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Competition policy: a question of enforcement

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Competition policy is an area of economic policy that has a fairly direct influence on the conditions governing production and wealth distribution in an economy. It is therefore pleasing to note that, in efficiency terms, the competition regimes of the developed and the major newly industrialised countries score highly with the OECD. However, there is greater variance in terms of how countries enforce their competition law than in how they frame it.

Countries with shortcomings in their competition legislation and its enforcement could benefit from reforms since having better competition law boosts productivity growth. However, changes to competition policy will be difficult to carry through if the current political decision-makers were to lose out in the reallocation of economic resources as part of such reforms.

Violating competition regulations in the EU can become very expensive. In December 2013, for instance, numerous banks were fined a total of EUR 1.7 billion by the European Commission¹ for distorting competition by colluding to manipulate prices.

Non-competitive behaviour is punished because competition benefits consumers and is therefore seen as a key component of an efficient market economy that is thus worthy of protection and support.

Competition policy is designed to ensure competition between companies. Jean Tirole, who won the Nobel Prize for Economics in 2014, has made an in-depth study of how best to set out these

rules, including whether and how the state should intervene in market activity.

Political decision-makers can act in the interests of the common good and to serve good governance. At the same time, the fruits of competition yield economic rewards fairly immediately, thus influencing the future economic resources available to the political decision-makers. It is, therefore, unsurprising that countries should differ in their competition policy and its enforcement, especially since resources are also needed to implement competition law.

Political institutions determine economic rules

Political, social and economic interactions are largely controlled by institutions. The exact form that these institu-

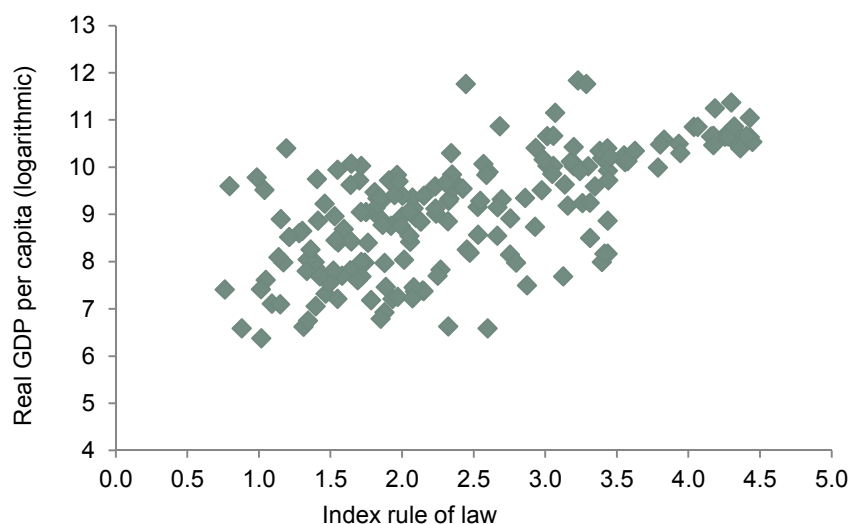
tions take varies markedly from country to country. The quality of the institutions certainly influences economic growth and the distribution of resources. For instance, better rule of law means more wealth in society as measured by per capita income (see Figure 1). The rule of law includes factors such as a functioning and independent legal system that guarantees ownership rights and equal opportunities. Institutions can be regarded as one of the fundamental drivers of long-term economic development.²

Competition policy as a governance issue

Formal economic institutions also have legal influence. Effective economic institutions, for instance, enable citizens and companies to be treated equally in the eyes of the law and guarantee enforceability of contracts.

A sound legal framework ensures, for example, that CEOs with profitable investment projects actually carry these through as they have legal certainty over the income from their investment. If these rules apply to new market entrants as much as they do to established businesses, then there are no barriers to ac-

Figure 1: Rule of law and wealth



Note: Real GDP per capita for 2013 measured logarithmically; "rule of law" (scale converted from -2.5–2.5 to 0–5) average for 2003–2013.

Source: World Wide Governance Indicators (World Bank), WDI; own calculations.

Box 1: Types of economic efficiency

In theoretical terms, there are three types of efficiency:

- (1) Allocative efficiency occurs when the marginal utility that consumers derive from goods equals the marginal costs of their production. Competition ensures that the price for the last unit produced is exactly this value and not any higher. This means that an economy's resources are being used in such a way as to generate the maximum benefit to society.
- (2) The concept of productive efficiency relates solely to a company's cost situation. Competition pushes inefficient companies out of the market, minimising the cost of production (both short-term variable costs and long-term fixed costs).
- (3) Also including a time dimension results in what is termed dynamic efficiency, whereby the welfare of society is not maximised at one particular point in time but over the course of time. Companies that dominate the market and exploit the position that this gives them have less of an incentive to invest in new production facilities or conduct research and development.

cessing or exiting the market. Even potential market entry of new competitors may be sufficient to prompt established companies to invest and innovate, which should ultimately benefit consumers.

Inadequate legal protection, however, is likely to make companies less willing to invest and reduce the number of new ones entering the market. Fewer (potential) market entrants benefits companies already active in the market as they have less (potential) fear of competition, even if they themselves suffer from lack of legal certainty. If established businesses receive additional political favours, in an extreme scenario the market would only be served by a single company. In other words, legal conditions influence competition intensity and thus ultimately the distribution of wealth between consumers and producers.

As well as the general legal framework, specific provisions of competition law and its enforcement also play a role. Competition policy encompasses all government measures designed to preserve free competition and prevent unfairness within and restrictions on competition.

Competition is necessary and must be regulated

Competition between companies is a cornerstone of a market economy. In theory, it improves efficiency of resource distribution and determines who reaps the economic rewards (see Box 1). In practice, however, market and competi-

tion do not always combine to produce the best possible result. Alongside market imperfections that competition policy cannot rectify, it can also be in the interests of the companies themselves to limit competition and gain market power in order to increase earnings. Restricting competition can also sometimes be necessary, particularly if companies are to be innovative in order to support technical advancements.

Yet government intervention on the markets can also create unfair competitive advantages if subsidies, tax incentives or other state privileges for individual companies ("crony capitalism") result in high market entry barriers.

Any debate on how much competition is appropriate and how it is to be enforced is therefore correspondingly complex. Although competition undoubtedly needs to be protected and promoted, the questions of how the institutional framework required for this is laid out and whose particular interests are taken into account depend on political institutions.

Institutions safeguarding competition can stimulate investment, innovation and economic development, although the impact of high competitive pressure is not as positive for some industry sectors or economies as for others. For instance, stronger competition has a greater effect on innovative strength and productivity in countries or industries that are closer to the cutting edge of technology.³ Experience also suggests a positive correlation

between the quality of competition policy and productivity growth in developed countries.⁴

Competition policy as an institutional framework, regulation as a decidedly governmental form of market intervention

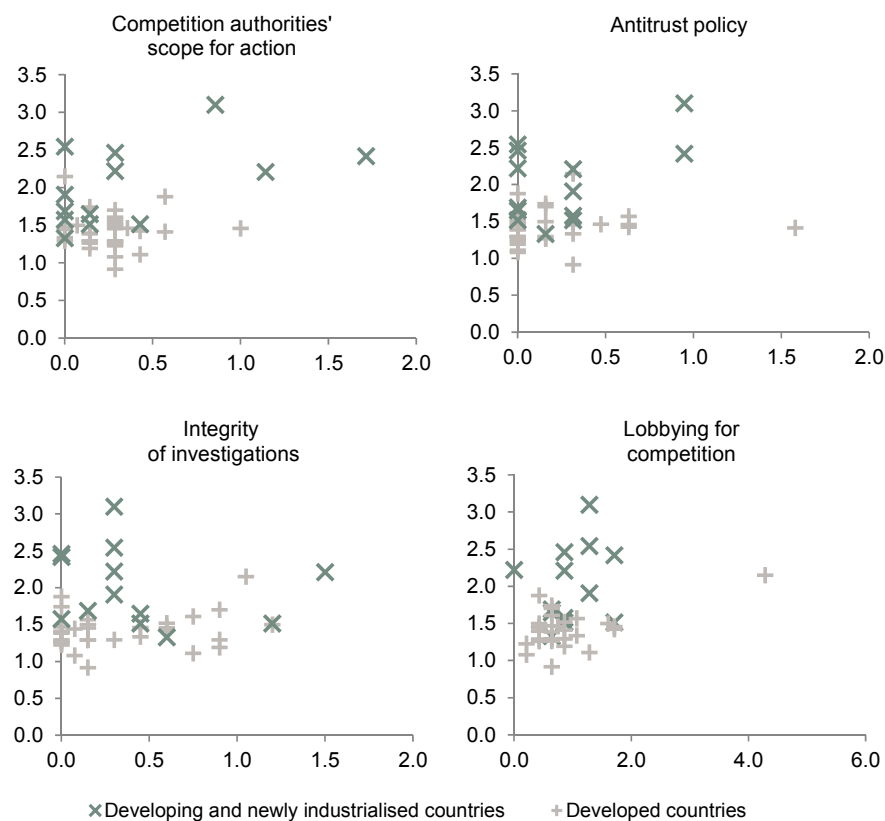
Regulation in the sense of government intervention in the economic process of some industries goes above and beyond establishing a relevant framework through competition policy. Regulation of this kind takes place particularly when there are natural monopolies, i.e. in telecommunications or energy supply, but also in service sectors such as finance. One requirement of regulation is that, as a bare minimum, it should not impede competition (OECD 2013).

The OECD analyses the effectiveness of a competition regime based on four factors:⁵

- legal scope available to competition authorities to investigate and penalise monopolies and cartels,
- antitrust policy, which includes strategies for evaluating cartels, horizontal and vertical collusion etc., as well as the corresponding effective measures,
- integrity of investigations, reflecting the independence and responsibility of competition authorities, and
- use of measures other than competition policy, such as regulation to defend and promote competition (lobbying for competition).

Developed countries tend to score more highly than developing and newly industrialised countries, both for the effectiveness of their competition regime and the regulation of their product markets. Overall, however, a more effective competition regime is generally associated with lighter regulation on product markets (see Figure 2). The sole exception to this rule is the integrity of investigations, reflecting the independence and responsibility of competition authorities, for which there is no discernible link to product market regulation.

Figure 2: Effectiveness of competition regime and product market regulation



Notes: Developed, developing and newly industrialised countries classified as per the IMF. y-axis: product market regulation index; x-axis: competition regime, OECD indices. The indices range from 0 (most effective competition regime/least restrictive product market regulation) to 6 (least effective competition regime/most restrictive product market regulation).

Source: OECD.

The relationship between competition policy and economic development also depends on

- how long current competition legislation has been in force and how much time it has had to influence competition. Institutional framework conditions change only slowly and often only take effect in the (very) long term.
- how effective a country's competition policy already is. The higher the degree of effectiveness, the harder it is likely to be to improve it any further and the smaller the effect on the level of development should be.

If an optimum level for formulating and enforcing competition law existed, then it would be impossible to generate any additional welfare gains once this has been reached. This could also explain why a better competition regime supports long-term economic development but does not have a simple positive correlation in the group of countries being studied.

The example of Mexico: a lack of competition and strategies for reform

The OECD scores Mexico's antitrust policy and the integrity of its investigations relatively highly and even awards top marks to the scope for action afforded to its competition authorities. Although this may initially appear to run counter to the perception of Mexico's economy being plagued by restrictions on competition, it is not the case.

This is because its national competition authority has to rely on other authorities further down the hierarchy. The lack of support for the idea of competition seen across society (to date) is reflected in a relatively poor score for how competition issues are taken into account in other policy areas.

Restricted competition on product markets also translates into quality of product market regulation that is in the bottom third of the OECD countries. Obstacles to competition include implicit and explicit entry barriers for foreign investors in network sectors, leading to some sectors being dominated by companies with market power siphoning off high profits.⁷

Competition law also needs to be enforced

The differences between countries lie more in how they enforce competition law (integrity of investigations, lobbying for competition) than in the competition law itself (competition authorities' scope for action, antitrust policy). In general terms, however, competition legislation that is designed effectively will also be enforced.

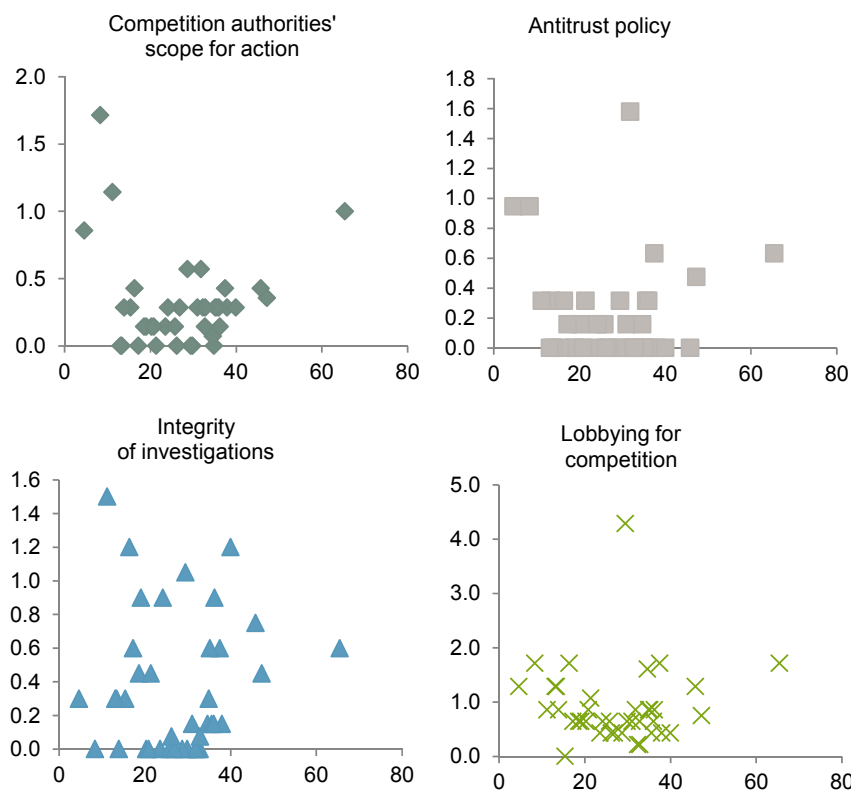
To enforce competition law, the relevant authorities need credible penalty mechanisms that they can impose without any interference from political or business figures. To insulate competition authorities against political influence and guarantee consistent decision-making over time they can be granted independence similar to a central bank.⁶ However, this independence must be de facto as well as de jure.

Efficient competition law depends on development level

At first glance, there is no real correlation between the effectiveness of competition law and per capita income (see Figure 3). Even countries with a relatively low level of development score relatively highly. Only a better rating for competition authorities' scope for action – taken in isolation – is associated with a higher income per capita (calculated logarithmically).

Amongst developed countries, by contrast, the link between per capita income and the indices reflecting competition regime effectiveness is not apparent. It should be noted, however, that it is generally larger developing and newly industrialised nations such as Brazil and Mexico that are studied. These countries already have a fairly effective competition law mechanism, meaning that the difference between them and the developed countries is fairly small.

Figure 3: Competition law and level of development



Notes: x-axis: real per capita income (in thousands, 2005 purchasing power parities); y-axis: competition regime index (0 = most effective competition regime; 6 = least effective competition regime).

Source: OECD.

regulation have been reformed over the past few years. Measures taken include:

- guaranteeing the competent competition authority more powers, a bigger budget and constitutional independence.
- increasing fines for breaking rules.
- bringing the overall legal framework into line with the principles of free competition.
- creating a new regulation and competition authority for the telecommunications sector with extensive intervention rights and setting up a specialist court.

The OECD estimates that the reforms to product market regulation alone – specifically in telecommunications, gas and electricity and oil – will increase Mexico’s gross domestic product by 0.8 percentage point within five years.¹⁰

Conclusions

Time and again, below-average growth or periods of crisis prompt calls for structural reforms in developed as well as developing and newly industrialised countries. These reforms can only be carried through with difficulty, however, as they generally change how wealth is distributed, even if they are desirable from an efficiency point of view.¹¹

Competition policy is also affected, as it has a fairly direct influence on an economy’s production and wealth distribution. It also determines the economic resources available to political decision-makers and how they will be changed by reform measures. Examples of reforms, such as we are currently seeing in the Mexican telecommunications sector, are therefore monitored closely. ■

The real nature of the problem can be seen in Mexico’s telecommunications sector. As late as 2012, it was still dominated by a single company with market share of 80 per cent for landlines and 70 per cent for mobile phones. Among all the OECD countries, Mexico is in last place in terms of market penetration for landlines and second-to-last place for mobiles, while the prices paid by end customers and the earnings generated by the telephone providers are well above the OECD average.⁸ The welfare loss in the telecommunications sector

caused by the uncompetitive environment amounted to an estimated USD 129 billion between 2005 and 2009.⁹

The regulatory framework benefited existing companies as they were able to oppose changes to the law in the courts, severely delaying their ultimate implementation. At the same time, the competent regulator lacked the independence and intervention rights necessary to increase competition.

Competition policy and product market

¹ http://europa.eu/rapid/press-release_IP-13-1208_en.htm.

² Acemoglu, D., Johnson, S. and J. Robinson (2004), Institutions as the fundamental cause for long-term growth, NBER Working Paper No. 10481.

³ Aghion, P. and P. Howitt (2006), Appropriate Growth Policy, Schumpeter Lecture. Journal of the European Economic Association.

⁴ Buccirosi, P., Ciari, L., Duso, T., Spagnolo, G. and C. Vitale (2013): Competition Policy and Productivity Growth: An Empirical Assessment, Vol. 95, No. 4, pp. 1324–1336.

⁵ Alemani, E. et al. (2013), New Indicators of Competition Law and Policy in 2013 for OECD and non-OECD Countries, OECD Economics Department Working Papers, No. 1104.

⁶ Most of the countries studied achieved the best possible score from the OECD for both independence and responsibility.

⁷ Chiquiar, D. and M. Ramos-Francia (2009): “Competitiveness and Growth in the Mexican Economy”, Banco de Mexico Working Paper, No. 2009-11.

⁸ OECD (2012), OECD Review of Telecommunication Policy and Regulation in Mexico, OECD Publishing.

⁹ World Bank (2013): "Toward a more competitive business environment", Mexico policy note; no. 2. Washington DC: World Bank.

¹⁰ OECD Economic Surveys Mexico, January 2015.

¹¹ Acemoglu, D., Johnson S. and J. Robinson (2004), Institutions as the fundamental cause for long-term growth, NBER Working Paper No. 10481.