

ICN panel on Small Economies

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I have been asked to focus my remarks on the relationship of small economies with other jurisdictions. This is an important subject: the environment in which the small economy operates significantly affects its competition-related issues and its ability to deal effectively with them.

In the short time I have, I would like to point to six effects that result from such a relationship. Some of them have been explored in depth in my book on competition policy for small market economies,¹ and some have been explored in my more recent work.²

First, and most basically- **definition**. In my view, the degree of trade with other jurisdictions is one of the main factors that determines whether a country should be considered a small economy or not, for competition law purposes. A small economy is an independent jurisdiction that can support only a small number of firms in most of its industries.³ If a country is economically integrated with its large neighboring state due to low entry barriers, then it will benefit from competition among importers who can easily operate within it. It will thus not suffer from the significant competitive constraints that characterize small economies. Think about Andorra, Monaco and Lichtenstein- do they suffer from significant competitive constraints? Not really, since they are effectively part and parcel of the markets of their large neighboring states. Thus, a high level of trade and integration with neighboring jurisdictions negates a presumption of smallness which is based on population size alone.

Second point: oftentimes increasing trade levels with other jurisdictions is a first-best **solution to solving** some of the competitiveness issues of the small economy. International trade offers an extremely important solution to domestic firms in small economies: export opportunities might enable such firms to realize scale and scope economies, by expanding the market beyond their domestic borders. In addition, imports may increase pro-competitive pressures in the small economy by increasing the number of firms operating in the market. Of course, international trade should be approached with some caution, especially where local industry has not

¹ See, in particular, Michal S. Gal, *Competition Policy for Small Market Economies* (Harvard University Press, 2003).

² See, inter alia, papers posted in http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=163287.

³ See, e.g. Gal, *Small Economies*, supra, chapter 1; Michal S. Gal, "Size Does Matter: General Policy Prescriptions for Optimal Competition Rules in Small Economies," (2001) 73 *University of Southern California Law Review* 1468.

yet realized learning economies, but if used properly is an important tool to overcome some of the problems that plague small economies.

Third point: trade levels determine, to a large extent, the **ability** of a small jurisdiction to **apply, in practice**, its competition laws to international firms. Indeed, a study I conducted to which many competition authorities have been extremely kind to contribute by answering questionnaires has confirmed what we all suspected intuitively: Small economies rarely, if ever, bring cases against international firms.⁴ One of the main reasons is because small jurisdictions can rarely make a credible threat to prohibit the conduct of a foreign firm.

Consider **an example** of a merger that has no negative welfare effects in a large jurisdiction. If trade in the small jurisdiction constitutes only a small part of the foreign firm's total world operation and thus the gains from trade within it are limited, were the small jurisdiction to place significant restrictions on the foreign firm and the costs of compliance would be high, it would most likely choose to exit the small country and trade only in other jurisdictions. In practice, however, such an exit will rarely occur. This is because the negative welfare effects on the small country from the exit of the foreign firm may well eclipse the negative effects from its continued operation within its borders. Accordingly, a small country usually has limited incentives to prevent the merged entity from trading within its borders even if the merger reduces its welfare. The foreign firm, acknowledging this effect, will not take into account, in its merging decision, the effect of its decision on the small country. It will only consider the effects of the merger on its own profits in such a market. This is a direct result of limited trade levels.

This fact has important implications, since it implies that in practice the small jurisdiction often cannot prevent the anti-competitive conduct of large, multi-national firms. Instead, small jurisdictions sometimes adopt behavioral and conduct remedies which do not constrain the operations of the international firm too much but solve the local problem. For example, they impose local divestiture remedies or behavioral constraints.

The **fourth point** relates to the **content** of a small economy's competition laws. Small size strengthens the motivation to transplant the competition laws of other, large and established jurisdictions.⁵ True, size affects the

⁴ Michal S. Gal, "The Globalization of Antitrust: The Unique Challenges of Small and Developing Jurisdictions" (on file with author at mgalresearch@gmail.com).

⁵ Michal S. Gal, "The 'Cut and Paste' of Article 82 of the EU Treaty in Israel: Conditions for a Successful Transplant" (2007) 9 *European Journal of Law Reform* 467, can be downloaded from

optimal content of some substantive laws but it does not affect the content of most rules. There are strong motivations for transplant: the adoption of "ready made" and pre-tested legal rules saves the costs of determining what content ought to be given to the law in a given jurisdiction. But more importantly for a small jurisdiction, an established antitrust regime has a long history of implementation, interpretation and academic discourse in its saddlebag, which is continuously evolving. Typically, the smaller the jurisdiction, the longer the time that can be expected to elapse before content will be given to a legal rule. This is because the limited size of the population implies that fewer disputes will reach the courts. Legal transplantation reduces this problem by allowing lawmakers in the small jurisdiction to rely upon analysis conducted in a foreign jurisdiction, which can also invest much more in creating better laws. It is thus no surprise that many small jurisdictions follow the laws and case law of large, established ones.

The last two points relate to the use that small jurisdictions can make of connections with other jurisdictions in order to **increase enforcement**. An important connection with neighboring jurisdictions involves the creation of **regional competition** authorities.⁶ Such authorities hold an important key for overcoming some of the enforcement limitations involved in small size. For one, such agreements can create a credible threat to foreign firms that reduce welfare in them. If, for example, a sufficient number of jurisdictions join forces to prevent a foreign merger, then this might create sufficient economic incentives for foreign firms to abandon their attempts to merge. In addition, such regional agreements may allow small jurisdictions to aggregate their enforcement resources and create a much stronger competition culture. Indeed, a growing number of small and developing jurisdictions are entering into regional agreements. Nonetheless, it is important to structure such agreements efficiently to deal effectively with the issues of member states.

Finally, a very interesting option which is based on connection with neighbors is the **recognition of foreign judgments**. As noted before, small economies rarely apply their laws to multinational firms. Most troubling- they rarely bring cases against international cartels. Rather, they often "free ride" on the prosecutorial efforts of large jurisdictions. This is problematic because it creates under-deterrence: as the OECD has noted, in the current system of unilateral enforcement most of the profits of an international cartel are not taken away unless a significant number of jurisdictions affected by it bring it to trial. One of the main reasons that

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⁶ Michal S. Gal, "Regional Agreement: The Next Step in International Antitrust" (on file with author).

small economies do not bring such cases is because of the high costs of proving the existence of a cartel, relative to their enforcement resources. I suggest that they can make good use of their connection with the prosecuting jurisdictions: they can adopt and rely upon foreign findings of international hard-core cartels, provided that the foreign decisions meet criteria that ensure that such reliance is reasonable and fair. This free movement of judgments holds potential to overcome the main obstacles to efficient deterrence and to significantly increase both domestic as well as global welfare.⁷

⁷ See Michal S. Gal, "Free Movement of Judgments: Reducing the Problem of Under-Deterrence through Judicial Reliance" available at ssrn.com.