

OVERVIEW

Competition and Productivity Growth in Latin America and the Caribbean



WORLD BANK GROUP

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James Sampi, Charl Jooste,
and Jorge Thompson Araujo

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PRODUCTIVITY
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LATIN AMERICA
AND
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*Ekaterina Vostroknutova,
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Foreword

The Latin America and Caribbean (LAC) region continues to grapple with depressed growth and job creation rates that are among the lowest in the world. A long-acknowledged cause is the lack of competitive pressure on firms, the related high degree of concentration in domestic markets, and the barriers to international competition. This situation leads to the poor allocation of factors of production and low levels of innovation that impede productivity growth. To date, however, the evidence making the case for a renewed effort to enhance competitive forces has been elusive.

This report fills that gap by employing case studies, new data, and novel empirical analysis to make the case that increasing competition should be part of the region's growth strategy. It highlights how market concentration continues to be high by global standards and how barriers to entry and expansion rooted in regulations or uncompetitive strategic behavior protect inefficient firms and prevent the entry of the new higher-productivity firms critical to growth. It provides some of the first documentation of how actions by national competition authorities to enhance competition do, in fact, increase output, productivity, and job creation; and it argues that these agencies need to be strengthened and given more autonomy.

However, the report also warns against a simple "more is better" recipe for competition policy. In line with the thinking of Philippe Aghion and coauthors, it documents how, faced with increased international competition from the China shock, most LAC firms were not near the technological frontier and thus were unable to innovate to confront new competition. Thus, greater competition internationally needs to be complemented by policies to strengthen firm capabilities and support national innovation systems.

Competition and Productivity Growth in Latin America and the Caribbean provides a fresh window into the troubled growth dynamics of the LAC region. Still, the lessons complement the work seeking to enhance growth and job creation more globally, like the World Bank Productivity Project and *World Development Report 2024: The Middle-Income Trap*. As such,

it provides an invaluable resource for policy makers and analysts globally on the critical role of competition in driving economic transformation and growth.

William F. Maloney
*Regional Chief Economist,
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Overview

Summary

There are many potential reasons for the decades of slow growth in Latin America and the Caribbean, including macroeconomic volatility, low savings and investment rates, underdeveloped institutions, and resource misallocation across sectors and firms. However, one significant factor stands out: the lack of competitive pressure on firms, which hinders creative destruction and results in inadequate incentives for innovation. This issue has not received sufficient attention from policy makers and analysts.

Creative destruction in the region is limited by barriers to entry that protect inefficient and unproductive firms from competition, allowing them to accumulate rents. Many of these barriers are rooted in local and national government regulations. These regulations reduce competitive pressure, leading to low entry rates, high markups, slower growth among firms, and limited efforts to innovate, all of which contribute to low productivity growth.

Could more intense competition accelerate productivity growth in the region? Empirical evidence suggests that national competition authorities have promoted greater competition, resulting in higher productivity and improved market outcomes. Both new entrants and established firms have benefited.

This report underlines the importance of competition policy in preparing countries—and the firms in them—for external shocks through import liberalization. It also notes that the success of competition policy in raising productivity depends on other complementary policies that amplify the benefits of competition for productivity. The competition-innovation nexus is crucial. Countries need coordinated progress in competition policy frameworks and national innovation systems.

The region requires deliberate measures to boost productivity at the firm level. Competition policy plays a key role by leveling the playing field for market participants, unblocking the creative destruction process, and providing highly productive enterprises with new incentives to grow and innovate, while enabling unproductive enterprises to exit. Yet competition in domestic markets must be accompanied by complementary policies that enhance worker and firm

capabilities to increase the share of firms that are closer to the global technological frontier and able to benefit from increased foreign competition.

Chapter 1. Competition, Innovation, and Productivity in Latin America and the Caribbean

Latin America and the Caribbean is characterized by low average growth. On average, countries in the region have not converged to the income level of the United States. The region's relative average income per capita has stagnated for over a century, at about 25 percent of the US benchmark. Given the ample factor endowments of land, labor, and capital, output per worker in the region should be about 60 percent of the US level. For a few decades in the twentieth century, the region outperformed emerging peers, thanks to factor accumulation, mainly fixed capital and skilled labor. However, since the 1980s, output per worker relative to the United States has steadily declined.

Economic growth in the region, when it has occurred, has not resulted from improved productivity or good productivity dynamics capable of sustaining future growth. Overall, productivity has contributed little and often negatively to economic growth. This low contribution to economic growth relative to factor accumulation distinguishes the countries in the region from other emerging markets and developing economies.

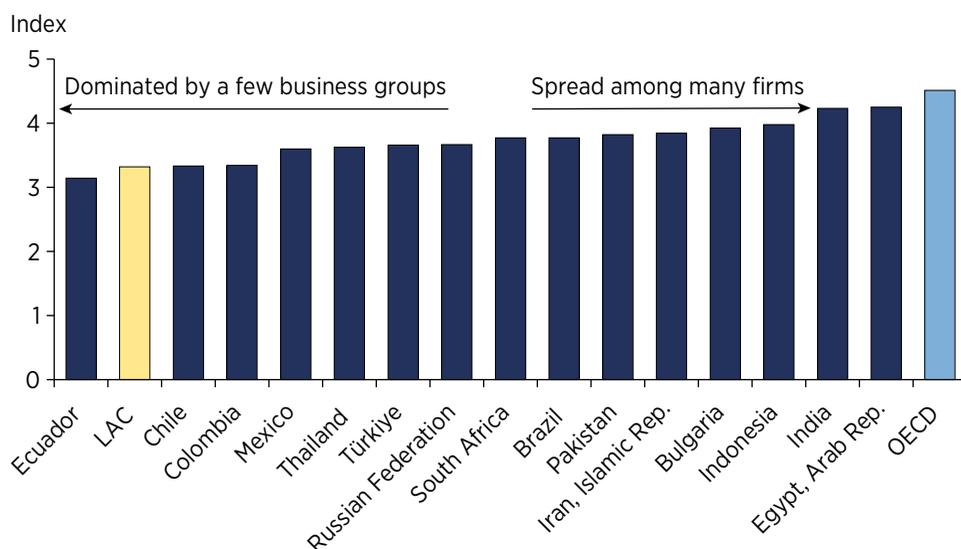
Aggregate productivity depends on the productivity of firms, and firm-level productivity is driven by innovation that increases firms' capabilities (the within-firm or innovation channel of productivity). Firms in the region introduce new products less often, hold fewer patents, and use less sophisticated managerial practices, compared to firms in other regions. Compared to countries in the Organisation for Economic Co-operation and Development (OECD), firms in the region invest less in research and development and rely more on non-frontier innovation activities. Some countries are better at innovating than others; however, they primarily engage in catch-up innovation by introducing products or processes established elsewhere but new to the firm.

Productivity growth depends on how well capital, labor, and other factors of production are allocated across firms and sectors. If they are not allocated to more productive units, aggregate productivity will suffer. Productivity also depends on the rates at which more productive firms enter the market and less productive firms exit. The survival of low-productivity firms reduces aggregate productivity.

Competition is crucial to the operating environment that contributes to productivity growth. It forces less productive firms to exit the market while more productive firms enter, survive, and grow. It is an incentive for innovation. In its absence, firms may operate at higher costs and fail to upgrade to more efficient technologies. Less intensive competition enables rent-seeking behavior. Firms with high market power often divert resources from productive activities to engage in rent seeking to maintain or boost their market power.

Markets in the region operate at low levels of competition and high average market power. Latin America and the Caribbean has a great number of tiny firms that employ a large share of workers. Approximately 70 percent of the workers are active in businesses with fewer than 10 employees, compared to 23 percent in the United States. The number of microfirms is also much higher: in Colombia and Mexico, almost 90 percent of establishments are microfirms, compared to 50 percent in the United States. A small number of firms dominate most markets (figure O.1). A typical manufacturing sector in the region has a dominant firm with a market share between 20 and 60 percent, and average markups—the difference between the cost and the selling price of a product—have been historically high, far above those in other regions. Dominant firms tend to be larger than what their productivity would predict: unlike in the United States, bigger firms are not necessarily more productive in Latin America and the Caribbean (figure O.2).

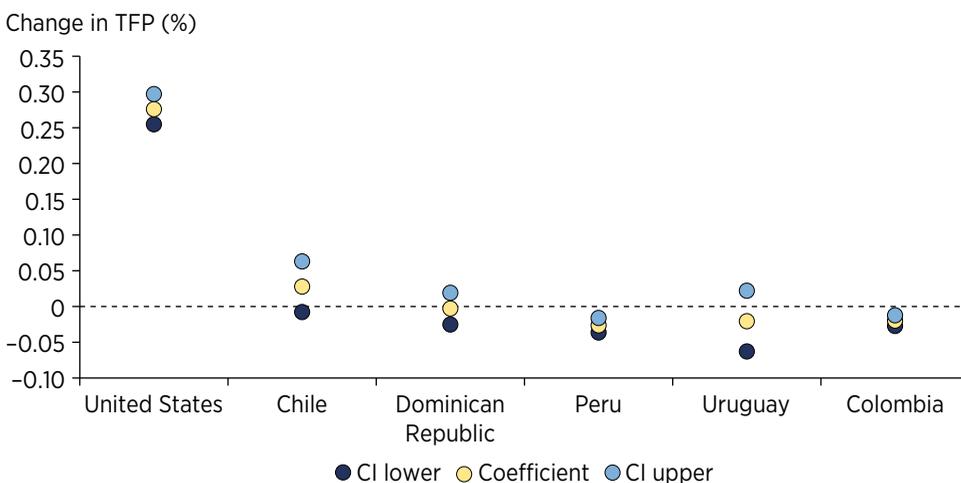
Figure O.1 Perceptions of market dominance, selected countries and country groups, 2019



Source: Schwab 2019.

Note: The market dominance index reflects the responses to the survey question “In your country, how do you characterize corporate activity?” 1 = dominated by a few business groups; 7 = spread among many firms. LAC = Latin America and the Caribbean; OECD = Organisation for Economic Co-operation and Development.

Figure O.2 Change in TFP of manufacturing firms with a 1 percent increase in number of employees, selected countries, various years



Source: Calculations using databases on manufacturing firms.

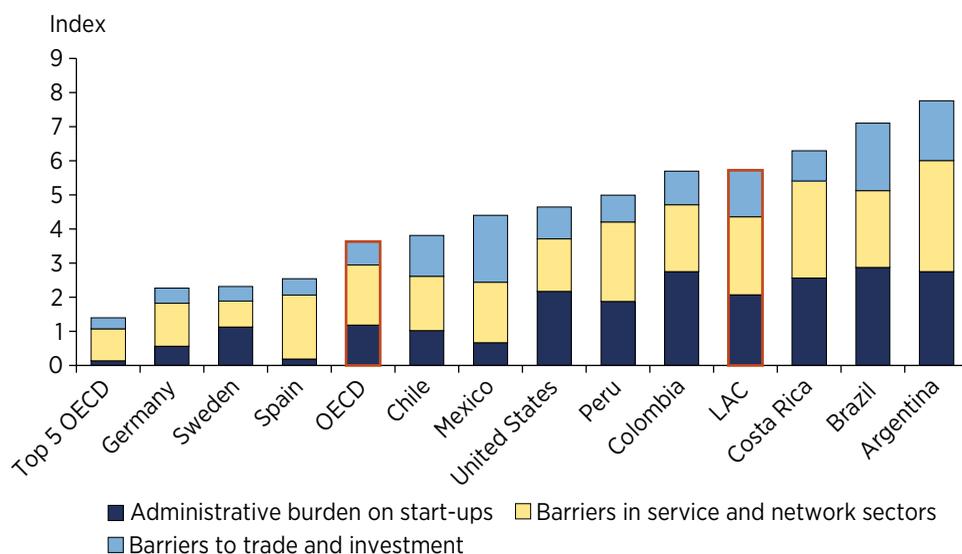
Note: Data for Peru and Colombia are from 2007–17; Chile, 2012–17; Uruguay, 2007–16; the Dominican Republic, 2015–19; and the United States, 1987–2019. Firm productivity is estimated by assuming a Cobb-Douglas production function and following the methodology of Akerberg, Caves, and Frazer (2015). The US numbers are based on aggregate information on manufacturing at the three-digit level from the US Bureau of Labor Statistics. In a robustness check, the regression coefficients for Chile and Peru remained near zero in a smaller sample including only large firms. CI lower = lower confidence interval band value; CI upper = upper value; TFP = total factor productivity.

Chapter 2. Removing Barriers to Entry and Expansion

Markets featuring low levels of competition are characterized by high entry barriers. There are different types of entry barriers, and they vary in their effects on markets. Natural or structural entry barriers result from industry structural characteristics, like economies of scale (when average production costs decline as the quantity produced increases) and network effects (when the number of consumers using a product or service affects the value of the product faced by other users). Meanwhile, incumbent firms intentionally erect strategic barriers to deter entry and protect market share. Often, government policies or regulations restrict entry by establishing exogenous barriers, such as tariffs and operating licenses. In Latin America and the Caribbean, regulations that limit entrepreneurship, trade, and investment and establish state control over certain business operations are almost twice as restrictive as those in the OECD top performers (figure O.3). This report presents evidence on the potential impacts of removing these barriers.

In Peru, following a competition authority intervention, the removal of local market entry barriers across 1,800 municipalities led to an 11 percent rise in firm-level productivity (figure O.4). A reform in 2013 granted legal authority to the Peruvian national competition authority, the National Institute for the Defense of Competition and the Protection of Intellectual Property (Indecopi), to investigate local and regional market access rules and publicly label as illegal or irrational those that did not align with the national framework or did not make economic sense. If a municipality persisted in imposing an offending rule, firms could use a reporting mechanism, which prompted swift sanction by Indecopi. Alongside a 400 percent increase in fines, this approach effectively removed local regulatory entry barriers. The impact of the reform was felt across 13 major sectors, a quarter of the country’s municipalities, and 16 percent of the formal firms. Firms in areas where entry barriers were removed saw a boost in productivity growth, compared to similar firms in nonreform areas.

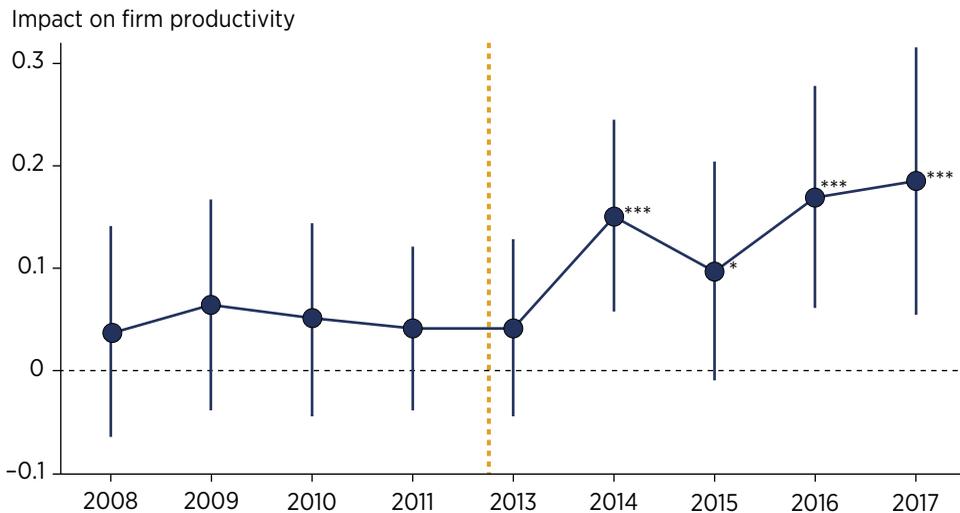
Figure O.3 Barriers to domestic and foreign entry, selected countries and country groups, 2018



Sources: OECD–World Bank Group Product Market Regulation database, 2018–20 (dashboard), Data Catalogue, World Bank, Washington, DC, <https://prosperitydata360.worldbank.org/en/dataset/OECDWBG+PMR>; PMR Indicators (Indicators of Product Market Regulation) (dashboard), OECD, Paris, <https://www.oecd.org/en/topics/sub-issues/product-market-regulation.html>.

Note: On the index, 0 = best practice. The countries included in LAC are Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, and Peru. LAC = Latin America and the Caribbean; OECD = Organisation for Economic Co-operation and Development.

Figure O.4 Change in productivity attributed to the reform, regression coefficient, Peru, 2008-17



Source: Schiffbauer, Sampi, and Coronado 2022.

Note: The figure reflects the estimated impact of the reform each year relative to 2012, showing that firms operating in municipalities and sectors that eliminated entry barriers experienced a large rise in productivity relative to comparable firms in the same sector but not located in reform municipalities. The underlying estimation controls for firm, province-year, and sector-year fixed effects. The blue vertical lines show the 95 percent confidence intervals.

Significance level: * = 10 percent, *** = 1 percent.

Another example from Peru is that ex ante regulations aimed at raising quality standards for the provision of information and communication technology services increased firm-level revenue productivity by about 20 percent. This example demonstrates the potential of regulatory frameworks to complement competition policy as a driving force behind innovation and productivity. The improvement was driven mainly by firms in the telecommunications industry and those in the top 5 percent of the productivity distribution. Regulations that weaken quality requirements or make entry easier reduce average product quality at the bottom of the productivity distribution. They do so because lower quality standards reduce the entry barriers facing low-productivity firms that may produce lower-quality products and services.

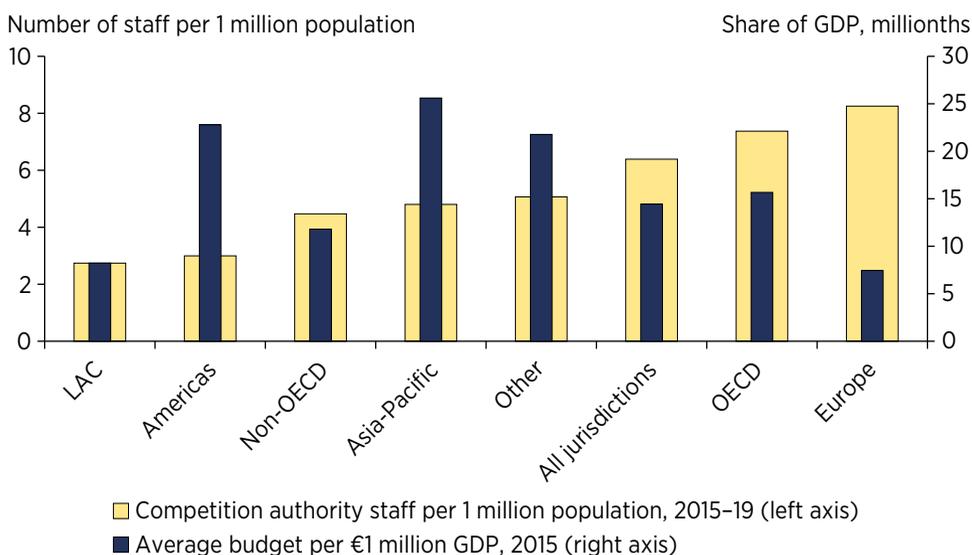
Chapter 3. Antitrust Enforcement

Competition agencies in the region are still weak on average. In recent years, the competition authorities in some countries have become more autonomous, operating as specialized bodies with strengthened sanctioning capacity. However, these agencies have remained small and underresourced for the

massive tasks they must carry out (figure O.5). International best practice has not yet been fully adopted. Agencies have struggled to enforce competition laws. Mexico has a competition law that dates back to 1917, but the authorities operated with inadequate funding until 1992, when an independent body was established to investigate anticompetitive behavior. Overall, competition law reforms have lagged behind other reform programs.

Competition agencies are understaffed and underfunded relative to peers in other regions. The average competition budget in Latin America and the Caribbean is lower than in the OECD and significantly affected by a few larger jurisdictions with particularly high competition budgets (OECD 2022). Although the ideal staffing and budget sizes are justifiably tied to the size of the local industry, budget and staffing data offer insights into agency capacity and positioning within government policy priorities.

Figure O.5 LAC competition authority staff and budget, selected regions and country groups, various years



Source: Araujo and Meester 2023 based on OECD 2020.

Note: Regions are named following the original data source. GDP = gross domestic product; LAC = Latin America and the Caribbean; OECD = Organisation for Economic Co-operation and Development.

According to several measures, competition agencies in the region underperform compared to peers, despite progress over the past three decades. For example, Latin America and the Caribbean significantly underperforms relative to almost any other group of countries as measured by the average number of cartel investigations launched by the competition authority on its own initiative (ex officio investigations) each year. Although this lower number might indicate a smaller industrial sector, it suggests that many cartels continue to operate

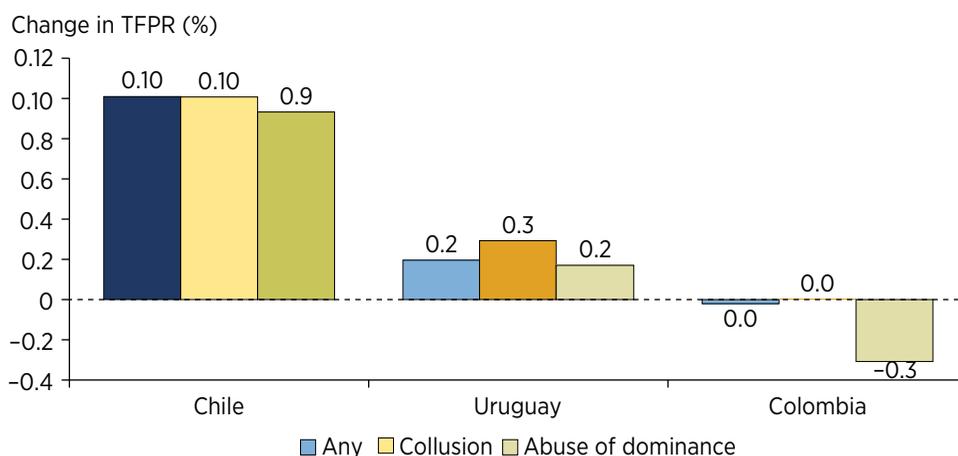
undetected. The region also makes less use of leniency programs and performs fewer unannounced inspections to investigate competition law infringements, compared to countries in Asia, Europe, and the OECD. Likewise, dawn raids are less common. The average value of fines imposed on cartels by competition authorities in countries across the region is low relative to the sanctions in OECD jurisdictions. However, the elevated sanctions imposed in some recent cases hint at progress among regional competition agencies.

Sound competition policy could lead to improved market outcomes in the region. Evidence of the impact on productivity of stronger competition laws and authorities has been limited. This report contributes fresh evidence on the impact of competition laws and agencies in enhancing market conduct and performance in Latin America. Country case studies reveal the largely positive impacts of these competition authorities even though these authorities are being underfunded and understaffed.

In Mexico, antitrust penalties in 2020 increased sector-level sales by 1.3 percentage points annually (Reed et al. 2022). The impact of the antitrust penalties imposed by the Mexican competition authority, the Federal Economic Competition Commission, from 1993 to 2018 was evaluated using 90 cases from a total of 261 investigations into suspected anticompetitive practices, for which a suitable control group was identified (Reed et al. 2022). About 40 percent of Mexico's economic activity was investigated for anticompetitive practices during this period. Monetary sanctions in antitrust cases translated into an increase of 5.8 percent in sales in the affected sectors. The identification and penalization of anticompetitive practices were effective in reversing declining sales in sectors that had previously been monopolized. Contrary to expectations, wage rates increased by 1.4 percent per year after the sanctions were imposed, alongside increased employment and a larger wage bill, challenging the idea that antitrust enforcement harms labor markets.

Enforcing antitrust rules is crucial for promoting competition, safeguarding consumers, and boosting productivity growth. Novel data highlight the effect of competition policy enforcement on relevant markets in Chile, Colombia, and Uruguay (figure O.6). Given the absence of systematic information to study competition policy enforcement in the region, the analysis builds on an effort to construct databases for these three countries, comprising a universe of 89 cases of collusion and abuse of a dominant position in Colombia in 1999–2020, 114 cases in Chile in 2009–19, and 87 cases in Uruguay in 2009–15. The agencies in these countries are well trained to identify cases appropriate for intervention. Preliminary econometric results suggest that affected industries experience increases in productivity following antitrust enforcement actions addressing collusive practices and cases of abuse of market power, such as predatory pricing and refusals to deal.¹

Figure O.6 Effect of antitrust enforcement on TFPR, by type of abuse, selected countries, 2007-17



Source: Sampi, Urrutia Arrieta, and Vostroknutova 2024.

Note: Darker colors indicate significant coefficients. TFPR is estimated using the methodological approach of Sampi, Jooste, and Vostroknutova (2021). TFPR = revenue-based total factor productivity.

Chapter 4. International Competition, Complementarity, and Capabilities

The economic literature provides empirical evidence on the effects of increased import competition on productivity and innovation. There is a consensus on the positive impact on productivity of the greater competition fostered by trade liberalization. Foreign entry into a domestic market equates to increased competition that reallocates resources in favor of more efficient producers and incentivizes firms to innovate to escape competition. The wider availability or reduced cost of intermediate foreign inputs may also help to improve market outcomes.

Competitive shocks associated with imports have been shown to generate diverse impacts across firms. For instance, firms in the United States that are exposed to competition from countries with relatively lower wages, such as China, are less likely to survive or grow. Capital-intensive and high-skill-demanding plants are less affected. Similarly, a trade shock may lead to reallocation decisions at the product level. Although the evidence on this result is scarcer, it reveals that firms are likely to drop products that generate lower sales to increase the weight of their core products in output.

Studies on the impact of imports on producers in Latin America and the Caribbean have focused chiefly on sector-level outcomes. Across the region,

the competitive force trade with China has favored producers and exporters of raw materials while competing with industries specializing in commodity chains, electronics, automobiles, and auto parts. For instance, the influx of Chinese goods into the United States has crowded out Mexican exports to that country. It has also led to greater innovation in Mexico, such as quality certification training and worker participation and training programs. Similarly, industry exposure to trade liberalization in Argentina stemming from the Southern Common Market (MERCOSUR) agreement has incentivized firms' investments in innovation. In Chile, imports from China and India have stimulated firm-level quality upgrading.

The forces at play in the relationship between the greater competition arising from trade and the incentive to innovate as the vehicle for long-lasting productivity enhancements are more nuanced. The relationship between increased import competition and innovation is mediated by a firm's proximity to the technology frontier. Findings in countries across the region indicate that firms' responses depend on their productivity level. Highly productive firms upgrade product quality to set themselves apart from foreign producers of competing goods, whereas less productive firms that cannot raise the quality of their products react by reducing prices, or they may shrink and exit altogether.

In Mexico, rising exposure to products of Chinese origin in 1995–2004 led to an expansion among larger firms (by sales) and the contraction or exit of smaller firms. Greater import competition elevated the likelihood that firms would restructure their output portfolios to focus on core competencies by prioritizing products with larger output shares and halting the production of marginal goods with lower relative weights in their portfolios. Larger firms and core products were shielded from the increased competition. These outcomes are considered to have led to higher aggregate productivity despite an overall contraction in sales as the exit of less productive businesses outweighed the expansion of more productive ones.

In Chile, increased Chinese imports in 2000–07 contributed to a reduction in average markups and an improvement in average product quality, as well as a decline in overall spending on innovation and the likelihood of engaging in process and product innovation. Frontier firms, defined as the top 10 percent of firms in the productivity distribution, sought to escape the new competition through investments in innovation that allowed them to become more competitive and productive. However, the bottom 90 percent of businesses, which were farther from the technological frontier, exhibited a decline in innovation. On average, the effect on aggregate productivity was null.

In Peru, the effect of tariff reductions under the US preferential trade agreement (PTA) varied across domestic producers, depending on whether the

reductions applied to final products or production inputs. Tariff reductions on final products under the China and European Union PTAs hurt productivity growth among non-exporters but helped to boost productivity growth among exporters. In contrast, in the United States, the tariff reductions hurt all domestic exporters and non-exporters. However, tariff reductions on production inputs acted in the opposite direction under the US PTA, boosting productivity growth among all domestic producers and contributing to higher average productivity growth. Tariff reductions on production inputs under the European Union PTA also contributed to higher productivity growth among businesses that do not export. This evidence points to the heterogeneous effects of import competition across firms. Only firms at the top of the productivity distribution—those that were exporters—were able to reap the benefits of lower trade barriers that affected both input and final output markets.

The remaining critical question is how to spark the engines of innovation and productivity at the firm level. Increased import competition fails to boost economic growth if the productivity distribution is skewed to the right because only a few firms are sufficiently close to the global technological frontier to survive and benefit. The challenge in creating the conditions for innovation and productivity improvement at the firm level lies in developing complementary policies and better innovation systems. This challenge is closely connected to the challenge of establishing and supporting sound institutions to defend competition in local markets.

Chapter 5. Getting It Right: Making Competition Work

The interface between competition policy and the broader regulatory framework is critical. Ill-conceived product market regulations, for example, may reduce contestability and dampen competition by creating barriers to entry, facilitating collusion, and tilting the playing field. To succeed, competition policy reform may require prior or accompanying regulatory reform.

Competition and innovation are generally mutually complementary, but there are also trade-offs that must be considered. The distribution of firms according to productivity or distance from the technological frontier matters for the success of competition-innovation reform. The desire to escape competition will be triggered only among firms that have the capacity to innovate, and innovation policy can lead to productivity growth only if there is also a competition policy. Development policy design thus becomes more complex if the complementarities and trade-offs are considered.

Capabilities matter for both private sector firms and public sector competition authorities. Strong organizational and managerial capabilities are necessary among firms if pro-competition policies, such as import liberalization, are also to be pro-innovation. Government enforcement capacity will determine the scope and prioritization of competition and innovation policies in each country.

Institutional independence and political support are vital for the success of pro-competition reform. Reform is more likely to succeed if there is a robust political consensus in favor of it and the competition authorities are beholden to no one in the political or business world. The popularity of anticartel enforcement among populations can provide momentum for competition policy reform.

Note

1. The estimated effects on productivity depend on the methodological approach to productivity estimation. Refer to Sampi, Urrutia Arrieta, and Vostroknutova (2024).

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Competition is a core element of economic growth, but empirical evidence on how competition affects productivity is often limited. *Competition and Productivity Growth in Latin America and the Caribbean* presents new empirical research that shows how competition policy in the region has effectively boosted productivity growth and improved market outcomes.

"A must-read if you are interested in understanding the relationship between competition law, competition enforcement, growth, and productivity in Latin America. A report rich with data, analysis, and recommendations that will guide policy makers in the region."

—Antonio Capobianco
Deputy Head of Competition Division,
Organisation for Economic Co-operation and Development (OECD)

"This is a very important work both for economists and competition law scholars, the latter of whom have long taken for granted that antitrust enforcement and increased competition contribute to economic growth. While journal articles have explored this relationship, this is one of the first books to examine the issue deeply and systematically. I only wish that this volume had been published earlier, as it would have certainly benefited my own work on the subject tremendously!"

—Thomas Cheng
Professor and Associate Dean, Faculty of Law, University of Hong Kong,
and author of *Competition Law in Developing Countries*

"It is critical to understand how competition and competition policy affect productivity growth, the key to economic development. This book makes big strides forward in understanding these connections. It takes advantage of novel antitrust enforcement and other legal data to build evidence-based insights into how competition policies can best encourage productivity growth. There is much to be learned inside."

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