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COMPETITION POLICY ISSUES IN DEVELOPING AND TRANSITION MARKETS

-- Contribution by Mark Dutz --

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Competition policy issues in developing and transition markets

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Outline

I. BENEFITS OF COMPETITION

1. Unique challenges of less mature markets
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3. Empirical impact of competition and competition law

II. IMPLICATIONS FOR LESS MATURE MARKETS

1. Special elements of effective competition policy
2. Implications for competition law authorities
 - **open ‘strategic bottlenecks’ to competition**
 - **emphasise ‘enhanced’ competition advocacy**
3. Directions for further work

I.1. Challenges of less mature markets

- **Inadequacy of business infrastructure**
 - **physical:** low level and restricted access
 - **institutional:** dysfunctional legal & regulatory frameworks and implementation capacity; legacy of excess intervention and weak governance; uneven playing field
- **Special problems with thin markets:** more substantial information asymmetries in credit and product markets; missing or insufficiently dense markets
- **Insufficiently educated & organised civil society:** industrial and end-use consumers lack understanding of benefits of competition; key beneficiaries of competition lack voice

I.2. Competition matters most in such markets

- greater impact of ‘discipline incentives’ **to spur competitiveness of firms** in countries with weaker markets for corporate control
 - reduces managerial slack
 - improves selection (closure of poorly-managed firms)
 - spurs innovation
- competition law **more important as a complement to trade liberalisation**
 - greater proportion of ‘localised’ (non-tradable) markets
 - more limited distribution channels
 - greater propensity for institutional public and private barriers that cannot be disciplined by imports (e.g. Turkey cases against entry barriers from legal monopoly and from private companies)

I.2. Competition matters most (cont.)

- internationally-accepted, independently-enforced competition law **enhances investment climate and FDI**
 - creates a level playing field with rewards based on performance
 - reduces need for government intervention and scope for corruption
 - provides a familiar environment with familiar remedies
- innovations in technology and new goods spurred by increased competition **stimulate job and income growth**, directly contributing to increased standards of living

I.3a. Competition spurs innovation & growth

- Chile: **Competition in long-distance telephony with equal access** mandated in mid-1994
 - by mid-1996, ave. rates fell by more than 50%
 - domestic long-distance traffic rose by more than 50%
 - reforms unlocked approx. USD 120 mn in consumer W in 1995 (Crandall and Waverman, 1997)
- Mexico: **Free entry into trucking, container and cargo handling**, 1989-93 (Dutz, Hayri and Ibarra, 2000)
 - increases in quantities and distances of freight hauled
 - increases in reliability (timeliness, transit losses)
 - overall benefits estimated at 10% of operating margin of a representative user company

I.3b. Effective competition law spurs growth

- Empirical test: whether countries with *effective* competition law implementation have higher growth
 - responses from over 3000 top business executives of large international and domestic firms in 53 countries to:
 - **‘Does antitrust or anti-monopoly policy in your country effectively promote competition?’**
- Dutz and Hayri (2001) find that *effective competition law implementation is positively associated with long-run growth*, controlling for other determinants of growth
 - association goes beyond trade liberalisation, institutional quality and a favourable policy environment

II.1. Special elements of effective policy

- **Starting small is better than not starting at all**
 - given that markets not functioning sufficiently well, desirable to have a **responsible entity** within the State (e.g. Albania)
 - **gradual build-up** of human capital and expertise
 - **focal point** for efficiency and consumer welfare, to deepen ‘culture of competition’
- A key focus of the competition institution should be to **promote entrepreneurship** (entry & exit)
 - **preserve rewards from productive entrepreneurship** by focusing on fundamental investment climate issues
 - **foster ‘grass-roots’ enterprises** that spur either revolutionary or evolutionary innovations

II.1a. Preserve rewards from entrepreneurship

Claim: Productivity and growth depend on **allocation of entrepreneurship** between different activities
(supply of entrepreneurs varies less between countries)

- allocation influenced by **relative payoffs**
(vs. rent-seeking or non-entrepreneurial activities)

Implication: legal & regulatory frameworks critical

- protect and ensure **property rights** serve public interest
- remove legal & other **obstacles misdirecting resources**
- ensure fair & speedy **dispute resolution** mechanisms



emphasise 'enhanced' competition advocacy

II.1b. Foster grass-roots entrepreneurship

Claim: Infrastructure services and other essential local inputs may be **more subject to monopolisation and foreclosure**

- more frequent (legacy of more SOEs)
- more persistent (imperfect, less dense markets)

Implication: emphasis on access policy through supply side

- eliminate **barriers to grass-roots entry**
- facilitate **access to essential business services**



emphasise opening 'strategic bottlenecks' to competition & enhanced competition advocacy

II.2a. Enforcement actions to open bottlenecks

- Focus enforcement resources on **detecting collusive agreements or exclusionary practices aimed at foreclosing access** to essential business services
 - focus on **ensuring provision of essential inputs** that are local in character such as localised real estate and banking, transport, distribution warehouses, communications & professional business services (information and market-making)
 - e.g. *examine exclusive supply or distribution contracts* (including shipping, importing and local supply)
 - e.g. at the rural level, *stop tyre slashing* that impedes new local transport services

II.2b. Enhanced competition advocacy

- Address **missing or poorly-functioning institutions** that help provide access to essential business services
 - **power to introduce or amend new laws** to promote competition (e.g. movable assets registry)
 - **oversight responsibility** to ensure that relevant institutions perform their role (e.g. unbiased property rights enforcement, speedy dispute resolution mechanisms, streamlining of administrative barriers to entry & exit)
- Eliminate **government policies that suppress rivalry**
 - **prohibitions in law** against anti-competitive acts by other governmental bodies (e.g. transition economies)
 - **power to modify existing laws** to promote competition (e.g. exclusionary trade & investment rules)

II.2b. Enhanced advocacy (cont.)

- Play strong pro-active role as **watchdog for network utilities: keep competition issues with competition authority** to ensure flexible availability of infrastructure services that facilitate entry and restructuring of efficient firms
 - **responsible for** initial setting of industry structure & restraints on companies' operations
 - **veto** power over determination of regulatory boundaries
 - power to **review** whether decisions in public interest
- Build **competition culture** and mobilise **pro-competition support constituencies** through broad-based education
 - activities to support natural allies (e.g. Mexican '*competition in regulatory reform*' benchmarks)

II.3. Possible further work

- **more systematic evidence that competition is good** for transition and developing economies
 - easy-to-understand case studies across countries of '**natural experiments**' of the removal of competition obstacles and their impact on enterprises and markets
 - links between improved competition policy implementation and **FDI** (investment more generally)
- **more systematic documentation and analysis of innovative implementation measures** taken by competition authorities
 - extension of the analytical framework of **foreclosure analysis** to various elements of business infrastructure
 - systems of **monitoring and oversight** that limit institutional capture and give voice to beneficiaries of competition