

Case study commissioned by the Department for International Development, UK

A Contribution to WDR 2005 on Investment Climate, Growth and Poverty

## **Investment Climate Reform**

### **Competition Policy and Economic Development: Some Country Experiences**

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#### **Key Messages**

1. There is broad agreement that competition policy is important for economic development.
2. Very few countries indeed have attempted to quantify the impact of competition policy and more empirical analysis is needed.

The views and opinions expressed in this study are those of the author and do not necessarily correspond to the views or policies of the Department for International Development (DFID), UK.

## Introduction

1. In recent years, most countries have sought seriously to improve their investment climates, including their business regulatory laws and administration. Competition policy regimes are part of the overall business environment, for domestic and foreign investors alike.

2. Since 1990 the number of countries with a competition law has grown rapidly. About 100<sup>1</sup> countries now have a competition law, and many others are at various stages of planning to introduce one. In addition, work is underway in some regions on plans for regional competition regimes, such as COMESA and CARICOM. This high level of interest suggests competition law is widely seen as a desirable and worthwhile economic policy.

3. There have been many international meetings on competition law and policy in recent years. At official levels, they include meetings of the WTO Working Group on the Interaction between Trade and Competition Policy (WTO Working Group), UNCTAD, OECD, and the ICN. Many meetings dealt with specialised topics, particularly the possible creation of a multilateral competition framework administered by the WTO. However, it would be natural to expect at least some presentations at these meetings to refer to studies that attempted to quantify the contribution of competition law and policy to national economic development. This paper reviews what participants at international meetings on competition law have claimed about the contribution of competition law to their country's economic development.

4. A favourable view of the contribution of competition law and policy is widely held. A paper by the OECD Secretariat<sup>2</sup> strongly reflects this view. The paper, which was based on a survey of OECD members, and the non-members invited to the OECD Global Forum on Competition in February 2002, asserted 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”.

### **What might be expected?**

5. What a country might expect to gain from competition law could vary according to its reasons for introducing the law. Competition law has two broad objectives, efficiency and fairness<sup>3</sup>. Their relative importance varies considerably between competition regimes, although there is a strong tendency to give principal weight to the former. Because some concepts of fairness might be culture-specific, attention in this paper will be directed principally at efficiency, which, at least in principle, is objectively quantifiable.

6. The conclusions drawn from models of perfect competition and monopoly about the favourable effects of competition on allocative and productive efficiency are not in dispute. However, when the analysis moves away from theoretical models, or from the static examination of an economy, to real-life situations that include dynamic factors such as innovation and firm behaviour, the range of views broadens.

### **What has been said?**

7. A synthesis paper of the WTO Working Group of September 1998<sup>4</sup>, reflecting the discussions in the first two years of the Group's existence, concluded that:

“In sum, 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 and to maximise the benefits of such 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.”

8. In a paper to the OECD Global Forum on Competition in 2002<sup>5</sup>, William Kovacic noted, “there seems to be a universal consensus that... (transition economies) should take affirmative measures to increase business rivalry as a tool for promoting growth”. He observed further that “many participants in the debate about economic law reform take a sanguine view about the contributions of competition policy...to economic growth”. In Kovacic’s view, commentators who favour competition policy as a central element of law reforms in transition economies offer the following justifications:

- (i) It can act as a catalyst for market reforms.
- (ii) It can preserve the benefits of privatisation.
- (iii) It can redress private trade restraints, and,
- (iv) It can deter corruption.

9. At the same OECD Forum, Mark Dutz and Maria Vagliasindi noted that by 1996, 22 of the 26 transition economies of central and Eastern Europe and the former Soviet Union had adopted competition laws<sup>6</sup>. While this appears a strong endorsement of the likely value of competition law to economic development, the paper’s authors noted that there had been “no empirical attempt to test whether effectiveness of implementation has any significant economy-wide impact in terms of intensity of competition”.

10. The papers of the OECD and WTO Secretariats referred to above gave strong endorsements on the value of competition law to development. Those conclusions are consistent with the views expressed by many participants in international meetings on the positive contribution of competition law and policy, either in general or to their own country. However, an examination of the record of many of these meetings shows that most references were brief, and that few participants attempted to quantify the impact of competition law on their own economies.

11. As examples of representative statements, interventions at a WTO Working Group meeting in September 2001 included the following:

- (i) India “recognised the need for countries to have effective national competition laws” (although it strongly questioned the need for a multilateral framework).
- (ii) Kenya said that its experience in enforcing competition law was that “it was useful and important for developing economies”.
- (iii) Zimbabwe referred to the membership of COMESA and said, “the importance of competition policy for economic development was increasingly recognised in the [COMESA] region”.
- (iv) Egypt said that “national competition laws were needed by developing countries to promote their development objectives”.

12. At a WTO Regional Workshop in 2001<sup>7</sup>, the heads of the competition authorities of Zambia, Gabon and South Africa gave positive accounts of the benefits they believed had resulted from the operation of their national competition regimes, but did not quantify these.

13. The Kenyan representative at the UNCTAD Intergovernmental Group of Experts on Competition Law in July 2003 said his country was convinced that “it is desirable for developing countries to have domestic competition law”. At the same meeting, the representative of Zimbabwe said that, in Africa, “it is now generally accepted that competition is the best process for encouraging and promoting production and operational efficiency and ensuring that the benefits are equitably allocated in the society”.

### **Detailed Analysis – The Few**

14. Only a handful of 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 summarised below.

## Australia

15. While there had been earlier legislation, Australia's current competition law is the Trade Practices Act 1974. Until 1995 this law did not apply to all sectors of the economy. From the mid 1970s, the Australian Government undertook some major initiatives to enhance national productivity through liberalisation of the economy. By the early 1990s, it had become apparent that these microeconomic reforms were less effective than they could have been because of significant exceptions to the application of the Trade Practices Act.

16. In October 1992 an independent inquiry was established into Australia's competition policy<sup>8</sup>. 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. The Federal and State Governments reviewed the NCP in 2000, and affirmed its importance "in sustaining the competitiveness and flexibility of the Australian economy and contributing to higher standards of living".

17. Australia's assessment of the contribution made by its competition law and policy has been given in communications to the WTO Working Group. A February 2002 paper stated that "The reforms implemented have contributed significantly to Australia's strong economic performance in recent years". The benefits were seen to include:

- (i) Productivity improvements, lower costs and prices and 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.”<sup>9</sup>

18. The paper quoted a study by the Australian Productivity Commission which 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 percent above what would otherwise occur in the absence of reform. This is equivalent to almost one year’s average annual growth in the Australian economy”.<sup>10</sup>

19. These strongly positive views were affirmed in an Australian paper to a 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 there is “solid evidence of the catalytic role that competition policy could play in enhancing economic growth and development”.<sup>11</sup>

20. A recent paper by Dean Parham of the Australian Productivity Commission<sup>12</sup> sought to identify the key sources of the surge in Australia’s productivity during the 1990s. He found “The Australian evidence supports the OECD conclusion that policy and institutional factors have been instrumental”. He 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 an enabled catch-up and innovation”.

### **Japan**

21. 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 claim 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 statements to the WTO Working Group (and researchers such as Simon Evenett have reached similar conclusions).

22. A paper from Japan to the WTO Working Group<sup>13</sup> asserted that Japan's economic competition policy and industrial policy had contributed equally to the development of its economy. Japan's experience had been 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 its experience showed that "competition policy primarily contributes to economic growth and development". In another paper to the WTO<sup>14</sup>, 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... Introduction of competition policy early 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."<sup>15</sup>

### **Korea**

23. A paper from Korea to the WTO Working Group<sup>16</sup> in 2003 noted that the monopolistic market structures that existed in Korea before the introduction of competition law "later acted as factors restraining our economy's qualitative development."

24. In a paper to the WTO Working Group in 2003<sup>17</sup>, the Director-General of the Korean Fair Trade Commission stated that the wide adoption of competition law was based on the belief that competition plays a positive and significant role in economic development. He believed that the enactment of Korea's competition law in 1981 had been "a remarkable turning point" for the economy. However, the market system had not been fully developed in the following years, and it was necessary for the Korean Government to undertake extensive restructuring measures to improve the working of markets after the 1997 financial crisis. In his view 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. A similar case has been presented by Korea to the OECD.<sup>18</sup>

### **Mexico**

25. A comprehensive Mexican paper to the OECD<sup>19</sup> noted “a growing consensus that under a wide variety of circumstances competition...has beneficial effects on social welfare and on various indicators of economic development... (and that) there seems to be a sound theoretical basis to assume the existence of such a positive influence”. The paper suggested that “if competition encourages economic development, then competition policy, to the extent that it promotes competition, must have effects upon economic development similar to those of competition itself.” However the paper noted the limited contribution of empirical research so far to confirming these views, and did not attempt to quantify the contribution of competition law in Mexico.

### **Peru**

26. One of the few reported cost-benefit studies of 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 totalled US\$120 million, against the operating costs of \$20 million<sup>20</sup>. Although it appears that part of the benefit was the result of trade liberalisation measures for which responsibility had been allocated to INDECOPI, the ratio is impressive.

### **Why hasn’t there been more empirical research?**

27. In a paper to the OECD Global Forum on Competition in February 2002, Mark Dutz noted the paucity of empirical studies showing a clear benefit from competition law. He suggested this reflected, inter alia, that many studies dealt only with particular industries, and that this failed to capture the economy-wide effects of changes in the intensity of competition. He noted also the problem of obtaining

sufficient data. Dutz's own 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 robust.

28. In a paper to the WTO Working Group<sup>21</sup>, a Korean representative said that, while the assumption of a favourable impact of competition on efficiency and social welfare is supported by economic theory and empirical research, it is "difficult ...to find straightforward data on the effect of competition policy on economic development". If the paucity of references to research on the effects of introducing competition law on economic development means that little such research has been undertaken, as seems probable, it might be asked why an important area of economic policy has been so little studied.

29. Factors that could have limited empirical research include the following:

- (i) For countries that have adopted competition law since 1990, the introduction was often accompanied by other significant policy changes, including privatisation, deregulation and trade liberalisation. Separating the effect of competition law from other policy changes introduces presents a formidable challenge.
- (ii) Many countries, and most developing countries, have a relatively short history of competition law. This, together with the time needed for a new competition authority to become fully effective (10 years is often quoted as representative), limits the number of countries for which adequate studies might be undertaken.
- (iii) The data available on matters such as the size of markets, and concentration levels in markets, will often be inadequate or absent.
- (iv) Selecting an adequate measure of the intensity of competition policy within a country presents substantial conceptual problems.

## Conclusions

30. There is broad and strong endorsement of the view that competition is beneficial for development and that competition law can enhance the working of competition in markets. However, few countries with a competition law appear to have the benefit of empirical research that attempts to quantify its impact on their economic development. Where detailed studies have been reported, the findings suggest that, as part of a range of sound public policies, competition law can contribute significantly to economic development.

31. A diminishing, but still significant, number of developing countries do not have a competition law.<sup>22</sup> The reasons for this vary. For some it might be that other activities take priority in the use of scarce financial and human resources. For others, it might be that policy makers remain to be convinced that introducing a competition regime would be worthwhile. If more research were undertaken on the national economic outcomes of adopting competition law, particularly on the experiences of developing countries, this would be a valuable aid to those policy makers who are at present on the sideline.

## Notes

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<sup>1</sup> Including individual EU members.

<sup>2</sup> "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, 4<sup>th</sup> Session, 3 - 5 July 2002.

<sup>3</sup> E. Graham and J Richardson (1997) "Global Competition Policy", Institute for International Economics: Washington, p. 8.

<sup>4</sup> WTO Paper WT/WGTCP/W/80 of 18 September 1998.

<sup>5</sup> Kovacic, W., "Institutional Foundations for Economic Legal Reform in transition Economies: the case of Competition Policy and Antitrust Enforcement" OECD Global Forum on Competition, 14 -15 February 2002.

<sup>6</sup> CCNM/GF/COMP/WD(2002)13 of 25 January 2002.

<sup>7</sup> "WTO Regional Workshop on Competition Policy, Economic Development and the Multilateral Trading System: Overview of the Issues and Options for the Future, Cape Town, South Africa, 22 – 24 February 2001. Note by WTO Secretariat.

<sup>8</sup> Chaired by Professor Fred Hilmer. The Inquiry's report is generally referred to as the Hilmer Report.

<sup>9</sup> WT/WGTCP/W/232

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<sup>10</sup> Australian Productivity Commission, 'Impact of Competition Policy Reform on Rural and Regional Australia, 1999.

<sup>11</sup> WT/WGTCP/M/22, 9 July 2003

<sup>12</sup> Parham, D. "Sources of Australia's Productivity Revival". Website of Australian Productivity Commission, <http://www.pc.gov.au/research/confproc/soapr/index.html>

<sup>13</sup> "Competition Policy and Exemption Systems" WT/WGTCP/W/177 5-6 July 2001.

<sup>14</sup> WT/WGTCP/W/176, July 2001.

<sup>15</sup> A similar conclusion was reached by Michael E Porter, see 'Competitive Advantage of Nations', 1990.

<sup>16</sup> WT/WGTCP/W/189

<sup>17</sup> Hur, J. S. "Evolution of Competition Policy and its Impact on Economic Development in Korea" 2003

<sup>18</sup> OECD paper CCNM/GF/COMP/TR(2003) 4, page 22.

<sup>19</sup> OECD document CCNM/GF/COMP/WD (2002) 19.

<sup>20</sup> Quoted in "Competition Policy, Economic Development and the Multilateral Trading System: Overview of the linkages and current proposals for an agreement in the WTO".

R. Anderson and F Jenny, 10 September 2002, p.7.

<sup>21</sup> Note 11 above

<sup>22</sup> For example, Bangladesh, Cambodia, Gambia, Lesotho, Liberia, Myanmar, Sudan and Uganda.