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COMPETITION AND POVERTY REDUCTION

Contribution from the Czech Republic

-- Session I --

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-- Czech Republic --

1. Introduction

1. Located in Central Europe the Czech Republic is a small open economy that has since 1990s undergone a major economic transformation into a functioning market economy based on principles of free and undistorted competition. As a member of the European Union the Czech economy is significantly dependent on the exports and imports within the European market and also on the international trade with other non-EU countries.

2. The following contribution is focused on the relation between poverty reduction and competition in the context of the Czech Republic. The text describes competition effects on markets with essential items, the impact of competition policy on small entrepreneurs and job seekers from the Czech perspective (i.e. Czech Office for the protection of Competition). Finally it deals with the competition law enforcement towards small and medium-sized enterprises (SME) in the Czech Republic.

2. Defining poverty and identifying its causes

3. From the methodological point of view, in the Czech Republic as a relative measure of poverty, the “at-risk-of-poverty” threshold seems to be the most suitable as it has been used by European Union since 2001.¹

4. The at-risk-of-poverty threshold is set at 60 % of the national median equalized disposable income after social transfers. The advantage of this measure is its objectivity and possible comparability with other countries as it takes into account the differences in the living costs in different countries. The other reason for using this measure is the assumption that people whose income fall below the nation’s average are more at risk of being excluded from the benefits that are considered standard in society.

5. Relative disadvantage of the “at-risk-of-poverty” threshold may lie in a fact that the measure does not reflect how far below the threshold the people are, for how long their income has been so low, what was the reason for falling below the poverty line or if they possess and use other assets (the non-monetary income is excluded).

6. By this threshold the *income deprivation* can be measured. In the Czech Republic, 9 % of people were at risk of poverty (in terms of this indicator) in 2010 which was one of the lowest shares among EU member states.

7. In terms of income poverty, the price reduction of essential items can have a positive effect on the improvement of poor people’s living standards. Poor people’s expenses on essential items form much bigger proportion of their income than it is for people whose income is higher (expenses on essential items

¹ http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-10-030/EN/KS-RA-10-030-EN.PDF

can be insignificant for them in comparison with their income). With respect to this fact, prices of essential items are crucial for poor people and their decrease can help them to escape poverty.

8. As for the factors causing the poverty, it is generally considered that poverty in developing countries is most often caused by poor quality or lack of education, health, economics and government.

9. For purposes of the Czech Republic and European Union, more specific causes of poverty can be mentioned²:

- Unemployment
- Low level of education
- Size and type of the family
- Gender discrimination
- Disability or ill-health

3. Competition in the markets for essential items

3.1 Improving the living standards through efficient competition

10. In general, competition should force companies to compete for the customers by offering the best quality for affordable prices. For poor consumers the lowest possible price is the crucial aspect of increasing their ability to afford all the necessary items and therefore to improve their living standard.

11. Effective competition in the market is expected to move the prices towards production costs or even to lower level for a short period of time. Efficient competition also forces undertakings to compete for the customers in the sense of improving the quality of their goods and services and production effectiveness to facilitate the most competitive prices. As for the poor the price of all necessary goods or services is the most important aspect of improving their living standard, efficient competition in the market for essential items should be an indivisible part of improving the welfare of poor consumers.

12. Effective competition also strengthens innovation and development which could facilitate possible further expansion of competitors which brings more jobs and opportunities for the poor to be employed or start their-own business and increase their income.

3.2 Provision of essential items through the protection of competition

13. One of the competition policy's objectives is to create conditions for better affordability of the essential items. Efficient competition should lead to the quality improvement of goods or services and improvement of production effectiveness which facilitates competitive prices. Lower and affordable prices are in most cases essential for the poor.

14. Besides the protection of competition there is also a specific legal provision focused on protection of food suppliers in the Czech jurisdiction the *Act on Significant Market Power in the sale of Agricultural and Food Products and abuse thereof*³.

² <http://www.eapn.eu/en/what-is-poverty/causes-of-poverty-and-inequality>

15. The Act is focused on the sensitive relation between suppliers of agricultural and food products and their customers which are retail chains. The Office started its activity in this area with a large market analysis in order to understand this specific area. The outcome of the analysis underlined problematic issues maintaining in this sector and pointed out other potential problems. General objective of this initiative is to maintain the protection of the farmers and food producers against unfair treatment of the retail chains as fair conditions will enable them to compete effectively, expand their business and increase their income.

16. The effective and efficient growth and development of number of farmers and food producers is significantly important for the employment in rural areas where the job opportunities tend to be constrained. Open and efficiently competitive environment provides better conditions for employment and also for the new market entrants that could help to create new job opportunities crucial for some of the unemployed to escape from the poverty.

3.3 Possible negative effects of competition on poor consumers

17. The protection of competition is focused on maintaining the competitive behavior of undertakings which tends to decrease the prices towards the production costs which increases the welfare of consumers. However examples of the procompetitive regulations, which at the end made the poor consumers worse off, may occur.

18. Competition advocacy efforts are often focused on strengthening the market economy and related deregulation of specific industries or privatization of state owned enterprises. The aim of deregulation is to create the competitive environment with all the related benefits for customers. In case of essential sectors (goods or services) governments tend to regulate the functioning of these markets and prices of related goods or services.

19. In the Czech Republic this was the case of regulated rents for housing⁴. The change of legislation should have deregulated the prices of rents, brought competition to this area and moved prices towards market levels. In particular, the related provision created the possibility for the owners to unilaterally change (increase) the rent by a specific amount even without the consent of the renter. The provision had entered into force in 2006 and the prices began to move in 2007. In December 2012 the rent regulation ended in all regions of the Czech Republic.

20. The aim of this provision was to establish the effective and efficient competition in the relevant market but in fact competitive prices turned out to be higher. Most of the owners tended to increase the prices and due to the nature of the deregulation's provisions the renters could not protect themselves against unilateral change of the housing contracts. Therefore the procompetitive deregulation at the end resulted in the increase of prices and had a negative impact on consumers. The poor ones were obviously harmed the most.

4. Competition enforcement in the markets for essential items

21. There are no available data showing the impact of decisions of the Office for the Protection of Competition (hereinafter referred to as "the Office") on consumers or specifically on the poor population. Generally, when drafting the decision the Office seeks to eliminate the anticompetitive behavior or practices that worsen the consumers' benefits resulting from the competitive markets. Therefore by

³ The English version of the Act: <http://www.uohs.cz/en/legislation.html>

⁴ After the year 1990 the rents were regulated for all rental housing however regulation was not applied on newly built houses.

focusing on the increase of the welfare of consumers the poverty reduction could be supported by the Offices' decisions.

4.1 Food Market

22. The Office has conducted several investigations in the food sector and intervened in the market of bakery products and in the poultry market. Short summaries of the cases and related sanctions are mentioned below. It is of course to be bear in mind that despite the fact the competition authority does not represent a price regulator; significant impacts on prices and thus consumers are derived from the Office's decisions, influencing possible improvement of living standards of poor.

- Producers of bakery products were fined of total amount CZK 120 million (approx. USD 6.5 million) for concerted practices when fixed prices of bakeries products. The existence of cartel agreement was confirmed but the decision was remand to the first instance for new assessment of fine. The new decision imposed a fine of CZK 53 million (approx. USD 2.9 million) in August 2006.

Fixed price is often above the competitive level which makes the consumers and particularly the poor ones worse off. Therefore the Office's investigation and final decision ensured that the prices would be set on the competitive level which is beneficial for the consumers' welfare.

- Producers of poultry were fined of total amount CZK 14 million (approx. USD 0.8 million) for distortion of competition. Companies agreed on joint strategy of price setting of their products in December 2006. Poultry is one of the cheapest meats in the Czech Republic so the potential long-term price increase of this commodity would have a negative impact on the poor consumers.

4.2 Energy market

23. In the Czech Republic the energy supplies could be considered as essential services and the significance of competition (and related customer benefits) in this area is worth mentioning when talking about improvement of the living standard of poor consumers. The Office supports provisions related to liberalization and improvement of the level of competition in the energy market as consumers could benefit the most from efficient competition in this sector. Despite the fact that the Czech market had been completely liberalized after the market transformation in 1990s the Office has intervened in the energy market mainly to prevent the abuse of dominant position for there hasn't been sufficient number of undertakings at all levels of energy market and former incumbents still tend to dominate particular sectors.

24. The aim of promoting competition in the energy market from the consumer perspective is to create competitive environment in the energy supply sector and provide consumers with the possibility to choose a supplier who offers the best services for the lowest price.

25. The Office supports directives related to unbundling which is an indivisible part of liberalization and establishment of effective competition in the energy market. The energy market was one of the sectors where a monopolistic structure maintained and introduction of competition was perceived as beneficial mainly for end consumers who would be able to choose a supplier offering the best services for the lowest price. As was already mentioned competitive environment forces undertakings to compete for the customers by offering the lowest possible price for their services and the price is exactly what the poor consumers care about.

4.3 *Dependence of the competition enforcement*

26. Smooth competition law enforcement is strongly dependent on other policies, government activities and other aspects, such as:

- functioning of regulated industries,
- presence of state owned enterprises and its behavior in the markets,
- legal framework for the protection of competition,
- scope of competence of the competition authority (CA) and its decision independence,
- functioning of courts and
- sanctions for non-complying with the CA decision;

5. Competition's effect on poor, small entrepreneurs and job seekers

5.1 *Job seekers*

27. According to the standard social theory, the likelihood of escaping poverty is higher in households with positive employment changes. On the contrary, the most likely to enter poverty are individuals living in households where one or more members have lost a job. Therefore the competition policy should be focused on employment growth. The low unemployment rate means that also the low-skilled workers/ workers with lower wages will be able to get a job/ work additional hours which leads to poverty reduction (decrease in income deprivation). The main tool for poverty reduction is a market creating new jobs and a labor market that is open, functional and flexible.

28. As the probability of falling into poverty is also influenced by the level of education or gender, we regard the "equal opportunities programs" as an appropriate tool for helping people to overcome their disadvantage in labour market.

5.2 *Small entrepreneurs*

29. Small and medium enterprises (SMEs) are considered to be a stabilizing element of the economics. They increase the market dynamics, increase competitiveness of production, adapt quickly to market requirements, develop new technologies, create new employment opportunities, etc.

30. The possibility to use this potential is dependent on the market environment. SMEs have to face to several restrictive conditions such as:

- Worse access to credit
- Shortage of reserve funds for temporary unsuccessful periods of time
- Limited access to advertising and company presentation in media
- Bureaucratic restrictions, requirements of the state and other institutions (complex accounting, number of procedures, etc.)
- High barriers to enter
- Weak position in the public tenders
- Sensitivity to unexpected changes of inflation or unemployment rates

31. The elimination of these restrictive conditions and support of SMEs is a common state policy that can be applied in several forms, for example:

- **State interventions:** The state intervention should lead to competitive environment that enables the development of SMEs, growth of per capita income and thus poverty reduction. It is important to highlight that a state should not deform the market environment and enterprise equality by its intervention. The intervention/support in this sense is a tool that is used to equalize opportunities, not to give preferential treatment to SMEs to the detriment of large companies.
- **Local interventions:** SMEs operate mostly locally, in the regions where the large companies or foreign investments do not head for. SMEs have a very positive effect on the development of those regions and small towns, especially on the unemployment reduction and competitive environment maintenance. Not all regions are however attractive for business. Those regions should artificially set reasonable conditions for SMEs in order to attract them, such as various reliefs and benefits.
- **National legislation, The Office for the Protection of Competition:** The supervision of the compliance with competition law is in the hands of the Czech central administrative body – Office for the Protection of Competition. The Office is responsible for the support of competition and its protection against prohibited restrictions by creating conditions that favour and protect competition and by supervision of public procurement. These competencies help to maintain effective competition that generates economy growth, competitiveness and employment which are the essential tools for alleviating poverty.

6. Competition's effect on poor, small entrepreneurs and job seekers, in reality

32. Some of the examples that could affect the poor people in the Czech Republic are described in the text below. Despite the fact that there are no statistics showing that these examples in reality helped some of them to escape poverty, we consider that they had a potential to do so by creating convenient conditions for small entrepreneurs and unemployed people.

6.1 Job seekers

- **Mergers:** The Office takes into account during the assessment of concentration between undertakings its impact on employment. However, the protection of the labor market should not be used as the only justification for the competition infringement as this would constitute the inefficient allocation of resources (surplus employees decreasing efficiency). Nevertheless as a supporting argument this reason can be considered.

As an example, the approved merger of two food producers in 2000 can be mentioned. One of the reasons that the Office stated in favour of approval of this concentration of undertakings was its positive impact on the employment. The merging companies agreed to maintain a steady and permanent employment throughout the year reducing the effects of seasonal production.

- **Public Procurement Procedure:** In 1999, the Czech government approved a National Employment Plan that included a requirement to use the public contracts to ensure the employment of job seekers, particularly those who are difficult to place in the labour market. Specifically, it was stated that the use of public funds should ensure also other societal goals (primarily employment) than only the efficient use of financial resources. The suggested application of this requirement in practice was a consultancy with a respective labour office initiated by contracting authority.

The similar initiative is implemented also in Europe Growth Strategy 2020⁵ within European Union. The initiative focuses on adjustment of public procurement procedures in order to integrate social considerations into them. The contracting authority can impose a specific condition on tenderer such as the obligation to recruit unemployed persons or to implement, during the execution of the contract, measures that are designed to promote equality between men and women or ethnic or racial diversity. As the Czech Republic is a member state of EU, it is very likely that it will be affected by this initiative as well and the initiative will help to decrease the unemployment and subsequently the poverty.

- **Operational Programs (“OP”):** Several operational programs in the Czech Republic are focused on reducing unemployment by active labour market policy, professional education and integration of socially excluded groups back into the society (OP Education for Competitiveness, OP Equal Opportunities for Women and Men, OP Integration of socially excluded groups in the labour market).

33. All examples stated above have a common goal to decrease unemployment in the Czech Republic. As the unemployed people are more likely to fall below at-risk-of-poverty threshold, it is probable that the interventions helped some of the people to escape poverty. Also the interventions aimed to decrease the unemployment that is caused by social factors can be assumed that they had a positive effect on poverty reduction. Unfortunately, there is no evidence for this statement.

6.2 *Small entrepreneurs*

34. In 2011, the share of the small and medium-sized enterprises (SMEs) was 99 % in the Czech Republic. They employed 61 % of all people working in enterprises. The similar situation can be observed in most of the EU countries (more than 99 % of all European businesses are SMEs).

35. The goal of the government policy that is focused on support of SMEs is mainly the elimination of restrictive conditions. Some of the tools that have been used for this purpose in the Czech Republic are:

- **Single Registration Form:** A form designed both for legal and natural persons in order to simplify the process of starting up and conducting a business in the Czech Republic. It replaced different forms that entrepreneurs had to fill in before starting up and even when conducting the business at trade licensing offices, revenue authorities, competent social security administration, employment offices, and health insurance companies. Requirements of these authorities have been integrated into a single form which is more entrepreneur-friendly and makes the administration for entrepreneurs easier.
- **Corporate income tax:** The tax was gradually decreased from 35 % (in 1999) to 19 % (in 2012). The goal of tax reforms was to support enterprises, their investments and growth. The low corporate income tax attracts also foreign investments which has a positive effect on employment.
- **Czech national programs to support SME’s business:** They are focused on supporting entrepreneurs in form of guarantees for bank loans and interest free loans for start-ups in the capital city of Prague and allowance and grants to entrepreneurs throughout the country.

⁵ http://ec.europa.eu/internal_market/publicprocurement/other_aspects/index_en.htm

- **Regional programs:** Ministry of Industry and Trade has in its scope the programs which goal is to support SME's business in the Czech Republic regions. E.g. INOSTAR, a program that provides guarantees for loans of new entrepreneurs in two regions of the Czech Republic. The main objective of the program is to allow new entrepreneurs to get credit for the realization of their innovative projects.
- **Public procurement law enforcement:** The Office ordered by its decision to the government agency CzechInvest to complete a tender for choosing an operator that should provide small businesses and entrepreneurs with telecommunication services discounted by 60 %. The discount will be subsidized by EU Operational Program Enterprise and Innovation.

7. Czech competition policy towards poverty

36. The competition law and policy should be focused on protection of competition and applied on all undertakings. However in the Czech Republic the legal framework provides the Office with the competence to prioritize when deciding the initiation of particular proceeding.

7.1 *Prioritization*

37. The prioritization means the competence of the Office not to initiate the proceedings if the impact of the conduct under consideration on competition is not significant. The Office takes into account the character of the infringement, the importance of relevant market and number of harmed consumers. In practice it should apply to vertical agreements of undertakings with the market share lower than 1 %. Therefore in practice the competition law enforcement is slightly different towards small/poor entrepreneurs.

38. The possibility to prioritize is quite common in a lot of European jurisdiction and provides competition authorities with the possibility to focus their resources on fighting such competition infringements that have more significant impact on the market and on the welfare of consumers.

39. Competition enforcement should be focused on protection of competition and related possibility to enter the markets. Sanctioning of undertakings with dominant position or significant market power could seem as a focus on more significant market player or large producers but ensuring conduct in compliance with competition law provides at the same time competitive environment for smaller entrepreneurs.

8. Conclusion

40. The contribution attempted to list the factors that have detrimental effect on the poverty, specifically in the Czech Republic. By defining these factors it was possible to determine the competition tools that enable to eliminate the impact of these factors and thus decrease the poverty rate. The contribution focused on three main groups affected by the poverty: consumers, job seekers and SMEs.

41. From the perspective of the Czech Republic (Czech Office for the Protection of Competition), it is possible to presume that in general there is an inverse relationship between the competition and poverty. More efficient competition means better conditions and the possibility of living standard improvement for the poor.