UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

MERGER CONTROL IN DEVELOPING COUNTRIES: LESSONS FROM THE BRAZILIAN EXPERIENCE

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UNITED NATIONS
New York and Geneva, 2002

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INTRODUCTION

When based on sound economic principles, the enforcement of antitrust policy is expected to enhance economic efficiency, improve consumer welfare and spur economic growth. This is one of the reasons why antitrust laws were adopted or updated as part of market-oriented reforms in several developing countries during the 1990s.[1] Achieving sound enforcement of antitrust laws in transition economies, nevertheless, is far from easy.

The analytical exercise underlying most antitrust cases applies economic reasoning to predict the likely impact of business behaviour on competition and economic welfare, which is a rather complex effort, inevitably subject to some mistakes. The risk of perverse antitrust enforcement is not exclusive to developing countries but may be aggravated in those jurisdictions by low levels of expertise and the scarcity of human capital.[2] The quality of antitrust enforcement may also be affected by interventionist ideologies and politics.[3] Interventionist ideologies and political pressure also affect antitrust enforcement in mature jurisdictions. Unique to emerging economies, perhaps, is the fact that the benefits of open markets are yet to come, undermining public confidence in market reforms. Also unique is the great extent to which the historical relationship between the public and the private sectors extremely state capture in the present.[4]

The hazards involved in the implementation of antitrust programs may be particularly high for developing countries in merger control cases.[5] Although the economic analysis of mergers may be considered one of the simplest analytical exercises in the antitrust field, it frequently involves pitfalls. Because merger control activities affect market structure and firm behaviour in all industries, they also seem to be a propitious environment for the reintroduction of interventionist ideologies – from price controls to picking winners.

A look at Brazil's recent experience may help in understanding the difficulties of implementing sound merger control in transition economies. For several decades, the role of competition policy was minimal, as import substitution strategies were in place and price controls were the norm.[6] Competition policy started to play a more active role in the Brazilian economy only in 1994, when a new antitrust law – which included provisions for merger control – was enacted (federal law 8.884/94).[7]

The Brazilian antitrust law broadly resembles competition laws of other countries. Articles 20 and 21 proscribe anticompetitive conduct, including single-firm conduct by monopolists or dominant firms and anticompetitive

agreements. Article 54 provides for the efficiency defence of potentially unlawful acts or contracts. In Paragraph 3, it specifically requires that mergers meeting certain thresholds must be notified, although notification need not occur before the deal is concluded. Mergers to be notified are those in which any of the participants in the transaction had total worldwide turnover in the most recent year of R$400 million or in which the resulting company or group of companies accounts for 20 per cent or more of the relevant market share. Because its language is relatively imprecise, Article 54 has been interpreted as a controlling provision of all contracts and agreements.

A peculiarity of the Brazilian system of antitrust enforcement is that it is formed by three different bodies: the Conselho Administrativo de Defesa Econômica – CADE (Administrative Council for Economic Defence) and the Secretaria de Direito Econômico – SDE (Secretariat for Economic Law Enforcement) within the Ministry of Justice, and the Secretaria de Acompanhamento Econômico – SEAE (Secretariat for Economic Monitoring) within the Ministry of Finance. Cases are initiated by SDE, which, with the assistance and advice of SEAE, conducts preliminary investigations and administrative proceedings before submitting the file and its recommendations to CADE. CADE, a statutorily independent agency, subsequently makes the final decision regarding the case, against which an appeal may be made to the courts.[8]

Since the enactment of law 8.884/94, the number of mergers reviewed has grown from 99 in the first two years to over 600 in 2001. The increase in quantitative work, however, has not been accompanied by an improvement in institution building. A good illustration of this point is the fact that no merger guidelines have been issued by any of the agencies since 1999.[9] Agencies have challenged very few cases, and no transaction has been prohibited outright since 1996, but some decisions incurred severe criticism from consumer protection groups, businesspeople and the press, who questioned whether the had agencies applied sound antitrust criteria in their analyses.[10]

This article reassesses three Brazilian merger cases and one joint venture as a basis for discussing some key difficulties that may arise in applying economic principles to antitrust enforcement in developing countries. All of the cases involve classic antitrust issues, and the conclusions reached by the authorities are to some degree controversial, providing good material for discussion. Each case also gives the opportunity to address issues that are particularly relevant to developing economies, such as the concern that strict merger control might damage the international competitiveness of local firms or

that temporary relief from antitrust laws should perhaps be recommended for sectors undergoing structural adjustments.

Section 1 discusses a classical horizontal merger case with homogeneous products. The acquisition of Pains would substantially increase Gerdau's market share, while entry and rivalry did not seem to be effective deterrents to the exercise of market power. Particularly interesting in this case is the discussion about the "failing firm argument", which may be frequently raised in transition economies as trade liberalization and other pro-market reforms tend to provoke structural adjustments.

Section 2 examines the AmBev case, a merger with differentiated products involving the two largest beer firms in the country. Post-merger market-shares would be as large as 75 per cent, investments made by incumbents in recent years made entry less likely, and control over the three most preferred brands made rivalry less effective. AmBev is perhaps the most interesting and controversial merger case to date in Brazil. One issue of particular interest is whether merger control in a developing country necessarily represents an obstacle to local firms' size and international competitiveness.

Section 3 deals with a vertical merger between the world's largest exporter of iron ore – the Brazilian CVRD – and the railway firms serving the company and its iron ore rivals. Vertical mergers have been a classic and controversial antitrust issue since Chicago School critics pointed out the pro-competitive effects of this type of merger and a more lenient approach towards them was recommended. The CVRD case illustrates the relevance of the recent economic literature based on the concept of "rising rivals´ costs" for understanding the potential harm of vertical mergers and examining related technical issues.

Finally, section 4 examines two linked cases in which agreements – presented in the format of joint ventures – were concluded between competitors to restrain the supply of alcohol and avoid further price decreases, reducing the pace of structural adjustment in the alcohol industry. Over the years, the Government of Brazil has adopted several measures to support the real income of alcohol and sugar cane producers, which provoked excessive entry, a systematic oversupply of alcohol and a progressive decrease in its prices even in the presence of such measures. The alcohol case involved an important discussion about the "crisis cartel" argument, as the rationalization of the alcohol industry would cause some redeployment of capital and labour, which normally raises political and social concerns.

All sections of the paper follow the same format. Each one begins with

an overview of the basic facts, including the main characteristics of the transaction, the defendant's view, SEAE and SDE technical opinions and CADE's final decision. Next, the microeconomic fundaments underlying the case are summarized, after which those economic tools are used to analyse the described facts. Each section ends with some tentative conclusions regarding the adequacy of the decision and some preliminary remarks on further issues.[11]

1. HORIZONTAL MERGERS WITH HOMOGENEOUS PRODUCTS: THE GERDAU-PAINS CASE

In February 1994, the Uruguayan steel maker Siderurgica Laisa S.A. (Laisa), which is controlled by the Brazilian group Gerdau, acquired the firm Korf GmbH (Korf). The latter firm controls several other companies, including the Companhia Siderúrgica Pains (Pains). At the time of the merger, Pains was the third largest producer of long steels (concrete reinforcing bars, wire rods, bars and profiles) in Brazil, with annual sales of over 230 thousand metric tons.

The Gerdau Group itself – through its affiliated steel makers Cosigua, Riograndense, Aço Norte, Usiba, Cearense and Guaíra – was the second largest producer, with annual sales of over 1.5 million metric tons. The merging firms therefore claimed that the acquisition would bring about considerable synergies, mainly related to cost reduction and product improvement by means of the technology transfer from Pains.

The Secretariat for Economic Policy of the Ministry of Finance (SPE) issued a technical opinion that was favourable to the acquisition.[12] SDE, on the other hand, recommended only partial approval of the deal. At first, CADE followed the technical opinion of SDE and recommended that the acquisition receive antitrust clearance on condition that the Pains business unit was sold. The merging firms requested a second ruling concerning the transaction, reinforcing the argument that the merger would bring several efficiencies (cost reduction, quality improvements and technology transfers) that would be shared with consumers, and making a new argument based on the alleged fact that the sale of Korf was a necessary condition for its survival (a “failing firm” defence).[13] The appeal made by the firms was successful, and in a second ruling the operation received clearance without any restrictions.

1.1 The economics of horizontal mergers

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