COMMENT AND ANALYSIS

ANTITRUST AND TRADE POLICY: A PEACEFUL CO-EXISTENCE

By: Lawson A. W. Hunter
Fraser & Beatty, Ottawa

Introduction

The past two years have witnessed significant developments in the sphere of international trade. The Uruguay Round of Multilateral Trade Negotiations, launched in September, 1986, represents the largest and most ambitious set of multilateral trade talks in history. Canada and the United States have also negotiated a *Free Trade Agreement* which will establish between the two countries the largest (in trade volume terms) two-way free trade relationship in the world. Such evolution in the trade policy environment will have a significant impact on competition in both international and national markets. Yet only recently has attention turned to the inherent tensions between international trade and competition law and policy, and the need to reconcile the two.

In important senses, the underlying philosophy of competition legislation and post-war approaches to liberalization of international trade are very similar. They both operate from the premise of allowing markets to determine the most efficient allocation of resources and to be the means by which the principle of comparative advantage determines economic activities. As the OECD Committee of Experts on Restrictive Trade Practices has noted:

> Competition policy is aimed at ensuring the efficient functioning of markets by the removal or control of restrictive business practices. Trade liberalization policies focus upon the removal of barriers to international trade both through action to reduce tariff levels and through agreements to limit the effects of non-tariff measures.[1]

But the fact that both competition and trade policy encourage reliance on comparative advantage is not to say that either has single-mindedly developed to promote the free operation of markets. Both policies have to some degree become skewed, if not subverted, to serve as protectionist devices for small competitors in the antitrust context and for domestic industries in the trade context. In fact, there are those who would argue that the fundamental purpose of trade policy is not the liberalization of international trade but the enactment of domestic laws and regulations designed to protect domestic industry. That view, unfortunately, is gaining ground in many industrialized countries, particularly as tariffs are reduced.

The original *GATT* negotiations, as well as the negotiation and consideration of most free-trade areas took place within the context of a tariff-centred commercial policy. When *GATT* was negotiated in the 1940's, it was conceived as an instrument for the progressive reduction and binding against increase of the high tariffs then in effect. Many of the other provisions of *GATT* were meant to sustain the beneficial effect of this tariff-cutting. Today, commercial policy is less concerned with tariffs than with other means of regulating commerce, means which in 1947 were incidental to, and had only a marginal effect on, trade. Today, it is the tariff which, as a result of progressive reductions and the introduction of floating exchange rates, has a marginal impact on trade. Yet, trade is not free. In place of tariffs, elaborate systems of non-tariff barriers have arisen to regulate foreign imports, to shield domestic industries and to act as a safety valve for short-term social, economic and political pressures based on what are perceived as "unfair" trade practices of foreign countries. Potentially much more

distorting than tariffs, this system of what has been termed "contingency protection" undermines investment and production planning in a way that the transparent and predictable tariff system never could.

The very use of the term "unfair behaviour" highlights a significant attitudinal difference between competition policy and trade policy. In antitrust circles, the notion of applying antitrust laws on the basis of "fairness" is generally rejected, unless one defines fairness as equal opportunity. Competition laws generally promote open markets, which means that the entry and expansion of businesses should not be deterred by the artificial and anticompetitive behaviour of existing competitors. Competition policy protects competition, not competitors. If this attitude were applied in the trade policy area, it would encourage the removal of barriers to international trade and stifle any desire to protect existing competitors in the market.

But in listening to the proponents of tougher trade laws, the sense one gets is that the term "unfair" is not used in the way just described, i.e. equal opportunity to compete. In the trade context, "unfair" seems to be defined in moralistic terms. The underlying issue is the legitimacy or illegitimacy of various competitive advantages which foreign producers enjoy. "Fair" is often used to mean equal treatment, protection of competitors or market shares, preservation of the *status quo*, and other deterrents to change and adjustment, all of which are generally frowned upon in the development of competition policies.

Competition law is one of the areas of public policy most influenced by changes in the trade environment. The original 23 *GATT* signatories were also engaged in broader, contemporaneous negotiations aimed at creating a comprehensive International Trade Organization (ITO) that would regulate state behaviour in several trade-related areas, including restrictive business practices.

Private restraints on trade were to be regulated under the *Havana Charter*, which set forth specific prohibited practices, but the *Charter* was never ratified, and *GATT* became the major legal instrument governing world trade. The OECD and the UN have codes of conduct dealing with restrictive business practices and have formed expert committees to further harmonization and cooperation. But none of these codes is binding and none is comprehensive. Accordingly, the regulation of restrictive business practices has been left to national legislatures while trade laws have developed pursuant to international standards. Moreover, there is little policy coordination between the two, although they are concerned with complementary conduct.

The increasingly important relationship between domestic markets and international trade is creating pressures for greater compatibility between international trade policies and domestic economic policies. In the context of the Canada-U.S. trade relations, negotiation of the *Free Trade Agreement (FTA)* highlights the need to address the respective roles of competition policy and trade law in the freer North American trading environment - a trade agreement that fails to address competition questions could lead to more rather than less tension between the participants. After all, tariff cuts, elimination of quantitative restraints, and changes in government procurement practices, etc., leave the field more open to the actions of private firms. Business practices, such as licensing and distribution agreements, pricing strategies, and mergers and acquisitions, are the central concern of antitrust and competition law. To the extent that substantive differences exist between bodies of competition law, conflict may arise as to the appropriate legal standard to be applied. To the extent that the pro-competition policies of those laws are subordinated to trade laws, trade liberalization efforts may be undone.

An important area to examine would be domestic competition legislation in both Canada and the United States which overlaps, or provides the domestic counterpart to, certain contingency protection laws. Of course, trade and antitrust laws do not deal with precisely the same subject matter. The price discrimination and predatory pricing provisions of Canadian competition and U.S. antitrust law are somewhat analogous to (though considerably less severe in operation than) the antidumping laws. There are, however, trade laws without antitrust equivalents (the most notable being the countervailing

duty law)[2] and, of course, antitrust with no trade law equivalent (such as horizontal agreements in restraint of trade, merger and monopolization). Thus, it is important to keep in mind the fact that these bodies of law are not directly analogous.

The fact that such an overlap exists, at least conceptually, raises the question whether in any free trade environment it would not be preferable to rely on competition law remedies for price discrimination or predatory pricing and to exclude the application of the equivalent trade laws for commerce between the parties.

Thesis

In the great preponderance of cases, application of contingency protection laws relating to the behaviour of foreign private enterprises, eg. antidumping and Article XIX actions produce anticompetitive, anti-market outcomes that would not be actionable or sustainable under domestic antitrust legislation. If this is, in fact, correct, then such measures run counter to the principle of a free enterprise system, (which has placed antitrust laws in the United States almost at the level of the Constitution). If this thesis is correct, it also means that these contingent protection laws harm consumer welfare. [3]

Finally, if this thesis is correct, it means that such trade laws, rather than promoting any sensible economic result, are merely a means to discriminate between domestic and foreign competitors. In fact, in recent years, it would appear that the discriminatory nature of these laws has become perhaps their most important selling virtue in the eyes of domestic proponents.

But is this thesis correct? To test this hypothesis one must examine the elements of an antidumping action.

By definition, dumping is the act of selling products in a foreign market at a price lower than the goods or articles are sold in the domestic market. So if a French widget manufacturer charges less for widgets in Canada than he does in France, he has engaged in dumping. Well, isn't that irrational behaviour on his part, one might ask? The answer, in a free market economy, is "not necessarily." Price levels should, ultimately, be determined by competition in markets, not by any artificial desire to ensure that prices in one geographic area are as high or higher than in another. If there is less competition in a particular market, it may mean that a supplier to that market can obtain higher prices for his products than he could elsewhere where there is more competition. There is absolutely nothing irrational about that behaviour, and, in fact, if one believes in a market economy, that is exactly the sort of behaviour one would encourage.

In addition, a supplier may price his product in a new market below the price he is obtaining in a more established market. The purpose for doing this, of course, is to obtain a toehold in the new market, to win customer loyalty, and to build a sufficient volume of sales to justify his continued presence, if not expansion, in that market. Such behaviour is entirely consistent and logical in a market economy and, in fact, many U.S. antitrust cases have recognized the legitimacy of such behaviour. Another reason why one might be forced to price at a lower level in one market than another is to meet competition in that market. Meeting the competition has always been recognized as a legitimate form of behaviour under U.S. price discrimination law and has a limited acceptance under Canadian price discrimination legislation. Accordingly, the notion of defining dumping as merely a price differential between a domestic and foreign market should be considered a test without much economic merit.

In contrast, the establishment of predatory pricing under competition law requires evidence of sales at unreasonably low prices. Although no conclusive definition of "unreasonably low" has been established in Canada or in the United States, it is generally accepted today that a price above average variable cost would not be considered unreasonably low or predatory in a case where there is overcapacity and the firm is minimizing losses by setting a price that still makes a contribution to its fixed overhead. Hence, the competition standard imposes a much higher burden of proof than the normal-value price standard adopted in antidumping laws. Moreover, in competition law, the low

pricing must be part of a policy. This avoids interfering with isolated or sporadic acts undertaken for legitimate business reasons such as meeting aggressive spot competition. General economic conditions of the industry, such as declining demand and large excess capacity, may also be taken into consideration in the determination of whether prices are set with a predatory intent.

But the fact is that existence of "dumping" alone is not sufficient to have antidumping duties imposed. Once a supplier is found to be dumping, in the sense of engaging in international price differentiation, it must still be demonstrated that the dumping has caused material injury to the domestic industry. But what does "material injury" mean? The problem, from an economic point of view, is that material injury in the United States, and to an extent in Canada, has come to mean anything more than an insignificant impact on the domestic industry. Factors such as idle capacity in the domestic industry, lower profitability, loss of employment or declining market share are accepted as evidence of material injury. The problem is that such evidence may merely demonstrate vigorous competition. All these factors have one common element: they focus on injury to domestic competitors and not injury to the process of competition. Such evidence in and of itself would not be sufficient as the basis for an antitrust action; but what it means for foreign competitors is that they have to move very, very cautiously in entering export markets where there is vigorous antidumping enforcement.

In competition law, unreasonably low pricing policies directed against competitors are prohibited when they are designed for, or have the effect of, substantially lessening competition or eliminating a competitor. Relevant evidence in an antitrust case will focus on various elements of market structure, conduct, and performance. While antidumping law has the effect of protecting domestic competitors whether they are efficient or not, competiton law is aimed at the protection of the competitive process. As such, it does not protect competitors against lower prices than are achieved through enhanced economic efficiency via economies of scale, lower labour costs, or superior technological expertise. Rather, a major benefit of competition law is that it enables the market place to operate in as efficient a manner as possible.

By contrast, the standards to obtain antidumping relief, under the United States law in particular, and to some degree Canadian law, are applied in a manner which restricts competition, does not promote efficiency, productivity, or innovation and serves only to protect domestic industry.

Antidumping laws are not only incompatible with trade liberalization, but become largely unnecessary in a freer trade environment, even in terms of the narrow objective of protecting domestic competitors. This is because the scope for market segmentation between the home and export markets, (a necessary condition for dumping) is significantly reduced by the removal of tariff and non-tariff barriers which allow dumping to occur. Without the artificial border impediments which separate what are economically and physically distinct markets, any price differential which may arise between two open economies will be rapidly arbitraged away. While some firms may find other ways to segment markets at the border, their pricing practices are likely to resemble those pursued at the purely domestic level. Price discrimination and predation can still exist, as they do now within national borders, due to physical or economic barriers, and firms capable of abusing their dominant market position. Such actions are already proscribed by domestic competition laws.

In conclusion, certain of the contingency protection laws may be counterproductive from the viewpoint of a market economy. In fact, they prescribe behaviour that would not be countenanced by advocates of sensible competition legislation. Competition laws provide a more rational standard than antidumping laws for dealing with the injury which may be caused by price differentials. Moreover, by focusing upon the effects of the practice on competition, stricter requirements for application of competition law provisions make it more unlikely that they can be abused by complainants seeking relief from legitimate competition. Overall, competition law standards foster the broader objectives of economic welfare and growth which, of course, are the underlying rationales for the current Canada -U.S. trade negotiation exercise. Antidumping laws tend to protect competitors, rather than the competitive process, and represent a serious impediment to the play of market forces in a free trade

area. The question then becomes: Does either Canada or the United States have sensible competition legislation which could replace trade laws in the areas where they overlap?

Substantive Differences - Canada-U.S Competition Law

Price Discrimination

The Canadian price discrimination law is contained in section 34(1)(a) of the *Competition Act*. It creates a criminal offence for a supplier to discriminate in sales of like quantity or quality to purchasers who compete in the same markets. The offence is committed only if the discrimination is a practice. This means that the section provides at least a minimal defence for "meeting the competition," since it would be possible to lower prices and discriminate to meet competition for a limited period of time in a particular market. The important feature of the Canadian law is that discrimination is illegal for sales of like quantity or quality, with quantity being by far the more important criteria.

The difficulties with the section are that by basing illegal behaviour on quantity considerations, it favours large buyers and, in fact, has the effect of encouraging even larger concentrations of buying power. It has led in Canada to the creation of enormous buying groups in certain sectors of the economy. The law is also criticized for not having a clearer defence of "meeting competition." This means that some suppliers are confronted with breaking the law in a situation where their response to competition only could be termed pro-competitive. Finally, the section is either difficult to prove and enforce, or the enforcement agencies have not been overly concerned with price discrimination issues. There have only been a handful of cases under the section in the 50 years the law has been on the books.

The American price discrimination law, contained in the *Robinson-Patman Act*, has some similar features to the Canadian law but is cast in somewhat different legal terms. It prohibits discrimination among buyers which harms competition, and the U.S. courts have generally held that any discrimination between competing purchasers has a harmful effect on competition. The U.S. law, however, allows discrimination to occur when the price differential is cost justified. The theory behind this defence is that, from an economic point of view, it makes sense to allow discrimination if it allows the supplier to lower his cost because of longer production runs or the volume of purchases involved. The notion in the American law of cost justification is similar to the volume consideration in Canadian law. However, the effect of the cost justification principle in the American law has been to make suppliers very cautious about discrimination, since it is extremely difficult to prove the cost savings necessary under the law.

The American law, unlike the Canadian law, has a clear defence for meeting competition. Finally, there has been more active enforcement of the price discrimination provision by U.S. antitrust authorities. In addition, the provision for private actions and the incentives to private plaintiffs in the American legal system have resulted in a number of cases initiated by buyers under the U.S. law.

Canadian and U.S. price discrimination laws stem from the same economic principles, but are applied in somewhat different terms. Both have been highly criticized by economists over the years for doing more harm than good. It is argued that these laws impose rigidities on pricing structures which, to some degree, prevent aggressive buyers from pushing suppliers for better prices and better deals. This anticompetitive effect of the laws is probably more pronounced in the United States than in Canada because of the cost justification principle. There are also strong views that these laws protect small businessmen at the cost of economic inefficiency. Nonetheless, the price discrimination laws, even in their less than satisfactory state, make more sense from a market-oriented point of view than antidumping or countervail laws.

Predatory Pricing

Both Canadian and American antitrust laws contain prohibitions against predatory pricing. The Canadian law, contained in section 34(1)(c) of the *Competition Act*, makes it illegal for any person to engage in a policy of selling products at prices unreasonably low having the effect or tendency, or designed to have the effect, of substantially lessening competition or eliminating a competitor. There have been a few cases prosecuted under the Canadian law. The main issue in those cases has been to determine when a price is "unreasonably low." The courts have generally tended to tolerate a rather broad range of considerations in deciding this issue, including consideration of "meeting competition." On the cost question, although the law is not absolutely settled, it seems that long-run, variable costs would be the criteria used in deciding whether a price was unreasonable.

Section 2 of the U.S. *Sherman Act* also has been used to attack predatory pricing. The major debate in the United States, as well, has been on the question of what costs should be relevant in deciding whether a price is artificially low. The issue is by no means clear, but it would appear that the Areeda-Turner test, which again looks at long-run, average variable costs, has the most supporters in the U.S. judicial system.

The great concern among both American and Canadian antitrust authorities in the application of predatory pricing law is the desire to ensure that the law is not used to prevent what is, in reality, aggressive, pro-competitive behaviour. The difficulty in winnowing out the bad behaviour from the good has undoubtedly had a chilling effect on the vigour with which these laws have been enforced. That abstinence probably also reflects a basic belief that markets are resilient, and that predatory behaviour, particularly where entry barriers are low, is not likely to have long-term effects on the economy.

In conclusion, while there are certainly difficulties in enforcing the antitrust laws in the areas of price discrimination and predatory behaviour, the problems stem more from the difficulty of establishing satisfactory tests to ensure correct results than in the principles underlying the proscribed conduct.

Enforcement and Institutional Differences

In any comparison of Canadian and U.S. antitrust laws, it is important to note the significant enforcement differences. For the most part, these differences do not arise from the method of public or governmental enforcement of antitrust rules. Although the actual structure of public enforcement may be somewhat different in the U.S. than in Canada, in the final analysis the approach to enforcement is very similar and the attitudes toward competition policy very much the same.

There is, however, a very major difference in the role that private parties play in the enforcement of antitrust laws in the two countries. In Canada, the scope for private remedies is narrowed by the fact that certain practices are controlled only by prospective restraining orders at the instance of the Competition Tribunal. For these areas of the law, which cover such things as refusal to deal, exclusive dealing, tied selling, and other vertical restraints, it is not really possible or effective for private parties to play an important role in enforcement.

Private parties have a statutory right under section 31.1 of the *Competition Act* to bring civil actions for damages based on a violation of the criminal provisions of the *Act*, or for a failure to comply with an order of the Competition Tribunal. The section permits the recovery of simple damages only and would not appear to allow the courts to grant other collateral relief, such as injunctions or declarations.[4] There is no provision to recover treble damages as is available in the present U.S. antitrust laws.

The issue of whether the federal government has the authority to authorize private parties to recover damages for breach of competition laws raises significant constitutional issues. These issues have not been finally resolved by the Supreme Court of Canada but, at the moment, the lower courts have upheld the constitutional validity of the provisions.[5]

There are three other aspects of the Canadian law which are relevant with respect to the viability of private enforcement in Canada. First, the normal rule with respect to costs in the Canadian legal system is that costs follow the event. This means that if a plaintiff sues a defendant and loses, he must pay the defendant's costs. Second, the use of contingent fees by lawyers is extremely uncommon in Canada. It is permitted in several provinces but it is not widely used. Third, there is no meaningful provision for class actions in Canada, with the exception of the Province of Québec. The federal competition legislation does not contain class action rules, which means that the provincial rules of civil procedure prevail. The existing common law rules on class or representative actions very narrowly confine their application. In conclusion, these three factors militate heavily against reliance on private damage actions in Canada. Nevertheless, there have been a number of cases relying on the private damage remedy, and those numbers seem to have increased slightly in recent years.

In contrast to the Canadian situtation, private actions play a very important role in the enforcement of American antitrust law. In fact, private actions generally are far more numerous than government actions to enforce antitrust laws in the United States.

There are, of course, important incentives promoting private enforcement under the U.S. laws. First, damages ordinarily can be trebled if proven. Second, the use of cost rules and contingent fees in the U.S. legal setting is exactly the reverse to that in Canada. This means that, in essence, a private plaintiff in the United States can commence an action with no risk whatsoever on his part. Finally, the class action rules in the United States are much more liberal than those in Canada.[6]

All of this means that the role of private plaintiffs in enforcing antitrust laws is much more vigorous in the United States than in Canada. If the domestic antitrust laws were to replace the unfair trade laws, it is arguable that Canadian businessmen would be at a distinct disadvantage to their American counterparts in being able to rely on antitrust legislation. It is also worth noting that the U.S. jurisdictional reach, for both personal and subject matter jurisdiction, is much more expansive than the Canadian rules.

Before concluding a discussion of the institutional biases of antitrust and trade laws, one further observation may be pertinent. Antitrust laws are generally seen as reflecting medium-to-long-run economic concerns. They are not designed, nor are they typically enforced, to deal with short-run and immediate problems or crises. The same cannot be said for the administration of the unfair trade laws. Although certain aspects of the trade laws have medium-to-long-run effects, they are very often used to alleviate perceived problems in the short-run. Additionally, the passage of the *Trade Agreements Act of 1979*, established, in countervailing duty and antidumping cases, a system of private rights and ready remedies for industry petitioners. The U.S., unlike any other *GATT* contracting party, has moved from a system of government to government consultations and negotiations in unfair trade disputes to a quasi-judicial, mandatory, administrative system initiated by private petitioners and exempt from the exercise of Presidential discretion or diplomatic resolution. These institutional differences may be the cause of some of the more uneconomic features of trade law enforcement.

Conclusion

What conclusions can one draw from the state of trade laws and competition laws described above? It would seem obvious that neither are without their imperfections. But a strong argument can be made that the antitrust laws reflect a more sensible economic policy in societies that are largely market-oriented.

The EC has recognized the incompatibility of antidumping with their economic arrangement, and member states do not maintain independent national antidumping and countervailing duty laws against other member states.[7] Transborder sales within the zone are treated as domestic transactions, and the antidumping provisions of the *Treaty of Rome* are enforced only against exports from non-member states.

In the Canada-U.S. context, the difficulty of relying solely on competition laws would seem to stem largely from the more aggressive private enforcement possibilities in the United States and possibly the greater jurisdictional reach of the U.S. laws. Efforts would also have to be made to achieve a closer harmonization of the substantive laws dealing with price discrimination and predatory behaviour. But, if these problems could be addressed, there would be real merit in relying on domestic competition laws in place of certain of the unfair trade laws of both Canada and the United States. It would be counterproductive to perpetuate overlapping and indeed contradictory legal regimes in a liberalized Canada-U.S. trading regime.

One of the key accomplishments of the *Canada-U.S. Free Trade Agreement* is the commitment to develop and implement a substitute system for antidumping and countervailing duties within five to seven years. No one should underestimate the importance of developing these new rules, for if economic efficiency and growth are to be fostered, it is important that businesses make decisions on the basis of an accurate understanding of the institutional environment in which they operate. The object of these provisions would be to shift the focus of a trade dispute away from injury to the domestic producer to injury to competition in the North American market. Insofar as Canada-U.S. trade would be concerned, the two states could dispense with laws whose substantive standards are somewhat suspect to begin with and which carry considerable nuisance value.

Negotiation of a new set of rules will not be easy. Nevertheless, development of "fair competition" standards will facilitate the changes in thinking necessary in the new trading relationship. Moreover, such standards would inject some sensible economic analysis into trade disputes, particularly where they introduce improvements in existing antitrust provisions so as to foster the objectives of the free trade area. To this end, it will be important for any new regime to reflect the current state of the art in antitrust thinking about price discrimination and predatory pricing, so as to ensure that only truly anti-competitive pricing practices are deterred.

Notes

1. *Competition and Trade Policies: Their Interaction*, OECD, 1984, page 11.
2. There is usually no competition law equivalent to countervailing duties since countervail is a trade remedy applied in a situation where a government has provided a subsidy. In competition law, the fact that a particular domestic level of government has provided a subsidy to industry, for example, one state government subsidizing its industries which compete in neighbouring state economies, is not the ground for any antitrust remedy.
3. Almost without exception, every credible study on the cost of trade protectionism has demonstrated that the cost to consumers exceeds the benefits to the domestic economy many times over. See *Competition and Trade Policies: Their Interaction*, *supra*, note 1, at 88.
4. This last issue has not been addressed squarely by the courts and is being raised in one case presently before the courts in Ontario.
5. *City National Leasing* v. *General Motors of Canada* (1986), 54 O.R. (2d) 626 (*C.A. and Pilote Ready mix* v. *Rocois Construction* (1985), 8 C.P.R. (3d) 145 (Fed.C.A.), heard on appeal to the Supreme Court of Canada May 17, 1988. Decision pending.
6. Even so, the use of class actions in antitrust cases has declined dramatically since the mid 1970's. In 1977 there were 235 antitrust class actions filed or pending, and in 1984 there were only 23. (1985), 8 *Class Action Reports* 3.
7. Regulation 3017/;79,22 O.J. Eur. Common (No.L339)1(1979).