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COMPETITION POLICY, INDUSTRIAL POLICY AND NATIONAL CHAMPIONS

Contribution from Ukraine

-- Session I --

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COMPETITION POLICY, INDUSTRIAL POLICY AND NATIONAL LEADERS

--Ukraine--

1. Introductory notes

1. The analysis of reference of competition policy to industrial policy requires, first and foremost, determination of their objectives.

2. The objectives of the competition policy, in our opinion, may be defined as formation of the product market functioning conditions to provide triple efficiency due to effect of competition mechanisms: allocative efficiency, that is efficiency of resources distribution; efficiency of resources use, or X-efficiency after Harvey Leibenstein, and dynamic efficiency or adaptive efficiency, that is efficiency of forming new resources, first of all, competence and skills.

3. In turn, the objectives of the industrial policy include provision of development of specific industries, which implies expansion of production capacity, sale of the relevant products and improvement of their quality.

4. As one of the main ways to achieve the objective of the industrial policy lies in scientific and technical progress, that is formation and use of new resources, the objectives of the industrial policy actually coincide with the objectives of the competition policy to the extent of providing adaptive efficiency by the latter.

5. At the same time, ensuring allocative efficiency implies maximal approximation of markets functioning to the model of perfect competition with the following essential features: setting prices at the level of marginal costs, dispersive market structure (low level of market concentration), absence of entrance barriers, full independence of economic agents and equal business conditions. However, according to proponents of the influential theoretical school connected first of all with the name of Joseph Schumpeter, the aforesaid perfect competition model is unable to ensure adaptive efficiency. So, there is some discrepancy not only and not just between competition policy and industrial policy, but rather between the priorities of the competition policy, depending whereon the competition model shall be determined (perfect competition versus symmetrical oligopolistic model versus asymmetrical oligopolistic model or model of national champions) to the utmost extent compliant with the needs of development of competitive economy at the specific moment.

2. Ukraine's experience

6. In Ukraine, as at the time of recovery from the transformational crisis (at the turn of 1990s and 2000s), several types of markets were formed (from the point of view of competitive conditions): markets with high competitive structure, markets with oligopolistic structure, markets with domination features, monopolised markets.

7. At the stage of recovery from the crisis, the most successful development indicators were shown by branches with formed oligopolistic structure. This is first and foremost connected with the fact that concentration of material and staff resources in the framework of industrial and financial groups, and opportunity to pursue active protectionist policy in own interests on the part of the state, formed conditions for the branches they operated in for the fastest recovery from crisis and provide stabilisation and entire economic growth. This particularly concerned iron-and-steel industry. Markets of this branch are typically oligopolistic (in 2004, 60 per cent of ferrous metals production was covered by 5 producers, the share of the biggest one was 21 per cent). In 1995, steel production constituted only 42.4 per cent compared to the volumes of 1990, but already in 1996, the decline in production was overcome, and in 1996-1999, steel

production grew by 22.9 per cent, production of rolled ferrous metals grew by 29.8 per cent. The growth continued further: in 2000-2004, steel production grew by 12 per cent, and in general for 1995-2004, it grew 1.55 times (average growth rate: 15 per cent). Ukraine was ranked the world's 5th steel exporter.

8. By analogy, production of motor petrol and fuel oil, which in 2000 was only 22.7 per cent compared to the volumes of 1990, in 2000-2004 grew 2.3 times upon formation of several large vertically integrated structures in the field (in 2004, the largest 5 structures covered 78 per cent of production). Production of beer, 88 per cent of which in Ukraine at the beginning of 2000 belonged to 4 business entities, from 1997 to 2001, grew in kind 2.16 times. Record growth rates in 2000-2004 were shown by the volumes of mobile communication services provided in Ukraine mainly by 2 large providers: services scope in money terms grew 6.8 times within this period.

9. It is important to note that in 2005-2007, 58,5-69,8 per cent of costs for innovation in production sector fell on 200 biggest enterprises while 54 thousands enterprises was covered only by 41,5-30,2 per cent of such costs.

10. At the same time, high rates of economic growth were observed in a number of industries, in which competitive environment was formed. The production growth rates in food industry in 2000 compared to 1999 constituted 26.1 per cent and twice exceeded the relevant general indicator of the country's industry, in light industry: 39.0 per cent, wood processing and pulp and paper industry: 37.1 per cent. In 2002, production growth rate in meat industry 4.6 times exceeded the industry's general indicator, in wood processing – 3.8 times, in vegetables and fruit processing – 3.5 times exceeded the industry's average indicator.

11. Low efficient business practices were demonstrated by monopolised branches of economy. For instance, the revenue from railway cargo transportations in 2001-2003 grew more than twice, but in kind they grew only by 27.5%. Physical volume of services on production and distribution of electric energy, gas and water for the same period grew by 8.6 per cent, though the revenue from them grew by 25 per cent. In the postal area in 2001-2002, revenue for rendering of services grew more than twice, and the scope of services in kind grew only by 2.1 per cent.

12. The attempts to achieve the objectives of the industrial policy by way of granting exclusive rights and preferences to individual business entities proved to be inefficient. In particular, in automobile production, which faced deep crisis (in 1997 compared to 1990, the number of light motor vehicles produced in Ukraine reduced 78 times), under the Law of Ukraine «On stimulation of automobile production in Ukraine» adopted in 1997, individual business entities acquired exclusive preferences. As a result, actually, in 1998, production of light motor vehicles grew 12.9 times, but in the same year, the foreign investor, which acquired these exclusive rights, became bankrupt because of the East-Asian financial crisis and in 1999, production of light motor vehicles in Ukraine again reduced 2.7 times. In 2001, the main provisions of the Law of Ukraine «On stimulation of automobile production in Ukraine» to the extent of providing exclusive preferences to an individual producer was cancelled. After that, in 2002-2004, production of light motor vehicles in Ukraine was performed at high rates, and in 2004, its volume 11 per cent exceeded the indicator of 1990. In 2006, the largest national producer covered nearly a half of the internal production of light motor vehicles, the 2 following ones covered nearly a one-fourth thereof.

13. We should note that advantages shown by the markets with oligopolistic structure at the stage of recovery from the crisis, at the stage of Ukraine's economy stabilisation (2004-2007) were to considerable extent lost. Consequently, the annual average growth rate in steel production for this period constituted only 0.11 per cent, the annual average growth rate of rolled ferrous metals and coal production: 0.43 per cent; in production of motor petrol and fuel oil aggregate reduction occurred, which constituted respectively 2.3 and 9.8 per cent a year. At the same time, a number of branches, whose markets had

competitive structure, showed in 2004-2007 stable production growth rates: for example, wood processing industry: 20.3 per cent a year, pulp and paper production and editorial activity: 14.8 per cent a year, production of meat and meat products: 14.6 per cent a year, food-taste industry: 11.5 per cent a year. In a number of cases, the Antimonopoly Committee revealed the behaviour bearing traces of monopolistic pricing in these fields. In the markets of some oil products and metallurgical industry, there were cases, when business entities simultaneously operating in external markets and facing considerable competition, and in the internal markets bearing marks of collective or individual domination, set internal prices at the level being considerably higher than external ones, thus doting promotion of their products in the external markets.

14. Export-oriented branches, for which markets with oligopolistic structure dominated, showed the lowest stability at the first stage of financial crisis of 2008: in metallurgy, in September 2008, decline in production compared to 2007 was 19.1 per cent, in coal production: 15.6 per cent, in oil processing: 20.7 per cent. At the same time, growth was observed in branches characterised by competitive market structure such as wood processing, pulp and paper production and editorial activity.

3. Preliminary conclusions

15. Experience available in Ukraine allows making the following preliminary conclusions in respect of reference of competition policy to industrial policy:

- Successful industry development implying availability of any model-based competition;
- At the stage of recovery from the structural crisis, efficient industry development may be contributed by the competition model implying symmetrically oligopolistic market structure;
- Similar competition model may be also allowed at the stage of technologic paradigm changes;
- In other cases, competition policy shall probably have the priority of approximation to the perfect competition model;
- In any case, to achieve the objectives of industrial policy, it is unfeasible to apply such measures as provision of exclusive rights to individual business entities or creation of obstacles to starting production of similar products by other entrepreneurs.