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OECD Global Forum on Competition

COMPETITION POLICY AND ECONOMIC GROWTH AND DEVELOPMENT

-- Secretariat Note --

-- Session I --

This note is submitted by the Secretariat FOR DISCUSSION during Session I of the second meeting of the Global Forum on Competition, to be held on 14-15 February 2002.

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COMPETITION POLICY AND ECONOMIC GROWTH AND DEVELOPMENT

Secretariat Note

1. This session of the OECD Global Forum on Competition will explore the relationship between competition policy and economic growth and development from a number of perspectives. Contributions by Forum participants are being placed on OLIS and on the Forum website. Annex A contains the introduction and summary of the paper that will be presented by the OECD Economics Department (as well as a citation to the Economics Department's website). Annex B contains short summaries of a non-exhaustive list of the most relevant published papers, some of which were prepared by individuals who will be speakers at the Forum. This note briefly pulls together themes identified in the various papers and identifies questions participants may want to discuss. It focuses on the general issues that will be the focus of the first half of the session; these and related issues will be examined from other perspectives during the second half.

2. In general, most of the written materials (a) address the effects of competition on economic growth, (b) identify barriers to competition in developing economies and policies to remove them, and (c) discuss the characteristics of competition law, policy, and institutions and how those might be tailored to suit particular economies' needs. The Economics Department paper does not have a direct "development" focus, but the implications of its conclusions on the economy-wide impact of competitive markets in OECD economies merit discussion by competition officials from all economies. The papers on the impact of hard core cartels on developing countries provides another perspective on these issues -- one that is of particular importance for competition officials everywhere and for economies that do not have laws banning such conduct.

3. The effects of competition on economic growth have been measured empirically in the various background papers. They use econometrics and data from a number of countries to address questions such as :

- How much does competition help economic growth (and other measures of economies)?
- How much does competition *policy* help economic growth?
- More specifically, what has been the effect of cartels on developing countries?
- How does more competition domestically affect international competitiveness?
- How does greater openness to international trade interact with domestic pro-competition policy? Are they substitutes or complements? Does the effect depend on the size of country?

4. Country submissions and some background papers identify specific types of barriers to competition and policies that may help overcome the barriers or otherwise promote competition. A common theme is access to essential inputs. In both developed and developing countries, infrastructure sectors contain "essential facilities." But in developing economies, there may be no or limited access to a much wider range of essential inputs. The inputs may be monopolised, or they may not be supplied at all. Examples include transport services, financial services, and various kinds of professional business services. Moreover, developing economies may lack marketplaces, such as for land. The cause of under-supply of these inputs may often be government rules, such as licensing systems, or government inaction, such as failure to provide a sufficient legal basis for one or another form of business conduct.

- What characteristics that are common in developing economies serve as barriers to effective competition?

- When does the existence of these characteristics imply regarding the benefits, costs, and means of introducing greater competition?

- What policies can be used to overcome problems caused by the partial or complete lack of essential inputs in potentially competitive markets? What role can competition law play?

- What policies can be used to deal with transitional economic problems without unduly delaying or preventing the evolution of an economy in which society as a whole benefits from market-based efficiencies?

5. The nature of competition law, policy and institutions is a major topic of many of the country submissions and of some background papers. One theme is how often action or inaction by government institutions or by government officials acting on their own is a problem in transition and developing economies. Another theme is how the heterogeneity of countries is reflected in heterogeneity of “appropriate design” and priorities of competition law, policy and institutions.

- The competition laws of many transition economies apply to unauthorised actions or inaction by government entities and officials that have actual or likely anticompetitive effects. Such provisions are very rare in developing economies that have competition laws. Would this approach be useful in developing economies?

- If an economy is uncertain about the likely effects of enacting a competition law dealing with monopolies, mergers, cartels, what are the pros and cons of alternative ways to "start small?" Alternatives might include (a) creating a small office with only "competition advocacy" authority, (b) starting with a ban on "unfair trade practices," such as fraud, misleading advertising, and appropriating intellectual property, (c) including some rules with a basis in market power considerations, such as bans on tie-ins by utilities, in the ban on unfair trade practices, and (d) banning only hard core cartels, abuse of dominance, or anticompetitive mergers?

- Do objectives and priorities differ systematically between developed and developing countries?

- Outside of the context of the EU and its accession process, to what extent have economies with new competition laws adopted most or all of the provision's of another jurisdiction’s competition law? What advantages have been realised? What risks must be avoided?

- Are there characteristics, such as the degree of independence of competition institutions from other parts of government, that are fundamental to an effective competition law and policy?

Annex A: Summary of OECD Economics Department paper

(paper available on Economics Department website:

http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-document-280-8-no-2-21578-0,FF.html**)**

THE CROSS-MARKET EFFECTS OF PRODUCT AND LABOUR MARKET POLICIES

Introduction and summary

OECD countries have pursued product and labour market reforms over the past two decades to increase employment and enhance productive efficiency. For example, countries have adjusted their employment protection and minimum wage legislation, reformed their benefits systems and modified their tax policies with the aim of reducing unemployment and stimulating labour force participation. Moreover, many OECD countries have initiated pro-competitive regulatory reforms of product markets, leading to positive effects on productivity and consumer welfare. However, little attention has been paid to the potential impact of product market regulations on labour market outcomes or of labour market policies and institutions on product market performance.

This chapter reports on recent OECD empirical analysis aimed at shedding some light on the potential long-run cross-market effects of policy reforms in products and labour markets. Focusing on anti-competitive product market regulations in potentially competitive markets (such as legal barriers to entry, price controls, state ownership, administrative burdens and trade and investment barriers), the first section presents quantitative assessments of the impact of regulatory reforms on employment, employment insecurity and earnings inequality. The following section examines the effects of selected labour market policies and institutions on innovation performance and industry structure.

The main message of the chapter is that there are significant cross-market of product market regulations and labour market policies and institutions. This has several policy implications:

- The reduction of barriers to trade and competition in potentially competitive product markets can be a complement to labour market reforms aimed at increasing long-run employment levels of OECD countries.

- At the same time, preliminary evidence suggests that these long-run employment gains do not come at the expense of greater long-run inequality in labour markets or greater insecurity about employment prospects, as proxied by several measures of job turnover and average job tenure. Nevertheless, the impact of regulation on job security appears to differ across different groups of workers and the adjustment costs can be significant for some displaced workers. This points to the need to accompany product market reforms with appropriate labour market policies.

- Depending on the industrial-relations regime, a relaxation of hiring and firing restrictions seems to be either positive or approximately neutral with respect to its effect on innovative activity in individual economic sectors.

In addition, the potential growth effects of labour market reforms (easing of employment protection, reducing the administrative extension of collective agreements and lowering tax wedges) are likely to be reinforced since they increase specialisation in R & D intensive industries.

Annex B: Summaries of a non-exhaustive set of papers related to competition policy and development

Carlin, Wendy, Steven Fries, Mark E. Schaffer and Paul Seabright (2001), "Competition and enterprise performance in transition economies: Evidence from a cross-country survey," CEPR discussion paper no. 2840, June.

Using an EBRD/World Bank survey of 3,300 firms in 25 countries, the authors found that the degree of competition perceived by enterprise managers has an important and positive effect on the growth of sales and of labour productivity, and also had a positive effect on firms' decisions to develop and improve their products. The two measures of perceived competition were the perceived number of significant competitors to the firm and the extent to which it believed demand for its product would fall if it raised (real) prices by 10%. Greater market power reduced cost-reducing restructuring.

Cooke, Sarah and David Elliott (1999) "Competition policy issues for APEC economies," mimeo, July.

This paper addresses four key concerns which may be raised by developing countries considering adopting a competition law or strengthening competition in their economies. These concerns are whether such a law is necessary given trade liberalisation, whether it would damage international competitiveness or lessen the ability to attract foreign direct investment, and whether increased competition would raise unemployment or cause other social problems. The authors summarise the evidence as suggesting that trade liberalisation and competition law are not effective substitutes, that competition law on balance will aid competitiveness, (based on very thin empirical evidence), that competition law will not deter FDI and indeed may help promote it, and that though the short-term social costs of transition to a more competitive economy can be highly significant, they will be insignificant when compared to the long-term costs to the economy of not being competitive.

Dutz, Mark A. and Aydin Hayri (2001), "Does Effective Antitrust Policy Spur Economic Growth?" *mimeo*, October.

The authors tested whether economy-wide antitrust policy or measures of concentration are significantly and robustly correlated with higher rates of per capita economic growth using data from over one hundred countries during 1986-1995. Effectiveness of antitrust policy was measured by answers to a large survey of top executives in 53 countries posing questions about anti-monopoly policy in their country, as well as a measure of mobility of the largest firms. They found that measures of effective antitrust policy are positively associated with residual growth (that is, growth that is not explained by variables for which there is some consensus that they lead to higher economic growth—for convergence (poorer countries have more scope for "catching up"), trade openness, human capital, and investment in physical capital). Additional sensitivity analysis indicates that effective antitrust policy has an impact distinct from that of trade openness.

Dutz, Mark A., Janos Ordover, and Robert D. Willig (2000), "Entrepreneurship, Access Policy and Economic Development: Lessons from Industrial Organisation,"*European Economic Review*, 44(4/6), May, pp.739-747.

The authors provide analysis arguing that two sets of policies—preserving rewards from productive innovation and fostering opportunities for grass-roots entrepreneurship—are key to further economic development through the promotion of entrepreneurship. They argue that mandatory access should be extended beyond the usual essential facilities of public utilities to other elements of the business infrastructure. These elements are local, such as production sites and industrial real estate markets, financial services, transport and logistical services, professional business services, appropriately skilled labour, and institutional infrastructure such as financial regulation and customs enforcement. These effects can be large: One study the paper cited estimated that the increase in competition in trucking in Mexico, due to regulatory reform, provided benefits to representative user companies of 10% of operating margin.

Dutz, Mark A. and Maria Vagliasindi (2000), "Competition policy implementation in transition economies: An empirical assessment," ***European Economic Review*****, 44, pp. 762-772.**

The authors assess the effectiveness of competition policy implementation in 18 transition economies. The effectiveness is measured in three categories: enforcement, competition advocacy and institutional effectiveness. The first category examines enforcement separately against enterprises and state executive bodies, and also measures the extent to which fines were actually levied. The authors find a "robust positive relationship between effective competition policy implementation and expansion of more efficient private firms."

Evenett, Simon J., Margaret C. Levenstein, and Valerie Y. Suslow (2001), "International Cartel Enforcement: Lessons from the 1990s" ***World Economy: Special Global Trade Policy Issue*** **24, pp. 1221-1245.**

The authors argue that international cartels are more stable than national ones. They provide three arguments: national borders are a "straightforward way to divide up international markets," monitoring is facilitated by import and export trade data [but there are difficulties relating "markets" to categories of trade data], and that the retaliatory threat is greater in international cartels (the punishment for cheating on the cartel in one market can be meted out in all markets supplied by the cartel), thus strengthening the cartel's effect in any single market. Applying a "law and economics" analysis, they suggest that penalties, including corporate leniency programmes, can reduce incentives to cartelize. They note, however, that international cartels are more difficult to prosecute successfully than cartels where evidence of the conspiracy exists domestically, and thus argue for stronger co-operation, larger penalties, and complementary vigilance in other areas of competition policy.

Hoekman, Bernard, Hiau Looi Kee, Marcelo Olarreaga. "Markups, Entry Regulation and Trade: Does Country Size Matter?" CEPR Discussion Paper No. 2853, July 2001.

The authors develop and test a simple model that shows that the effects of barriers to import competition and domestic entry on industry price-cost mark-ups depend on country size. The effect of the former are predicted to be stronger in small countries, and of the latter in large countries. After estimating mark-ups for manufacturing sectors in 41 developed and developing countries, the model is tested and the hypotheses cannot be rejected by the data.

Khemani, R. Shyam and Mark A. Dutz (1995), "The Instruments of Competition Policy and their Relevance for Economic Development," in Claudio Frischtak (ed.*) Regulatory Policies and Reform in Industrializing Countries*.

The authors argue that an "appropriately designed competition law" should be part of governments' central framework policies. Such a law, with competition advocacy, complements other government policies aimed at promoting competition by inhibiting increasing barriers to entry into markets. They note that the common feature of the 23 East Asian countries, which had above-average growth rates as compared with other regions, was a high degree of inter-firm rivalry and exposure to domestic or international competitors. They say that, "Broad questions relating to the likelihood of truly effective administration and enforcement of competition law lie at the center of an active debate regarding the desirability of having such a law in developing and emerging market economies." The concerns raised are that the law might be applied in such a way that the freedom and rewards of markets are taken away, or that the enforcement agency becomes a target of rent-seeking. Long-standing competition regimes suggest certain principles which ought to be reflected in designing the institutional framework for competition policy implementation—independence from political and budgetary interference, publicly accountable, separation of investigation, prosecution and adjudication, built-in system of checks and balances with rights of appeal and transparency, expeditious proceedings and case resolution, and imposition of significant fines, penalties and various remedies. They argue that trade liberalisation is a complement not a substitute to competition policy.

Kovacic, William E. (2002), "Institutional Foundations for economic legal reform in transition economies: the case of competition policy and antitrust enforcement." ***forthcoming in*** **Chicago-Kent Law Review.**

The author focuses on competition policy as one part of economic law reform in transition countries. Competition policy has many instruments, including advocacy, education about the merits of market processes, research to support those activities, and antitrust law enforcement. However, countries can follow an intermediate strategy such as phasing in instruments and responsibilities and sharing tasks through regional co-operation.

The paper discusses the dangers of misguided competition law enforcement, but also the rationales for making competition policy central to reform. The dangers include subversion to protect existing patterns of wealth and privilege, discouragement of investment and entrepreneurship, and detraction from other more pressing needs. The rationales include promoting liberalisation, preserving the benefits of privatisation, protecting consumers and government against harmful private restraints on trade, and reducing corruption by removing from public officials the power to provide an illicit economic privilege.

There is growing awareness of significant differences in initial conditions and challenges in transition from Western countries. The initial conditions include substantial resistance to market-oriented reform manifest in competition-suppressing policies at all levels of government, fragile political support for competition agencies, little indigenous expertise in competition law or industrial organisation economics, courts ill suited to adjudicate antitrust disputes, frail transparency safeguards and consequential vulnerability to corruption, and resource and data shortages.

Langhammer, Rolf J. (2000) "Changing Competition Policies in Developing Countries: From Policies Protecting Companies Against Competition to Policies Protecting Competition,",*mimeo*, presentation at Workshop on the Institutional Foundation of a Market Economy, World Development Report 2001/2, Berlin, 23-25 February.

The author argues that, since the mid-1980s, the perception of markets in developing countries has fundamentally shifted. The earlier reluctance to apply competition laws in a competition-enhancing way was due to: a) fears that intensified competition would make subsidies and public equity shareholdings obsolete; b) concerns that markets in developing countries were too small to allow for workable competition, and the presumption that losses due to below-scale operation would exceed losses due to monopolisation; c) concerns that control over the tax base through government ownership would be eroded by competition; d) hostility to market economics; e) desire to maintain positive discrimination in favour of domestically-owned firms. The shift since the mid-1980s has resulted in liberalisation in foreign investment and trade policies and rationalisation of tax policies. These changes engendered more exports, which gave rise to contingent protection measures by industrialised countries. These induced many developing countries to either introduce competition policies or revise the old ones. Thus, differences in competition policies between developing and OECD countries shrink. Despite earlier noting that "it would be misleading to argue that trade liberalisation can fully substitute for competition laws," the author notes that, for countries with weak administrative capabilities and rudimentary institution building, "enforcing trade liberalisation may still be the most straightforward strategy to help competition to increase."

Levenstein, Margaret and Valerie Suslow (2001), "Private International Cartels and Their Effects on Developing Countries," background paper for the World Bank's World Development Report 2001. version January 9, 2001.

The paper examines the possible effects of recent private international cartels on developing countries by use of five case studies and in estimating the quantitative effect of cartels on developing country incomes. The five case studies are the prosecuted cartels in bromine, citric acid, graphite electrodes, steel tubes, and vitamins. The estimate of cartel effect relies on the following chain of reasoning: It begins with the set of cartels prosecuted by the US or EU in the 1990s where both the members and the markets affected were not limited to one country. Of these, a match between the categories for trade statistics (for goods, *i.e.* excluding services) and the products in which the set of cartels operated was found for 16 products. "Cartel-affected" imports of these products to developing countries was 6.7% of all imports into developing countries. This overstates the cartel effect since the trade data categories are generally broader than the product markets of the cartels, but the lack of trade category "matches" for many prosecuted cartels understates the cartel effect, as does the likelihood that not all cartels are successfully prosecuted. The price effect of the cartels ranges from almost nothing to an estimated increase of fifty percent in the graphite electrodes case.

Maskus, Keith E. and Mohamed Lahouel (2000), "Competition Policy and Intellectual Property Rights in Developing Countries," *World Economy*, vol. 23, pp. 595-611.

Primarily focused on intellectual property rights and a possible multilateral agreement on competition approaches, one section of this paper explicitly addresses competition policy in developing countries. The authors give examples of interventionist competition policy—weak patent protection, industrial policies aimed at achieving scale economies, industrialisation through protection of state-owned enterprises, subsides, state aids and procurement policies—and argue that such policy is inherently anti-competitive and counter-productive. They state that, "In many developing countries the public sector is at least as responsible as the private sector for anti-competitive conduct," and give examples of investment licensing restricting entry and of state trading boards or public enterprises monopolising imports of some products in Tunisia. But they note that developing countries increasingly recognise the longterm net benefits of promoting competition and so are unilaterally strengthening IPR regimes and adopting competition legislation.

World Bank (2002), "Global Economic Prospects and the Developing Countries."

While generally not focused on competition and development, the report argues for reducing barriers to entry into services and promoting competition in transport, especially liner shipping and air transport. In *Chapter 7 Competition*, the report notes that product market competition increases efficiency and productivity. However, "In developing countries, productivity growth has mostly been attained through technology spillovers from trade, foreign direct investment, licensing, and joint ventures." [p. 133] It says that a priority for policymakers is to ensure free entry and exit and exposure to international competition. Government regulation that inhibits entry/exit include factor market regulation (labour regulation, restitution laws in transition countries), budget subsidies or quasi-fiscal support such as soft loans, restrictions on the establishment of new firms, mandatory start-up procedures such as approvals and inspections. One study found that developing countries generally require more procedures to start a new business than industrial countries. The report notes that, "International trade is particularly useful in promoting competitive markets in developing countries, where there are information difficulties, inadequate contract enforcement, and human capital constraints." [p. 143] Further, international trade pressures government to address institutional barriers to competition since these barriers undermine the domestic economy's ability to respond to foreign competition.

WTO (1998) Synthesis paper on the relationship of trade and competition policy to development and economic growth, WT/WGTCP/W/80 18 September.

The paper discusses the relationship of trade and competition policy to development and economic growth. It provides the reasons competition law and policy have been implemented in developing market economies, the interconnections between trade and competition policy in fostering sound economic development, the reservations and/or practical considerations regarding the need for and/or design and application of competition law and policy in developing market economies, and the role of international co-operation in facilitating the implementation of competition policy in developing countries. With respect to the interconnections between trade and competition policy in fostering sound economic development, the paper addresses: (1) the complementarity between trade liberalisation and competition policy in promoting economic efficiency, development and growth; (2) whether open trade and investment policies effectively substitute for competition policy; and (3) whether there are welfare tradeoffs between enforcing competition legislation and attaining "critical mass" for firms to succeed in international markets. On the third main topic, the paper discusses concerns that transition to a competition-based economy may cause social and economic dislocation, whether a competition law needed to be comprehensive, and the priorities for implementing competition law and policy in developing market economies.

UNCTAD (1998) Empirical evidence of the benefits from applying competition law and policy principles to economic development in order to attain greater efficiency in international trade and development (TD/B/COM.2/EM/10/Rev.1, 25 May)

The paper describes the theory and reviews empirical evidence on the static and dynamic efficiency and consumer welfare benefits of competition, especially that developing from deregulation and liberalisation, mainly with data from developed countries but with some evidence from developing countries. It reviews evidence on the effects of competition on various measures of growth, and of the effect of industrial policy on competition and efficiency. The paper reviews some information on the price effects of control of restrictive business practices and of competition advocacy.