

Competition, Growth and Poverty Reduction

Why is DFID interested?

DFID, the Department for International Development, is the government department responsible for the UK's work in promoting development and reducing poverty in developing countries. The UK is committed to the United Nations Millennium Development Goals, including that of halving the proportion of people living in absolute poverty by 2015.

To some people, 'competition policy' might sound remote from the Millennium Development Goals. What, for DFID, is the link between development and competition?

Development is a complex task that involves a wide range of policy areas, but most poverty reduction strategies that have been adopted around the world recognise the importance of economic growth.

DFID has found a positive relationship between economic growth and poverty reduction. That is, in the countries examined, where there was overall economic growth in the economy, poverty was reduced. Faster economic growth was accompanied by a faster reduction in poverty. This finding is significant, because it shows that the benefits of growth are not confined to small groups. Of course, dealing with the non-income dimensions of poverty, that include malnutrition, access to education and child mortality, is no less important than bringing about increases in money incomes.

DFID believes that the competitive environment within which firms make decisions on production, distribution and investment is directly linked to enterprise productivity, and thus to growth and poverty reduction. Some key aspects of this view of the competitive environment are that:

- A market economy is the key to economic growth and development.

- A sound competition policy, including a well-designed and well-administered competition law, is needed to keep markets operating effectively.
- It is necessary to foster a competition culture to ensure that competition considerations form part of the background to business decisions, and to government decisions affecting markets.

In the past four years DFID has sponsored or co-sponsored a number of competition law and policy projects. They include an international competition Roundtable in London in 2000, a WTO competition workshop for African WTO members in South Africa in 2001, the COMESA regional competition policy, the '7-Up' study of competition policy in four African and three south-Asian countries, the CARICOM regional competition policy and work undertaken by UNCTAD.

Competition Policy and Development

In recent years there has been a 'quiet revolution' in the adoption of competition law. Of the nearly 200 members of the United Nations, about half now have a competition law, and an appreciable number are preparing to introduce one. This suggests there is a broad-based view that competition law can contribute to national development.

Markets are powerful mechanisms that, within the right framework, work to society's advantage. However, markets sometimes fail to work effectively. The causes of market failure include anti-competitive practices and the misuse of market power.

'Competition policy' can be defined to include all measures by a government, which directly affect the behaviour of firms and the structure of industry, and which thereby, impact on the intensity of competition. This broad definition includes sector regulation, trade policy (which includes policies on tariffs, quotas and antidumping measures), investment policy, foreign exchange policy and labour market policy.

Competition policy seeks to make markets work better. Making markets 'work better' involves two subsidiary objectives: efficiency and fairness. While 'efficiency' is a concept that can be measured objectively, the idea of what is 'fair' reflects the cultural values of the society concerned. Although all countries with a competition law reflect both objectives at least to some extent, the goal of efficiency appears to be given increasing importance in a number of countries.

Competition law is an important strand of competition policy. When used appropriately, it provides the means for anti-competitive practices to be identified, for their effects to be analysed, and for any necessary remedial action to be taken.

The existence of competitive markets can reduce the scope for corruption, because impersonal market forces replace other types of decision-making. Having a competition law extends this benefit, because of the increased transparency that is provided for examining competition problems.

An issue of importance to developing countries is the effect of FDI on growth. Some case studies suggest that competition policy, through its impact on foreign firms' market shares, could have a significant impact on the scope for growth-enhancing spillovers from FDI. In addition to this direct effect, competition policy could affect the growth-enhancing impact of FDI indirectly, through its impact on the intensity of competition in the host country. Some empirical testing of this theory was undertaken by a DFID staff member. She found a positive relationship between FDI and growth for countries with effective competition policy, but no significant relationship for countries with ineffective competition policy.

There are various theoretical approaches to viewing the relationship between competition and innovation. At one extreme is Schumpeter's hypothesis that monopoly power stimulates innovation. However, many economists take different views. Many, though not all, empirical studies find a positive relationship between competition and innovation, and there are a number of

reasons for expecting this. Scherer has made the point that if fewer firms are searching for an innovation, this may reduce the likelihood of achieving the innovation within a given time period. In oligopolistic industries, resources may be spent on strategic behaviour, such as investing in excess capacity to deter rivals, which may reduce productive efficiency. Jovanovic suggests that competition may enhance growth not just by forcing individual firms to maximise efficiency, but also by allowing market entry to many firms, and ensuring that only the best survive.

An important implication of having a generic competition law is that it applies broadly to the economy. While every national competition law has some exceptions, these should be kept as few as possible and should be adequately justified. It is generally accepted that a competition law should be applied to the trading activities of government agencies as well as to the private sector, and to both domestic and foreign-owned firms. The existence of a generic competition law minimises the distortions created by exemptions or differential treatment.

Does every country need competition law?

It has sometimes been argued that markets can be made competitive through trade liberalisation and de-regulation, and that there can be a satisfactory competition policy without a competition law. Such views are expressed less frequently these days. Liberalisation and de-regulation can indeed have a strongly positive impact on competition. However, it is increasingly recognised that they are insufficient to prevent anti-competitive practices. Despite the pressures from globalisation, there are still significant sectors of most economies that are subject to little or no international competition. These sectors include goods for which transport costs are a large part of the value, perishable goods, and many services. The types of sectors that are non-tradable vary with the economy concerned, but categories frequently encountered include the acquisition and processing of farm products, road and other transport, professional services, the distribution of consumer goods, and finance.

In the past, Hong Kong and Singapore were associated with the view that small open economies, such as them, did not need a competition law. It is instructive to look at how their policies have developed.

While Hong Kong's official position is still that it does not need a generic competition law, it has introduced major measures that include competition law principles.

Sector-specific competition provisions were introduced for telecommunications and broadcasting. Several industries that operate under Government franchises (including power generation, legal services, medical services, bus operation and driving schools) are subject to criteria designed to maintain competition. Several cartels, including an interest rate fixing arrangement by banks, were dismantled with government prompting.

For competition in general, the Hong Kong Government established a high level forum chaired by the Financial Secretary, the Competition Policy Advisory Group (COMPAG). In May 1998, COMPAG issued 'The Statement on Competition Policy', which contains a comprehensive competition policy framework.

To encourage wider observance of the Statement, COMPAG issued Guidelines in September 2003, after wide consultation with business groups and the Consumer Council. The Guidelines define anti-competitive practices, and provide remedies. They contain provisions for assessing the overall competitive environment, for measuring the effects of restrictive practices on the market, and for identifying types of anti-competitive practices. All government entities were directed to adhere to the Guidelines, and all businesses were called on to apply them. Complaints about alleged restrictive practices may be made to the relevant government agency, and are monitored to identify any policy or systemic implications. The Hong Kong Government said it would take administrative or legal steps against anti-competitive practices where necessary.

Singapore first introduced competition provisions in the laws it adopted to regulate the liberalised market sectors of telecommunications, electricity and the mass media. In February 2003 the Economic Review Committee recommended that a national competition law be enacted, and public consultations were commenced on a draft bill. It is intended that a competition bill will be presented in Parliament later this year, and that a generic competition law will be enacted by 2005.

My conclusion is that with few exceptions, an effective competition policy requires a competition law.

What Competition Problems?

Discussion of the role of competition policy and law in remedying market failure can seem somewhat abstract, and it can be useful to consider concrete examples of the form market problems can take.

An interesting example of the effects of domestic anticompetitive practices is provided by the ornamental flower industry in an African country. A ready market for flowers was available in Europe, but growers found it hard to compete on price. The investigation found three reasons. The first was that there was a cartel of the truck operators who carry flowers from the farms to the airport. The second was that the freight forwarders operated a cartel. The third was that it was compulsory for exporters to use the national airline, a high cost operator. The combined effect was to increase costs by 30 to 50%.

A problem that has become more widely known in recent years is the existence of international hard-core cartels, and the severe effects they can have on developing countries. Presentations made to WTO regional workshops last year by Professor Jenny highlighted some examples. Three cartels, for aluminium, steel and heavy electrical equipment, made annual overcharges of US\$100 to \$120 million to Kenya, and \$220 to \$290 million to SACU members. An interesting point revealed by a study of one international

cartel, that for vitamins, found that countries without a competition law were overcharged more than countries that did have such a law.

Cartels, both domestic and international, can be difficult to deal with, but, if a country has no competition law, it has little hope of even attempting to deal with them.

Sector regulators are widely used where there is a natural monopoly or where other special factors exist. Their responsibilities may include service reliability, safety issues, environmental protection, social service commitments, and price or profit controls. However, issues involving anti-competitive conduct and mergers arise in regulated sectors. For example, questions on the terms on which interconnection should be provided by the dominant firm to other firms often arise with networks such as telecommunications.

The allocation of responsibility for dealing with competition problems between the competition authority (where one exists) and sector regulators varies. However, even where a sector regulator has exclusive powers to deal with competition issues in the sector, the competition authority can play an important role in encouraging the regulator to use these powers in a pro-competitive way. If there is no such guidance, sector-regulators are at risk of 'regulatory capture', that is, of giving priority to the interests of the regulated sector rather than the economy as a whole, thereby introducing distortions into the economy.

What is the evidence?

DFID seeks to make the maximum use of approaches that are evidence-based. What is the evidence on the contribution of competition law and policy?

The value of competition can be demonstrated in economic models that analyse the behaviour of firms in perfect competition and monopoly. Game

theory can be used to assess the likely behaviour of firms under the more typical market structure of oligopoly. These arguments can be extended to making a case for competition law on the basis that it can remove some of the causes of market failure that prevent effective competition taking place. However, more research is needed on the theoretical linkages between competition policy and law and development.

Empirical research would be of even greater value to policy makers who are looking for guidance, but there has not been much of it. There are several reasons for this.

Competition law is still relatively new in much of the world, particularly so in developing countries. Competition law takes a number of years to become fully effective, and this limits the number of countries for which adequate studies might be undertaken. Data on the size of markets and concentration levels is often inadequate or absent. Selecting an adequate measure of the intensity of competition is a major problem. The fact that competition law has often been introduced at the same time as other policy reforms, such as trade liberalisation and de-regulation, makes analysis more complex.

An economist now with the World Bank, Mark Dutz, suggested that many studies on the effect of competition dealt only with particular industries, so that the findings failed to capture the economy-wide effects of changes in the intensity of competition. His study, which was of 53 countries, and which was based on the perceptions of over 3,000 top business executives, found a “strong correlation between the effectiveness of antitrust policy and growth” and a relationship that appeared to be robust¹.

The prevailing view

While more research is needed on the link between competition law and policy and development, there is wide support for the view that the relationship is a positive one.

¹ Mark Dutz, paper to the OECD Global Forum on Competition, Paris, February 2002

A synthesis paper of the WTO Working Group in 1998, reflecting the discussions in the first two years of the Group's existence, concluded that:

"...the discussions to date in the Working Group have revealed broad (if not universal) agreement on the importance and relevance of competition policy as a building block of economic development. The specific benefits that have been attributed to such policy include promoting an efficient allocation of resources, preventing/addressing excessive concentration levels and resulting structural rigidities, addressing anti-competitive practices of enterprises, enhancing an economy's ability to attract foreign investment, reinforcing the benefits of privatisation and regulatory reform, initiating and establishing a focal point for the advocacy of pro-competitive reforms and a competition culture..."².

An OECD paper³ based on a survey of OECD members and non-members invited to the OECD Global Forum on Competition in February 2002 reported that:

"There are strong links between competition policy and numerous basic pillars of economic development...There is persuasive evidence from all over the world confirming that rising levels of competition have been unambiguously associated with increased economic growth, productivity, investment and increased average living standards"

Statements by participants at more recent meetings of the WTO Working Group and of UNCTAD have included favourable views on the contribution to development expected from competition policy. However, the comments were generally brief, and few participants attempted to quantify the impact of competition law and policy on their own economies.

² WTO paper WT/WGTCP/W/80, 18 September 1998

³ "Capacity Building for Effective competition Policy in Developing and Transitioning Economies", presented at the meeting of the UNCTAD Intergovernmental Group of Experts on Competition Law and policy, 4th Session, 3 – 5 July 2002.

Detailed Analysis – The Few

Only a few countries have given detailed assessments of the contribution of competition law to their national development. Some of the information provided by this small group is outlined below.

Australia

Australia's current competition law dates back to 1974, but it contained substantial exceptions until 1995. In 1992 an independent inquiry was established into Australia's competition policy⁴. The recommendations led in 1995 to the adoption of the National Competition Policy (NCP), which has the objective of systematically extending competition throughout the economy.

A paper presented to the WTO Working Group on the Interaction between trade and competition policy in February 2002 stated that Australia's national competition policy had "contributed significantly to Australia's strong economic performance in recent years". The benefits were seen to include:

- (i) Productivity improvements, lower costs and prices, an enhanced innovation in production processes and management practices.
- (ii) The creation of a competitive and more flexible economy that allowed "more rapid and less costly adjustment to changes in the domestic and international environment, such as the 1997-98 Asian slowdown. Reducing structural rigidities...enabled Australia to increase productivity growth".
- (iii) "Competition policy involves continuous efforts to reduce barriers to market entry and exit, to reform anticompetitive regulations and to expose government-owned businesses to competitive market forces in a competitively neutral manner".⁵

The paper quoted a study by the Australian Productivity Commission, which had estimated that selected National Competition reforms "are cumulatively estimated to provide a sustained increase in output from the economy, as measured by real GDP, of 2.5% above what would otherwise occur in the

⁴ The inquiry was chaired by Professor Fred Hilmer, and the Inquiry's report is generally referred to as the Hilmer Report.

⁵ World Trade Organisation document WT/WGTCP/W/232

absence of reform. This is equivalent to almost one year's average annual growth in the Australian economy".⁶

These strongly positive views were affirmed in an Australian paper to the WTO Working Group meeting in May 2003, which stated that Australia's experience was that "competition law and policy had provided an important underpinning of Australia's economic welfare". When presenting the paper, the Australian representative said that there is "solid evidence of the catalytic role that competition policy could play in enhancing economic growth and development".⁷

A recent paper by the Australian Productivity Commission⁸ sought to identify the key sources of the surge in Australia's productivity during the 1990s. It found that "The Australian evidence supports the OECD conclusion that policy and institutional factors have been instrumental", and concluded that "Whilst more analysis would help...The strong surge in efficiency can be explained largely in terms of increased competition and flexibility, which have driven and enabled catch-up and innovation".

Japan

The relative contribution of competition policy and of industrial policy to Japan's economic development after the Second World War has been the subject of considerable interest. Some commentators have claimed that Japan's economic development path demonstrates that developing countries should give primacy to industrial policy. However, Japan has emphasised the contribution of competition policy in its statements to the WTO Working Group, and independent researchers such as Simon Evenett have reached similar conclusions.

⁶ Australian Productivity Commission, ~"Impact of Competition Policy Reform on Rural and Regional Australia", 1999

⁷ WTO document WT/WGTCP/M/22, 9 July 2003

⁸ Dean Parham, Australian Productivity Commission, "Sources of Australia's Productivity Revival"

A paper from Japan to the WTO Working Group⁹ asserted that Japan's competition policy and its industrial policy had contributed equally to the development of its economy. Japan's experience was that many of its substantial industries that had been subject to domestic and foreign competition performed much better than industries that had been permitted to form cartels or for which domestic competition had been regulated. Japan believed that its experience showed that "competition policy primarily contributes to economic growth and development". In another paper to the WTO¹⁰, Japan stated that "Much of Japan's economic dynamism has...been rooted in the robust market mechanisms created through competition among firms. Industrial policy and competition policy coordinated mutually. ... (The) introduction of competition policy in Japan's economic reconstruction, as well as the subsequent evolution of this in response to economic development, was one great factor in Japan's rapid economic growth in the past. Even today, it is those sectors where competition has been intensive ...the automotive industry for example – which tend to have the greatest international competitiveness". (A similar conclusion was reached by Professor Michael Porter, in "Competitive Advantage of Nations", 1990.)

Korea

A paper from Korea to the WTO Working Group in 2003¹¹ noted that the monopolistic market structures that existed in Korea before the introduction of competition law in 1981 "later acted as factors restraining our economy's qualitative development".

In a separate paper¹², the Director-General of the Korean Fair Trade Commission said that the 1981 competition law had been "a remarkable turning point" for the Korean economy, but that the market system had not been fully developed in the following years. The Korean Government had

⁹ WTO document WT/WGTCP/W/177, July 2001, "Competition Policy and Exemption Systems"

¹⁰ WTO paper WT/WGTCP/W/176, July 2001

¹¹ WTO paper WGTCP/W/189

¹² J S Hur "Evolution of Competition Policy and its Impact on Economic Development in Korea", 2003

found it necessary to undertake extensive restructuring measures to improve the working of markets after the 1997 financial crisis. Mr Sur believed it was incorrect to argue that “countries like Korea have succeeded in developing their economies without antitrust policies”. He believed that, to achieve continuous economic development over the long term, it is necessary to introduce competition policies as soon as possible, and to constantly expand and reinforce them.

Peru

One of the few reported cost-benefit studies on the effect of introducing competition law is that undertaken several years ago on the operation of the Peruvian competition authority, Indecopi. This study, of Indecopi’s operations from its commencement in 1993 until 1996, concluded that the economic benefits from intensified competition cumulatively totalled US \$120 million, against the operating costs of \$20 million¹³. Although part of the benefit resulted from certain trade liberalisation measures for which Indecopi had responsibility, the ratio suggests that competition law can make a worthwhile net contribution to an economy.

Conclusions

Competition in markets, reinforced by sound competition policy and law as part of a range of sound public policies, does appear to contribute to growth, with growth leading to poverty reduction. This is a view that appears to have broad endorsement from a large number of countries.

A diminishing, but still significant, number of developing countries do not have a competition law. The reasons vary. For some, it might be that other activities are felt to have greater priority in the use of scarce financial and human resources. For some others, it might be that policy makers remain to be convinced that introducing a competition regime would be worthwhile. For

¹³ Quoted in “Competition Policy, Economic Development and the Multilateral Trading System: Overview of the linkages and current proposal for an agreement in the WTO”, R. Anderson and F. Jenny, September 2002, p. 7.

countries that are undecided, empirical research that endeavoured to quantify the effect of competition law on development and poverty reduction would be valuable.

DFID intends to undertake work on this important issue, particularly on the relationship of competition and investment, and hopes that researchers elsewhere will be encouraged to take up this task as well.

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