

13. Economic Integration and Competition Policy: The Agenda for APEC

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1. Introduction

The decision by eighteen countries in the Asia Pacific region to form a free trade group via the Asia Pacific Economic Co-operation (APEC) processes by 2020 has led to attention being placed on obstacles to economic integration. Trade liberalisation is a significant first step to closer economic ties between countries at various stages of economic development. As traditional trade barriers such as tariffs are removed, non-tariff barriers become more visible. One of the major emerging issues for Asia Pacific integration is the different approaches to competition policy taken by APEC members.

Trade policy and competition policy would appear to have a similar objective. Competition policy aims to improve technical efficiency by increasing competition between firms. Trade policy which lowers tariffs and other barriers to trade would increase domestic competition and improve efficiency. However trade policies which introduce or maintain restrictions on imports and foreign investment may be contrary to the objectives of domestic competition policy. Further, inconsistent treatment of certain anti-competitive practices between countries may diminish the benefits from dismantling tariffs barriers between countries.

The increasing globalisation of markets and the development of trade blocs such as APEC and NAFTA (North American Free Trade Agreement) have led to attention being focussed on mechanisms to enhance cooperation between national competition authorities and perhaps at a later stage encourage greater co-ordination and consistency of competition law and policy between countries.

Section 2 of this chapter explains the case for competition rules within trade groups. There has been considerable discussion in the literature in recent years on whether a worldwide system of competition rules is appropriate. Approaches include those discussed by the Organisation for Economic Co-operation and Development (OECD) (1994), Scherer (1996) and Waverman, Comanor and Goto (1997). The general theme of much of the discussion has been that there is a need for international co-operation in competition policy administration. However there is considerable diversity in views as to how such co-operation should take place. For trade groups such as APEC, with widely divergent levels of economic development, and different legal, social and political institutions, the issue of co-operation versus autonomy in competition policy is particularly complex.

Section 3 of the chapter examines the general elements of competition policy found in APEC countries and the different approaches taken to certain types of

market conduct. The attitude of competition authorities to activities such as import and export cartels, vertical restraints, resale price maintenance, mergers and dominant firm behaviour will likely have a significant impact on the pace of integration between APEC members.

The methodology for establishing co-operation between APEC members is considered in the section 4 of the chapter. While there have been some attempts at bilateral harmonisation of competition policies between APEC members, much remains to be done. It may be that supra-national organisations such as the World Trade Organisation (WTO) provide the appropriate mechanisms for examination of these issues. However, it is likely that greater co-operation will occur first, between trading partners and, at a multilateral level, within trade groups. Section 5 concludes the chapter.

2. The case for co-ordination of competition rules

In many countries national markets are becoming more widely affected by international factors. After the completion of the seven rounds of the General Agreement on Tariffs and Trade (GATT), tariffs are now a minor impediment to international trade in manufactured goods. Within APEC, many of the members will move to free trade within the group by 2010 with the remainder moving to free trade by 2020.

The liberalisation of foreign investment rules and improvements in transport and communications have led to goods and services being produced by large multinational corporations in a range of countries. Components are produced in different countries and perhaps assembled somewhere else. The existence of independent competition policy jurisdictions in each country and the possibility that competition policy rules may not be consistent between countries is likely to reduce the efficiency gains that might result from such specialisation. Differences in competition rules between countries may distort investment decisions and production flows to the detriment of efficiency in resource allocation between countries.

Greater co-operation between countries on competition policy may assist in breaking down domestic monopolies in countries within the non-traded goods sectors and especially service sectors. The liberalisation of domestic foreign investment rules may be insufficient to encourage the entry of foreign firms if such entry requires access to some monopoly facility. Competition policy which mandates access to essential facilities such as electricity grids and/or telecommunications lines may be needed to allow foreign firms to compete effectively in domestic markets.

One of the most important areas where competition policy co-operation may be appropriate is where domestic industry policy and competition policy have been used to benefit local firms at the expense of foreign firms and countries. Krugman (1994) observed that the non-implementation of competition policy domestically might give firms from that country an advantage in foreign markets. For example, policies which

allow joint ventures and export cartels in international markets may be rational from the point of view of the domestic country if they raise the returns to domestic firms from their international businesses. However, if practiced by all countries, total economic welfare from such behaviour would be significantly reduced.

Industrial policy directed towards a specific industry may be contrary to international competition policy co-operation. Gifford and Matsushita (1996) claimed that the most frequent and widely experienced conflicts between industrial policy and competition policy occur in circumstances where a domestic industry is subject to competition from foreign competitors after having lost its international competitiveness. Under such circumstances, governments may intervene to encourage the restructuring of the domestic industry and to temporarily protect the local industry from foreign competition. The restructuring often consolidates domestic firms, reducing domestic competition as well as preventing foreign firms from entering via acquiring the assets of those firms no longer able to compete.

A related issue is the sometimes inconsistent treatment of industries within a country. Competition policy tends to be more universally applied within a country than industry policy, which is often used to favour certain industries at the expense of others. International competition policy co-operation can be a useful mechanism by which countries prevent certain industries from gaining specific advantages. For example, in many countries, certain domestic industries may lobby governments for industrial policies which assist those industries at the expense of other domestic industries. International competition policy co-ordination may assist governments in avoiding politically motivated assistance to particular industries for fear of breaching international obligations. Further, competition policy co-ordination may allow countries to avoid taking action against specific problems. The best example here is the problem of dumping. Countries sometimes take specific anti-dumping actions such as import duties and 'voluntary' restraints, which generate competitive distortions. Such distortions are more likely to be avoided if competition policy co-ordination between the countries can be used where dumping allegations occur.

Many trade policy issues are essentially issues of international competition policy. For example disputes over dumping may best be addressed by applying competition policy. As such disputes are essentially related to allegations of price discrimination and/or predatory pricing, the application of the competition policies of the countries concerned may offer the most satisfactory resolution mechanisms. An arrangement between Australia and New Zealand provides an example of such an approach.

Australia and New Zealand have replaced anti-dumping laws between the two countries with the application of competition policy with regard to the misuse of market power. As a consequence, Robertson (1996), noted that anti-dumping actions, which are often designed to prevent foreign competition in domestic markets and tend to favour the import competing complainant, are replaced by application of

general competition policy and take into account the interests of consumers and user industries and the effects on overall economic welfare.

Co-ordination of competition policy between countries can enable competition policy administrators to extend their reach to areas of behaviour which may not be covered by domestic competition policy. Markets such as international aviation and shipping may best be regulated via international co-operation between competition policy authorities.

A related issue is the circumstance where anti-competitive behaviour might adversely affect domestic competition but that behaviour is not within the jurisdiction of the domestic competition regulator. For example a merger between a domestic firm and a foreign firm where the foreign firm has no domestic presence may still impact on competition in the domestic market. The foreign firm may have been able to easily enter the domestic market via exporting to the domestic market. The threat to the domestic firm of such entry via imports may have been a sufficient threat to maintain competitive pricing behaviour in the domestic market. The merger, by eliminating such a threat, may impact on competition in the domestic market yet be beyond the scope of domestic competition policy regulation. Agreements between transnational firms to engage in international market sharing may also be examples of anti competitive behaviour not caught by domestic competition policy regulation.

There may be substantial cost savings to firms and regulatory agencies from better co-ordination of competition policy. Different competition rules between countries can give transnational firms considerable uncertainty. For example acquisitions may be legal in some jurisdictions and not in others, while certain types of behaviour considered anti-competitive in some countries may not be a concern in others. The cost to the regulatory agencies may also be substantial in terms of duplication of investigations where different jurisdictions and rules apply.

3. Areas of Conflict in APEC

At present there are considerable differences in the treatment of certain types of market behaviour in APEC countries. The treatment of conduct such as import and export cartels, vertical restraints and resale price maintenance impacts considerably on trade. Similarly, competition policy relating to market structure, such as merger policy and treatment of dominant firms may impact on trade relations between countries.

Export and Import Cartels

Many APEC members permit and even encourage export cartels. There may be a deliberate attempt to use an export cartel to improve a country's terms of trade by shifting economic rents from the importing country to the cartel sellers of the exporting country.

Scherer (1994) describes a range of possible cartel situations. Domestic producers may join international cartels with producers from other countries.

Sometimes these cartels then engage in market sharing and no compete arrangements worldwide. Such cartels affect international trade relations as well as facilitating monopoly pricing by engaging in output restrictions.

Domestic cartels may also have international effects. If members of a domestic cartel also produce for export, these firms may be advantaged by earning high domestic profits which might be reinvested in expansion of capacity and/or research and development, further enhancing their competitive position in export markets. The increased output may be “dumped” in the markets of trading partners generating trade and competition policy issues. Of course, for such a strategy to be effective the domestic producers would generally need to be protected from import competition, which would otherwise likely occur, given the high domestic cartel prices.

Within APEC no country explicitly prohibits export cartels. For example, in Taiwan export cartels can be authorised. Under Japanese and US competition policy they are partially exempt. Mexico provides exemptions for specific exporters. New Zealand grants exemptions if the export cartel affects only export markets.

Sometimes countries exempt import cartels from competition policy. Taiwan and Japan both allow import cartels under certain circumstances. This may be in response to the activities of an export cartel or it may be simply to take advantage of monopsonistic buying power to turn the terms of trade to the advantage of the importing country. In some countries domestic petroleum importers have been given exemption from domestic competition laws so that they were able to form a monopsonistic buyer group to provide countervailing power to the OPEC oil export cartel.

In some APEC countries cartel exemptions are extensive. Taiwan, Japan and South Korea provide exemptions for what are commonly called ‘crisis’ cartels. Under circumstances such as exist in economic recessions, rationalisation and specialisation cartels are allowed whereby plants are closed and production is reallocated to particular plants to increase efficiency. The major objective of a crisis cartel is generally to rescue a domestic industry suffering severe import competition.

Crisis cartels are sometimes justified on the grounds that they do nothing more than the market would have done, closing inefficient plants and shifting production to the efficient, but do it faster. However in the absence of the cartel arrangement, the final market structure derived from market forces might be different. In particular, as the crisis cartel often occurs because of rapid import growth, the free market outcome may be a market dominated by foreign rather than domestic production. Crisis cartels, especially if assisted by foreign investment restrictions, may ensure the maintenance of domestic ownership of production at the expense of freer international trade.

Vertical Restraints

One of the more difficult issues for governments is the treatment of vertical relationships between suppliers and customers. Such vertical relationships include

vertical integration where upstream and downstream firms are under common ownership; foreclosing or hindering entry at a single level; refusals by a firm to buy from particular upstream suppliers or sell to particular downstream customers; and restrictions imposed by the upstream firm on the selling behaviour of downstream customers such as restrictions on the geographic area in which the customer can sell and restrictions on what competing products the customer can sell through the use of exclusive dealing arrangements. Price restrictions imposed by upstream suppliers on downstream customers (resale price maintenance) may also be examples of vertical restraints. (Price restrictions will be considered separately).

Competition policy with regard to vertical practices varies considerably between countries. It has also varied within countries over time. One of the major difficulties in developing a consistent policy is that economists disagree as to the extent of the anti-competitive effects of vertical arrangements.

Until around the mid 1980's there was a popular view among economists that vertical foreclosure was unlikely. However there is now considerable debate among economists as to the anti-competitive impact of vertical arrangements. Carlton and Perloff (1994) summarise the arguments and note the lack of consistency between economists by concluding that vertical restrictions have the potential for both pro-competitive and anti-competitive effects.

The treatment of vertical relationships by competition authorities is the source of some considerable friction in international trade. Lawrence (1991) noted that vertical arrangements have been cited as one of the major reasons why foreign suppliers have had difficulties in gaining access to Japanese markets. However the US also treats vertical arrangements fairly generously. Comanor and Rey (1995) commented that between 1981 and 1992 no US enforcement action was taken against vertical price or non-price restraints. While exclusive dealing and tie-ins are subject to a competition test under US law such that they are illegal if the result is to lessen competition, there are no specific prohibitions or anti-competitive tests with regard to other vertical behaviour such as third line forcing or territorial restrictions.

While in Japan these vertical links are subject to a competition test, US and other foreign suppliers argue that the existence of corporate networks, (the so-called 'keiretsu' relationships) exclude foreign suppliers from Japanese markets. However it is probable that the keiretsu relationships are not specifically designed to prevent foreign competition. Foreign suppliers are probably treated no differently to any other suppliers from outside the keiretsu arrangements according to Matsushita (1993).

As the APEC members move towards their objective of free trade by 2020, the treatment by member countries of vertical arrangements will be a significant issue. At present APEC countries have no significant competition policy towards vertical relationships. In Australia most vertical practices are subject to a competition test and/or may be authorised. In Taiwan a rule of reason test is applied to vertical restraints with emphasis placed on the market share of the firm or transaction

involved. In Korea, Japan, Mexico and the USA most vertical relationships are subject to a competition test or a test of reasonableness. In Thailand prohibitions on vertical restraints exist for 'controlled' products, generally consumer products for daily usage. It is likely that vertical arrangements will become a significant issue in APEC trade yet co-ordination of such arrangements will be extremely difficult when there is no generally accepted economic theory as to the anticompetitive effects of such arrangements.

Resale Price Maintenance

Resale price maintenance (RPM) affects competition between domestic and foreign firms. RPM agreements between suppliers and resellers insulate the resellers from price competition. At first sight it would seem that RPM arrangements would have little impact on international trade and therefore would not be an issue in terms of potential conflicts between different countries' competition policies.

However RPM can affect distribution and retail structures which in turn affect the ability of foreign firms to compete. For example, in those countries where RPM has been legal, its intent has often been to protect small retailers from competition from large department stores, supermarkets and discount chains. Large retail groups carrying a wide range of goods are more likely to carry imported goods, so to the extent that RPM is successful in maintaining the distribution structure based on small retailers, imports may be restricted.

Most APEC countries with specific competition legislation restrict RPM. In Australia and Japan RPM is a per se offence and is once again enforced in the US after the Clinton Administration abandoned the previous administration's policy of not enforcing the RPM provisions of US antitrust law. In Taiwan, Korea and New Zealand, RPM may be authorised while in Mexico it is subject to a competition test and is illegal if the result is to lessen competition. Other APEC countries such as Singapore, Hong Kong, Indonesia and the Philippines have no restrictions on RPM.

Mergers and Dominant Firm Behaviour

Competition policy directed towards horizontal agreements (cartels), vertical arrangements and RPM are designed to impact on the conduct of firms affected. A second part of effective competition policy is directed to market structure. Here the approach is to provide market structures with a sufficient number of firms to ensure that competitive behaviour is the natural outcome. Structural aspects of competition policy relate to preventing monopoly and/or dominance via merger restrictions, and to breaking up monopolies where they have already occurred.

There is considerable potential for internal policy conflict between industrial policy and competition policy in the area of merger regulation. A major objective of industrial policy in all countries is the establishment of large firms capable of achieving economies of scale, and gaining efficiency. In many smaller economies, markets dominated by a few large firms may be the outcome. In certain APEC

countries governments have deliberately encouraged the growth of large firms in particular sectors. For example, the Korean industrialisation program relied on a big-business oriented growth strategy together with regulations on entry and protection from foreign competition. Takahashi (1995) observes that the outcome has been a highly concentrated oligopolistic industrial structure of large business conglomerates.

In some countries the 'national champion' industrial policy has considerable influence. The argument that small economies can at best produce one or two firms in an industry capable of achieving scale of economies, undertaking research and development and securing world markets has been used at times to give industrial policy precedence over competition policy. This argument has of course been strongly criticised, most notably by Porter (1990) who argued that policies which encourage intense domestic rivalry are more likely to lead to greater international competitiveness and innovation than policies encouraging monopoly.

It would seem that issues of market dominance and monopolisation are primarily an internal matter. But while the policy conflict is internal, there is also an international trade dimension. Domestic competition policy, which allows the development and maintenance of monopoly, can cause international concern. This could occur in two ways.

First, a dominant firm may use the power of the domestic monopoly to try to dominate or monopolise a foreign market. For example, by using monopoly profits earned in the domestic market, the dominant firm may engage in predatory pricing or subsidisation in the foreign/export market. Under such circumstances, the failure of the exporting country to have effective competition law against dominance and monopolisation impacts on the industry of the importing country.

Secondly, the dominant firm may be able to keep imports out of its home market. For example, a dominant firm may control distribution mechanisms via a vertically integrated structure or it may be able to use its dominant position as a supplier to coerce independent distributors and/or retailers from buying competitive imports. While such activity tends to provide the greater harm to the consumers of the country where the dominant firm is based, it distorts trade flows and is likely to be a source of friction between trading partners.

All APEC countries that have some specific competition policy have controls over monopolisation and dominant firm behaviour. However the definitions of monopolisation and dominance vary considerably between APEC members. Some countries use a quantitative measure. For example in Taiwan and Korea, a firm having a 50 percent market share is described as dominant. In other countries a behaviour test is adopted whereby regulators examine the extent to which a firm's behaviour is constrained by the conduct of rivals. However, there is no consistency between APEC members on appropriate merger policy.

4. Barriers to Co-operation

There is widespread agreement among APEC member countries that greater international co-operation in the enforcement of competition policy is both desirable and necessary. However there are many difficulties in achieving such an outcome.

A major issue is the sequencing of trade, industry and competition policy reforms. In most APEC countries trade liberalisation has been proceeding for many years. Industry deregulation is generally of more recent origin while competition policy has generally been instituted last. In many of the countries of the Association of South East Asian Nations (ASEAN), trade liberalisation and industry deregulation began up to a decade ago while competition policy is only now just being considered. In contrast, Japan is second only to the United States in terms of how long some form of competition policy has been in operation. Australia followed a different sequence, introducing competition policy in the early 1970s, but its trade liberalisation did not begin in earnest until the late 1980s and much industry deregulation even more recently.

Bollard (1997) argued that trade and industry deregulation could be promoted independently in the early stages of liberalisation, but as their effectiveness depended on how efficiently domestic markets operated, competition policy reform needed to keep pace. He claimed that without competition policy reform, deregulated firms might merge and restore the monopoly power eliminated by deregulation.

An alternate view is that as trade liberalisation and industry deregulation reduces market distortions and the market power of national firms, there may be less need to institute competition policy co-ordination. However Nicolaides (1997) argued that such an approach relied on the assumption that national markets were competitive prior to trade and industry deregulation. He pointed out that in most countries, markets are not competitive and the process of economic integration between countries may enable firms with national market power to preserve and enhance their power in a now larger market.

A reduction in tariff barriers, for example, might provide an incentive for domestic firms to collude to keep out foreign rivals. Alternatively the reduction in trade barriers between countries may encourage firms in each country to enter into market sharing arrangements to preserve market shares in their 'home' country.

It seems therefore that APEC members will have little choice but to attempt some form of competition policy co-ordination over the next few years as trade barriers fall.

However there are significant problems to be overcome. In the first instance economists do not agree on the essential elements of a competition policy nor on the relative importance of these elements. For example, concepts of market dominance and monopolisation, the anti-competition impact of vertical arrangements and RPM are issues where economists provide no clear-cut guidance for regulators.

Various countries in APEC have profoundly different views on business behaviour. In Australia, Canada, the US and New Zealand competition policy reform has had a high degree of support from the political processes. In some Asian APEC

countries, competition policy has less support. In the Western democracies competition policy concerns are primarily related to anti-competitive agreements between businesses while in some Asian APEC countries competition issues are sometimes related to anti-competitive arrangements between business and government or monopolisation by business via facilitating regulation from the government.

Waverman and Wu (1995) noted that cultural and economic factors have influenced competition policy. Japan has historically tended to look more favourably on co-operation between firms than the US. The US approach has tended to see efficiency as the sole objective of competition policy, while in other countries, social objectives have greater relevance.

One of the major difficulties for APEC countries in developing greater co-ordination of competition policies is the considerable difference in the stage of economic development. Some developing countries may wish to exempt government trading enterprises from competition to allow such enterprises to pursue social objectives. While such exemptions are provided by a number of the developed APEC countries, these countries typically have alternative mechanisms to promote social objectives and nowadays have fewer government trading enterprises which can be used for this objective. The slowdown in the rate of growth of many Asian economies and the return to inward looking economic policies may cause some APEC economies to give even greater weight to social objectives over the next few years.

The Way Ahead for APEC

It is unrealistic to expect that APEC will be able to move to total harmonisation of competition policies. Harmonisation would lead to the ultimate convergence of competition law and policy across all APEC countries. Given that economic theory provides no clear-cut direction to pursue and that many of the countries in APEC have substantially different industry policies impacting on competition policy, harmonisation should not be the objective at this stage. However at the Singapore Ministerial Conference of the WTO in 1996, it was agreed that a new working group be established on 'The Interaction between Trade and Competition Policy'. A number of meetings have been held subsequently. At this stage the meetings have as their major objective, the development of an understanding of the links between trade and competition policy, rather than an agenda for competition policy harmonisation.

There is a high degree of resistance to an international competition code in some industrialising APEC countries. A number of countries have expressed concern that the WTO processes will be used to impose an international competition code. The OECD (1994a) indicated that while it saw the desirability of convergence in competition policies between countries, it did not see convergence as leading to uniformity. The OECD recognised that competition law will necessarily reflect the institutional and policy framework of each member country.

Nevertheless, the OECD (1995) encouraged greater co-operation between competition policy authorities. Three different approaches were suggested. First it recommended that countries provide notification to another country of any investigations or proceeding which affect another country. Second it recommended greater co-ordination between competition policy authorities with regard to information sharing, subject to confidentiality laws. Third it recommended that countries assist each other by responding to requests for information by providing public information and by informing another country if it is aware of conduct which might breach the competition laws of the other country.

APEC has begun to develop mechanisms to co-ordinate competition policy. APEC workshops in Canada in 1997 and Thailand in 1998 and 1999 addressed competition policy co-ordination. One of the first developments has been the establishment by Taipei's Fair Trade Commission of a database, which will provide information relating to competition laws and policies, administrative procedures, organisational structures and co-operative agreements between APEC members. A Competition Policy Information and Research Centre is also being established.

The APEC Eminent Persons Committee has proposed that a dispute settlement process be established to deal with competition policy issues between APEC members, and at APEC's November 1995 meeting in Osaka, Japan it was agreed that collective action on competition policy would be necessary.

One option for improved co-ordination is that those APEC countries with long established competition policies should make available their resources and expertise to those APEC members with less developed competition policy regimes. Such assistance would likely promote opportunities for co-ordination and perhaps harmonisation. For example, Australia has provided training to officials from Thailand, Malaysia, Indonesia, China, the Philippines and Vietnam to assist in the development of competition policies. Such assistance and training programs have the potential to promote improved co-operation between APEC members over the long term.

There are a number of areas where multilateral co-ordination may be possible. In many APEC countries, even those with strong competition laws, there is a difference between the treatment of domestic consumers and foreign consumers. The exemption from national competition laws of cartels directed solely to foreign consumers is the prime example. APEC government co-ordination to include export cartels in the scope of national competition laws might be an appropriate first step. The commitment of APEC governments to free trade might be measured by the extent to which they adopt and enforce laws against cartels that harm trading partners.

It is however probable that most competition policy co-ordination within APEC will develop from bilateral rather than multi-lateral negotiation. Greater economic integration between APEC members will facilitate the establishment of bilateral agreements. It is no surprise that the major bilateral co-operation arrangements have been made between countries with closely integrated economies and similar legal

systems. The agreement between Australia and New Zealand sets a very high benchmark for future bilateral arrangements by APEC members. Two national systems are linked in a manner similar to the European Union but without a single regulatory authority and without supranational law.

In this regard, the application of “positive comity” principles might be logical next step in bilateral arrangements. This principle involves seeking the foreign government to take action on anti-competitive behaviour in its country that damages business in another country. Immenga (1997) quotes a review of the US-EC bilateral arrangements which states that ‘positive comity’ is likely to lead to the creation of conditions favouring the gradual alignment of laws, lower firms’ costs and increase their legal security, and lead to the promotion of equal conditions of competition across countries.

5. Conclusion

Increased co-operation between APEC members with regard to their competition policies is a necessary adjunct to the removal of trade barriers within APEC. However it is unrealistic and probably damaging to trade objectives to promote harmonisation of competition policy at this stage. The diverse economic, social and cultural conditions prevailing in the various APEC countries cannot be reconciled to a single competition policy or supranational competition regulator.

Co-ordination within APEC via greater co-operation between competition policy agencies and the promotion of bilateral and sub-regional arrangements may be the best that can be achieved in the short term. However, to ignore the issue would mean that the potential gains from economic integration of the APEC economies would be diminished.

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