impose on the conduct of their domestic subjects.<sup>6</sup> In the next part of this paper, therefore, the common principles of existing national competition policies shall be discussed in view of their adequacy to contribute to shaping a new framework of multilateral rules for high-technology competition under the auspices of the international trading order.

#### **IV. Implications of Applying Competition Policy Principles on International Trade Relations**

##### **1. „Unfair“ International Competition in the Perspective of Essential Principles of National Competition Policies**

Competition law and policy in the modern understanding was essentially invented in the United States. This precedent, and its evolution over time, has ever since heavily influenced the policy stance in almost all industrial countries with regard to the proper role of governments in supervising and

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<sup>6</sup> Main elements of a common approach designed to remove frictions and instead to achieve synergies between competition policies and trade policies would have to include

- a clarification of terminology, objectives, methods and tools of analyses of competition and trade policies;
- an evaluation of systematic differences across countries in design and practice of competition and trade policies;
- a mutual international consensus on the role of basic principles, such as transparency, non-discrimination, and national treatment;
- rules for international co-operation in the enforcement of competition and trade law;
- rules for conflict resolution, in particular regarding cases in which trade and industrial policy measures can be suspected to restrain market competition.

guarding market competition. It is therefore tempting to take competition law and policy of the United States as an example in order to sketch the main principles of this kind of government activity.<sup>7</sup> Competition policy is ideally meant to protect the functioning of market competition, regardless of other government market interventions that do in fact constrain market competition.

The first and foremost reason for an active competition policy has ever been the purpose of keeping in check economic power of private economic agents. The Sherman Act of 1890, the leading act in US competition law, per se prohibited any „restraints of trade“, referring in particular to vertical agreements, horizontal agreements, and to any misuse of monopolistic market power. The Clayton Act of 1914 took a decisive further step in proclaiming that attempts to establish monopolistic market power should be stopped by the government from the very beginning („incipiency doctrine“). The basic underlying idea was that a reasonable possibility of future restraints of competition sufficed to make a case for immediate competition policy intervention. Later amendments to the Clayton Act mainly concerned a tougher government supervision and regulation of mergers and acquisitions. The Federal Trade Commission Act of 1914 then established a special federal authority to pursue federal competition policy. It enlarged at the same time government policy competencies with respect to interference in the case of unfair or deceiving business practices, all this aiming mainly at the purpose of consumer protection. Furthermore, the FTC was authorised to act not only in cases of a breach of given formal obligations laid down in existing competition law, but also in cases where not the letter but the

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<sup>7</sup> For an overview see, for example, Scherer [1993, 1994] and Fikentscher [1994].

underlying spirit of existing competition law may have been violated. This is in fact a potentially far-reaching extension of the powers of government authorities, though of course always underlying later reviews, interpretations, and decisions by the US juridical system. All in all, these basic elements of US competition law and policy have remained the pillars in government supervision and regulation of market competition, notwithstanding various legal amendments and changing attitudes of administrations in applying these principles. It is interesting to consider, just as an experiment of thought, whether and to what extent a transformation of this set of principles towards the regulation of international trade, in particular in the field of high-technology products and services, can be expected to work.

The purpose in this context is just to sketch the basic elements of the regulatory system designated to safeguard market competition:<sup>8</sup>

- The „incipiency doctrine“ states that it shall be illegal to build up or to reinforce market power with the purpose of, or with the effect of, restraining market competition.
- The „prima-facie-illegality doctrine“ says that in cases of companies with an already high market share on the relevant market – the definition of the „relevant market“ as such tends to be a highly critical issue in relevant

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<sup>8</sup> For example, the per-se rule was applied in court decisions concerning the prohibition of price arrangements between firms, arrangements on the restriction of production, arrangements on market shares or on regional market divisions, coordinated boycotting of certain sources of supply or coordinated refusal to supply certain customers, and coupling commitments. As a rule, any kind of hard-core cartel arrangements tends to fall under per-se prohibition.

competition policy cases – a further expansion of this market share through merger or acquisition shall be held illegal.

- The „market-foreclosure doctrine“ postulates that mergers and acquisitions, or horizontal and vertical arrangements among independent firms, shall not restrain the openness of markets and the possibilities to compete for third parties. This doctrine in principle also covers the fact that a company already holding a strong position on its main market misuses financial resources (its „deep pocket“) and technological ownership advantages of its main domain (e.g. its „network advantages“) in order to expand on other markets, thereby „unduly“ reducing the equality of opportunity to compete for other firms.
- The „failing-firm doctrine“ allows for qualified exemptions from the prohibition rule in the case of vertical mergers and acquisitions; similar reasoning applies to mergers between small companies.
- The „price-differentiation doctrine“ holds that companies shall sell products of a specific kind at uniform prices across customers, unless price differences do reflect true differences in production or marketing costs; the latter condition would have to be proven by the companies if there were a query about such a practice of price differentiation.
- Arrangements of exclusive sourcing or of coupled sourcing in supply relations between companies are usually held to be illegal, unless the foreclosure effects on the relevant market are so small that they can be neglected.

The American system of regulating business practices seems to provide appropriate rules that could serve as a blueprint for an international

regulatory system in order to supervise restrictive business practices in international trade relations with regard to high-technology competition. In particular, the „market-foreclosure doctrine“ would appear relevant because market access even for latecomers in a certain field of economic activity is to be warranted, at least if such latecomers can compete on equal terms. However, the American system even provides possibilities to punish firms having had too much success on their own account of mere internal firm growth, without any mergers or acquisitions having been involved.

## **2. Regulating Common Competition-Policy Principles**

### *a. The Main Issues*

Trade policy of nations tends to be traditionally concerned with the well-being of particular national clienteles, i.e. with claims of special interest groups, according to their actual or perceived influence in the political arena. The interests of foreign economic agents, whether or not their pursuit would in fact raise national welfare, do usually not count much when it comes to national political decision-making. Competition policy of nations traditionally tends to be concerned with actual or only potential misconduct of resident economic agents. So the boundaries between these two types of policies seem to have been previously relatively well-defined: Transnational economic actions fall into the domain of trade policy, intra-national economic actions fall into the domain of competition policy. Over the past decades, however, the increasing globalization of markets and of company activities has blurred the distinctions between truly domestic and truly foreign economic agents, and between truly domestic and truly transnational economic transactions. The consequences of these changes have also affected traditional policy perceptions on what national governments could

or should do in the field of technology and industrial policies in order to further the development of the national economy. On the one hand, globalization of economic activities implies that aspired economic returns of national policies can to a lesser and lesser extent be reserved to accrue to the domestic economy only, while at the same time international effects of national measures have to be increasingly taken into consideration. On the other hand, national technology and industrial policies seem to have assumed, just because of the globalization of markets and of company activities, an even more important role with being held in charge of creating domestic winners in the international technologies race.

Nowadays, trade policies, competition policies, and technology and industrial policies, tend to be intertwined to such an extent that it seems necessary to consider always this whole policy bundle, irrespectively of particular peculiarities of certain national policy approaches or systems.<sup>9</sup> What seems to be needed, is therefore an agreed upon multilateral framework of international rules, regulations and obligations covering the whole range of possible national misdemeanours in economic policies, as well as definitions of national policy actions that shall be considered as per se legitimate in the context of international economic relations. A couple of the major issues involved will be discussed in the following parts of this paper. They should be taken to serve just as examples for the directions

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<sup>9</sup> As experience with international trade policy frictions shows, accusations of misdemeanour assumed to have been done by a country are often countered by "tu quoque?" objections related to measures in different policy fields, but assumed to serve quite a similar objective as that of the accused practice.

towards which a new global framework for high-technology development, production and trade could evolve.<sup>10</sup>

*b. The National Treatment Standard*

The principles of non-discrimination and of transparency apart, the national treatment standard (currently embodied essentially in Article III of the GATT) seems to be a necessary basic standard for any new global framework for high-technology competition. This principle alone, notwithstanding all the restrictions limiting the scope of its recognition in current international economic law [Mc Govern, 1986], could, if really transformed into a basic law for international economic relations, contribute

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<sup>10</sup> A major source of frictions in international economic relations seems, at a first glance, to rest with opposing interpretations of existing international economic law. It would, however, be a quite fundamental error to think that shortcomings or ambiguities of existing international law are at the root of the problem. International economic law, as it exists, is essentially of the kind how national governments can agree upon that it should exist in just that manner. In this sense all proposals towards reforming international economic law are to be directed to national governments which are expected to understand that in the last event newly-shaped international rules would also serve their national interests.

Another apparent cause of frictions in international economic relations has to do with the fact that there tends to be a difference between what national governments are stating and what they are doing or intending to do. A fine example in this context can be taken from a recent Trade Policy Review of the GATT concerning the European Community [GATT, 1993, Vol. II]. The self-representation of the EC Commission on past trade policy which in fact hardly dealt with trade relations with third countries, led the first discussant to begin with the following statement [p. 118], reported in indirect speech: "The first discussant reminded the meeting of a scene of the classic movie "Casablanca" in which the French Chief of Police asked the adventurous character, incarnated by Humphrey Bogart, why he had come to Casablanca. Bogart answered, not devoid of irony, that he had come "for the waters". When the inspector said that Casablanca was in the desert, Bogart simply replied that he was "misinformed". The discussant felt that, should Adam Smith or one of his followers attend a TPR meeting, particularly if it concerned a large entity, a similar situation could arise. If Smith came for free trade, he would have to be disabused, without irony this time, that he was misinformed. The "artificial" term to disabuse is used in the quoted passage without further qualifications.



to a fundamental change of the international economic order. National treatment means, put to the extreme, that national governments do not make any difference whether they are dealing with domestic economic agents or with foreign economic agents.<sup>11</sup> In reality, a strict adherence of national governments to such a principle would have far-reaching effects, implying, among other things, that governments would no longer be allowed to nurture the development of domestic high-technology companies. When it comes to details in the application of such a principle, however, almost certainly problems of judgement will arise, because the border lines between nurturing domestic high-technology companies and building up an infrastructure that is favourable for high-technology activities at the domestic location, tend to be fluid. In a sense, it is questionable, whether and to what extent even a sweeping mutual recognition of the national-treatment principle would be conducive to reduce or to resolve international frictions in high-technology competition. It is rather more certain that the areas of alleged misdemeanour by foreign governments will change according to newly established rules in this field, but the conflict potential will always remain present. The simple reason for all this is simply that all major trading nations tend to suspect that other trading nations might carry home an „undue“ or „unreasonable“ share of the gains from trade in international economic relations, and quite naturally want to carry home themselves the highest share possible to acquire. What remains to reason about this is, then, quite simple: How to advise national governments on ways, which seem

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<sup>11</sup> National security matters are the foremost exemption which can be expected to prevail in any case. Other current exemptions from international economic law [Robertson, 1992, esp. pp. 30 sqq., and Robertson, 1994] might seem easier to be negotiated in order to establish international rules. To the international perspectives of national security matters see also Glismann, Horn, Schrader [1993].

conducive to reduce the costs of international frictions in high-technology competition without blocking the national pursuit of opportunities to further national welfare. The problem at hand is somewhat similar to the – impossible – resolution of the question how to square a circle. In international economic relations, however, even marginal extensions of areas of consensus, and be it only with procedures in conflict resolution, have proven to have had a quite substantial impact afterwards. Therefore, it appears worthwhile to consider even seemingly marginal changes of the rules of the game in international economic policy relations. And here, the most promising way is to try to persuade national governments to oblige in international economic relations to the same principles they are imposing on the behaviour of their domestic economic agents, and on foreign economic agents, insofar as the latter are affected by domestic competition policy regulations.

c. *Efforts to „Level the Playing Field“*

It is standard wisdom with regard the pursuit of national trade policy under the auspices of GATT that not foreign companies, but foreign governments, usually don't play to the rules and that therefore countermeasures against such unfair practices are in place. The principal problem with all this is, however, what a „level playing field“ is to mean in international economic relations. As the old theorem of comparative cost advantages tells us, differences across countries cause trade flows and, in the consequence, cause gains from trade [Klodt, 1995]. There have ever been critics of international economic relations suspecting unequal terms of exchange to prevail and to be perpetuated under conditions of free market competition. Nowadays, a modern variant of this argument is often advanced by

seemingly well-meaning people - often just protectionists in disguise - claiming that international differences in labour conditions or standards in environmental protection should be considered as an unjust cause for international economic exchange. The argument for a need to „level the playing field“ in international high-technology competition tends to be ambiguous in just this sense [Petersmann, 1994; Phillips, 1994]. It could mean that „unfair“ government or business practices abroad should not be allowed to take advantage from international economic exchange. But it could likewise mean that practices in a foreign system of technology development and production differing from domestic practices are considered as per-se unfair. In order to assess the relevance of the „level-playing-field“ argument, a quite simple, but nevertheless quite persuasive, approach seems to be to apply the common principles of national competition policies in the case of international economic relations.

#### **V. Towards an International Competition Order**

There are always complaints about allegedly „unfair“ gains from trade accruing to this or that nation. In a narrower perspective, complaints about an allegedly missing level playing field in certain international trade relations could be interpreted as an accusation that one or another trading nation is not playing to the rules of the international trading order, thereby trying to win an unfair extra-gain from international economic exchanges. Be this as it may, the apparent problem at hand is, whether and to what extent the contracting parties of international trade regulations can and do agree upon rules of the game which are to be observed by national governments, and which insofar restrict national sovereignty in the pursuit of economic

policies - or what regulatory powers shall be left to the discretion of nation states in the international trading system.

The emerging order of international economic relations has, of course, diminished national autonomy in shaping economic policies. This is not per se a disadvantage of the international trading order, because its very advantage rests with the fact that it supplies international public goods which can enable national governments to resist to claims put forward by national pressure groups.

The increasing integration of the world economy seems to require a kind of supervision by an international institution that is in charge for the enforcement of existing rules and for dispute settlement. The problems concerned in this area refer in particular to the following points:

- The national autonomy in regulating national economic policies is constrained by international agreements. As past experience shows national governments tend to look for ways how to circumvent their explicit international obligations.
- The mutual recognition of „trade concessions“ is of course essential in the process of multilateral trade negotiations under the auspices of the GATT.
- The monitored control of actual behaviour of national governments as established in the Trade Policy Reviews of the GATT (concerning in particular the compliance of trading partners to certain rules) is an essential feature of the existing trading order.
- International co-ordination of national economic policies is, in the last event, left to dispute settlement processes. The strongest, and last,

instrument in such a process is national retaliation, meaning that small countries have only small power to pursue their interests.

- Explicit harmonisation of rules in commercial policies is hard to achieve in the presence of diverging interests among trading nations. Past experience tends to reveal, however, that stepwise concluded compromises can over time lead into situations where previously seemingly unreconcilable national positions can actually be reconciled in a consensus.
- International trade regulations imply diminished national sovereignty; they imply, therefore, in the extreme, a federalist mutual government in the areas where international agreement has been agreed upon.

According to Scherer [1994] there exists a peculiar problem with respect to the internationalisation of competition policy. This refers in particular to the fact that governments and private economic agents face different kinds of the prisoner's dilemma in their strategies with respect to international economic relations. In economic relations among nations, the first-best solution tends normally to be simply free trade. But in the relations among internationally or only nationally competing firms, collusion seems to be always attractive. This is the result of the most probable pay-off matrix resulting from game-theoretical considerations. The conclusion from considerations of this kind is that an international regime of competition policy should be established which could reconcile diverging interests between national governments and private economic agents.

While Scherer's conclusions are hardly to be doubted in general, the problem remains of how to establish an international competition order that

could supplement, and be in accordance with, the international trading order. Several possible solutions have been discussed so far. The main issues involved may be summarised in the following points:

- There is, first of all, to be stressed the necessity that any new international code on rules for competition policy would require consensus among the members of the WTO at large, or, following the plurilateral approach, consensus among the member states of the corresponding club agreement concerned [Jackson, 1994].
- Secondly, one has to ask the question of why the member states of the WTO, or a certain group of member states, should have an incentive to agree upon rules for an international competition policy that go beyond the rules of the international trade order as currently established in the wake achievements of the Uruguay Round of trade negotiations. It is, for instance, hard to imagine that member states of the WTO should be willing to accept the consequences of the effects doctrine they were not able to agree upon so far in international negotiations [Immenga, 1995]. The case in point is here the degree to what extent an extraterritorial reach of national competition law should or could be recognised within the international community of sovereign nations. In this context, the concept of „comity“ (referring to the courtesy shown by one nation to the laws, customs etc. of other nations) seems to be of high relevance for the conduct of international economic diplomacy.<sup>12</sup>

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<sup>12</sup> One may well ask the question what else than a truly international competition policy would be needed in a world of completely free trade in goods and services, defined to include the rights of establishment and national treatment [Blackhurst, 1994].

- Thirdly, there is the problem of what can be done with regard to restrictive business practices within the framework of the existing rules of the WTO, and what kind of additional international agreements might be needed and what they should, then, regulate in detail. As past experience shows, the contracting parties of the WTO have proven to be rather reluctant to agree upon rules which could effectively deal with private restrictive business practices. The same reluctance can be expected to prevail with regard to using existing WTO rules in order to deal with private restrictive business practices [Blackhurst, 1994].
- Fourthly, WTO-regulations on national industrial or technology policies are marked by a considerable murkiness on what is allowed or on what may be tolerated by the international community. There seems to be a need for defining rules for co-operative games among governments in the field of high technology. As past experience shows, the „best“ rules are always self-enforcing rules (where sanctions have teeth). Enforcement of the rules could be guaranteed by mutual agreements on the effects doctrine (i.e. mutual agreements on extraterritorial application of national law) or by the creation of an international and impartial expert body with the competence for dispute settlement.

Summing up, the problems posed by private restrictive business practices to national governments, and to the international community of national governments, are focused on two points:

- Private companies may play foul in relation to (weak) national governments.

- National governments may promote private restrictive business practices by domestic companies at the expense of foreign competitors.

In both of these cases, the existing international economic law does not provide efficient rules for remedy. And - still to be established - international minimum and enforceable standards against restrictive business practices could well prove to be an efficient, and perhaps the only one, solution to problems of this kind.

As the best rules for business behaviour seem always to be self-enforcing rules, it is tempting to suggest that for complaints against private restrictive business practices a similar international law be created as it has been established with regard to international competition conditions in public procurements (see below).

## **VI. Opening up the Markets for Public Procurement: State of Affairs and Future Issues**

Public Procurement in advanced industrial economies covers a significant part of overall market demand. Non-defence public procurement in the member states of the European Union is estimated to represent about seven to ten per cent of gross domestic product.<sup>13</sup> It is therefore tempting for governments to use their demand for goods and services in order to achieve aims of technology and industrial policy.

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<sup>13</sup> See Messerlin [1994]. Figures of this kind do of course depend on the underlying definition of what is considered as public sector procurement. This concerns in particular the procurement policy of government owned firms and the procurement policy of firms operating in markets that are heavily regulated by government (such as utilities).



The GATT procurement code of the Tokyo Round (in force since 1981) established for the first time internationally binding rules that secured foreign competitors open and undiscriminatory access to bidding procedures for public procurement of goods (though not yet of services).<sup>14</sup> It is based on the conditioned most-favoured-nation clause, i.e. it applies only to the relationships between those contracting parties of GATT that have actually signed the code.

The Tokyo Code which was at that time widely regarded as one of the most far-reaching achievements of the Tokyo Round Agreements [Stern, Hoekman, 1987], committed only central governments and directly related entities to internationally open tenders (i.e. those surpassing certain threshold levels of tender value). The rather limited range of the Tokyo Code - covering less than ten per cent of non-defence public procurement in the United States and the European Community [Messerlin, 1994] - clearly constrained its impact from the outset and goes a long way to explain its actually very limited economic consequences. As a part of the Uruguay Round accord, the new Government Procurement Agreement (GPA) - in force from 1 January 1996 - extends the reach of the Tokyo code to potentially all kinds of non-defence procurement, i.e. to all non-defence goods and services.

The GPA is one of the three major agreements of the Uruguay Round that are not included in the so-called Single-Undertaking procedure. This means that these agreements apply only their signatories, not to all contracting

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<sup>14</sup> Government procurement had been previously exempted from GATT regulations (Art. III (8) GATT).

parties of the World Trade Organisation at large.<sup>15</sup> The potential value of contracts that will be covered by the GPA in signatory states is roughly estimated to about US \$ 400 billion annually in current prices.<sup>16</sup>

There are mainly two areas in which the GPA breaks new ground by the standard of its Tokyo Code predecessor. these concern (i) extensions of the coverage provided by the GPA, and (ii) disciplines imposed by the GPA on signatories.

(i) Coverage of the GPA: The principle of exchange of „trade concessions“ that has governed all multilateral trade negotiations under the auspices of GATT means in the context of GPA that contracting parties concede

- „Items“ (i.e. certain groups of goods and services) to be opened in public tenders to foreign competition, and
- „entities“ (public or semi-public bodies) designated to open their tenders for bids by foreign suppliers.

The new GPA extends the range with respect to both „entities“ and „items“ concerned. Under the new agreement (Article I) all tenders regarding rentals or leases of goods and tenders regarding the procurement of services shall be included.

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<sup>15</sup> The other two agreements are the Arrangement Regarding Bovine Meat and the International Dairy Arrangement. A fourth plurilateral agreement under the umbrella of the WTO, the agreement on Trade in Civil Aircraft, was not changed at the end of the Uruguay Round and remained open to signature only in its already existing form. Parties of the GPA are at present Canada, the fifteen member states of the European Union, Norway, Switzerland, Japan, the United States, Israel and South Korea. Singapore was a signatory of the Tokyo Code, but opted out this time. In turn, South Korea entered the club as a new member.

<sup>16</sup> See Schott [1994], OECD [1994(b)], Ostry and Nelson [1994].

These general extensions are, however, limited by exemptions listed in the Annex of the Agreement for each signatory state.<sup>17</sup> Limits concerning goods are listed as exemptions, limits concerning services apply to all items that are not explicitly enumerated. This distinction is in accordance with the different philosophies of regulation in the GATT (for goods) and the GATS (for services). The institutional solutions chosen in service sectors are likely to favour bilateral deals of sectoral reciprocity, thus undermining attempts to arrive at a multilateral framework. A similar tendency prevails in the so-called exempted areas of public procurement of goods, notably of telecommunications equipment. As far as public or semi-public „entities“ are concerned, the new GPA has in principal been extended to „sub-central“ entities, i.e. basically regional and local government entities. However, those sub-central entities that are in fact obliged to open their tenders to foreign competition, are enumerated in the annex to the GPA.<sup>18</sup>

There are two major problems involved in the definition of „public entities“. First, the power of the contracting party - the central government - to control the conduct of sub-central entities may be rather limited, e.g. in the case of federal member states. Second, previously „public firms“, once included in international arrangements on public procurement, may become privatised, thus leaving other contracting parties with a loss of „trade concessions“ formerly granted to them.

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<sup>17</sup> Note that the public procurement regulation of the European Union which in many instances seems to have served as an example for the WTO procurement regulation, does not contain exemptions by „public entities“ or „items“ except the general exemption of defence procurement.

<sup>18</sup> For instance, in the case of the United States, many of the obligations under this treaty are limited to a rather small number of states.

(ii) Disciplines Imposed by the GPA. According to the two basic principles embedded in the GPA, suppliers from other signatory states should benefit from the conditional MFN clause, and thus tendering procedures should not entail any discrimination between domestic suppliers and suppliers from other signatory states [Hoekman and Mavroidis, 1995]. In turn, discrimination against suppliers from third countries (i.e. non-members of the GPA) is still allowed, which is consistent with the philosophy of the WTO as an open club.

A core achievement of the new GPA is that foreign suppliers discriminated against in a national tendering process can use the so-called challenge procedure, i.e. they can submit their appeal directly to a ruling by the courts of the country that issued the respective tender, and these courts are then obliged to provide reasonably rapid proceedings.<sup>19</sup>

Moreover, „offsets“ (i.e. deviations from the GPA) are explicitly prohibited by Art. XVI meaning that additional requirements attached to a bid on a national public tender (e.g. local content, countertrade and the like) are to be considered illegal. Furthermore, the GPA does not contain any safeguard clause that could allow signatory states to refrain from or to circumvent their obligations under this agreement. On the other hand the GPA does not contain any provision against collusion among bidding domestic firms, which is left to the competence of domestic competition policy.

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<sup>19</sup> In addition, the WTO dispute settlement procedures are open to such cases and can also be used. There are, however, significant differences between these two routes of appeal against discriminatory treatment by particular national „public entities“. To be successful in a WTO dispute settlement procedure, the claimant (the government of the affected firm) must provide evidence that its previously granted trade concessions were impeded in the case in question.

The regulations of the GPA, which by themselves appear to be quite strict ones<sup>20</sup>, may yet be undermined by regulations of the TRIPs Agreement (Agreement on Trade-Related Intellectual Property) of the Uruguay Round. This means in particular that a national government will still be allowed to specify the conditions of a tender, if „there is no sufficiently precise or intelligible way of describing the procurement requirements and provided that words such as ‘or equivalent’ are included in the tender documentation (Article VI.3 GPA).<sup>21</sup> This provision may give national governments enough leeway to restrain international competition whenever they think it to be appropriate.

In practice, foreign firms affected by discrimination in public tendering procedures will weigh the possible advantages of a court ruling in their favour against the disadvantages of possibly foregoing the good will of the respective government. In the longer term, however, the opportunities established for foreign suppliers’ access to domestic court procedures should work in the direction that national governments will increasingly behave more strictly according to the rule laid down in the GPA.

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<sup>20</sup> Here are selected articles of the GPA with some relevance to the issue of maintaining club discipline: Art. VI defines rules for technical specifications of the items included in a tender; Art. VII regulates the choice among possible tendering procedures; Art. VIII is concerned with qualification requirements for tenderers; the invitation procedures to participate in a tender are circumscribed in Art. IX; the selection procedure is outlined in Art. X; prescriptions on time schedules are given in Art. XI, on necessary documentations in Art. XII; submission procedures are regulated in Art. XIII; Article XIV to XVIII are primarily concerned with other technicalities of the tendering process; finally, Art. XIX requires that the parties concerned have to collect annual statistics and to provide these statistics to the Committee on Government Procurement at the WTO - which by the way can be considered as the „nucleus“ of a future supervision board in this area the creation of which is considered necessary by many experts [Ostry, 1995].

<sup>21</sup> See also Laffont and Tirole [1991].

Although, clearly, the GPA is a major step in the right direction, there remain also major problems unsolved:

- At present, WTO regulations still allow legal subsidies to R&D activities and subsidies on regional policy grounds. This opens the gate for abuse in national procurement: E.g. a national government may grant R&D subsidies and then define the terms of a later procurement tender on the basis of those specific R&D requirements that only a domestic firm can possibly meet. Bidders from the outside would quite have little chance to succeed in such a procurement tender.
- Decisions of governments on matters of national security are exempted from WTO regulations. Clauses of this kind can also be misused, in particular with respect to the treatment of dual-use goods and services (i.e. goods and services that can be used for both military (security) and civilian purposes).
- The many national exemptions in the GPA with respect to public entities and items (or sectors) are likely to encourage bilateral bargaining, which is not in the spirit of an international and multilateral framework of trade regulation.
- The question of what has to be considered as a public enterprise or as an enterprise under significant influence of government, can be hardly answered on the basis of common criteria across countries. As this definition is highly critical for the assessment of trade concessions in international trade negotiations, there is a strong need for further international agreements on this matter.

As the new GPA code is entering into force by 1 January 1996, it remains to be seen, how effective this code will prove to be, and whether the problems enumerated above will in fact put into question the overall spirit of the whole venture.

## **VII. Conclusions**

To sum up, in the case of globalizing markets and mutually integrating national economies, the question is becoming increasingly irresistible of why global economic relations should be subdued to a different set of rules than national economies - as expressed in national competition laws. There is in fact every reason to treat foreign subjects always in the same manner as domestic subjects („national treatment“ in the GATT-language). This would have far-reaching consequences. And there is a for-rider for all this institutional change, namely the Government Procurement Agreement. If the disciplines embodied in the GPA were to be generalised, one would in fact end up in a more or less world-wide internal market where any economic agent of whatever country's origin would be entitled to sue against any other country's undue government behaviour in commercial policies. But that is certainly a too futuristic view on the future of international trade policies.

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