

Memorandum

To: Johnson Spratt
Dev Tech
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From: David D. Smith, Ph. D.
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RE: Comments on the Economic Content of Panama's Draft Antitrust
Law

I. Introduction and Background

The Government of Panama, ("GOP"), has underway an economic program to implement free market reforms.¹ This program contains a variety of aspects such as reductions in tariff and non-tariff trade restrictions, the privatization of certain state-owned companies, and, in general, the freeing of prices to respond to market forces.² An antitrust law, combined with an effective enforcement agency and judicial body, is a key part of the policy because of its fundamental role in preventing anticompetitive behavior.

I spent the week of 9/19/94 in Panama City meeting with various members of a team assembled by USAID and its contractor, DevTech, to discuss the draft as it was being prepared.³ In this memorandum I comment on the economic content of the draft law as it existed at that time. Further revisions will be made in the draft before it is ultimately presented to The Minister of Planning and Economic

¹The initial reforms were begun under the administration of President Guillermo Endara Galimany. The new President, Ernesto Pérez Balladares, whose administration took power on September 1, has also announced plans for free market reforms.

²The draft also contains a new Consumer Protection Law. In this memorandum, however, I limit my comments to the area of antitrust.

³The authors of the draft law are the Panamanian lawyers, Dr. Jorge Fábrega, Dr. Jorge Lee, and Dr. Gustavo Paredes. Michael Trott, Chief, Economic Policy Office at AID was the head AID official involved. Dr. Hector Vega and Johnson Spratt represented DevTech. The authors were assisted by Dr. Jorge Jimenez, an attorney from Costa Rica; Paul Karlsson, an attorney from the United States Federal Trade Commission; and Terrence McDonald, an attorney with the Antitrust Division of the United States Department of Justice.

Policy. I understand, however, that it is the intent of the law's authors to keep these revisions in line with the general principals outlined here.

II. Economic Issues

A. The Benefits of Free Competition

The resources of every society are scarce relative to the demand for them. As a result, each society needs a system to allocate its scarce resources to their most valued uses.

Competition is a process by which the private economic incentives of producers are harnessed to benefit consumers. The full benefits of competition for consumers are not assured, however, merely by a system of private enterprise. Monopolies, agreements in restraint of trade, and artificial barriers to entry are all ways in which firms can undermine competitive market discipline and reduce economic efficiency. Antitrust law helps to ensure that producers do not subvert the market process in ways that harm consumers.

B. The Panamanian Situation⁴

Panama is a relatively small country with a population of a little more than 2.5 million. About one-quarter of these people live in the capital of Panama City. Between 1990 and 1993 it had real economic growth of over 25 percent, while benefiting from a very low rate of inflation.⁵ Nevertheless, forecasts call for declining rates of economic growth in the near future. Policies of free trade and free competition, however, could be implemented to promote growth by encouraging economic efficiency and expanding the economy's access to both customers and suppliers.

The Panamanian economy is now, in some important respects, protected from vigorous price competition. Cartels appear to be common, especially in the agricultural sector. Government policies and agencies, such as the ORP have often discouraged price competition and encouraged the development of cartels.

⁴I am grateful for the help of Horacio Estibir of the Ministry of Planning and Economic Policy in assembling the information in this section.

⁵This followed a drop in real GDP of 15 percent from 1989-1990.

Government policies have also protected these cartels from competition provided by imports or new entrants. For example, very high effective tariffs and non-tariff trade restrictions have limited imports into Panama for a number of products, especially in the agricultural sector.⁶ An antitrust law, combined with the proper enforcement agency and judicial body, are essential tools to be used to promote competition in Panama.

C. Economic Aspects of the Draft Law

The following is a list of specific types of economic behavior, and the institutional issues, that are being addressed by the draft law.

Prohibited Economic Behavior

1. Private sector cartels

Private sector cartels among competitors, involving behavior such as price fixing, customer allocation, or bid rigging are to be treated as being *per se* illegal. This approach is used in the United States and elsewhere. The *per se* standard is appropriate because it is less costly to investigate and prosecute under this standard than under a “rule of reason” approach and there are no efficiency benefits to result from these cartels.

2. Abuse of monopoly power

Abuses of monopoly power will appropriately be treated under a “rule of reason” standard. This is the preferred way to handle these matters because the differences between pro-competitive and anti-competitive behavior are generally difficult to discern.

3. Mergers and acquisitions

A comprehensive antitrust law needs to deal with mergers and acquisitions. Especially after cartels are declared illegal, firms will have an incentive to combine as a way to circumvent the law. The draft law will deal with mergers

⁶Until about 1990, the country had had a recent history of protectionism. Although import restrictions are still high, since 1990 attempts have been made to lower them.

and acquisitions under a “rule of reason” standard, and include a pre-notification system. A pre-merger notification system is important because it is much easier to deal with these transactions before they are completed than afterwards when the assets of the companies may have been “scrambled.”

4. State-sponsored restrictions on competition

In Panama, a variety of practices, laws, and regulations implemented by the state have had anticompetitive effects. Some of these state-sponsored policies circumvent free market forces and even encourage collusive pricing. The new law will include an inventory of the parts of previous laws and decrees that have anticompetitive effects, and repeal them.

5. State-sponsored barriers to entry

There are also practices, laws, and regulations sanctioned by the GOA that create unnecessarily difficult entry conditions for new firms wishing to begin doing business in certain industries. The list of the anticompetitive parts of previous laws and decrees that will be repealed will include those that anticompetitively increase entry barriers.

6. Import restrictions

Cartels involving domestic Panamanian companies would not succeed if sufficient imports were available to undermine the collusive prices. For this reason, reductions in import restrictions promoted by this and any other law will help promote free market policies in Panama.

Institutional Issues

1. Education

Panama does not have a history of antitrust law or enforcement. Indeed, it has a history of cartels and other anticompetitive behavior in certain industries. As a result, the new law will require substantial changes in economic behavior. To help the country to make the adjustments needed, the enforcement agency will have the authority to provide education on the new law and its implications to consumers, businesses, attorneys and others that might be affected when it is

implemented. This part of the new law is important to the long range acceptability and, therefore, success of the antitrust policy.

2. Advocacy

The new law will also give the enforcement agency the power to be an advocate for free competition policies in a number of situations. To begin, the law will repeal the parts of existing laws that are anticompetitive. The agency will then have the power to intervene in regulatory hearings, and legislative matters, as well as before judicial bodies. This role for the agency as an advocate of free market policies in general, and antitrust in particular, will help to prevent new anticompetitive laws and regulations from developing.

III. Conclusion

USAID, DevTech, and the team of lawyers and advisors that they have assembled, have made an excellent start on a new antitrust law to further free market policies in Panama. The law contains the important provisions found in the antitrust laws of other countries. It also focuses on the particular anticompetitive conditions and behaviors that are found in Panama. Furthermore, it establishes an enforcement agency that will have the power to educate the appropriate groups and individuals, and advocate free market policies. These education and advocacy activities will play an important part in ensuring the long run success of the new law in Panama.