OECD Global Forum on Competition

COMPETITION POLICY AND ECONOMIC DEVELOPMENT

-- Contribution by Fernando Sanchez Ugarte, Chairman of the Federal Competition Commission of Mexico --

This note was submitted by Fernando Sanchez Ugarte, Chairman of the Federal Competition Commission of Mexico, under Session I of the second meeting of the Global Forum on Competition, held on 14-15 February 2002.
COMPETITION POLICY AND ECONOMIC DEVELOPMENT

Fernando Sánchez Ugarte
Chairman of the Federal Competition Commission of Mexico

Paris, France
February, 2002

COMPETITION AND ECONOMIC DEVELOPMENT

- Competition is an important factor in fostering economic development.
- Economic development comprises:
  - social welfare
  - productivity
  - product innovation
  - competitiveness
  - economic growth
  - income distribution

- Both, economic theory and the empirical evidence support a strong relationship between competition and the above variables.
Competition is the process of rivalry of firms in the market. It can be analyzed in a static or a dynamic perspective.

**Static Perspective**

- Competition improves social welfare by bringing market prices closer to the marginal social cost of production.
- Allocative inefficiency arises when the private and social cost of production differ.
- Productive inefficiency arises when production is not carried out at the lowest possible cost.
- Increased competition leads to a once and for all improvement in social welfare.

**Dynamic setting**

- Firm dynamics give rise to creative destruction, successful firms gain market share while unsuccessful ones lose market share or disappear.
- Competition leads to a continuous process of efficiency improvement that leads to higher economic growth.
DYNAMIC COMPETITION

- In high-tech markets competition is not static but dynamic
  - products enjoy transitory monopoly position but are replaced after some time by new and better products
  - competition is not in the market; competition is for the market

- Traditional antitrust analysis is not suited to tackle problems of dynamic competition

- Fortunately newly installed competition agencies are hardly called upon to evaluate cases in high-tech markets
  - they may confine themselves to simpler cases such as merger control and horizontal collusion
  - there is time for learning by doing

CREATIVE DESTRUCTION

- Competition is a process of creative destruction (Schumpeter)

- Industrial policies and antidumping authorities care about the destructive nature of competition and are often concerned about short-run employment and the survival of national champion industries

- Competition authorities care about the creative nature of competition and tolerate the destruction for the sake of long-term health of the industries

- This may give rise to important controversies
COMPETITION AND ECONOMIC DEVELOPMENT

- Empirical evidence suggests a significant relationship between competition and economic development.

- This evidence is applicable to specific sectors of production and to cross country studies (Report by the OECD)

HOW TO ATTAIN COMPETITION?

- Several policies concur:
  - Trade and investment liberalization.
  - Regulatory Reform
  - Privatization.
  - Protection of Property Rights.
  - Institutional Reform
  - Competition Policy
ARGUMENTS AGAINST COMPETITION POLICIES

➢ Trade liberalization is sufficient to promote competition.
➢ Welfare losses from reduced competition are insignificant.
➢ Competition policies are not suited to deal with dynamic competition.
➢ Competition policies do not take proper account of the destructive nature competition may have.

TRADE LIBERALIZATION AS A SUBSTITUTE

➢ Trade liberalization is not enough basically for two reasons:
  □ trade liberalization only brings competition for tradeable goods and services
    ▪ most services are non-tradeable
    ▪ tradeability of many goods is limited
  □ competition from abroad is not always so competitive
    ▪ restrictive business practices by multinational corporations
    ▪ international cartels
WELFARE LOSSES FROM REDUCED COMPETITION ARE INSIGNIFICANT

- Arguments
  - early estimates of welfare losses are low (Harberger)
  - where losses are important, as in natural monopolies, regulation not competition policy is the right answer
  - contestability of markets reduces welfare losses
- Counterarguments (Stiglitz)
  - early estimates of welfare losses are incorrect
    - rentseeking behavior
    - raising rivals’ costs
  - most markets are not contestable
    - sunk costs
    - strategic entry barriers
  - markets are fairly segmented
    - incomplete information
    - search costs

FOREIGN INVESTMENT AND COMPETITION POLICY

- The implementation of an effective competition policy can be an important factor for enhancing the attractiveness of an economy to foreign investment and for maximizing the benefits of such investment.
  - Increases investor confidence.
  - Creates incentives for more state of the art productive investments.
  - Reduces risk of transferring monopolistic rents and prevents exploitation of consumers.
PRIVATIZATION AND REGULATORY REFORM

- Competition Policy is an essential element to bring about the benefits of privatization and deregulation programmes.

- Without competition policy privatization could replace a public monopoly with a private one.

- If deregulated industries are not subject to the discipline of competition law, could lead to poor performance and abuse of dominant position.

- Greater risk of regulatory capture.

INTELLECTUAL PROPERTY PROTECTION

- The establishment and enforcement of an adequate competition framework that addresses monopoly abuse of intellectual property rights is important to assure the welfare benefits of innovation and intellectual property protection.
INSTITUTIONAL CHANGE

➢ There is an increasing recognition of the central importance of institutions in the development process.
➢ The institutional set up that has to be displayed to implement competition policy is an important element in assuring that markets operate efficiently and to the full benefit of the economy.
➢ Transparent and internationally consistent rules of the game create an adequate environment that induces productive efficiency, investment and innovation.

COMPETITION POLICY AND ECONOMIC DEVELOPMENT

➢ Much less work has been done about the relation between competition policy and economic development

➢ The main reasons are:
  □ the strength of competition policy is difficult to measure:
    ▪ existence of a competition authority
    ▪ budget to GDP ratio
    ▪ fines to GDP ratio
  □ other policies interact with competition policy:
    ▪ trade liberalization
    ▪ foreign investment liberalization
    ▪ deregulation
    ▪ privatization
  □ most competition regimes were put into place until the 1990s
COMPETITION AND TECHNICAL EFFICIENCY

- Competition is found to have a curvilinear relationship with technical efficiency within firms (Green and Mayes):
  - in highly concentrated industries technical efficiency is low
  - in very atomized industries efficiency is also low
  - maximum efficiency is reached at industrial concentration ratio’s of 40% for the largest 5 firms.

- This underscores the importance of promoting competition and controlling mergers for countries that try to raise the technical efficiency of their industrial base.

EMPIRICAL ANALYSIS OF COMPETITION

- Econometric cross-country study quantifying the effects of privatization, competition and regulation on telecommunications in 30 African and Latin American countries.
  - Privatization by itself is not necessarily beneficial. However, privatization combined with an independent regulator seems to be correlated with increased connection capacity and payphones per capita.
  - Competition has a positive influence on telecoms performance:
    - increased mainline penetration
    - more payphones
    - higher connection capacity
    - lower prices
LACK OF EMPIRICAL STUDIES

- One empirical study by Dutz and Hayri found a positive association between competition policy and economic growth in a sample of over 100 countries.
- There is a need for more empirical work to demonstrate the positive influence of competition policy upon economic performance and development.
- This is important because competition law enforcement is controversial and competition authorities are often under attack from different angles.

COMPETITION AND COMPETITIVENESS

- Michael Porter has conducted studies using a microeconomic and sectorial approach.
- Elements of competitive advantage:
  - Conditions of factors of production.
  - Conditions of domestic demand.
  - Status and interaction of related industries.
  - Degree of rivalry.
COMPETITION AND COMPETITIVENESS
IMPLICATIONS FOR GOVERNMENT POLICY

- Governments can influence the share of institutional structure.
- Dynamism leads to competitiveness.
- Geographic concentration of industries.
- Promote education.
- Deregulation and privatization should be a priority
- Mergers and alliance among industry leaders should be prohibited.
- Competition policy should create the institutional framework to enhance competitiveness, not allowing excessive concentration and promoting deregulation. Cooperation among firms in the same cluster should be allowed when it induces improvement and does not eliminate diversity and reduces rivalry.

IMPORTANCE OF COMPETITION POLICY FOR DEVELOPING COUNTRIES

- Summarizing, competition policies have an important role to play for developing and transition economies to:
  - raise the technical efficiency of their industrial base
  - enhance long-run economic growth
  - complement other policies intended to enhance competition in domestic market
  - reduce welfare losses caused by a lack of competition
  - encourage a process of creative destruction enhancing the competitiveness of industries in the long-run to the benefit of the society as a whole.
CONCLUSIONS

> Competition Policy is an important instrument to promote economic development. To attain this:

> Enhance complementarity with other growth inducing policies.
> Design competition policy that induces competition.
> Build up an institutional set up that will assure transparent and consistent application of competition law.
> Assess the effectiveness of competition policy.