HOW CAN COMPETITION CONTRIBUTE TO THE G-20 COMMITMENT TO RAISE GDP BY AT LEAST 2%?

The G-20 has committed to lift its GDP by more than 2 per cent above the trajectory implied by current policies over the coming 5 years. The underlying assessment of how this goal could be reached noted that "product market reforms contribute the most to the higher growth".[1]

Competition raises productivity growth, and may lead to higher investment and job creation. In a static sense, it brings prices and costs closer together thereby increasing output and raising consumer surplus. In a dynamic sense, competition creates incentives for firms to innovate and move towards the technological frontier, while encouraging resources to be reallocated towards more productive activities.

This note looks at how policy affects competition, what policy reforms can be expected to contribute to increasing GDP, and what the G-20 can contribute to the policy process.

- The restrictiveness of product market regulations and the effectiveness of competition policy can have powerful effects on competition.
- Moving towards more appropriate regulations and policy could lead to sizeable impacts on productivity and investment. Reforms of the average size of past OECD reforms would boost GDP by 1 to 1.5%.
- G-20 peer pressure could play an important role in overcoming resistance to reforms.
- There is an important gap in international co-operation in competition policy enforcement that the G20 could take a lead in closing.

Boosting productivity and growth through pro-competitive regulations and competition policy

The regulatory environment and effective competition policy, together with openness to external trade and investment, are key determinants of competition and productivity.

There are three main policy levers:

- ***Market regulations*** should promote rather than inhibit competition in markets where competition is deemed viable and efficient. This should recognise fully the need to ensure market integrity, including preventing fraud, protecting consumers, and ensuring health and safety. Possible market failures and other important policy objectives such as environmental and social considerations can affect how far competition is viable and efficient, but this should be objectively assessed.
- ***Competition law*** should be designed according to recognised best practices and consistently enforced through appropriate sanctions by a well-staffed and competent independent competition authority. These policies help to ensure that competition-friendly market regulations have the desired competitive effect.

[1] G20 Macroeconomic Reform Priorities Report prepared by IMF Staff with inputs from the OECD and the World Bank. The report notes that "world output gains stem largely from productivity increases, with substantial contributions from higher employment and capital accumulation. Product market reforms contribute the most to the higher growth, followed by labor participation reforms and infrastructure investment."

- ***Trade and international investment policies*** have a mutually reinforcing effect on domestic competition. Openness in trade and investment policies increases competition in domestic markets, while many of the frictions to trade and investment come from strict domestic regulations and differences in regulations and standards across countries.

Product market regulations

Competition that would contribute to growth and other objectives can be hindered by excessive regulations that create barriers to entry or restrict the ability to compete, and weak competition policy. These include:

- Undue ***barriers to market entry*** including limits on the number of firms permitted, the granting of exclusive rights to specific suppliers; the establishment of a lengthy and costly process to obtain licenses, permits or authorisation required for operation or other start-up procedures; limits on the ability of some types of firm to provide a good or a service; and start-up procedures beyond obtaining the permit.
- ***Limiting the ability of firms within a market*** to compete such as by regulating the ability to set prices, limiting the freedom to advertise and treating incumbents and new entrants differently. Providing subsidies can also distort competition within markets and reduce incentives to innovate.
- ***Reducing the incentives of suppliers*** to compete through self-regulatory or co-regulatory regimes; encouraging information on competing firms' outputs, prices, sales or costs to be published; exempting the activity of a particular industry or group of suppliers from the operation of general competition law.

Some countries maintain a much more restrictive regulatory stance than others, as reflected in the OECD's indicators of Product Market Regulation (PMR) updated in 2013. These cover a range of cross-cutting and sector-specific regulations that affect competition, and openness to trade and investment (Figure 1). The indicators also cover state intervention, including through state control and the governance of state-owned enterprises. Evidence (e.g. Bourlès *et al.*, 2010, and Bas and Causa, 2012) suggests that restrictive regulatory settings have an important impact on productivity, growth, innovation, investment and job creation.

There has been easing of the restrictiveness of regulations in advanced economies for network industries such as utilities, transportation and communications. This has brought significant benefits. However, barriers to competition remain high in many areas, notably the services sector. For example, Figure 1 suggests that there has been considerable convergence internationally towards a less restrictive stance of regulation in the telecommunications sector, but that professional services remain highly restricted in some countries. The difficulty to reform the services sector is likely to a reflect a number of factors. On the one hand, services are more likely to be non-tradeable than goods and important information asymmetries (for example, about quality) are likely to require stronger regulatory intervention. On the other hand, these factors can also provide cover to these industries to argue for regulatory obstacles that go beyond the public policy objective.

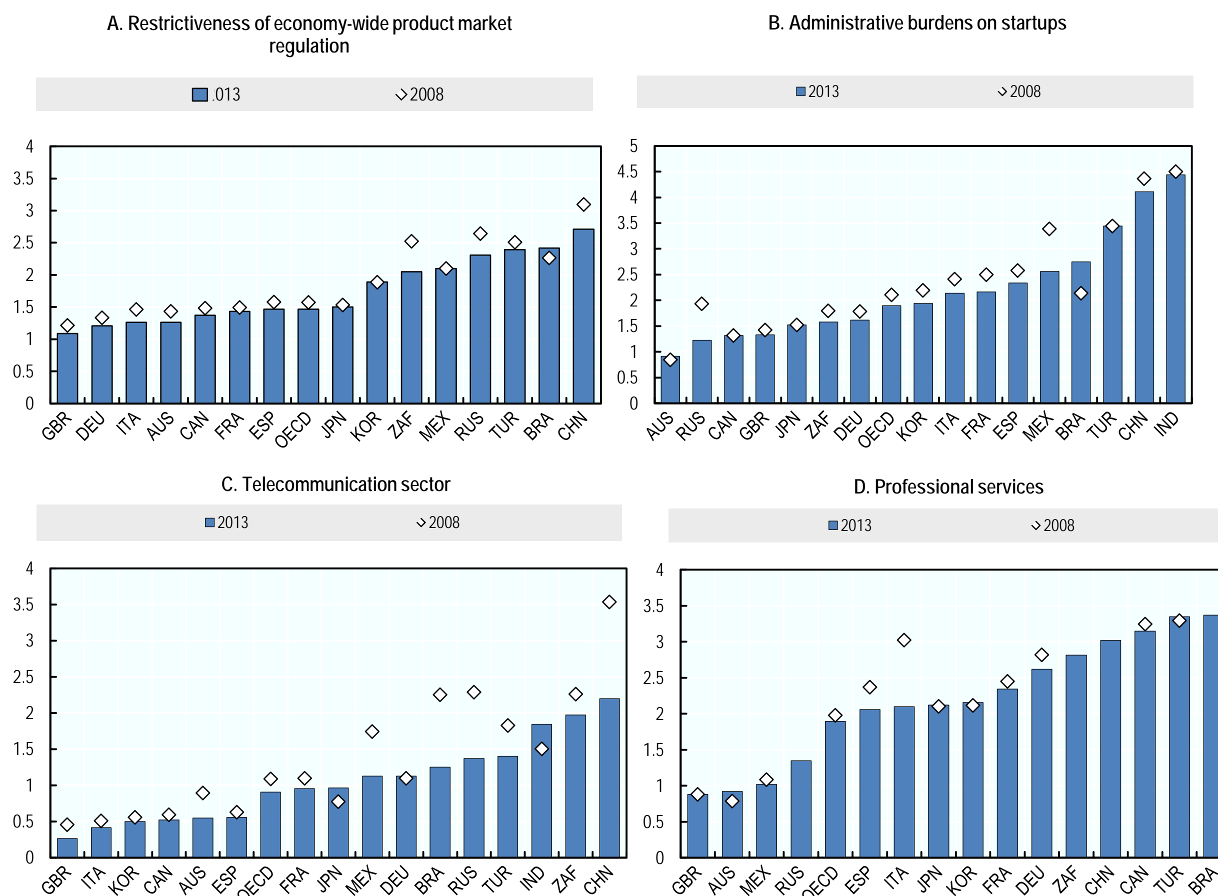
On 7 May 2014, the OECD will release a comprehensive database of regulatory measures covering the services, both in terms of explicit barriers to openness in trade and investment and implicit barriers and implicit barriers created by domestic regulations that impede market entry and competition. The new Services Trade Restrictiveness Indices (STRI) will cover all major services sectors for most G-20 economies, including telecommunications, a range of transport activities, distribution, banking, media and professional services.[2] The STRI will assist countries in identifying priority areas for domestic and trade services reforms likely to stimulate significant growth and employment opportunities.

The heterogeneity of regulations across countries can hold back market entry from foreign firms, as well as the degree of restrictiveness of the regulations themselves (Nordas and Kox, 2009).[3] Even as the overall

[2] Except Argentina and Saudi Arabia.
[3] The authors find that regulatory heterogeneity has a relatively large impact on trade through commercial presence. If all countries in the sample harmonized or recognized each other's regulation, total services trade through commercial presence could increase by between 13 and 30% depending on the country.

stance has converged towards a less restrictive framework, differences in standards across countries make it more costly for foreign firms to compete on domestic markets.

Figure 1. OECD Product Market Regulation index scores for G-20 countries[1]



1. Preliminary for China, India and Russia.

Source: OECD Product Market Regulation (PMR) database

Competition policy

Competition law and its enforcement can limit undesirable anti-competitive practices, creation of excessive market concentration, and work to undo restrictive product market regulations. It should ensure that small and medium-sized enterprises (SMEs) are protected from dominant practices by larger firms. There have been considerable efforts over past decades to strengthen competition policy, including most recently in major emerging economies.

The degree of implementation of these policies and the effectiveness of competition policy enforcement varies widely. Effective competition policy requires:

- ***Adequate scope of action*** – including a sufficient range of competences, investigative powers, sanctions and remedies. Furthermore, there should be realistic options for *private* enforcement by affected businesses and consumers.
- ***Clear guidance and consistent enforcement*** on horizontal agreements, vertical agreements, mergers and exclusionary conduct.
- ***Probity of investigation*** – authorities should be independent, accountable and follow fair procedures.

- ***Advocacy*** – the authority should be an advocate for competition, with a formal duty to promote deregulation and trade liberalisation, to reduce barriers to entry and obstacles to effective competition and to minimise unnecessary government intervention in market.

How can competition reforms contribute to raising growth and other SSBG objectives?

Quantification of the gains from competition reforms should take into account the detailed situation of each market and the knock-on benefits to downstream producers in other industries. While the gains of individual measures are often significant but not huge, a package targeting a wide range of practices and industries can have more significant impacts.

There is an extensive research literature pointing to the benefits of pro-competitive regulations and policy settings in boosting productivity, reducing prices and raising output.[4] Restrictive regulations have a negative impact on innovation, the adoption of state-of-the art management practices, and the reallocation of resources towards the most innovative and productive firms (Andrews and Criscuolo, 2013). Evidence also suggests that reforms can spur investment (Alesina *et al.*, 2003). Young firms generate more jobs than incumbent firms and tend to introduce more disruptive innovations. Structural reforms that help reallocate resources to young, knowledge-intensive firms – through well-functioning product, labour and capital markets as well as bankruptcy laws that do not overly penalise failure – are essential.

Estimates suggest that a 10% reduction in the level product market regulations, as measured by the OECD's PMR index, boost GDP by 1 to 1.5%.[5] This corresponds to the size of reforms made by countries that have undertaken significant reforms over the past decade. The increase in output would be largest in countries with the most restrictive regulations and with the greatest potential to accelerate catch up growth. Initial gains are likely to materialise over a horizon of 2-3 years.

Many of the market restrictions and uncompetitive practices have sector-specific impacts. Estimates of the output gains and effects of reforms should be quantified using detailed industry-level analysis. A review of the impact of easing regulatory restrictions on competition derived from more than 200 existing studies of specific industries indicate that adopting the least restrictive policy option in terms of competition considered in each substantially would lead to substantially lower prices in each industry - the average reduction in prices across the studies is estimated at around 20%.[6]

The services sector is likely to have high potential in terms of output gains from reform. This reflects in part the much slower pace of reform in this sector than in the goods sector over recent decades. Gaps in productivity are often especially high in services activities, while some parts of the services sector have high potential for growth and job creation that can be hindered by regulation. Furthermore, services play an important role in facilitating global trade through global value chains and services account for almost half of the embodied value-added in advanced economy exports.[7] Reforms in this area would therefore contribute to the realisation of competitive and productivity gains through trade.

The gains from reforms to product market regulations and competition depend on other structural factors and policy. In particular, labour market institutions that allow workers to move more easily to emerging sectors and ensure that workers have incentives and opportunities to upgrade their skills are likely to lead to benefit more from policies to raise competition. At the same time, a well-functioning financial system is required to support the development of new activities.

One concern is that reforms to increase competition may impact negatively on jobs on the short run, as employment is scaled back in incumbent businesses and before new activities get off the ground. However,

[4] See for a review OECD Fact Sheet on Competition and Growth.

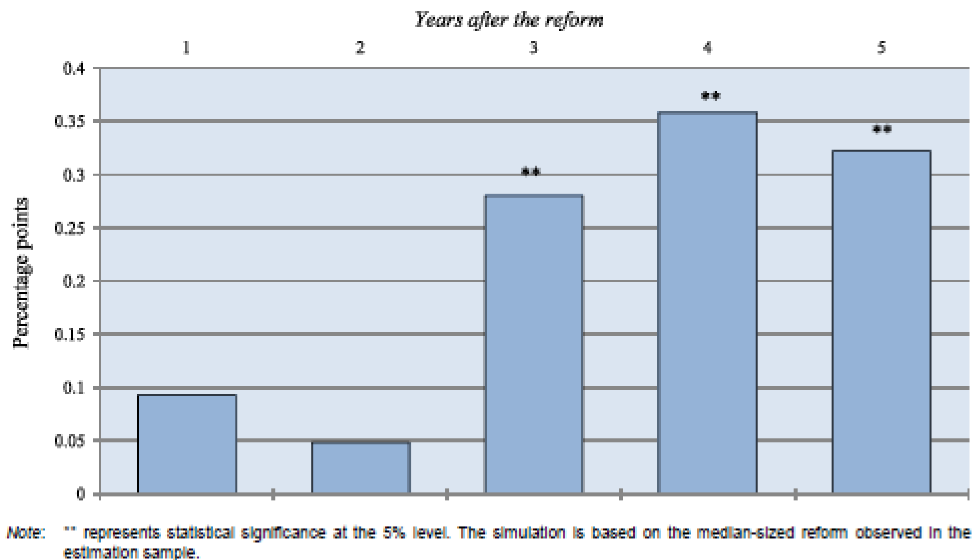
[5] See Bourlès, R. et al., 2010.

[6] OECD, Evaluation of Competitive Impacts of Government Interventioms, *OECD working document*. The restrictions are relative to the based on the OECD's Competition Checklist from the Competition Assessment Toolkit classification.

[7] This includes through services that support trade such as R&D and engineering, finance, transport, logistics, supply chain management, marketing, distribution, after-sales services, and recycling.

cross-country evidence suggests that - on average - there is no significant negative impact on employment in the near term but there are significant gains after about 3 years (Figure 2).

Figure 2. Change in aggregate labour force following an easing of product market regulation



Note: ** represents statistical significance at the 5% level. The simulation is based on the median-sized reform observed in the estimation sample.

Source: Bouis et al, 2012.

Reforms to regulations and competition policy should be developed side-by-side and take into account the full range of policy objectives, including consumer protection, the environment and social impacts.

Reforms in this area can contribute to other aspects of strong, sustainable and balanced growth above and beyond their impact on the level of activity:

- The G20 Macroeconomic Reform Priorities Report simulations show a narrowing of macroeconomic imbalances as a result of a scenario including product market reforms.
- Most reforms in this area have few if any direct budgetary costs, while sales of state-owned enterprises – if this increase the value of the asset – can strengthen the net worth of the government, as well as reduce gross debt.

How can G-20 contribute to the policy discussion?

Increasing efficient competition should benefit consumers through lower prices, greater choice and the development of new services. Lower barriers to entry and fewer restrictions would create opportunities for new businesses to be set up or to enter domestic markets. However, some incumbent businesses in protected markets may lose out from stronger competition and are likely to resist policies to increase competition.

International peer pressure can help to overcome this resistance, together with learning from experience and success stories from other economies. An effort across markets to remove restrictions simultaneously may create foreign opportunities for firms that offset domestic losses. The development of the EU Single Market and trade deals focussing on behind-the-border obstacles have led to gains through greater competition in domestic markets.

Many harmful restrictive practices thrive because they are relatively opaque to consumers and other businesses – it may appear "normal" that goods or services are only available at a high price from a restricted set of domestic competitors. Focussing policy attention on these issues can help build support for change.

Increasing competition policy should be a promising area for international co-operation because policies are relatively "win-win". There should be relatively few fiscal costs and the additional activity is likely to boost revenues.

All G-20 countries have the scope to make significant additional gains in output through reforms in this area and contribute through these policies to the overall G-20 objective. Table 1 shows that the OECD sees priorities to reform product markets across a wide range of countries.

Table 1 Summary of OECD recommendations to G-20 countries in the areas of competition and trade

	Austalia	Brazil	Canada	China	Germany	European Union	France	India	Indonesia	Italy	Japan	Korea	Mexico	Russian Fed.	South Africa	Spain	Turkey	United Kingdom	United States
Strengthen competition in network industries			✓		♦	✓				♦				♦	✓		✓		
Reform/simplify product market regulations						♦			✓									♦	♦
Reduce barriers to competition in the services sector		✓			✓	✓										✓			
Reduce barriers to foreign ownership/investment/trade	✓		✓			♦		✓			✓	✓	✓	✓					
Reduce regulatory barriers to competition							✓			✓		♦	✓		✓				
Reduce state control over economic activity or public ownership			♦	✓										✓					
Reform planning regulations																		✓	

Note: √ refers to *Going for Growth* priorities and ♦ refers to *OECD Economic Survey* recommendations.

Greater international co-operation would be most helpful in two areas:

- ***Enforcement of competition policy*** to avoid duplication, inconsistency and increase predictability, as discussed below.

- ***International regulatory cooperation,*** for example in product standards, to strengthen regulatory consistency and reduce costs of regulatory heterogeneity. Evidence suggests that the gains from greater co-ordination of rules and their application across jurisdictions is high but remains largely untapped (OECD, 2013c). For instance, regulatory co-operation that would decrease the (Canadian or American) domestic regulatory burden by 10% could yield an increase of 2.5% in exports of goods and services.

Building effective international co-operation in the enforcement of competition policy

It is increasingly important that governments provide their competition authorities with the most effective ways to co-operate with enforcers in other countries as business - and business practices - are increasingly global and as more national competition authorities (particularly in emerging economies) are becoming increasingly active in pursuing anti-competitive cases with a cross-border dimension.

While co-operation in the enforcement of competition law has improved significantly, the legal mechanisms for co-operation have hardly evolved. The harm from failure to co-ordinate can be substantial. For example, there can be inconsistent international treatment of the same merger; refusal of requests to co-operate that hinder enforcement of national laws; or the requirement on firms to make repeated provision of duplicative and potentially excessive amounts of information to multiple jurisdictions.

As with the G-20 work on international tax co-operation (information exchange, BEPS), there is a significant gap in the international policy discussion around these issues that the G-20 could helpfully take the lead in. Competent national authorities are often subject to purely domestic mandates and therefore cannot take into account the international spillovers of their actions.

Effective co-operation on the other hand can generate substantial benefits for competition authorities and businesses alike. Co-operation offers authorities the opportunity to have more effective investigations and to generate efficiencies, for example through the use of each other's analysis; and this in itself is beneficial for businesses as well, and in certain cases can reduce their regulatory costs.

Options for international cooperation include moving towards a global agreement on co-operation and mutual recognition between the competition laws of different countries. More ambitiously, the approach could include establishing common jurisdictional rules under the framework of a convention. Other options that could be developed are set out in Box 1.

Box 1. Options for improved international cooperation in the enforcement of competition policy

1. Improved bilateral co-operation, for example to allow exchanges of confidential information between enforcers;
2. Developing standards for legislative/regulatory frameworks that would enable sharing of information and include legislative protections for information received from counterpart regulators;
3. Developing common form waivers and suggestions to facilitate the use of such waivers;
4. Adopting multilateral instruments that address most pressing needs for co-operation. These could relate, for example, to sharing information, merger notification, or convergence of leniency policies for cartel investigations;
5. Developing international standards for formal comity, such as a legal instrument defining criteria for requesting an enforcement action in or assistance to another authority, and clarifying participating authorities' comity obligations;
6. Allowing authorities to choose to recognise the decisions of other competition authorities in the investigation of cross-border matters. There could even be an agreement for giving non-binding deference to one 'lead authority'; and
7. Reaching a multi-lateral agreement for exchange of information, comity and deference standards based on jurisdictions voluntarily opting in to the agreement.

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