



Australian Government

Department of Foreign Affairs and Trade

Enforcement of Business Regulation and Commercial Laws in the APEC Region





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APEC Branch
Department of Foreign Affairs and Trade
R G Casey Building
John McEwen Crescent, Barton
Canberra ACT Australia 0221

Telephone: (+61) 2 6261 1111
Facsimile: (+61) 2 6261 3009
Email: apec@dfat.gov.au
Internet: <http://www.dfat.gov.au>

Allens Arthur Robinson
Melbourne Office
Stock Exchange Centre
530 Collins Street
Melbourne VIC Australia 3000

Telephone: (+61) 3 9614 1011
Facsimile: (+61) 3 9614 4661
Email: melbourne@aar.com.au
Internet: <http://www.aar.com.au>

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About This Report

This report highlights the importance of enforcing “black letter laws” in the Asia-Pacific Economic Cooperation (APEC)¹ region, with a focus on the enforcement of commercial laws, corporate governance and competition policy. It ascertains key enforcement issues and challenges in the Asia-Pacific region and identifies the progress made by APEC economies in this area. The report provides information about current “best practice” enforcement models and suggests next steps and areas for further work.

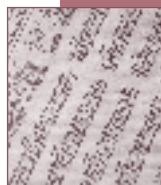
Improving the enforcement of business regulation and commercial laws in APEC economies will enhance their economic legal infrastructure, provide greater confidence and certainty to the business community and investors, and ensure that the benefits of trade liberalisation and facilitation are maximised and sustained. This report will assist in raising awareness within APEC economies of the need to ensure that their black letter laws, rules and regulations are implemented and enforced.

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Allens Arthur Robinson 

¹ The 21 members economies of APEC comprise: Australia; Brunei Darussalam; Canada; Chile; the People’s Republic of China; Hong Kong, China; Indonesia; Japan; the Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; the Philippines; the Russian Federation; Singapore; Chinese Taipei; Thailand; the United States; and Vietnam.



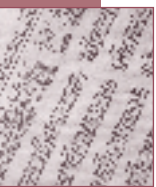
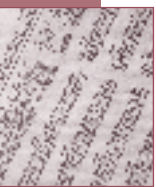


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1. Executive Summary

Many Asia-Pacific Economic Cooperation (APEC) economies have taken significant steps to improve their economic legal infrastructure in recent years, particularly since the Asian economic crisis of 1997. Most of that work has been directed towards improving formal laws in the areas of corporate governance, bankruptcy, privatisation and industry restructuring, consumer protection, corporate law and intellectual property rights. The quality of an economy's "black letter" law is an important factor in establishing confidence among investors in that economy: confidence that their investments can be made and their businesses can operate in a fair and transparent environment where it is possible to make business decisions on their merits without fear of direct or indirect interference by third parties. Investor confidence can lead to higher levels of investment, greater business activity, higher employment levels and increased tax revenues.

However, black letter laws on their own are not sufficient to ensure investor confidence: those laws must be applied in practice. *Enforcement* is just as much an element of an economy's economic legal infrastructure as are the formal laws themselves.

The main objectives of this report are:

- to increase the level of awareness of the enforcement efforts of APEC economies;
- to provide information about current "best practice" enforcement models; and
- to identify enforcement gaps and suggest actions to deal with them.

The report does not deal with the relative merits of the substantive laws of any particular economy. On the contrary, the intention is to provide information from many economies about their actual experiences in enforcement of their substantive laws and to offer suggestions which might be applied by other APEC economies in their own circumstances.

The report considers enforcement experiences in three discrete areas. Chapter 4 describes enforcement in six fundamental areas of commercial law and business regulation: company formation; foreign direct investment; business licensing; formation of contracts; bankruptcy; and corruption.

Regulations which are out of date, impractical, unnecessarily complex or which leave significant discretion to officials create substantial business risks for investors and so raise the costs of investment or ultimately drive investment away. Enforcement which is selective or unpredictable can have similar consequences.

Inadequate corporate governance rules and inadequate enforcement of those rules can leave economies excluded from major international sources of investment funds or increase the costs of those funds because investors require risk premiums for investment protection.



In Chapter 5, the report considers enforcement of corporate governance rules as they affect the main stakeholders in the operation of corporations: the shareholders; creditors; directors; employees; and government. It considers how failings in enforcement can disadvantage stakeholder interests, and the steps which have been taken in some economies to deal with those failings.

Many APEC economies have developed specific corporate governance codes and instruments. Most corporate governance codes focus on issues of ownership and control: the rights of individual shareholders; minority protections; class rights; insider trading; and board independence. In principle, companies which are subject to regulatory regimes which ensure that minority shareholders are protected against abuse of power by majorities will be managed in a way which benefits the company as a whole – that is, the shareholders, employees, creditors and the society in which it operates – not just the narrow interests of the majority shareholder. However, the effectiveness of these regimes depends on the extent to which the rules are actually observed.

Corporate governance rules in APEC economies are enforced through a range of techniques, such as fines and penalties, specific prohibitions (eg. against acting as a director) and delisting, trading suspension orders which are designed to protect the market, and the use of derivative actions by shareholders. Other methods include requirements for public accountability, compulsory reporting, disclosure and transparency, mandatory improved accounting standards, self-regulation, and education of both management and investors. Some economies have introduced corporate “whistleblower” legislation.

Sustainable development depends on efficient, competitive markets, but most developing economies have operated without any formal competition policy until quite recently. Structural changes over the past two decades through deregulation and privatisation of state-owned enterprises and the wave of cross-border mergers, however, have focussed attention on the risks to developing economies of monopoly power and anti-competitive behaviour. As a result, many economies have developed competition policies and introduced competition laws. Chapter 6 deals with experiences in enforcement of competition policy.

There are two broad approaches to enforcement of competition policy: *prosecutorial*, using fines and criminal prosecutions, and *administrative*, which depends on consultation, persuasion and the use of restraining orders. In some economies, there is an opportunity for enforcement of competition policy directly by the private sector, by allowing private legal action against businesses which engage in anti-competitive behaviour causing private loss or damage. The costs of those actions are paid by the private parties themselves, not the state, so private enforcement is a very cost-effective enforcement technique for governments. It has to be said, however, that the costs can be so high as to create a disincentive to private parties wanting to take action.

Education is a significant tool in the enforcement process, and regulatory agencies can play a significant role in the advocacy of the benefits of competition policy.

There are several common observations in relation to enforcement.

- The laws themselves must be accessible to, and understood by, the business community. Laws which are incomplete, leave significant issues to administrative discretion, impractical, or difficult to follow will either be ignored in practice or observed only in a formal but not substantive way and may discourage investment altogether. On the other hand, laws which are clear, straightforward and accessible are more likely to be observed in practice than those which are difficult.
- Laws which are not enforced consistently or in accordance with their terms will not be respected and will be disregarded or avoided.
- Enforcement techniques vary from one economy to another according to business and social cultures, and the size and nature of the economy. Particular techniques will succeed in some jurisdictions, but not others.
- The effectiveness of any particular enforcement regime is linked to the competencies of the relevant regulatory agencies, the legal and business culture of the relevant economy, and the capabilities of the judicial system.
- Fines and penalties may not be the best techniques for ensuring compliance. Adverse publicity and economic incentives can be useful enforcement tools.
- In most economies, business laws are administered and enforced by a regulatory agency appointed under statute. There are a number of common features of effective regulatory agencies: they are well-resourced and have strong political support; appointments are made on merit through a transparent process; they are (and are seen to be) independent from government and business; they are accountable in a public way; they make their decisions through a fair, independent and transparent process; and their procedures are open to review by the courts.
- The regulatory agencies themselves depend on a competent and fair judicial system. Compliance is more likely where the judicial system is respected and operates efficiently and independently. Respect, of course, must be earned.
- Education and training – at all levels – are significant compliance tools.

Finally, in Chapter 7, the report suggests some areas of further work which might be considered by APEC. Suggestions include:

- the development of programs for continuous review of business laws to ensure they are consistent with policy requirements, comprehensive and straightforward;
- research into the use of alternative enforcement techniques, such as “equity fines” and community service orders;
- capacity building for regulatory agencies and the judiciary;
- development of specialist courts; and
- education and training programs.



2. Introduction

2.1 Aims and Objectives of the Report

This report aims to respond to the current needs of APEC economies to continue institutional and regulatory reform and to facilitate enforcement of business regulation and commercial laws. The underlying premise of the report is that effective enforcement of these laws will enhance APEC economies' economic legal infrastructure, provide greater confidence and certainty to the business community and investors, and ensure that the benefits of trade liberalisation and facilitation are maximised and sustained.

To this end, the report's substantive aims are to:

- (a) increase the awareness of APEC economies about enforcement efforts to date in the fields of commercial law, corporate governance and competition policy;
- (b) inform APEC economies about best practice enforcement models and identify existing gaps where further efforts will be required to improve enforcement of commercial laws and business regulation across the region;
- (c) improve the capacity of legal regulatory institutions and government agencies to apply and enforce commercial law rules in a manner which does not impede business activity;
- (d) provide a better understanding of the differences in culture, systems and structures and promote a common understanding of the key enforcement issues; and
- (e) focus the attention of APEC on the need for member economies to conduct further work on regulatory and institutional reform by building their capacity to implement and enforce sound commercial laws.

The report identifies benefits, issues and challenges in enforcement and recommends areas for further work. Specific examples are included to demonstrate the different approaches and experiences in the region.

2.2 Structure and Methodology

The methodology used in preparation of this report comprised, first, identification of relevant reference materials drawn from a wide range of sources such as multilateral agencies, APEC economies, international peak bodies and representative groups, non-government organisations (NGOs), academia and the private sector. The materials were then reviewed and analysed to identify examples of effective enforcement experiences and recurring themes.

2.3 Enforcement

"Enforcement" comprises those actions taken by government, regulatory agencies or commercial parties to ensure that all business entities comply with applicable laws, rules and policies.

The effectiveness of an economy's commercial laws, corporate governance and competition policy is best measured by the extent to which the participants in that

economy comply with them, that is, the extent to which they are enforced in practice. There may be a variety of reasons why participants do or do not comply: the clarity of the particular rules; culture and tradition; familiarity; the existence and capacity of regulatory agencies; the sanctions for non-compliance; or the perceived benefits (or disadvantages) of compliance.

Compliance may be through formal enforcement and prosecution, private litigation or other dispute resolution processes, or informal techniques of awareness-raising, publicity, advocacy and negotiation.² It is possible to distinguish between approaches to enforcement which emphasise the use of measures falling short of prosecution and approaches which are penal and utilise a form of prosecutorial process.³

In some instances, rules are self-enforcing, that is, commercial parties comply because it is perceived to be beneficial to them and their stakeholders (or perhaps the economy as a whole) to do so. In those cases, the need for direct oversight by a regulatory agency is relatively low. In other instances, governments find it necessary to introduce specific penalties, including fines and imprisonment, in order to ensure compliance. In those cases, it is usual to find a regulatory agency with significant authority.

It is also possible to view enforcement as involving a progression through different compliance-seeking strategies and sanctions.⁴

Effective and efficient enforcement of a particular law assists in the achievement of the objectives of that law. This report focuses on the institutions and legislative and regulatory frameworks of APEC economies that are generally perceived as promoting effectiveness and efficiency in enforcement practices. It identifies and reviews the tools used by governments to ensure that the relevant rules are followed, and charts the experiences of economies in the use of those tools. Finally, it assesses the need for new or different tools and considers the key factors which contribute to effective and efficient enforcement of commercial laws.

All economies can benefit from observing and understanding the levels of success in the enforcement of commercial laws and techniques adopted in other economies. It should be noted, however, that the rigid application of enforcement techniques in any one economy simply because they have been (or appear to have been) effective in another is unlikely to be successful. There is a need to take into account a range of factors affecting the nature of each economy – its size, its economic base, the level of sophistication of the business community, the degree of internationalisation, as well as the overall economic objectives of government. Information, ideas and opportunities can be presented to governments so that they can consider the experiences of others, identify the choices available to them and so develop and implement policies which are appropriate for their own economies.

² See generally, Baldwin, R., and Cave, M., 1999, *Understanding Regulation*, Oxford University Press, pp.96-117.

³ See Reiss, A., 1984, "Selecting Strategies of Social Control over Organisational Life" in K. Hawkins and J. Thomas (eds), 1984, *Enforcing Regulation*, Baldwin, R. and Cave, M., op.cit., p.97.

⁴ Baldwin, R. and Cave, M., op.cit., p.99.



3. The Importance of the Enforcement of Black Letter Laws to Engender Investor and Business Confidence in the APEC Region

Strengthening economic legal infrastructure leads to improved investor confidence, higher investment levels, lower business costs, efficiencies, innovation and increased levels of employment.

One of the most significant issues for investors is certainty that:

- an investment can be made quickly, directly and without unnecessary government regulations;
- businesses will be able to operate under the protection of a legal system which is competent, fair and accessible; and
- investments can be realised at the end of their lives.

Investors are certainly attracted by fiscal concessions, but those concessions are less necessary where investors have confidence in the investment's security.

Many APEC economies have made significant changes to their business laws in recent years, particularly since the economic crisis of 1997. Those changes have concentrated on laws relating to restructuring and governance in the banking sector, privatisation, insolvency of companies, competition, consumer protection and intellectual property rights.

This report identifies some of the conditions where enforcement has been effective.

The quality of an economy's "black letter law" does a great deal to create business confidence. However, it is plain that the introduction of new laws is not of itself sufficient to bring about changes in behaviour. Those laws must be applied and enforced if the policies behind them are to be effective.

Business confidence soon fades where the black letter laws are not actually applied in practice. The loss of business confidence can lead to investments being relocated elsewhere or directed towards short-term profitability or areas of investment which are contrary to government policy. Ultimately, this leads to declining private and government revenues, fewer jobs and lower levels of social services, and damages the reputation and standing of governments, state agencies and the economy itself.

4. Key Issues and Experiences in the Enforcement of Commercial Laws and Business Regulation

4.1 Introduction

The “commercial laws” of an economy are those laws which make up the legal framework for the conduct of ordinary commercial activities, and include those laws which materially impact upon the conduct of ordinary business within an economy. The expression includes corporate governance laws and competition (anti-trust) laws which are the subject of separate chapters in this report.

Business regulations are those pieces of subordinate legislation which implement commercial laws.

This Chapter concentrates on the most basic commercial laws, that is, those laws which apply to the formation of business entities, their day-to-day activities and their relationships with third parties such as creditors.

There are three stages in the development of commercial laws and business regulations:

- the legislation stage – the enactment of enabling legislation;
- the administration organisational stage – the creation of regulatory administrations and rules; and
- the enforcement stage – the bringing to bear of those rules on persons or institutions sought to be controlled or influenced.⁵

The third stage, enforcement, is as vital to the success of regulation as the first two.⁶

4.2 Formation of Companies

Companies are the most common form of business organisation. It follows that the procedures for formation of companies are among the most fundamental elements of a commercial legal system. In the absence of special circumstances, the procedures should be straightforward.

The laws and policies governing the formation of companies vary greatly across APEC economies.⁷ The simplest of regimes, as found in Australia, involves just two procedures: notification of existence; and tax registration.⁸ All of the necessary forms and information are available electronically. Most APEC economies impose additional

5 See generally, Hutter, B. M., 1997, *Compliance: Regulation and Environment*, Oxford; Hutter, B. M., 1988, *The Reasonable Arm of the Law?*, Oxford; Ayres, I. and Braithwaite, J., 1992, *Responsive Regulation*, Oxford University Press, Ch 4.

6 Baldwin, R. and Cave, M., op.cit., p.96.

7 See International Bank for Reconstruction and Development and World Bank, 2004, *Doing Business in 2004: Understanding Regulation*, Chapter 2.

8 Ibid, p.17.



requirements. Generally, the more developed economies regulate less, as do those of the common law tradition.⁹

In some economies, the process is transparent, centralised, efficient, reliable, fast and inexpensive. For example, in Singapore the establishment of a company is facilitated by an electronic application process and can be achieved in approximately eight business days.¹⁰ For foreign investors, the incorporation process is coordinated with immigration matters. Also in Singapore, as in Thailand, Chile and Hong Kong, China (hereafter Hong Kong), there are no minimum capital requirements for new companies.¹¹

In other economies, the opposite is true. For example, Indonesia's procedures for incorporation are slow, formal and relatively inflexible. The administrative formalities required before an entity may lawfully start operations can take up to six months.¹² In some economies, investors find the procedures to be unnecessarily bureaucratic.

It is possible to measure the effectiveness and efficiency of regulatory regimes governing the incorporation of new companies by reference to the number of procedures involved, the level of regulatory discretion, transparency, predicability, time and cost. It is often the case that the greater the number of administrative discretions which have to be exercised in the process, the longer the process takes and the less certain the outcome.

Table 1 contains some statistics on the incorporation process in a number of APEC economies.

	Australia	Chile	Indonesia	Japan	Mexico	Singapore	Vietnam
Number of procedures	2	10	29	11	7	7	11
Time (days)	2	28	225	31	51	8	63
Cost (% of income per capita)	2.0	11.6	269.0	10.5	18.8	1.2	29.9
Minimum capital (% of income per capita)	0.0	0.0	302.5	71.3	87.6	0.0	0.0

Source: International Bank for Reconstruction and Development and World Bank, 2004, *Doing Business in 2004: Understanding Regulation*.

9 Ibid, p.18.

10 Ibid, pp.17-27.

11 Ibid, pp.17-27.

12 Ibid, pp.17-27.

Cumbersome entry regulation tends to be associated with lower levels of private investment, higher consumer prices, greater administrative corruption and a larger informal economy.¹³

In most APEC economies, there are specific stages to be completed before company formation can be regarded as complete. Responsibility for enforcement is usually given to a government department or regulatory body with the power to fine or sanction non-compliant individuals.

In those economies where company formation requirements are clear, straightforward and consistently applied, compliance levels tend to be high. Generally, where incorporation requirements are expensive, slow, bureaucratic and involve many separate steps, levels of compliance tend to be lower. This is especially the case in developing economies, where the costs of compliance may be relatively high.¹⁴

Other factors which contribute to non-compliance include:

- a perception that the costs of compliance exceed the cost of probable sanctions for non-compliance;
- a deliberate lack of enforcement by regulatory bodies where the rules are impractical, outdated or contrary to an important policy objective; and
- a lack of resourcing of regulatory bodies.

Where the incorporation process is expensive and slow, bureaucratic investors may look for other, less formal methods of business organisation. Those arrangements may not protect their rights adequately, are often difficult to monitor, and are outside the ordinary scope of state revenue collections and other laws and policies.

4.3 Foreign Direct Investment

Foreign investment laws and regulations define a government's policy towards foreign participation in its economy. They are complex structural economic policy tools.

There are many variations in the nature and scope of regulation across APEC economies, but most cover restrictions on foreign investment in specified industry sectors, limit the percentage of ownership by foreign investors in projects, provide guarantees against expropriation and set out investment controls and conditions.¹⁵


In many APEC economies, enforcement of foreign investment laws and policies involves preventative intervention by a government entity through a requirement that proposed foreign investments need to be approved at their inception by one or more government entities.

¹³ Ibid, p.18.

¹⁴ Ibid, pp.17-27.

¹⁵ Gutterman, A. and Brown, R., 1997, *Commercial Laws of East Asia*, Sweet and Maxwell, Hong Kong, p.37.





There are a number of variations on the approval procedures which might need to be followed. For example, approval may only be required where the proposed investment falls within a restricted sector, where the value of the investment exceeds a certain threshold or where the foreign investor proposes to acquire a certain percentage of the local concern. Approvals may be required on an ongoing basis where, for example, the foreign investor proposes to reinvest earnings, expand its operations or otherwise move away from the terms on which the original investment was made.

Box 1: Foreign Investment in Indonesia

In most business sectors in Indonesia, foreigners can own all of the shares of a foreign investment company, but must divest an unspecified proportion of the shares to an Indonesian party within 15 years after commencing commercial operations. The difficulty for the investor is that the proportion of shares to be divested is not stated. This leads to uncertainty and to the adoption of exotic forms of business structures which seek to circumvent policy altogether in order to remove the risk, leading in turn to diversion of revenues. There is also a risk that those structures may not be legally enforceable.

The regulations are enforced through reporting (investors must regularly report changes in legal ownership of shares), the risk of forced divestment for non-compliance, and most significantly by the tax system which creates additional tax risks for both domestic and foreign shareholders where the regulatory requirements are not followed. As a result, officials responsible for regulating the foreign investment laws often rely on indirect, unofficial methods of enforcement, investors bear the risk of participating in arrangements that they may only be able to enforce through informal means, and government policy is, ultimately, not achieved.

Those APEC economies where the laws establish clear, efficient, practical and internationally familiar rules, and have an administrative regime which is centralised, well-resourced and independent, generally have higher levels of compliance than those economies where the opposite is true. In the latter economies, “selective enforcement” (the practice of enforcing foreign investment rules on a less than consistent basis) can be a concern. For example, laws are sometimes not enforced strictly because the regulator believes that the laws contradict some other important policy objective. Where laws are not consistent with government policy, there may be a mismatch between foreign investors’ expectations and actual experience, as well as discomfort for officials. Governments need to review existing legislation and implementation/administration practices regularly to ensure they are consistent with policy.

Box 2: Foreign Investment Approval Processes in Australia

The underlying rationale of Australia’s *Foreign Acquisitions and Takeovers Act 1975 (FATA)* is that an investment proposal covered by the FATA can be prohibited by order of the Treasurer if the Treasurer considers that it is “contrary to the national interest”.

Section 26 of the FATA provides for the compulsory notification of acquisitions by foreign persons of interests in Australian corporations whose gross assets exceed A\$50 million over a 15% threshold. The Treasurer may approve, reject or defer consideration of the notified investment.

If the Treasurer does not take at least preliminary action within thirty days, the Government loses the ability to either block the proposal or impose conditions on its approval, and the investment can proceed.

If a notifiable proposal is not notified, the Treasurer has power to order divestment at any time in the future. So there are significant practical risks in non-compliance.

While a number of APEC economies have established a single centralised agency, others use inter-ministerial investment boards or commissions to coordinate foreign investment matters. Other structures involve simultaneous review by two or more agencies, such as the central bank, the ministry with responsibility for the particular industrial sector, and the agency charged with oversight of trade and business development.

The sanctions and penalties for failure to comply with foreign investment laws are as diverse as the underlying laws and regulations themselves. For example, a failure to register an investment of foreign capital may prevent the investor from repatriating profits. In some economies, any violation of the foreign investment laws can result in fines and other penal sanctions against the companies involved, or against individual directors, officers and other managerial personnel.

Where the relevant regulatory agency is active and has strong powers to sanction breaches of the laws, compliance tends to be high. In other cases, investors may comply with the formal requirements of the law but in substance avoid the policy requirements through private arrangements.

4.4 Regulation and Licensing of Business Activities

Regulatory regimes vary greatly depending on the policy objectives and the social, political, economic, constitutional and legal circumstances. Differences among APEC economies can be identified in terms of *what* is regulated and also *how* a particular behaviour is regulated. Points of differentiation include the form of rules, the use of economic incentives, the identity of the regulator, its level of discretion, its enforcement powers, forms of sanction and the availability of appeal mechanisms.

Generally, developing economies regulate business more than developed ones do.¹⁶ One significant variable explaining different levels of regulatory intervention is legal origin: common law jurisdictions tend to regulate less, civil law ones the most.¹⁷

In some APEC economies, notably Indonesia and Thailand, it is common practice for the legislature to pass laws which are expressed in quite general terms, leaving significant issues (not just administrative) to 'official' notification.

This effectively delegates law-making powers to an unelected body, which may lead to reduced levels of accountability, transparency and democratic processes. It confers

¹⁶ International Bank for Reconstruction and Development and World Bank, op.cit.

¹⁷ Ibid.



on regulators more discretion and power than might be warranted and raises risks of corruption where levels of resourcing and public respect are low. The lack of clear rules can lead to uncertainty in enforcement and ultimately embarrassment for politicians and officials alike, as well as a number of other undesirable consequences (including increased scope for corruption and selective enforcement). Ultimately, the economic and social costs of incomplete legislative processes may be lower investment levels, misdirected investment and overall higher costs to the economy itself.

Enforcement powers in relation to business regulation and licensing are usually delegated to a range of regulatory agencies appointed under statute (eg. government departments, independent agencies or directors-general). In some cases, legislation allows private entities to enforce the regulations directly, without the intervention of a regulatory agency.

Factors limiting the effectiveness of regulators in certain economies include lack of independence and broader problems affecting the legal and judicial sectors.

Where compliance is low due to a perceived inadequacy or impracticality of the relevant regulation, enforcement may be correspondingly low. This can lead regulators to aim for less than total compliance in their enforcement activities. Enforcement costs tend to rise alongside increases in levels of compliance and a point may be reached where the costs of further enforcement are not justified by the gains from changed behaviour in the market.¹⁸

4.5 Formation of Contracts

The law of contract is a basic element of the legal framework for the conduct of commercial activity. While the law of contract differs across APEC economies, most regimes (whether common law or civil) recognise fundamental principles of contract law relating to formation of contract, performance of contractual obligations and the consequences of a breach or violation of contract. The value of a contractual right or obligation depends on its enforceability.

The knowledge that business contracts can be enforced is an important determinant of investor and business confidence. Investors wish to be confident that their agreements will be performed and to know what will happen if circumstances change and what their position will be if their commercial bargains are not performed. High levels of contract performance and enforcement are associated with high levels of investment and economic activity.

There is, obviously, significant business activity in those economies where contractual rights and obligations are only enforceable through negotiations or third party influence. However, in those economies, investors assume a greater risk of contract default and rely on, among other things, relationships (with counterparties and others in positions

¹⁸ Breyer, S., 1993, *Breaking the Vicious Circle*, Harvard University Press, pp.10-13; Stigler, G. J., 1970, "The Optimum Enforcement of Laws", *Journal of Political Economy*, vol. 78, p.526.

of influence) and reputation mechanisms in order to manage that risk. The ability of those economies to attract significant international investment is prejudiced.

Enforcement techniques include negotiation, mediation, conciliation, arbitration and litigation. The choice of enforcement technique depends mainly on the nature and quality of the available remedies, efficiency and cost. These characteristics vary greatly across APEC economies.¹⁹

The World Bank has identified four types of reform which can make enforcement of contracts easier:²⁰

- The establishment of judicial information systems on caseloads, which allow the identification of primary users and bottlenecks. For example, Mexico recently piloted a management information system in the courts. The program revealed that 60 per cent of cases do not go beyond the initial filing of the claim. This information gave the government a more accurate picture of the actual caseload of judges.
- Removal from the courts of matters that are not disputes (eg. non-contentious company formation or dissolution matters).²¹
- Simplification of court procedures, especially in relation to summary matters. Other initiatives include the use of oral (rather than written) procedures, limiting the number of appeals, reducing or eliminating the need for legal justification, and simplifying rules of evidence.
- Introduction of small claims and specialised commercial courts. Specialised courts often use simplified, less formal, procedures. For example, Australia and Singapore have specialised courts, while Japan and New Zealand recently increased the maximum claim eligible for hearing at the small claims court. However, where the judiciary is still developing, the introduction of specialised courts may be premature.²² An alternative is to have specialised judges and/or establish specialised commercial procedures within the general courts. Also, out of court resolution mechanisms are often a better short-term solution in economies with a less developed judiciary. Compulsory and voluntary mediation have been successful in several APEC economies.

4.6 Bankruptcy

Effective bankruptcy laws maximise the total value of proceeds received by creditors, shareholders, employees and other stakeholders from a bankrupt entity, by either rehabilitating viable businesses or efficiently liquidating those which are not viable²³.

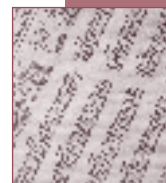
19 See International Bank for Reconstruction and Development and World Bank, *op.cit.*, Chapter 4.

20 See International Bank for Reconstruction and Development and World Bank, *op.cit.*, Chapter 4.

21 *Ibid*, p.50.

22 *Ibid*, p.52.

23 *Ibid*, Chapter 6.



This in turn reduces the risks faced by investors in a company by ensuring the stability of priorities in claims on a company's assets.²⁴

Many APEC economies (for example, Thailand and Indonesia) have adopted new bankruptcy laws, but few of them have the benefit of the levels of judicial, professional and commercial experience required to make them effective, so that adjustments to the new laws and related procedures have become necessary. In Thailand, the Corporate Debt Restructuring Advisory Committee (CDRAC) was established by the Bank of Thailand and various associations to help facilitate restructuring. In March 1999, a number of financial institution creditors agreed to a framework devised by CDRAC to be applied in an informal workout. The pace of restructuring significantly increased as a result.

One test of whether bankruptcy laws are effective is the extent to which financially distressed companies and their stakeholders use them, but the number of bankruptcy filings is not of itself a sound measure of effectiveness.²⁵ A declining number of insolvencies may indicate reduced enforcement levels or a practice of resorting to private settlements rather than improved compliance or financial performance of an economy.

Box 3: Bankruptcy Filings

During the 1990s, 3.65% of total firms in the United States (hereafter the US), 3.67% in New Zealand, and 3.06% in Singapore filed for bankruptcy or liquidation.²⁶ By contrast, the figure for Hong Kong was 0.55%, for the Russian Federation (hereafter Russia) 0.31%, for the Republic of Korea (hereafter Korea) and Thailand 0.17% and 0.13% respectively, and for Peru 0.05%.

This data gives rise to expected and unexpected conclusions.²⁷ For example, bankruptcy rates are generally higher in common law economies with well-resourced judicial and governmental authorities. They are also higher among economies where the rate of firms starting up is also higher, and they are higher for economies with a greater proportion of large, as against small or medium sized businesses.

Strong rules for creditor protection – such as a “no automatic stay on assets” rule allowing creditors to seize assets during a bankruptcy – reduce the formal number of bankruptcies.²⁸ This suggests that having strong insolvency laws can perform an important role in promoting out of court settlements and protecting creditors' rights. It also suggests that strong creditor rights can compensate for weaknesses in legal enforcement.

In economies without efficient bankruptcy procedures, out of court negotiations (workouts) are by far the most common mechanism for reorganising debt, but the entitlements of stakeholders, shareholders, creditors, employers and received lenders

²⁴ Ibid, Chapter 6.

²⁵ Ibid, Chapter 6.

²⁶ Claessens, S. and Klapper, L., 2002, “Bankruptcy Around the World – Explanations of its Relative Use”, *World Bank Policy Research Working Paper 2865*, July 2002, p.34.

²⁷ Ibid, p.22.

²⁸ Ibid, pp.1 and 22.

are not clear or predictable. That leads to loss of investment protection and higher investment risks. Effective bankruptcy laws provide for negotiated arrangements without formal bankruptcy (eg. the US and Australia), but in circumstances where the rights of all stakeholders are known and taken into account.

The effectiveness of bankruptcy laws can also be assessed by considering the time and cost involved in insolvency proceedings.²⁹ In Singapore, bankruptcy can be resolved within one year at a cost of approximately one percent of the value of the assets the subject of bankruptcy. By comparison, in Thailand and the Philippines, the cost of formal bankruptcy may consume as much as half the assets of the debtor.

The World Bank has identified three key elements of an efficient bankruptcy regime:³⁰ the choice of appropriate institutions to deal with bankruptcy given an economy's income; the involvement of stakeholders rather than the court in business decisions; and the availability of well-trained judges and bankruptcy trustees.

Some economies have relatively less efficient bankruptcy regimes but efficient judicial processes. Others have sound bankruptcy laws but inefficient judicial processes. In both cases, creditors generally perceive the bankruptcy system to be inefficient and rarely use it. This leads to inadequate credit assessments, risk premiums, high investment risks, higher costs for business and ultimately lower levels of investment.

Several APEC economies have taken steps to improve the enforcement of their bankruptcy laws. Mexico has recently implemented significant reforms to its bankruptcy procedures,³¹ aimed at improving the conditions for effective debt enforcement outside insolvency, increasing the involvement of stakeholders in the insolvency process, and training judges and bankruptcy administrators in insolvency law and practice. Japan has reformed its bankruptcy law to make it more attractive to debtors. Thailand has reformed its judicial structure to allow for specialised courts.

4.7 Corruption

The economic and social consequences of corruption are well known. They include:

- poverty traps;
- undermining democracy and the rule of law;
- distortion of national and international trade;
- jeopardising governance and ethics in the private sector;
- creation of opportunities for social, economic and political crises;
- threats to domestic and international security;
- retarded social and economic development; and
- threatened sustainability of natural resources.

²⁹ International Bank for Reconstruction and Development and World Bank, op.cit, Chapter 6.

³⁰ Ibid, p.79.

³¹ Ibid, Chapter 6.



The importance of curbing corruption is well understood by APEC economies, but there are no easy or simple solutions.³² Patterns and levels of corruption and the regimes designed to curtail them vary greatly across APEC economies. No economy has yet designed the perfect model, and perhaps none exists. However, while each APEC economy has a unique history and culture, political systems and stage of economic and social development, similarities do exist and experiences can provide useful lessons.

Many governments, including those of APEC economies, have established “independent” anti-corruption agencies or commissions.³³ The model often used is the Hong Kong Independent Commission Against Corruption (HKICAC), the functions of which include the handling and investigation of allegations of corruption, the conduct of public awareness programs and the auditing of management systems of individual government departments and agencies from an anti-corruption perspective. The power to prosecute after completion of investigations is vested with the Secretary for Justice. The separation of powers ensures that no case is brought before the courts solely on the judgement of HKICAC.

Box 4: Anti-Corruption Initiatives in Some APEC Economies

- Hong Kong: The HKICAC was established under the *Independent Commission Against Corruption Ordinance 1974*, as an independent institution subject only to the direction and control of the Governor. It consists of a Commissioner and a Deputy Commissioner appointed by the Governor, and other staff appointed by the Commissioner. The duties of the Commission include: the investigation of offences under the *Prevention of Bribery Ordinance*, the revision of practices and procedures of government departments and bodies which are conducive to corrupt practices; advice to any person on ways in which corrupt practices may be eliminated; education of the public against the evils of corruption; and the fostering of public support in combating corruption. Hong Kong’s model is regarded as effective for three reasons: the quality and determination of the HKICAC’s staff; the excellent legal framework which has facilitated its work; and because prevention and enforcement are both functions of the Commission. Prevention (including education and awareness-raising activities) has been a core focus of the HKICAC, supported with information from the enforcement side of the Commission. This has allowed the HKICAC to pursue a coordinated and coherent set of anti-corruption strategies. Another important factor in the Commission’s success is that it is well-resourced.
- Japan: In Japan, an anti-corruption law came into effect in 2001, prohibiting holders of public office from receiving payment in return for favours. Offenders face up to three years in prison.³⁴
- Singapore: Singapore’s Corrupt Practices Investigation Bureau was established under the *Prevention of Corruption Act (Cap 241)* in 1960. The law defines several offences and provides for their investigation and prosecution. The Act applies to citizens of Singapore

32 See Langseth, P., Stapenhurst, R. and Pope, J., 1997, *The Role of a National Integrity System in Fighting Corruption*, World Bank.

33 Transparency International, 2000, *Transparency International Source Book 2000*, Chapter 11 and Appendix (Emerging Best Practice in Containing Corruption).

34 See Transparency International, 2003, *Global Corruption Report 2003*, pp.128-139.

in respect of offences committed both within and outside the country. Placement of the agency in the office of the Prime Minister may be an important factor in its success.

- Korea: The Korean Independent Commission Against Corruption (KICAC) was created in 2002. Under the law, corrupt officials may face jail terms of up to 10 years, fines of up to 50 million won (US\$40,000) and a ban on employment by public or private enterprises lasting five years. The law also gave KICAC a specific mandate to investigate cases involving high-ranking officials.³⁵ The Commission's functions include: handling corruption reports (including the exercise of powers to charge corrupt high-ranking officials); institutional improvement; policy formulation and evaluation; and public education and promotion. KICAC recently issued a Code of Conduct of Public Officials which it hopes will strengthen integrity in the public sector and encourage voluntary compliance.
- Thailand: Article 297 of Thailand's 1998 Constitution provides for the establishment of the National Counter-Corruption Commission. The Commission comprises a chairman and eight experts appointed by the King on the advice of the Senate. Its functions include the investigation of state officials for corruption, abuse of power or being unjust, and the verification of declarations of assets and liabilities submitted by public office holders.³⁶

Sources: Transparency International 2000, *Transparency International Source Book 2000*, Chapter 11 and Appendix (Emerging Best Practice in Containing Corruption) and other sources.

According to Transparency International, to operate successfully, an anti-corruption agency must possess the following characteristics:³⁷

- committed political backing at the highest levels of government;
- the ability to survive and operate consistently, notwithstanding changes in power;
- adequate resources to fulfil its role;
- political and operational independence to investigate even the highest levels of government;
- adequate powers of investigation (including for access to documentation and for the questioning of witnesses), prosecution and prevention;
- appropriate anti-corruption related laws (including the criminalisation of "illicit enrichment"); and
- leadership which is recognised as being of the highest integrity.

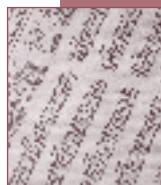
It is also important that the agency's powers are consistent with international human rights norms and that the agency itself operates within the law and is accountable.

Where laws have been passed which create anti-corruption agencies, formal power is usually conferred on the agency to investigate and bring action against allegedly corrupt individuals.

³⁵ See *ibid*, pp.128-139.

³⁶ See *ibid*, pp.140-152; Economist, 2004, *Corruption in South-East Asia: Who Will Watch the Watchdogs?*, 19 February 2004.

³⁷ Transparency International, *op.cit.* (2000), Chapter 11.



Some agencies (eg. HKICAC) also adopt softer approaches to enforcement by promoting anti-corruption through media campaigns. In the People's Republic of China (hereafter China), the Supreme People's Procuratorate, the main anti-corruption body, names fugitive public officials or employees suspected of corruption, and in this case, the risk of public humiliation is seen as an effective practical detriment.³⁸

There are many reasons why anti-corruption agencies are unable to enforce laws adequately, including:

- lack of independence;
- political bias;
- inadequate resourcing;
- inadequate powers;
- lack of political leadership; and
- a corrupt or inept judiciary.

In some economies, anti-corruption agencies have been established but they are weakened by conflicting mandates, insufficient resources and the fragility of other political and legal institutions.

4.8 Enforcement Strategies and Techniques

It is possible to draw a distinction between "compliance" approaches to enforcement, such as awareness-raising, advocacy and negotiation, which emphasise the use of measures falling short of prosecution, and "deterrence" approaches which are penal and use a form of prosecution.³⁹

Within the compliance approach, it is also possible to distinguish between two sub-strategies: "persuasive" and "insistent".⁴⁰ The persuasive approach is more accommodating. Officials educate, coax and encourage offenders into complying with the law, and explain the policy and possible means of compliance in a patient, open-ended way.⁴¹ The insistent approach is less flexible, and there are defined limits to the tolerance of officials who will increase pressure if there is not compliance within a specific period of time.

Regulators usually have a range of administrative and criminal sanctions available to them to deal with non-compliance.⁴² Administrative measures operate without recourse to the courts and can be provided for either in legislation or in contracts (eg. within the

38 See Transparency International, op.cit. (2003), pp.128-139.

39 See Reiss, A., op.cit.; Baldwin, R. and Cave, M., op.cit., p.97.

40 Hutter, B. M., op.cit. (1997), p.15.

41 See also, Braithwaite, J., Walker, J. and Grabosky, P., 1987, "An Enforcement Taxonomy of Regulatory Agencies", *Law and Policy*, vol. 9, issue 3 (July), p.321.

42 Baldwin, R. and Cave, M., op.cit., p.112.

terms of concessions or franchises). Two examples of statutory administrative sanctions are “improvement notices” which require remedial actions to be taken within a fixed period and “prohibition notices” which order the discontinuance of a specified activity. Contract-based measures may include license revocation, curtailment or suspension of contract rights.

Criminal sanctions usually include fines against the company, but sometimes against company officers as individuals, and imprisonment of company officers. Fines can be deficient in a number of ways.⁴³

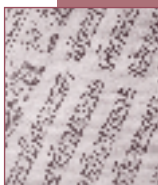
- The benefit to the company that causes harm may be greater than the fine, so that the fine is no deterrent.
- Companies may treat fines as business expenses which they may be able pass through to consumers.
- Large fines may prejudice a company’s financial condition and therefore punish innocent parties such as employees or trade creditors and consumers.
- Fines remove funds from the company which might be spent on measures to limit the harm caused.
- The risk of fines may not deter the actual decision-maker within the management structure of a company.
- Fines do not of themselves ensure that the behaviour concerned will be changed.

Some other sanctions include:⁴⁴

- *Equity fines*: the company is required to issue shares to a victim compensation fund to a value equivalent to the cash fine. This effectively passes the cost of the fine on to the company’s shareholders (who have the power to discipline management) and reduces the negative effect of corporate penalties on employees and consumers. However, equity fines may be unattractive to governments that are opposed to state equity holdings.
- *Punitive injunctions*: these may require companies to change their internal procedures and to introduce (perhaps at significant expense) preventive equipment or safeguards.
- *Corporate probation and enforced accountability*: the activities of a convicted company can be monitored by a court, official or regulatory body which can insist on the use of reporting, record-keeping and audit mechanisms.
- *Community service and compensation orders*: companies can be compelled to provide services to the community or to compensate individuals or groups for the harm done.
- *Adverse publicity*: companies may be ordered to place notices in the media informing the public of their failings and the remedial measures they have taken.

43 Ibid, pp.112-113.

44 Ibid, pp.113-114.



5. Key Issues and Experiences in the Enforcement of Corporate Governance

5.1 Introduction

Corporations are one of the most common forms of business organisations in developing and developed economies. Corporate governance is the way in which the relationships among stakeholders in a corporation, and between stakeholders and the corporation itself, are structured and controlled. International investment decisions increasingly incorporate minimum corporate governance standards, which are substantially accepted by investors around the world.

There is broad international consensus that, while markets are not driven by corporate governance standards alone, effective corporate governance is a critical factor in achieving sustainable economic development.⁴⁵ In 1999, the Organisation for Economic Cooperation and Development (OECD) published the *OECD Principles on Corporate Governance* (the OECD Principles). The OECD Principles were revised in April 2004 through consultation with many developed and developing economies and are an important multilateral attempt to set down a regulatory framework for corporate governance. They constitute a non-binding, principles-based approach to governance which recognises the need to adapt to varying economies and legal circumstances⁴⁶. The OECD Principles comprise an internationally recognised reference point for efforts to improve corporate governance rules.⁴⁷

The OECD Principles, and most domestic corporate governance codes, are based on ideas of *ownership* and *control* of corporations and business entities. They recognise that although there is a range of potential corporate governance practices for different jurisdictions, the stakeholders are broadly the same:⁴⁸

- majority and controlling shareholders;
- individual and institutional shareholders;
- creditors;
- directors;
- employees and managers; and
- government.

45 OECD, 2003, *Experiences from the Regional Corporate Governance Roundtables of Asia, Russia, Latin America, Eurasia and South East Europe, (Roundtables)*. Between 1999 and 2003, the OECD Roundtables process involved discussions among OECD member economies and 38 non-member economies – 25 meetings in 18 economies over four years. This chapter draws on a range of academic and empirical analyses of corporate governance, but is indebted to the work the Roundtables' process has done comparing and contrasting actual international experiences of corporate governance.

46 OECD, 2004, *Revised OECD Principles of Corporate Governance*, April 2004, p.1.

47 OECD Roundtables, op.cit., p.1.

48 OECD, op.cit. (2004), and OECD, 1999, *OECD Principles of Corporate Governance*.

Different approaches to enforcement can be explained by reference to four factors: legal design; social and economic environment; political environment; and internal leadership.⁴⁹ Cultural differences may also produce differences in enforcement styles, although often national approaches are not homogenous.⁵⁰

5.2 Rules of Corporate Governance

Many economies, including both developing and developed, have formal corporate governance rules based on, or similar to, the OECD Principles. The ways in which these rules are likely to be enforced in practice, in culturally, historically and economically diverse settings, may differ.⁵¹

Box 5: Examples of Corporate Governance Codes and Instruments in the APEC Region:⁵²

- Australia (eg. Principles of Good Corporate Governance and Best Practice Recommendations, Australian Stock Exchange Corporate Governance Council, March 2003);
- Canada (eg. Proposed New Disclosure Requirement and Amended Guidelines (Draft), Toronto Stock Exchange, 26 March 2002);
- Hong Kong (eg. Model Code for Securities Transactions by Directors of Listed Companies: Basic Principles, Hong Kong Stock Exchange Listing Requirements, Appendix 10, June 2001);
- Indonesia (eg. Code for Good Corporate Governance, the National Committee on Corporate Governance, March 2001);
- Japan (eg. Revised Corporate Governance Principles, Japan Corporate Governance Forum, 26 October 2001);
- Korea (Code of Best Practice for Corporate Governance, Committee on Corporate Governance, September 1999);
- Malaysia (Malaysian Code on Corporate Governance, Securities Commission, Malaysia, March 2000);
- Mexico (Código de Mejores Prácticas Corporativas [Code of Good Corporate Practices], Mexican Stock Exchange, the Mexican Bankers' Association, the Mexican Institute of Finance Executives and the Mexican Institute of Public Accountants, July 1999);
- Peru (Principios de Buen Gobierno para las Sociedades Peruanas, Comisión Nacional Supervisora de Empresas y Valores [CONASEV], July 2002);
- Russia (the Russian Code of Corporate Conduct, the Coordination Council for Corporate Governance, 4 April 2002);
- Singapore (Code of Corporate Governance, Corporate Governance Committee, Council on Corporate Disclosure and Governance [CCDG], 21 March 2001); and
- United States (Final NYSE Corporate Governance Rules, New York Stock Exchange, November 4, 2003).


49 Kagan, R., 1994, "Regulatory Enforcement" in D. H. Rosenbloom and R. D. Schwartz (eds), 1994, *Handbook of Regulation and Administrative Law*, M Dekker Publishers, New York.

50 Baldwin, R. and Cave, M., op.cit., p.97.

51 OECD, 2003, *White Paper on Corporate Governance in Asia*, 15 July 2003, p.13.

52 See http://www.ecgi.org/codes/all_codes.htm.






The main focus of corporate governance rules is on the rights of individual shareholders. Typical formal rights include: rights to registration of ownership; to receive income distributions (in the form of dividends); to transfer shares; to obtain timely and relevant information on the company; to participate in meetings; to vote; to elect the board; and to share in profits. They also include equitable treatment among classes of shareholders, prohibitions on insider trading, and compulsory disclosure by board members of material interests in matters affecting the company.

The fundamental theory of formal corporate governance is that the interests of all stakeholders will *automatically* be advanced when shareholder rights, especially minority rights, are protected.⁵³ The basic concept is that a company that is fully accountable to its owners will be run as efficiently as possible, or shareholders will effectively improve it by voting their shares, exercising legal rights under contract or insolvency laws, or by selling out. Minority rights are important because when they are protected, a corporation is less likely to advantage only the interests of a majority owner, and so there will be good conditions for managers and employees, healthy returns for creditors, and returns for government through taxation and domestic harmony.

5.3 Enforcement of Corporate Governance



The interests of all stakeholders in corporate governance depend on enforcement. Where there are problems with enforcement of formal corporate governance rules, the interests of some or all stakeholders are likely to be disadvantaged. Best practice behaviour is a more important objective than a best practice official regulatory regime.

Formal corporate governance rules are more likely to be enforced in economies with developed formal judicial and governmental mechanisms for their enforcement.⁵⁴ For developing economies, where the human and financial resources available for institutional reform are limited, there are specific resourcing, judicial and regulatory strategies that may help to improve corporate governance. These strategies are almost always associated with efforts to achieve overall greater certainty and consistency in an economy's legal system, and may include shareholder suits and criminal penalties as well as actions by regulators, stock exchanges and self-regulatory bodies. There are also many private and informal methods of enforcing good corporate governance, such as:

- derivative actions, class actions and representative actions;
- promoting the role of investors, creditors and employees as monitors of corporate performance;
- improving the transparency, timeliness and completeness of available information;
- use of the media;
- self-regulation through business organisations;

53 Berglof, E. and Claessens, S., 2003, *Draft Discussion Paper: Enforcement and Corporate Governance*, Stockholm School of Economics, Global Corporate Governance Forum.

54 OECD Roundtables, op.cit., p.6.

- improving the skills of investors in understanding and reporting on corporate performance; and
- education.

5.4 Recent Developments

There have been several recent significant developments in corporate governance regulations in the APEC region. These changes are responses to business and investor concerns, not just governments and regulators.

In Korea, the possibility of class actions to enforce corporate governance rules is now available. Hong Kong law permits private and derivative actions, and representative actions are possible in Chile. In Australia, important corporate governance reforms are included in the 4 December 2003 *Corporate Law Economic Reform Program (Audit Reform and Disclosure) Bill*, which is currently before the Australian Parliament.

New Zealand

Corporate governance reforms in New Zealand include the New Zealand Stock Exchange's mandatory Corporate Governance Best Practice Code of August 2003 (the *Code*) and the New Zealand Securities Commission's Principles and Guidelines for Good Corporate Governance of February 2004 (the *Guidelines*). The Guidelines are not limited to listed entities, and are intended to "establish a benchmark for shaping the behaviour of New Zealand businesses."

The Code includes a requirement that boards consist of at least two independent directors, or that a third of the board be independent. It defines independence by reference to shareholding (ie. an independent director must control less than 5% of the company's shares) and salary (independent directors must earn less than 10% of their personal income through the company). The board must identify the independent directors to shareholders twice each year. Companies are required to appoint an audit committee.

The Guidelines cover ethical conduct, board performance, board committees, reporting and disclosure, remuneration, risk management, auditors and shareholder participation.

Hong Kong

Hong Kong is introducing reforms to the Listing Rules of the Hong Kong Stock Exchange, on the basis of its *Consultation Conclusions on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues* of 17 January 2003. Included among these reforms are requirements that companies have at least three independent directors and that they develop Codes of Best Practice.

Corporate disclosure obligations in Hong Kong are contained in Part XV of the Securities and Futures Ordinance which provides for:



- additional powers for Hong Kong Securities and Futures Commission (HKSF) to obtain documents and seek explanations from parties involved with a listed entity under investigation;
- the establishment of a Market Misconduct Tribunal to deal with insider trading, market manipulation, and false and misleading disclosures;
- a private cause of action for investors to seek compensation for losses caused by misleading public disclosure or market misconduct; and
- exemption from liability for auditors who report examples of fraud or misconduct.

The law is enforced by the HKSF and since July 2003, its approach to enforcement has focussed on prosecutions for non-disclosure of material interests, false or misleading disclosure, and late or non-disclosure.

Singapore

In 2003, the Monetary Authority of Singapore issued a consultation draft of guidelines on corporate governance. These guidelines include:

- a clear definition of a director;
- requirements for the composition of the board of directors and board committees; and
- a requirement that the roles of chairman and CEO be separated.

Revised OECD Principles

In April 2004, the OECD published a revised version of its Principles of Corporate Governance. The revised principles emphasise that institutional investors should disclose their own governance policies and voting intentions, and that opportunities for shareholder participation in board appointments should be increased. They also recommend totally independent audit arrangements, board independence and objectivity, and the need for rating agencies and analysts to avoid conflicts of interest.

5.5 Stakeholder Issues

(a) Majority, controlling and institutional shareholders

In many regional economies, especially developing or transitional economies, companies typically have highly concentrated shareholdings.⁵⁵ Asian economies, in particular, tend to be dominated by family-run firms.⁵⁶

Majority ownership is seen as the solution to the fundamental principal/agent problem in corporate governance – ie. how an owner protects an investment in a

⁵⁵ Ibid, p.5.

⁵⁶ OECD, op.cit. (2003), p.11.

business without supervising the business day to day.⁵⁷ A majority owner can be an excellent monitor of corporate performance.

However, if there are inadequate rules of corporate governance or if they are not well enforced, this can allow controlling interests to run corporations for their own benefit to the detriment of all other stakeholders. A high degree of corporate control without enforcement of corporate governance standards allows a majority owner to “tunnel” benefits away from minority shareholders and creditors. Opportunities for abuse are increased when a majority owner has more voting than ownership rights.

However, majority owners may also suffer when the rules of corporate governance are not enforced, for example through reduced access to finance. Recent research⁵⁸ suggests that investors are prepared to pay a premium for companies which operate in jurisdictions that recognise the importance of good corporate governance. This may be particularly significant in China.⁵⁹

Institutional investors also play a role in enforcing governance rules in the interests of themselves and as a way of protecting their own investors.

(b) *Individual Shareholders*

Formal and informal enforcement of corporate governance rules should address the following abuses, in the interests of minority shareholders:⁶⁰

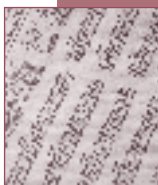
- using confidential information for personal gain;
- related party transactions and insider trading;
- changing the capital structure of a company to increase the control of the majority shareholder and to dilute the interests of minorities;
- using the sale of controlling stakes to advantage the majority owner;
- patterns of vertical and cross-holdings which increase the effective voting control of the majority owner;
- liability transfers, where unfavourable liabilities are transferred into a company in exchange for benefits confined to the majority owner; and

57 OECD Roundtables, op.cit., p.5.

58 McKinsey & Co, 2002, *Global Investor Opinion Survey: Key Findings*. This research suggests that the premium payable by an investor, where a corporation has a reputation for good governance, is 12% to 14% in North America and Western Europe, 20% to 25% in Asia and Latin America and over 30% in Eastern Europe and Africa.

59 Brockman, P. and Chung, D., 2003, “Investor Protection and Firm Liquidity”, *Journal of Finance*, vol. 58, issue 2. Specific analysis has been done comparing the respective valuations of Chinese and Hong Kong-based stocks traded on the Stock Exchange of Hong Kong (SEHK). Market supervision and disclosure requirements imposed by the SEHK itself are the same for both sets of companies. The research shows that, because of investors’ concerns about the level of protection in China as against Hong Kong, Chinese companies have significantly higher liquidity costs than do otherwise comparable Hong Kong-based stocks.

60 OECD Roundtables, op.cit., p.30 and OECD, op.cit. (2003), p.43.



- abuse of transfer pricing, where majority owners secure benefits for themselves or related parties by artificially inflating or deflating the value of regularly traded assets.

Improving the enforcement of corporate governance is about trying to solve these problems.

A clear way to address abuse of minority rights is to promote enforcement through judicial or government agencies. Possibilities include enhancing shareholder litigation and derivative lawsuits. Securities regulators may themselves bring criminal or civil court proceedings. There may also be administrative actions that do not involve the same time and financial commitments.

Box 6: Shareholder and Derivative Lawsuits

In many APEC economies, there is increasing recognition of class actions and derivative lawsuits as a means of protecting minority corporate interests.⁶¹ The Malaysian Securities Commission is seeking to develop rules making derivative actions cheaper and more procedurally straightforward. Chinese Taipei has introduced rules permitting class action lawsuits by shareholders, and a court in China recently allowed for the first time a common action by shareholder plaintiffs.

Korea has made a serious attempt to institute corporate governance reform since the 1997 Asian economic crisis, including by facilitating derivative lawsuits. Since 1997, there have been three high profile derivative lawsuits.⁶² The first was filed in 1997 against former directors of the Korea First Bank. In 2002, the Supreme Court found for the shareholders. However, after the US\$33 million award was reduced to US\$3 million because of legal fees, the Bank still failed.

A second derivative lawsuit was filed in 1999 against a former president and ten directors of Samsung Electronics, for making an illegal political contribution, giving benefits to related parties and failure to exercise "business judgment". Plaintiffs won a judgment for US\$72 million of the US\$282 million claimed, although the result was appealed. A third lawsuit was filed against a former chairman of Daewoo in 1999, with a court ruling in April 2004 that the defendant was liable under a guarantee to cover debt incurred of approximately A\$20,000.

Nonetheless, these hesitant steps towards formal corporate governance enforcement have made a valuable contribution to increasing general awareness of corporate governance issues in Korea.

(c) *Boards of Directors*

If formal corporate governance rules are not enforced, majority owners are effectively able to control the appointment and functions of boards of directors.

61 OECD, op.cit. (2003), p.21.

62 OECD Roundtables, op.cit., p.24; Jang, H., 2002, "Empowering Shareholders' Rights: Derivative and Class Action Lawsuits", *OECD Asian Roundtable on Corporate Governance*, 12 November 2002; and Milhaupt, C., 2003, "Nonprofit Organisations as Investor Protection: Economic Theory and Evidence from East Asia", *Columbia Law and Economics Working Paper No. 218*, 10 March 2003.

The specific problem that arises in these circumstances is board passivity, whereby boards can become a rubber stamp for the wishes of majority owners.

Many legal systems do not have a tradition of recognising and refining directors' duties to act for the benefit of "the company" or shareholders "as a whole."

Two priorities for improving the role of directors in corporate governance are ensuring the independence of directors from majority owners, and developing the expertise and skills of directors. Enforcing the independence of directors – or the appointment of independent directors – requires regulatory reform and increased transparency.

There are other enforcement strategies which may prove valuable such as cumulative voting. Cumulative voting is mandatory in Russia. China's Code of Corporate Governance requires cumulative voting for listed companies more than 30% owned by controlling interests. Korea's approach is innovative – if a company has more than 2 trillion won (US\$1.54 billion) in assets, shareholders with more than three percent of voting rights are limited to voting three percent of their shares when voting for non-executive directors. However, these strategies are not always successful and can be frustrated through restrictive nomination procedures or staggered board terms.

Developing the skills of directors is part of improving the overall corporate governance framework. As corporate awareness and information are more widely distributed, so the skills base of directors is likely to improve.

A more specific informal enforcement strategy is developing Institutes of Directors, to improve the education and training of board members, and to develop rules of professional certification.

(d) *Creditors*


There is an important relationship between debt and the protection of minority interests.⁶³

In a transparent corporate governance regime with effective formal enforcement, lenders are able to protect their funds by invoking insolvency laws. This can also be an important protection for minorities. If a majority owner seeks to expropriate a minority interest, a creditor may intervene to safeguard its own investment. If levels of transparency are sufficient, creditors continue to perform this supervisory role, even in relation to large corporate groups.

Where firms are dominated by majority owners and closely-held interests, and the corporate governance regime is opaque, the role of debt is quite different. Financiers are not able to keep track of their funds, are less likely to be aware of abuses by majority owners, and are less likely to intervene in support of minority interests.

⁶³ Faccio, M., Lang, L. and Young, L., 2001, *Debt and Corporate Governance*, 10 January 2001; and Gray, C., "Creditors' Crucial Role in Corporate Governance", *Finance and Development*, June 1997.





This means that, where formal corporate governance is weak, debt can actually assist majority owners to effectively expropriate minority interests by increasing resources without adding to accountability. For example, in the lead-up to the 1997 Asian economic crisis, the most highly leveraged bank loans were made to loosely-affiliated corporations, where the risk of minority expropriation was greatest. Accordingly, for the period to 1997, this “points unmistakably toward systematic expropriation on a regional scale.”⁶⁴

As described in Chapter 4, financiers often equate investment security with the availability of formal enforcement – the ability of court or arbitral systems to hold parties to the terms of their agreements. An investment may be even more valuable if it appears to guarantee financial returns in the future than if it actually does so, because in effect a whole network of investors and investment businesses are relying on the perceived certainty of those future returns.

Many financiers in developing jurisdictions are themselves improving approaches to corporate governance. Accordingly, the need to guarantee future investment returns is likely to become increasingly important for all sources of finance, and related-party lending is likely to decline. As this happens, problems of majority exploitation will become increasingly significant as a disincentive to investment.

For creditors, there are two clear directions for corporate governance reform. The first is the promotion of corporate disclosure and transparency. Creditors are only able to monitor whether corporations are complying with good corporate governance if information about the company is freely available.

The second is strengthening avenues for formal enforcement of creditors’ rights, especially under insolvency laws. This is not only about improving access to courts and regulators, and the effectiveness of court systems. There are also important ways of strengthening opportunities for creditors to take matters into their own hands.

(e) *Employees*

The role of employees is central to the economic performance of a corporation. They are often well-placed to judge whether a corporation is running effectively, because they are so closely involved with daily business. Also, contented employees are more committed to their employers, and are more likely to add to the value of a business enterprise.

In an environment where majority owners are able to exploit their position, contractual and legal rights of employees are often neglected.⁶⁵ This in turn contributes to social dissatisfaction and reduced performance.

64 Ibid.

65 OECD, *op.cit.* (2003), p.61.

In many respects, the protection of employee rights is related to the protection of minority shareholder rights – most important are increasing the capability of the judiciary and regulators, and increasing popular awareness of employee rights.

A specific means of using employees as a form of corporate governance enforcement is the protection of “whistleblowers”, who alert outsiders to corporate governance problems.

(f) *Governments*

Many of the issues discussed above are relevant to governments in their position as shareholders in corporations, in particular where there is majority state ownership. There is a risk that majority state ownership can result in similar abuses of minority rights to majority private ownership. However, state ownership can also be an important means of maintaining historical and administrative continuity.

Box 7: Privatisation in China

Over the last ten years, China has privatised hundreds of previously state-owned enterprises – today, the Shanghai and Shenzhen stock exchanges have 1200 listed companies with a market capitalisation of more than US\$5 billion.⁶⁶ Between 30 and 60 million Chinese people own shares. Private firms were allowed to list in 2001, but it is believed the state still owns more than two thirds of shares in listed companies. Only 35 listed companies in China are classified as private.

This raises important issues. Plans to divest further state holdings in China have been deferred because of concerns about diluting existing companies. However, the value of state-owned firms is significantly determined by the effective rights of new shareholders.

Part of the reason China has managed to achieve privatisation on such a massive scale has been because of the level of government bureaucracy involved.⁶⁷ Although judicial enforcement of private rights in China can be uncertain, the flexibility of Chinese state machinery has managed to achieve a relatively smooth transition to market-based development so far.

This demonstrates two key ideas about corporate governance in transition economies:

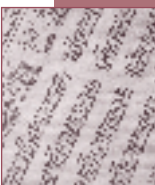
- value in corporate governance is assessed using market concepts; and
- market concepts must be accommodated within the practical constraints imposed by social, historical and cultural heritage.

The question of how China tries to balance its bureaucratic traditions, with its role as state-owner, with its role as regulator, with market forces, will intrigue investors of the future.

As state-owners, governments may encounter additional problems, but the primary corporate governance objectives remain the same – the protection of minority rights and the promotion of disclosure, transparency and education.

⁶⁶ OECD Roundtables, op.cit., p.19.

⁶⁷ Pistor, K. and Xu, C., 2003, “Beyond Law Enforcement: Governing Financial Markets in China and Russia” in J. Kornai and S. Rose-Ackerman (eds), 2003, *Building a Trustworthy State: Problems of Post Socialist Transition*, Palgrave Macmillan.



5.6 Enforcement Strategies

The priority issues for enforcement of corporate governance rules are transparency and disclosure of corporate information.

Most of the abuses described above can be countered to some extent by making investors more aware of the risks of minority ownership. This is, of course, a two-way process. As companies disclose more information, so investors become better educated about how corporate information works and are better able to make informed investment decisions. Corporations could be required to regularly disclose relevant information, especially information that is price sensitive.

There are many important recent developments in this area.⁶⁸ Examples include China's requirement that listed corporations provide annual reports within four months of their year-end and provide unaudited quarterly reports. Singapore has recently reduced the time for annual reports from six months to five months from a company's year-end, and Hong Kong has reduced the period from five months to four. The period is four months in Chinese Taipei, which also requires listed companies to provide quarterly reports signed off by a certified public accountant.

A culture of responsible corporate reporting is often associated with higher rates of economic return. The financial results for listed companies from Indonesia, Korea, Malaysia, the Philippines and Thailand suggest that performance is better in firms whose accounting disclosures are overseen by major international audit firms.⁶⁹ Auditors enhance their own corporate governance profiles by improving the corporate governance practices of their clients, especially in developing markets.

Stock exchanges, professional associations, trade organisations and government departments also have roles in enforcement of corporate governance rules. The forms of practical enforcement available to a stock exchange are usually limited to trading halts, de-listing or suspending securities. They can be important means of enforcing governance standards, although there is a risk of causing damage to innocent investors in the process. By improving its own reputation for enforcing high corporate governance standards, a stock exchange can improve the value of member companies.

Professional and trade organisations promote consistent corporate governance by adopting industry-wide standards that can be transplanted into different regional settings. As they educate their members, so those members educate their clients.

The priority for governments is to recognise how these different groups can work together to create an environment of greater corporate transparency. Governments could direct efforts to improve formal and informal enforcement – from the role of regulators to state-run education – towards this goal. For example, government

68 OECD Roundtables, op.cit., p.40.

69 Mitton, T., 2001, "A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis" AFA, New Orleans.

initiatives could include the licensing of industry organisations, which could result in the delegation of oversight responsibilities. Educating the judiciary about matters of corporate governance is also an important step.

Another strategy is to facilitate participation in shareholder meetings. A number of jurisdictions impose limitations such as restricting the number of proxies to two per nominee (Singapore) or prohibiting voting in absentia (Korea, the Philippines and Thailand).⁷⁰

The Revised OECD Principles confirm the need for economies to improve the practical enforcement of corporate governance rules. In particular, they recommend improved protection for “whistleblowers” and enforcement agencies.

Development of civil society may be the most significant form of enforcement in corporate governance. The importance of developing awareness at all levels of all societies about the nature of corporate governance cannot be overemphasised. Corporations are the engines of economic growth. Education and awareness in populations – especially as promoted by the media and NGOs – may prove even more important for business than formal enforcement of governance rules by courts or regulators.

Box 8: NGOs and Shareholder Litigation in Korea and Japan

An important aspect of derivative lawsuits in Korea has been the involvement of the NGO People’s Solidarity for Participatory Democracy (PSPD). In addition to pursuing the derivative suits, PSPD has taken a range of steps to improve corporate governance. These include successfully recommending legal reform, filing administrative complaints about corporate irregularity, and filing proxy solicitations aimed at attracting foreign institutional investors to its cause.

A similar NGO is the “Shareholder Ombudsman” in Japan, which between 1996 and 2001 filed 12 derivative suits targeting problems with Japanese corporate governance. The Shareholder Ombudsman has also filed shareholder resolutions, petitioned for legal reform and promoted awareness of corporate governance standards and breaches.

By promoting this kind of action within civil society, governments can effectively delegate supervision of corporate governance. Organs of civil society may offer governments clear insight about how to accommodate formal corporate rules within different regional and cultural contexts.

⁷⁰ OECD, *op.cit.* (2003), p.20.



6. Best Practice Models in the Enforcement of Competition Policy

6.1 Introduction

Competition policy comprises those government measures aimed at creating a commercial environment which permits and encourages market competitive behaviour, thereby stimulating competition, benefiting consumers and creating business opportunities. Policy areas include control of dominant firms, control of mergers to prevent industries becoming monopolised, and control of anti-competitive behaviour. It covers the generation of competition law, rules and regulations; non-legal public and private sector programs that address competition issues; and community initiatives including advocacy and education.⁷¹

Effective sustainable development requires well-functioning, competitive markets. Where conditions for balanced competition are missing, an effective competition policy regime is required, not just to address the dangers posed by restrictive business practices but also to ensure a favourable environment for the development of national and international competitiveness.⁷²

The development, implementation and enforcement of competition policy in developing economies must balance the need to protect local industries and consumers in order to maintain community and economic self-reliance.

A range of international and domestic conditions have recently emerged to shape the current environment in which competition policy operates.

- Enormous structural changes have occurred in developing economies over the last two decades as a result of privatisation and deregulation. These changes are a result of technological, economic, political and ideological forces leaning towards liberalisation and greater integration of the world economy. Many of the privatised firms include natural monopolies.
- An international cross-border merger movement has been reshaping global economies over the last decade. One of the benefits of mergers, the potential synergies between activities acquired and acquiring firms, also threatens competition, by exacerbating the potential monopoly power of the merged firms. Developing economies have been particularly vulnerable to the increased market power of multinationals.⁷³
- International cartels continue to operate in a number of industries and regions.

71 Lachmann, W., 1999, "The Development Dimension of Competition Law and Policy", *UNCTAD Series on Issues in Competition Law and Policy 1999*, Nuremberg University, p.14.

72 Singh, A., 2002, *Competition and Competition Policy in Emerging Markets: International and Developmental Dimensions*, UNCTAD.

73 Ibid, p.14.

Enforcement of targeted competition policies has historically proved effective in addressing market dominance by international cartels.⁷⁴

In response to these international economic issues increasing the need for competition policy, and also as a result of economic reforms and international funding programs, there has been a significant push across developing economies, including in the APEC region, to adopt competition law regimes and establish competition authorities.

However, until recently, most developing economies have operated without a formal competition policy. History shows that it takes on average about 10 years to develop the necessary infrastructure and expertise to effectively implement competition policy and laws.⁷⁵ Also, the differences among developing economies in terms of factors such as resources, geographical size, population, infrastructure, political structure, formal/informal sectors, cultural profile and educational levels have a significant impact on the choice of appropriate enforcement regimes for individual economies.

Vietnam recently completed the final draft of its Competition Law which is expected to be submitted to the National Assembly for approval in 2004. This legislative reform occurred as a result of Vietnam, a transitional economy, recognising that the development of a competition-related law and policy system in Vietnam is necessary in the process of economic reform, globalisation, trade liberalisation and in laying foundations for fair and effective business environment.

Box 9: Competition Law Review in Australia

In Australia, a formal, independent and comprehensive review of the competition provisions of the Trade Practices Act 1974 (TPA) (the Dawson Review), was recently completed. The review provided a unique opportunity for competition law stakeholders, through submissions, to contribute to reforms that would ensure Australia's competition law regime effectively responded to the regulatory needs of the Australian market.

The business community considered this review timely, having expressed ongoing concerns about the operation of the TPA particularly in relation to mergers, administration of the TPA by the Australian Competition and Consumer Commission (ACCC) and a range of perceived anomalies in the TPA. The ACCC itself welcomed the Review, having expressed concerns about the inadequacy of the TPA with respect to misuse of market power and the competition law penalties regime.

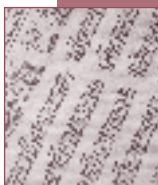
The review considered the operation of the TPA to determine whether, inter alia, they:


- inappropriately impeded the ability of Australian industry to compete locally and internationally;
- provided an appropriate balance of power between competing businesses, and in particular businesses competing with or dealing with businesses that have larger market concentration or power; and
- promoted competitive trading which benefits consumers in terms of services and price.

Australia's experience serves to demonstrate the need for all APEC economies to continually review their competition laws and policies.

74 Ibid.

75 Ibid.





The APEC Competition Policy and Law Database provides an overview of the status of competition regimes for all APEC economies. A review of this database demonstrates that despite the cultural, economic and political diversity between economies, many members have well-established and functional competition regimes. A majority of members have enacted competition legislation (many in the last 10 years) and a significant proportion of these members have also either established or are developing policy on the establishment of regulatory authorities.⁷⁶

6.2 Enforcement of Competition Policy – What Does It Involve?

Enforcement of competition policy should be assessed at different stages, from initiation of competition reforms through the development of competition legislation to implementation at the national and international levels.

Enforcement may be informal, via advocacy which facilitates self-regulation and raises stakeholder awareness of enforcement responsibilities, or formal, by ensuring compliance with competition laws and regulations with a view to realising the aims and objectives of competition policy. Competition policy enforcement effectively entails all initiatives, programs, activities and legal instruments aimed at ensuring formal and/or informal compliance with an economy's competition policy regime.



The enforcement work of regulatory agencies and competition legislation at the national level is paralleled by cooperation at the international level, through cooperation between national regulatory agencies and governments, advocacy, and policy development by multilateral organisations.

6.3 An Effective Competition Policy Enforcement Regime – Essential Criteria

(a) *General Criteria*

A sound competition policy enables an economy to use the power of competitive markets to control prices, encourage efficient production and stimulate innovation.⁷⁷ Recurring themes used to evaluate the desirability of varied regimes include:

- the extent to which they enhance the contestability of markets for foreign firms;
- the likely impact of alternative options on national economic welfare; and
- their effect on the functioning and integrity of the existing trading system.⁷⁸

While the International Competition Network considers the most central goal of a competition regime to be consumer welfare,⁷⁹ the International Chamber of Commerce

⁷⁶ APEC, *Competition Law and Policy Database*.

⁷⁷ Ross, T., 2000, *Competition Policy in Canada: Views on the Law, its Enforcement and the Proposed Amendments*, University of British Columbia, p.4.

⁷⁸ Hoekman, B., 1997, *Competition Policy and the Global Trading System: A Developing-Country Perspective*, World Bank, p.12.

⁷⁹ International Competition Network, 2003, *Building Credible Competition Authorities in Developing and Transition Economies*, Working Group on Capacity Building and Competition Policy Implementation, p.19.

has stated that non-discrimination on the basis of nationality should be considered a core principle of all competition laws, as should due process and transparency when designing, implementing and enforcing competition law and policy.

These principles are considered essential because they provide stakeholders – the public, consumers and competitors – with some assurance that the system will produce consistent and rational results and generate confidence in the system of competition policy enforcement.

(b) *What Makes an Effective Competition Regulatory Authority?*

Again, there is a range of views with respect to key characteristics of an effective competition authority. Recurring themes include:

- real and perceived independence;
- resourcing;
- operational transparency;
- professional/technical credibility; and
- status.

Box 10: Indonesia: Electricity Market Supervisory Board


In 2002, Indonesia introduced a new law on Electricity. Among the objectives of the new law are provisions designed to encourage private sector investment and to encourage competition among electricity generating businesses. One of the features of the new law is the establishment of a Supervisory Board with the role of regulating and supervising electricity supply (generation, transmission, distribution and consumer sales) in areas which are open to competition.

Its mandate includes prevention of unfair competition, regulation of electricity supply prices, issuing business licences, facilitating dispute resolution, arranging public hearings, and regulating consumer complaints procedures. The Government Regulation establishing the Board states that the Board is to be 'independent' in carrying out its tasks, functions and authorities.

Some of the provisions of the Government Regulation which are designed to ensure independence are as follows.


- The members of the Board are responsible directly to the President, not the Minister.
- The members are appointed by the President based on approval of the House of Representatives, which means that the appointments are open to public scrutiny.
- Candidates for appointment must meet a number of requirements including education, a willingness to forego other employment, having no financial interest in businesses operating in the electricity sector, and not being an executive of a political party. The stages in the process for appointment of members include submission by the Minister of a list of candidates which is at least double the number of position to be filled.
- Appointments are for a fixed term. Members can be removed by Presidential decree but only on specified grounds.
- Board decisions which affect the public interest can only be taken after a public hearing. Board decisions require a two-thirds majority.



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- The Chairman must provide reports to the President through the Minister every six months.
 - A code of conduct applies to all members. It expressly requires that priority be given to the public interest over personal or sectional interest. There is an express prohibition on holding personal financial interest in licences, misuse of information, making promises relevant to the member's role on the Board and receiving gifts related to the position.
 - Sanctions apply for breach of the code of conduct, but there must first be a hearing before a panel comprising two (external) government appointees and one member of the Board. The panel reports to the President through the Minister. This provides protection against arbitrary termination of appointments.
 - The members' salaries are set by Presidential decree based on a recommendation from the Ministry of Finance and the views of the Minister.

6.4 Enforcement of Competition Legislation

(a) *What Approach is Most Effective?*




There are two broad approaches to enforcement of competition policy. The first places a heavy emphasis on criminal prosecution, the use of litigation by the enforcement agencies and private parties, and (in the case of the US) treble damages. The other system is characterised by an emphasis on the administrative process, such as the imposition of administrative fines and administrative orders restraining unlawful conduct.

Within the APEC region, most economies fall between these two extremes. It is a matter for each economy to assess which approach works best for it.

(b) *The Role of the Regulatory Authority*

Most competition laws give specific regulatory powers to a competition authority to assist with enforcement of the legislation.



Formal compliance with a competition law regime may include: the use by the competition authority of broad powers to enact preventive measures; demand testimony; documents or information pertaining to private persons and public bodies; and the ability to engage in litigation. Most competition laws, including those enacted in the APEC region, also authorise regulatory bodies to apply administrative fines to those committing prohibited conduct and impose forcible binding commitments.

(c) *Interface between the judiciary and the regulatory authority*

The courts play a vital role in the enforcement process. Most competition regimes provide the right to seek review of the acts or decisions of the regulatory or administrative organs before the courts.

A recent survey by the International Competition Network of its members demonstrated a common concern that the judiciary often has difficulty in enforcing

competition law. This may be due to a lack of understanding by the judiciary of the interface between courts and the competition authority, or a lack of understanding where judges are asked to adjudicate on laws in an economic context rather than the legal process in which they are expert.

These challenges are common in the early stages of efforts to enforce competition policy, when procedures are still being tested, particularly in transitional and developing economies, against recent adopted constitutions which are themselves still relatively untested by the courts. Important stakeholders may gain the impression that the competition authority, far from meeting society's already ambitious expectations, is preoccupied with fighting obscure legal battles at considerable cost.

In recent years, programs have been developed and implemented to raise awareness amongst the judiciary of effective competition policy enforcement. This has contributed to an increased understanding of the substantive issues involved with judicial decision making regarding competition policy enforcement and to clarify the distinct roles of the agency and the judiciary in this process.

6.5 Competition Authorities – Enforcement Through Advocacy

(a) Aims of Competition Policy Enforcement Advocacy

Introducing or increasing competition usually benefits an economy as a whole and consumers in particular. Unfortunately though, those who oppose competition are often few and forceful while beneficiaries of competition are dissipated and unaware of competition's benefits. Competition authorities can advocate to correct this imbalance.⁸⁰

Advocacy includes raising awareness of the benefits and obligations of all stakeholders with respect to competition policy. It may include an objective of increased self-regulation by stakeholders with respect to their obligations under the competition policy regime. It may also include providing comments and opinions on regulations, policy and programs which might prove adverse to competition, and recommend their amendment or elimination.⁸¹

Credibility as an advocate for competition policy requires an authority to have a reputation as an independent and competent enforcer of competition policy and law.

(b) Raising Awareness of the Benefits and Obligations of Competition Policy

At its most basic level, advocacy addresses the public's right to know its rights and obligations under the prevailing competition policy regime.

80 APEC-OECD Cooperative Initiative, 2003, *Fifth Workshop of the APEC-OECD Cooperative Initiative on Regulatory Reform – Agenda for Paris*, France, December 2003.

81 Free Trade Agreement of the Americas Negotiating Group on Competition Policy, 2002, *Inventory of Domestic Laws and Regulations Relating to Competition Policy in the Eastern Hemisphere*.



As a key source of expertise and information, competition regulatory agencies have a fundamental role with all stakeholders in this advocacy process, and so, arguably, a positive duty to advocate.

Effective advocacy can facilitate the cultural internalising of the value of competition policy, by demonstrating that competition obligations are not inflicting an unfair burden on those abiding by the law, and can create wide-ranging benefits for stakeholders post-reform.

Box 11: Road Transport in Mexico

In the Mexican transport sector prior to 1989, road freight transport on federal highways was subject to a rigid regulation with a high degree of interference by government.

In 1989, the government formulated a new policy framework to deregulate the road transport industry. The government's vision was to create a competitive trucking industry with free exit and entry and market-based pricing, without intrusive government regulation. Its reform was deemed essential to achieve more rapid and sustainable growth.⁸²

The Mexican Federal Competition Commission played a critical role in regulatory reform initiatives through upfront advocacy and post-reform formal enforcement. It laid the groundwork for reform by making a compelling case for the costs of the reform regime and the expected benefits of reform, through media relations, and more systematic relationships with representatives of consumer and interest groups (chambers of commerce, small business and entrepreneurship organisations, consumer protection institutions, consumer groups, local training and research groups and other relevant parties).

According to the World Bank, the reforms can be attributed to increasing competition in the trucking sector in a range of ways. Besides expected gains from reductions in trucking prices, there have been some additional downstream gains. Faster and more reliable trucking has allowed user companies to offer new goods, both introducing previously unavailable products as well as making it possible for existing products to reach new areas. Cheaper and more responsive trucking services have also led to other logistics-related innovations within user firms. Further, some user firms, instead of continuing to invest and maintain a private owned fleet of trucks, have outsourced and purchased the services on a more open and efficient market.

(c) *Enhancing the Standing of Competition Policy and Regulatory Authorities*

Understanding of, and respect for, the competition policy regime and its regulating authority is vital to ensuring compliance by all stakeholders.

- When working with governments, competition authorities face the ongoing challenge of maintaining their advisory and regulatory independence, while also working to promote common goals. It is important to retain an advocacy identity that is distinct from the funding government. This is particularly dependent on the structure of the authority, and on whether the authority is operating in a resource constrained environment.

⁸² Hayri, A., Dutz, M. and Ibarra, P., 2000, *Regulatory Reform, Competition and Innovation: A Case Study of the Mexican Road Freight Industry*.

- The judiciary plays an integral role in the enforcement of competition policy and law. Advocacy to the judiciary through training programs can assist the judiciary to be more aware of, and able to perform its role within, the enforcement process.
- Civil society stakeholders are those non-government and non-private sector groups affected by competition and competition reforms. It includes consumer groups, welfare bodies, and other organisations that play a role in, or are affected by, the prevailing competition policy regime.

Traditionally, businesses and labour organisations are well-resourced, coherently organised and usually know how to influence the political process. Civil society on the other hand is often under-resourced and disparate. Advocacy by the competition authority can assist in addressing this imbalance of influence.

Competition policy aims to provide greater choice and increased competition with respect to provision of goods and services. This is particularly important in developing economies where the effects of competition reforms can directly address poverty. In the developing economy context, specific attention should be given to potentially low income levels and high illiteracy rates, both of which may impact on the ability of consumers to make choices.⁸³ Engaging consumer organisations and peak welfare bodies in the reform process can increase the efficacy of those reforms.

Box 12: Case Study – Peru

Peru's Commission on Free Competition is a technically and administratively autonomous agency which is part of the National Institute of Defence of Competition and Protection of Intellectual Property, created in 1991. The Commission is responsible for ensuring compliance with the law against practices that are monopolistic, or designed to control or restrict free competition. The Commission also has an advocacy role in distributing the benefits of a competition culture in Peru, being empowered to carry out studies and reports, and run information and awareness campaigns as required.⁸⁴

In an effort to shore up consumer support and provide competition and consumer benefits to vulnerable and disadvantaged groups, the Commission focused on dismantling Peru's bread and chicken producers' cartels. Peru took early action against cartels in the bakery industry, which resulted in a reduction in the price of bread, and then followed with similar action in the chicken industry. The idea was that while a low income parent may fail to understand the value of competition in high technology or industrial sectors, they can easily grasp its importance in this context.⁸⁵ By focusing on anti-competitive practices relevant to the daily lives of low income earners, the Commission raised its profile in the community, informed disadvantaged socio-economic groups of the benefits of competition policy and assisted with addressing poverty and sustainable development.

⁸³ International Competition Network, op.cit., p.19.

⁸⁴ OECD Global Forum on Competition, 2002, *Contribution from Peru*.

⁸⁵ International Competition Network, op.cit., p.19.



- Engagement of the business community in acceptance of the importance of competition policy can encourage enforcement through self-regulation. There is a need for impartiality, objectivity, freedom from political influence and transparency to ensure the business community is willing to adopt competition policy aims and objectives. It is also important that the competition authority is technically competent to ensure the respect and attention of the business community.

Box 13: Case Study – Australia

The ACCC Cooperation Policy for Enforcement Matters is the means by which the ACCC grants immunity or leniency in circumstances flowing from business cooperation in enforcement matters. This policy is a good example of encouraging self-regulation with respect to competition policy and law within the business community, with a view to maximising resources and inculcating attitudinal change within a stakeholder group. It represents a clear commitment to enforcement via encouraging business self-regulation.

The policy acknowledges that it is not possible for the ACCC to pursue all breaches under the Trade Practices Act, or other legislation under which it has jurisdiction. As a result, the effective use of resources in the public's best interests requires that the ACCC has clear priorities in its selection of matters for enforcement and its chosen enforcement vehicle.

The policy focuses on one aspect of the Commission's approach to enforcement – the adoption of leniency as a policy in circumstances flowing from cooperation. Given that the policy continues to evolve in the light of experience and changing markets, it is presented in terms of flexible guidelines. It covers cooperative conduct by individuals and corporations, for which there are separate policy streams.

According to the ACCC, recognition of cooperation and assistance takes a variety of forms, for example, complete or partial immunity from action by the ACCC, submissions to the court for a reduction in penalty or even administrative settlement in lieu of litigation. The policy on litigation relates only to civil matters, with the ACCC having no power to grant immunity for actions for criminal conduct under the Trade Practices Act. The policy applies to directors, managers, officers or employees of a corporation who come to the ACCC as individuals and not on behalf of a corporate entity with evidence of conduct contravening the Trade Practices Act (or other legislation administered by the ACCC).⁸⁶

6.6 Increasing Enforcement Capabilities: Regulatory Agency Capacity Building

The capacity of a regulatory agency can be measured by the extent to which it has the necessary physical, organisational and legal structures, experience, expertise in advocacy and compliance necessary to establish it as a credible institution in its jurisdiction. The regulatory authority is the key competition policy enforcer, although capacity building encompasses all actors involved in the creation and implementation of a competition regime.⁸⁷ Capacity building for regulatory agencies includes the agency structure, resourcing and training.

⁸⁶ Australian Competition and Consumer Commission, 2002, *Cooperation Policy for Enforcement Matters*.

⁸⁷ International Competition Network, *op.cit.*, p.51.

The agency must be independent but still have relevant influence, integrity and respect. If enforcement is the most important goal that the authorities are pursuing, then the institutional structure should favour predictability, fairness of decision-making and independence. On the other hand, if competition-oriented reforms are the most important policy objectives, then the institutional structure must allow for the greatest possible influence with the policy makers.⁸⁸ A balance of the two requires distinct internal structural arrangements.

It is expensive to establish and maintain a competition authority, but the harm done to developing economies by anti-competitive practices is substantial, and the existence of an effective national competition agency makes that economy less vulnerable to the effects of international anti-competitive practices.⁸⁹ It is generally accepted that a ‘paper regulator’ is detrimental to achieving competition policy enforcement.

Resourcing issues impact on the ability of an authority to function independently from its funding source – usually government.

Box 14: Case Study – Canada

The Canadian Competition Bureau demonstrates the challenges faced by regulatory authorities when trying to maintain the independence that is critical to effective performance of their enforcement role, while also being resource dependent on the government, a key stakeholder in the competition policy regime. There are various institutions in the enforcement of Canadian competition law. These include:

- the Commissioner of Competition (Commissioner) who directs the Competition Bureau;
- the Minister of Industry;
- the Attorney General of Canada;
- the Courts; and
- the Competition Tribunal.

The Commissioner is an independent law enforcement official responsible for the administration and enforcement of the Competition Act. The Commissioner directs the Competition Bureau, an independent unit of the federal Department of Industry responsible for assisting with the enforcement and administration of the Competition Act.


In respect of criminal offences, the Commissioner may refer a case to the Attorney General of Canada for consideration. In the case of civil reviewable matters, the Commissioner may apply to the Tribunal for remedial orders.

The Minister’s primary responsibility, in relation to the Competition Act, is to cause the Annual Report prepared by the Commissioner to be laid before Parliament. In addition, the Minister has certain statutory powers to compel specific action by the Commissioner: the Minister may instruct the Commissioner to undertake an inquiry; to provide an interim report with respect to an inquiry; or to make further inquiry where a matter has been discontinued. Conversely, the Minister has no power to compel the Commissioner to discontinue an inquiry. Further, and most importantly, any decision to apply to the Tribunal or to refer a matter to the Attorney General is the Commissioner’s alone.

⁸⁸ Ibid, p.30.

⁸⁹ Ibid, p.22.






Canadian academic Ross considers that, given recent resource constraints faced by the Bureau, its decision-making structure is compromised:

The Competition Bureau in Canada has staff that are qualified, capable and efficient. They also have a solid, modern anti-trust law that reflects contemporary economic thinking. But the Bureau is understaffed and generally under-resourced. This has created concerns that the independence of the Bureau is not as well protected as it should be. Recent deregulation and privatisation has expanded the beat of the competition authorities and the seemingly everlasting merger wave has also put pressure on the resources of the Bureau. While they have had increased funding from the Federal government, a policy of case specific funding did occur in Canada. This threatens the independence of the Bureau. A bureau that might need the government to step in to help it pay its expenses risks reduced independence.⁹⁰


In the case of small states, often the establishment of a regional authority can assist with streamlining costs. Secondees from industry to the regulatory authority are another means of increasing authority resources without relying solely on government funding.



An agency's technical competence is essential to its enforcement capabilities and its reputation with stakeholders. In developing economies with only recently established competition authorities, this may require training and skills transfer. The Japan Foreign Trade Commission and Thailand, in cooperation with other APEC economies, have organised a training program in the field of competition policy every year since 1996. The program aims to assist in the capacity building of mid-to-high-level experts in APEC economies, and particularly developing economies, by providing a variety of courses in the area of competition policy.

6.7 International Cooperation on Competition Policy Enforcement

An international approach to competition policy enforcement is increasingly necessary due to the strong and growing links between globalisation, trade and competition.



Enforcement cooperation in cases with international implications has helped to improve the quality and effectiveness of enforcement and to decrease costs. International cooperation in enforcement mirrors and often reinforces the enforcement efforts of regulatory agencies and governments at the national level. It has also reduced friction that might arise between economies because of recourse to extraterritorial enforcement of competition laws or jurisdictional conflicts.

International cooperation in competition policy and law covers cooperation aimed at:

- avoiding conflict between governments;
- facilitating enforcement against restrictive business practices;
- provision of technical assistance for adopting, enforcing, or reforming competition law and policies by economies with more experience than others;

⁹⁰ Ross, T., *op.cit.*, pp.1 and 4.

- promotion or convergence of harmonisation of competition laws and policies;
- within the context of a regional grouping, increased economic integration.⁹¹

Cooperation may take the form of cooperation agreements providing for information exchange between competition authorities, harmonisation of national laws or the establishment of regional competition authorities.

Cooperation agreements in relation to enforcement of competition policy between governments and/or competition authorities may be bilateral, multilateral, regional or plurilateral. These agreements are typically non-binding soft law agreements, providing for cooperation in investigation, exchanges of information and notifications of actions that each party takes that affect enterprises of the other party.

- Australia and New Zealand no longer apply their anti-dumping laws to conduct affecting trade between them. Instead they apply their competition laws (which have been harmonised) to predatory trade conduct by dominant firms.
- Under the Canada Competition Act, the Competition Bureau has the authority to communicate confidential information to a foreign competition authority, where doing so would enhance the Canadian case. This would most often occur when the other jurisdiction is in a position to provide the Bureau with useful information or assistance in return.
- US and Canadian authorities have cooperated closely in their investigation of a Japanese cartel in which several paper mills fixed the price of fax paper to be sold in the US and Canada. Their close cooperation resulted in the successful criminal enforcement of US and Canadian competition laws against this cartel.⁹²

To date, bilateral agreements have proven the most successful combined enforcement approach due to their capacity to target specific enforcement issues. They are also the most prolific forms of agreement.

Mutual recognition of anti-trust judgments is often incorporated into bilateral or multilateral agreements. This can be done either by requiring one party to an agreement to apply its domestic competition law to remove anti-competitive practices that occur within its jurisdiction and that adversely affect the other party, so as to prevent conflicts of jurisdiction, or to refrain from applying its competition law to the conduct of an enterprise if such application is inconsistent with the policy of the other party.

Harmonisation of competition laws can reduce the harmful effects of anti-competitive conduct that cuts across borders without unduly encroaching upon purely domestic competition matters. Anti-competitive conduct that directly affects the smooth operation

91 UNCTAD, 2000, *Fourth United Nations Conference to Review all Aspects of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices*, Geneva, 25 September 2000, p.5.

92 Matsushita, M., 2002, *International Cooperation in the Enforcement of Competition Policy*, Washington University Global Studies Review, p.470.



of international trade and investment can be declared unlawful with the domestic laws of the economies involved. This often includes prohibition of international price fixing arrangements and agreements that restrict trade and boycotts, which have as their primary purpose the exclusion of foreign goods, services and enterprises and denial market access.⁹³

The results of efforts so far to harmonise national competition policy enforcement laws have been mixed, as a result of the logistical, cultural and economic obstacles to harmonisation.

The United Nations Conference on Trade and Development (UNCTAD), however, considers that the experiences so far of regional groupings of developing economies points to an increased need for harmonisation of national laws, albeit with minimal substantive provisions.⁹⁴

Many multilateral organisations and peak international bodies participate in international cooperation enforcement efforts. These efforts include: advocacy by peak stakeholder representative groups such as the International Chamber of Commerce; coordination of government and stakeholder policy and law enforcement efforts by multilateral organisations including the United Nations (UN), the World Trade Organization (WTO) and regional organisations such as APEC itself; and advocacy and policy development by sectoral relevant multilateral agencies such as the OECD.

The International Competition Network is a virtual organisation of governmental competition agencies with over 60 government members drawn from the UN and WTO membership. It provides leadership networks, undertakes projects and shares the information and expertise of its members. It also increasingly performs an international advocacy role.

6.8 Challenges and Obstacles

There are several challenges to effective enforcement of competition policy.

- Competition policy enforcement reflects the legal history and traditions of the economy in which it operates, and a direct transplant of the policy and enforcement structuring from one economy to another has limited chance of success. Any attempt to harmonise the enforcement process should not focus on the uniformity of the enforcement system at the expense of the traditions of national enforcement. A convergence or harmonisation of enforcement systems is probably more difficult than that of substantive laws.
- Economies marked by a sizeable informal economy and limited respect for the law and legal process may see competition law as inflicting an extra burden on

⁹³ Ibid, p.474.

⁹⁴ UNCTAD, 2001, *Report of the Expert Meeting on Consumer Protection, Competition, Competitiveness and Development*.

operators in the formal part of the economy, and competition law may be misused by the enforcers.⁹⁵

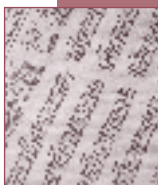
On the other hand, the informal sector, partly as a result of not being subject to a competition regime, can play an important role in ensuring the provision of locally produced cheap goods in developing economies.

- Arguments against non-discriminatory application of competition policy across economies often focus on the fact that developing economies may need special consideration, given their substantial disadvantage in international trade when compared with developed economies. Competition policy and law may have to take into account concessions such as waivers as temporary adjustment measures to enable developing economies to participate in trade on equal footing. They can also be seen as countermeasures to the neo-protectionist behaviour of developed economies.
- Internationally coordinated enforcement can often only be based on exchanges of non-confidential information unless the enterprises concerned waive their objections to the exchange of confidential information. Where enterprises have been prepared to waive their objection to sharing confidential information, often good results are achieved. For instance, when Microsoft waived its objection, this enabled the European Union and the US authorities to coordinate their investigations in respect of similar practices of a dominant computer software firm in both jurisdictions, contributing to similar settlements being reached, despite substantive differences in competition laws.⁹⁶
- Economies are unlikely to agree to cooperate unless there is a shared perception of mutual benefit and common interest. This includes a mutual confidence in enforcement capabilities, for instance in respect of confidentiality, arising from a shared commitment to upholding the competition process.⁹⁷

95 International Competition Network Report, op.cit, p.21.

96 UNCTAD, 2000, *Experiences Gained So Far on International Cooperation on Competition Policy Issues and the Mechanisms Used*, p.26.

97 Ibid, p.22.



7. Conclusions and Recommendations

7.1 Observations and Conclusions

There are many lessons that can be taken from the review conducted for this report.

(a) *Laws and regulations*

- Cumbersome, outdated and impractical rules are difficult to enforce and are more likely to be disregarded. This leads to pressure on the regulatory agencies which in turn leads to corruption opportunities, non-compliance or creative non-compliance. Difficult regulations drive investors into the informal economy and out of the reach of fiscal and other regulatory authorities, that is, beyond the control of government.
- Legislation which leaves major areas of discretion to unelected officials can be difficult to comply with, lead to uncertainty in applications, raise investor costs, increase the risk that policy will not be implemented, and produce corruption opportunities.
- Inadequate enforcement of insolvency laws, even if only because of a lack of resources, leads to the laws being disregarded and regulatory processes being avoided, making the laws themselves meaningless. The economy is then less attractive to investors and the costs of “doing business” are higher.
- Regulations which are clear, straightforward and consistently applied are more likely to be observed in practice. The need for active enforcement of such regulations through regulatory agencies is lower and less expensive to government.
- Stringent, detailed business regulation is not always associated with higher levels of private investment, lower prices or other economic benefits. On the contrary, it can be associated with higher prices and administrative corruption.
- Business regulations should be prepared with an understanding of the interests of all stakeholders. Stakeholders whose interests are ignored are less likely to comply.

(b) *Enforcement strategies and techniques*

- The more steps which are required to comply with a business regulation, the higher the costs will be to the investor, raising the risk of non-compliance.
- Investors look for relative certainty when assessing business opportunities. Uncertainty leads to adverse risk ratings, higher investment costs and lower overall investment levels.
- Over-regulation and under-enforcement should be avoided.
- Under-resourced regulatory agencies have limited enforcement capabilities and lose respect so that the regulations they are appointed to enforce are more likely to be disregarded.



- Soft or selective enforcement of business regulations leads to disrespect for regulations, regulatory agencies and the law in general – even though the rationale may be that the regulations themselves are out of date or impractical. However, strict enforcement of inappropriate regulations can lead to a reduction in business activity.
- The costs of compliance can exceed the risks of non-compliance. Where this occurs, enforcement can be very difficult.
- Coordinated multi-departmental approval processes (“one-stop-shops”) reduce investor costs and encourage compliance but require commitment from the departments concerned.
- Fines and penalties do not always lead to compliance. The possibility of the loss of rights (for example through compulsory divestment of an unauthorised investment) or adverse publicity may be more efficient, low cost methods of enforcement.
- Economic incentives can lead to compliance, without the need for expensive direct enforcement regimes.
- Education of all parties – regulators, consumers and business participants – assists compliance.
- Training is a significant requirement for regulatory agencies, particularly in bankruptcy, finance and technical areas.
- There is a need to manage public expectations.
- Information sharing can assist regulators and should be encouraged.

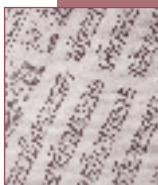
(c) *Regulatory agencies*

Features of an efficient regulatory agency include:

- committed political support;
- independence;
- transparent appointment and removal processes;
- adequate resourcing;
- adequate statutory powers;
- leadership; and
- operational transparency (decisions, reasons and public records).

(d) *Corporate governance*

- Poor enforcement of corporate governance can lead to “tunnelling” of profits and benefits away from minority shareholders and creditors in favour of a powerful groups.
- Enforcement of corporate governance rules can lead to higher values for investors.



- Enhanced transparency and disclosure improves the ability of stakeholders to make decisions, can restrict forms of “tunnelling”, improves efficiency and reduces business costs and risks.
- Poor corporate governance is associated with employee exploitation, reduced performance standards and social disaffection.
- It takes a long time to develop the infrastructure necessary for effective enforcement of corporate governance.

(e) *Competition policy*

- Competition policy should take into account the systems and standards of local businesses in order to encourage pro-competitive behaviour while allowing time for adjustment.
- Developing economies are particularly vulnerable to international anti-competitive practices. Merger of competition laws and policies and encouragement of international cooperation can help to control and reduce those practices.
- The judiciary often requires training in economic aspects of competition law. There is a need for a blending of skills and experience in competition regulatory agencies.
- Advocacy of the benefits of competition policy is important at all levels – business, consumers, shareholders and the judiciary are particularly important in the introduction of competition policy in developing economies.

(f) *The judiciary*

- Compliance is more likely where judicial systems are respected and operate efficiently and independently. On the other hand, where the judiciary is not respected, the risks of non-compliance increase significantly.

7.2 Major Issues

(a) *The standard of “black letter” laws*

It is fundamental that businesses and regulatory agencies know and understand the laws that apply to them. However, business laws are often drafted in ways which are unclear, ambiguous or incomplete, or which leave gaps to be filled in by others. This means that businesses do not know with certainty what their obligations are and so risk arranging their affairs in ways which do not comply with law or policy.

Where the law is unclear, businesses bear additional risks which makes investment in the host economy relatively less attractive and raises business costs. There will be additional workloads for the courts in attempting to resolve uncertainties in the law, and where the judiciary does not enjoy public confidence and respect, this will also increase costs and risks to business and so deter future investment.

It is almost always the case that those parts of government which are responsible for administration of a law will have a level of administrative discretion. However, where those discretions are very broad or where the administration is untrained in their areas of responsibility, the risks of differential application of the laws can be high. Where an administrative discretion extends, in effect, to formulation of policy, businesses will feel even greater uncertainty.

Laws which are drafted on the basis that material parts of the law are to be developed later or are delegated to officials to prepare risk being ineffective altogether, and so government policy will not be implemented.

(b) *Development of effective regulators*

In almost all areas considered in this report, there is a recognised need for a regulatory body to have responsibility for the enforcement of business laws.

There are four fundamental features of an effective regulatory regime.

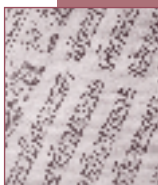
(i) *Independence*

The regulator's role is to implement government policy as set out in relevant laws and regulations, not to make the law. Regulators are not elected, but are appointed by government.

To be effective, a regulator should be, and be seen to be, independent of both government and industry. Where a regulator has authority to make decisions, those decisions should be made according to law and stated policy, and not on the basis of influence from government or industry/business. Regulators must avoid capture by industry and government.

There are several factors to consider in assessing a regulator's independence.

- The process for appointment and removal of the members of a regulatory agency should be clear and accessible to the public. Appointments will be made by government, but the public should be made aware of the appointment, the terms and conditions of appointment and the prerequisites for appointment. Appointments made through a public process will help to satisfy interested parties that the regulatory agency will make its decisions based on the law and the facts available to it, rather than at the discretion of the government or influential individuals.
- The prerequisites for appointment should include educational and professional qualifications and experience, and lack of bias.
- Dismissal of members of a regulatory agency should only be for cause – and not simply because they make decisions which are unpopular with the government. The government has the capacity to change laws and policy, but removal of members of regulatory agencies because of decisions which are consistent with the law but contrary to the government's view only serves to diminish the respect and integrity of the regulator and its decisions, and for the regulatory process in general.





- Financial and operational autonomy are essential. Regulatory agencies require funding and there are really only two sources: the government and business (through licence fees, etc). In almost all cases, primary funding is by government, but there is a risk that an agency which is dependent on political decisions for its ongoing funding may lose its independence. This is a difficult issue to manage in all economies.
- Political support is a key element of independence, that is, the executive arm of government should be supportive of the role and performance of regulatory agencies.
- Independence is also a matter of attitude within the agency itself. Good personnel selection is crucial.

(ii) *Transparency*

- The decisions of the regulatory agency should be transparent and available to interested parties, subject to suitable arrangements for the protection of confidential and commercially sensitive information. If decisions are made in public, interested parties and the general public can assess for themselves both the quality of the regulator's decisions on the merits and the extent of outside interference, and so give confidence to investors.
- However, it is not enough for decisions to be delivered in public: reasons must be given for the decisions and that requires an opportunity for interested parties to make representations to the regulator. It is often the case that public hearings, at least for important decisions, can provide opportunities for broad public and industry consultation. This has a number of advantages: it increases respect for the process, the decision and the regulator itself; it ensures that the regulator has available to it information from many sources; and it demonstrates the abilities and capacity of the regulator.
- Transparency in decision-making also requires that decisions (and reasons) are readily available (in writing) to interested parties and the general public for scrutiny at nominal cost. Regulators are more likely to make decisions according to the law and facts if their decisions are open to public examination.
- Whether the decisions of regulatory agencies should be open to formal review either by the courts or through the political process is really a question of what is suitable for individual economies. As a general comment, regulatory agencies should be responsible for their own decisions and external review should only be necessary in cases of an error of law, dishonesty or incompetence. The administrative decisions of regulatory bodies should not normally be subject to review of the merits.

(iii) *Accountability*

- Regulatory agencies should be accountable for their actions. Their decisions should be available for public scrutiny and debate, and there should be a process of regular reporting of their activities and decisions.
- If a regulatory agency does not act in accordance with the agency's charter or the terms of appointment, the members should be subject to dismissal, but the removal process itself should be transparent so that interested parties can access for themselves the reasons for removal and understand the decision. Removal of incompetent members enhances rather than diminishes the integrity of the agency and the respect to which it is entitled.

(iv) *Capacity*

- A regulatory agency cannot perform its tasks unless it has the technical and human skills necessary for the task, in addition to funding. It is obvious enough that regulatory agencies cannot carry out their tasks if their members are not trained in, or have no experience of, the relevant field of activity, if they do not have an office or facilities to do their work or if they do not have access to research, information and advice.
- Each economy's ability to provide the operating needs of its regulatory agencies is different, and the allocation of available resources is generally a political question.

(c) *Enforcement strategies*

Enforcement strategies should be thoughtful and subtle, and should be careful to direct punishment towards wrongdoers rather than innocent third parties. Fines and penalties may be less effective than more directed strategies, for example, publicity affecting reputations. Transparency, independence and information flows are key factors.

(d) *The judiciary*

Enforcement techniques will not function effectively unless there is, ultimately, access to a competent, independent, respected and adequately resourced judicial system.

7.3 Recommendations: Possible Next Steps and Areas for Further Work

This section suggests some possible activities for APEC in the area of enforcement.

(a) *Laws and regulations*

Consider:

- introducing programs for review of business regulations to ensure unnecessary regulations are removed and processes are simplified on a regular basis. Regulations should be updated regularly to ensure they are consistent with government policy and match business understanding.



- improving information flows and intra-government communications.
- simplification and consolidation of investment processes where possible. This will reduce costs to investors, reduce risk and uncertainty, and improve compliance levels – cheap and easy means of enforcement.
- simplification of regulatory procedures and requirements. Eliminate unnecessary or unproductive steps and processes.
- recognise the interests of stakeholders in the regulatory reform process and consult with them to ensure that they understand change and can comply with new requirements.

(b) *Enforcement techniques*

Consider:

- alternative sanctions: “equity fines”, punitive injunctions, probation and accountability orders, community service and compensation orders and publicity but adjusted in each case for cultural and social differences.
- resolution of procedural disputes away from the court system.

(c) *The courts and regulatory agencies*

Consider:

- caseload management training.
- simplification of court procedures to reduce time spent on formalities and to allow courts time to consider cases on the merits.
- introducing specialist courts and small claims courts. This can reduce costs, improve court access and lead to better, more informed judicial decisions.
- assisting in the development of an independent competent and experienced judiciary. This requires time, significant resources, training, legislative change, cultural change, and political leadership.
- improving technological capabilities and support of regulatory agencies and the judiciary.
- encouraging international cooperation in the development of competition policy and enhancement of enforcement capabilities.
- enhancing the capacity and independence of competition regulatory agencies through training, education, experience and resourcing.

(d) *Corporate sector*

Consider:

- developing education programs for company directors and shareholders to help them understand their rights and obligations. This can lead to higher levels of self-regulation and reduced government regulatory costs.
- developing enhanced shareholder rights through derivative actions.



- improving levels of transparency in corporate disclosure.
- improving business and professional standards and encouraging professional and trade organisations.
- encouraging shareholder participation.
- providing education and training for company directors. Advocate director responsibilities. Encourage independence. Encourage the development of Institutes of Directors.
- introduction of “whistleblower protection” legislation.



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