Competition Policy and Economic Growth

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1. Introduction

Does competition policy promote economic growth in developing countries? Prior to addressing this issue, the question is what is competition policy? Broadly defined, competition policy encompasses any policy (including competition law) that promotes competition and facilitates efficient resource allocation. Therefore the major goal of competition policy is to promote and protect competitive processes in order to foster allocative, internal and dynamic efficiency. Hence, it could be said that "efficiency is the goal, competition is the process".

To address the question of whether competition policy promotes economic growth, this paper first presents some concerns of developing countries then discusses the impact of competition on efficiency and productivity and the importance of legal institutions for economic growth.

Section 2 address some of the concern developing countries have of the role of competition policy. Section 3 explores the relationship between competition policy and economic growth. Section 4 introduces a competition policy relevant to ASEAN. Section 5 provides empirical evidence and concludes.

2. Concerns of Developing Countries

Developing countries have raised some concerns about the role of competition policy and their economic development. These can be divided into the following categories:

*Competition policy, trade policy and regulatory reform*

Competition policy complements trade liberalisation and regulatory reform. While trade policy eliminates governmental barriers to international trade and deregulatory reform eliminates domestic regulation that restricts entry and exit, competition policy targets business conduct that limits market access and reduces actual and potential competition.

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1 Yamawaki, Sleuwaegen and Weiss (1989) found no significant changes in domestic concentration of 5 EU economies between 1963 and 1978 and concluded that the result provided evidence that as the internal Common Market became increasingly liberalised the oligopolistic interdependence between firms grew over time and this offset the effect of increased trade.
Trade and competition policies are often substitutes. However, not all goods are traded. Tariff reductions might be ineffective if substantial non-tariff barriers exist. Access to markets might be highly dependent upon access to distribution and retail networks. Vertical agreements between domestic producers and distributors might well limit the ability of importers to compete. As well, domestic firms might engage in strategic behaviour to erect new barriers.\(^2\) The extent to which exclusionary practices impede trade following trade liberalisation is an empirical issue, as is the question whether the benefits of intervention are worth the costs. Often, business complaints against exclusionary practices are complaints by less efficient firms.

Competition law may be necessary if deregulation policies do not bring about expected efficiencies due to collusion or exclusionary conduct by an incumbent with considerable market power. Again, intervention should only occur if it is possible, in a cost-effective way, to improve outcomes.

*Competition policy and state owned enterprises*

Though generally recognised as being less efficient, state owned enterprises play an important role in developing countries by providing public with essential goods and services at an affordable price and quality. This is especially important in developing countries since markets are relatively undeveloped and so are more vulnerable to market failures. Traditionally, governments have played a leading role in building infrastructure because of its public nature and economies of scale and scope. However due to recent technological innovation and economic globalisation, it is now increasingly feasible to introduce competition in sectors long thought to lack the conditions for effective competition.

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\(^2\) Chang and Fang (1997) found that the practice of strategic deterrence was common in Singapore. Over half of the respondents of their survey indicated that attempts to deter entry were as important as strategic marketing and production decisions. These include advertising, filling all product niches, and dominating channels and hidden profits.
Competition policy and competitiveness

A major concern of some developing countries is that competition law could hinder the international competitiveness of local enterprises by imposing unnecessarily strict restrictions on mergers. Firms may need to achieve economies of scale through mergers in order to cope with international competition. Therefore, strict merger regulations could obstruct the growth to minimum efficient size of firms in developing countries. However, it can be argued that monopolies or concentrated oligopolies are desirable in developing countries because there exists a minimum scale of efficiency. As a result, the optimal number of enterprise in a market may be relatively small in developing countries – until export markets are developed. However, some empirical evidence suggests that the argument that firms lose competitiveness by being small appears to be of little significance.3

Social impacts of competition

Some claim that competition policy leads to increased unemployment and endangers incumbent industries and enterprises. Since competition expels inefficient enterprises from the market, bankruptcy and unemployment would most likely occur.4 Such cost of competition policy cannot be ignored in the social context. In fact, a failure to consider the social impact of competition policies can harm their long-term acceptance. However protection of inefficient enterprises imposes a burdens on consumers and user industries in terms of higher prices and/or lower quality in the longer term. A more positive approach would be to increase national economic welfare by implementing competition policy on one hand but at the same time adopting policies to cushion any negative impacts. For example, education and policies to promote job mobility and provide short-term unemployment benefits can help to minimise short-term dislocation

3. Competition policy and economic growth

How does competition policy promote economic growth?

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3 Scherer et al (1975) found that minimum efficient size (MES) was generally small compared to market size and that the penalties from operating at less than MES did not become significant unless plant size was relatively small. It suggests that actual plant sizes are not driven by MES but a random process.

4 Shughart and Tollison (1991) examine the impact of antitrust enforcement by Department of Justice (DOJ) on employment in the United States over the period of 1932-1981. They found that on balance antitrust led to more unemployment. The elasticity of unemployment with respect to unanticipated antitrust case activity is 0.15. This translated to an average annual increase of about 5400 individuals in the stock of unemployment participants in the labour force.
First, competition results in goods and services being provided to consumers at a lower price and so more is consumed and produced. Most producers are also consumers. To the extent that they pay higher prices for their inputs than foreign competitors because of lack of competition or anti-competitive practices in those markets, firms will be less competitive.

Second, competition policy, properly implemented, promotes efficiency and productivity. Firms faced with vigorous competition are continually pressed to become more internally efficient and more productive. Competition compels managers to reduce waste, improve the technical efficiency of production, abandon outdated production techniques and operations and invest in new technologies.

Third, competition fosters innovation – firms who do not innovate are left behind.

Fourth, competition forces restructuring in sectors, at the appropriate time, that have lost competitiveness. The competition for capital and other resources by firms throughout the economy leads to money and resources flowing away from weak uncompetitive sectors towards the more competitive sectors. Hence competition directs resources to its most efficient use and leads to the closure of inefficient firms and the freeing up resources for more productive uses.

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5 UNCTAD (1998) survey the literature providing quantitative evidence of the benefits of competition policy. In a cartel involving real estate in Washington DC, prosecution led to a 32% decline in prices received by real estate sellers.

6 Dutz (2002) argued that the adoption of competition policy inculcate a culture of competition. A greater impact of ‘discipline incentives’ spurred the competitiveness of firms by reducing managerial slack (X-efficiency) and leads to the “natural selection” of domestic firms, i.e. closure of poorly managed firms.

7 Nickell (1996) examined the link between competition and total factor productivity for 670 manufacturing companies in the UK over the period 1972-86. He found that high rent firms have lower labour productivity growth on average compared to low-rent firms. Firms in less concentrate industries were also found to have higher total factor productivity growth.

8 Blundell, Griffith and Van Reenen (1995) showed that while firms with higher market share indeed tend to innovate more, firms in competitive industries tend to have a higher probability of innovation. In particular, as large market shares generate an increase in the level of industry concentration, they might lead overall to a reduction in aggregate level of R&D investment.
The importance of legal institutions

Recent literature has also recognised the importance of legal and institutional structures to economic growth. Competition law protects firms’ rights to compete on efficient terms. Individuals will invest for economic growth when they can capture the returns from their investments. Competition law can help to ensure that firms cannot take advantage of their market power to reduce the profitability of other, more efficient firms. As a result, there will be increased confidence that competition will be on the merits that will encourage the entry of more efficient firms. Firms will also be more likely to engage in competitive conduct if they know they will not be subject to ‘disciplinary action’ by less efficient dominant firm’s or competitors acting jointly.

Competition law can help to protect developing countries against anti-competitive practices. In the early stages of their industrialisation, given their narrow domestic industrial base, developing countries have to rely on imports. To the extent that such imports are subjected to anti-competitive practices either by domestic firms or by foreign suppliers of these imports, importing countries will be penalised by higher than necessary import prices. Developing countries may be penalised, also, by import cartels and by abuses by firms with dominant positions in the countries to which they export.

Competition law helps to ensure investor “property rights”. Internationally accepted and independently enforced competition laws enhance the investment climate for foreign direct investment because it can help to create a level playing field where property rights are respected, by providing recourse against anti-competitive acts by less efficient firms.

Competition policy helps to allow firms to compete on the basis of relative efficiency, and therefore provides the incentive to improve internal efficiencies, and invest to promote dynamic efficiency.

4. Introducing Competition Policy

Competition policy is less interventionist than policies currently adopted by many developing countries. Graham notes that:

“When the leading export sector of a nation becomes increasingly complex, industrial policy fails to work as well as it apparently did at earlier stages of development. Hence in order to continue to develop internationally competitive export industries, government... have found that as a pragmatic matter, adoption of less interventionist policies has been necessary.”

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9 Competition policies in the dynamic industrialising economies: the case of China, Korea and Chinese Taipei, Mimeo prepared for OECD Development Centre.
The current General Counsel of the US FTC Bill Kovacic has commented that transition economies should embrace a gradual policy that rolls out a competition law system in phases. One way is to begin with austere law that emphasises the establishment of implementing institutions promotes competition advocacy and imposes few enforcement duties. The austere law can be augmented over time with more expansive enforcement commands as the need and the requisite institutional capabilities are developed.

Kovacic further suggested that the drafting of a competition law should follow efforts to study major sources of market failure and to identify distinctive institutional conditions that affect the choice of strategies for correcting such failures. At each step of the law drafting process, transition should reveal and defend their assumption about how the new legal commands will be put into effect.

Dutz suggested some specifics for developing countries. He pointed out that a key focus of competition institutions should be to promote entrepreneurship. Dutz suggested two ways to achieve that. First, it is imperative to preserve rewards from productive entrepreneurship by focusing on the fundamental investment climate issues. Specifically the legal and regulatory frameworks are critical to protect and ensure property rights, to remove legal and other obstacles misdirecting resources and to ensure fair and speedy dispute resolution mechanisms. Second, to foster ‘grass roots’ enterprises that spur either revolutionary or evolutionary innovations by eliminating barriers to grass root entry and facilitating access to essential business services.

On the type of anti-competitive practices to target, Dutz suggested that enforcement could be directed at detecting collusive agreements or exclusionary practice aimed at foreclosing access to essential business services. Hence the focus is on ensuring provision of essential inputs that are local in character such as localised real estate, banking, transport, distribution warehouses, communication and professional business services.

5. Some Empirical Evidence

Is there empirical evidence that competition policy promotes economic growth?

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Dutz and Hayri (1999) studied the strength of association between intensity of economy wide competition and growth. To capture intensity of economy wide competition, they constructed three types of variables related to policy, structure and mobility. Policy measures capture the quality of the microeconomic incentive regime and the enabling legal and regulatory framework in areas that directly promote competition. Structure variables reflect the extent to which market structure is concentrated from an economy wide perspective. Mobility variables capture the ease with which new enterprises can enter and grow in any market. Their results indicate that there is a strong correlation between the effectiveness of competition policy and growth. They concluded that the effect of competition policy on growth is robust and goes beyond that of trade liberalisation, institutional quality and a generally favourable policy environment.

Bee San and Changfa Lo (2002) examined the social and economic impact of the implementation of the Fair Trade Law (FTL) on Taiwan's economy. They utilised a multi-equation system taking into account FTC's statistics on decision with sanctions, together with key macroeconomic indicators. Their results showed that the implementation of the FTL in Taiwan would significantly enhance Taiwan's international competitiveness and its exports. In addition, the implementation of FTL will also create more job opportunities and stimulate more innovation efforts.

**Conclusion**

This paper attempts to address the relationship of competition policy and economic growth and presents supporting empirical evidence. However due to constraints on data and the difficulty in separating the effects of competition policy from other factors (e.g. trade liberalisation) the availability of empirical work is limited.

A lack of empirical evidence and the experience of countries that have introduced competition laws suggest that competition laws should be introduced carefully by developing countries. As experience in developed countries shows, competition laws take time to implement. It is an exercise that should only be undertaken with a full appreciation of the implication of its introduction for economic efficiency and social goals.

**References**


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