Competition Assessment Toolkit

Workshop hosted by the Ministry of Corporate Affairs and the Competition Commission of India

Delhi, 11 July 2008

Bernard J. Phillips

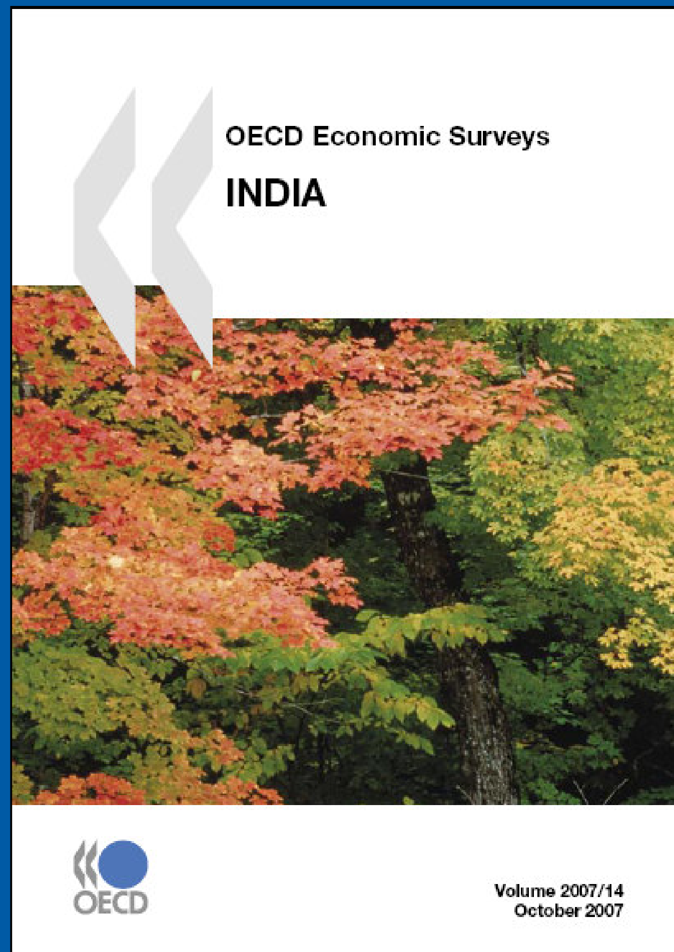
Competition Division, OECD

bernard.phillips@oecd.org

Main Points

- Growth the key to raising India's living standards
- Raising productivity is a key to growth
- Competition reforms raise productivity
- Competition assessment: one method to help implement competition reforms

OECD Survey of India, 2007



OECD Survey of India, cont'd

The Key message:

- "Reaching the government's target for medium-term output growth of 10% will require additional structural reforms. The following sections identify a number of key challenges that policy makers should address to foster the catching-up of the Indian economy."
- The OECD's first recommendation? Increasing competition by lowering the extent of regulatory intervention.

OECD Survey of India, cont'd

"A central determinant of India's future growth rate will be the extent to which the regulations and laws governing economic activity are conducive to competition in the markets for goods and services."

"At the economy-wide level, India has made good progress in improving some aspects of product market regulation. … Overall, however, despite considerable deregulation during the past 20 years, product market regulation remains much more restrictive than in typical OECD countries."

OECD Survey of India, cont'd

"Experience in other countries suggests that reducing regulation and increasing competition enhances productivity growth by improving the efficiency of resource use and encouraging a stronger effort on the part of managers to improve efficiency … but efficiency does not come at the expense of lower employment. Greater product market competition has also been found to improve employment … and fixed investment … The link between increased competition and productive performance is related to the stimulus that a competitive market gives to innovation and technological diffusion … These are potentially key sources of productivity growth in India and are likely to be improved by more liberal product market regulation." (references omitted)

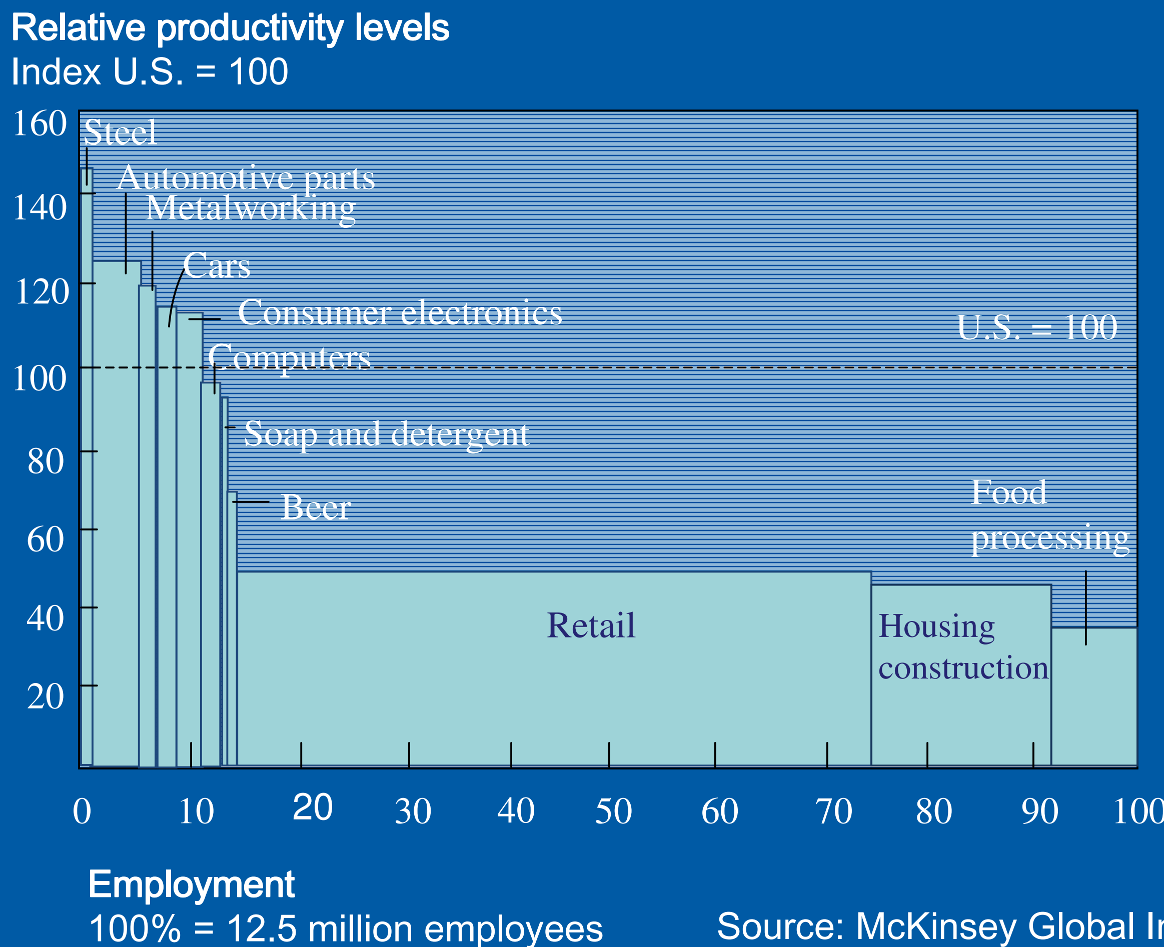
OECD economists link competition to productivity and economic performance

- Recent OECD papers explain how reforms to stimulate stronger market competition affect growth by
  - spurring efficiency and productivity growth by 4-10%
  - disciplining managers
  - increasing investment by removing barriers
  - increasing employment – the employment rate is up to 2.5-5.0% higher where in-depth reforms have been adopted
  - reinforcing incentives for innovation
  - speeding the adoption of new technology and process of adjustment to change

McKinsey studies link regulatory restrictions to economic performance

- McKinsey and Company compared productivity levels in Japan and the United States.
- In the sectors of the Japanese economy that were exposed to international competition – in steel, automotive parts, metal working, cars, consumer electronics and computers -- productivity levels were about the same or higher compared to productivity levels in the U.S.
- Where Japanese sectors were protected from competition – in the retail sector, housing construction and food processing -- the productivity levels were as much as 50% below those of the U.S.
- These differences can largely be explained by competition and regulation. In the underperforming sectors, competition is highly restricted, in large part because of regulation.

Competition and Productivity -- Japan’s Dual Economy



Source: McKinsey Global Institute

Australia’s economy benefited from removing laws and regulations restricting competition

•Australia’s National Competition Policy reviewed about 1,800 laws and regulations for unnecessary restraints on competition

•“The implementation of Australia’s ambitious and comprehensive National Competition Policy over the past seven years has undoubtedly made a substantial contribution to the recent improvement in labour and multifactor productivity and economic growth. The Productivity Commission estimates that Australia’s GDP is now about 2½ per cent higher than it would otherwise have been, and Australian **households’ annual incomes are on average around A$7 000 higher** as a result of competition policy.
- OECD 2003

Australia's competition reforms (2)

•Domestic product (GDP) growth since the millennium has averaged above 3% per annum

•Growth in real gross domestic income averaged over 4%, with terms of trade gains, among the best of OECD countries

•Unemployment rate has fallen to around 5%, its lowest level since the 1970s;

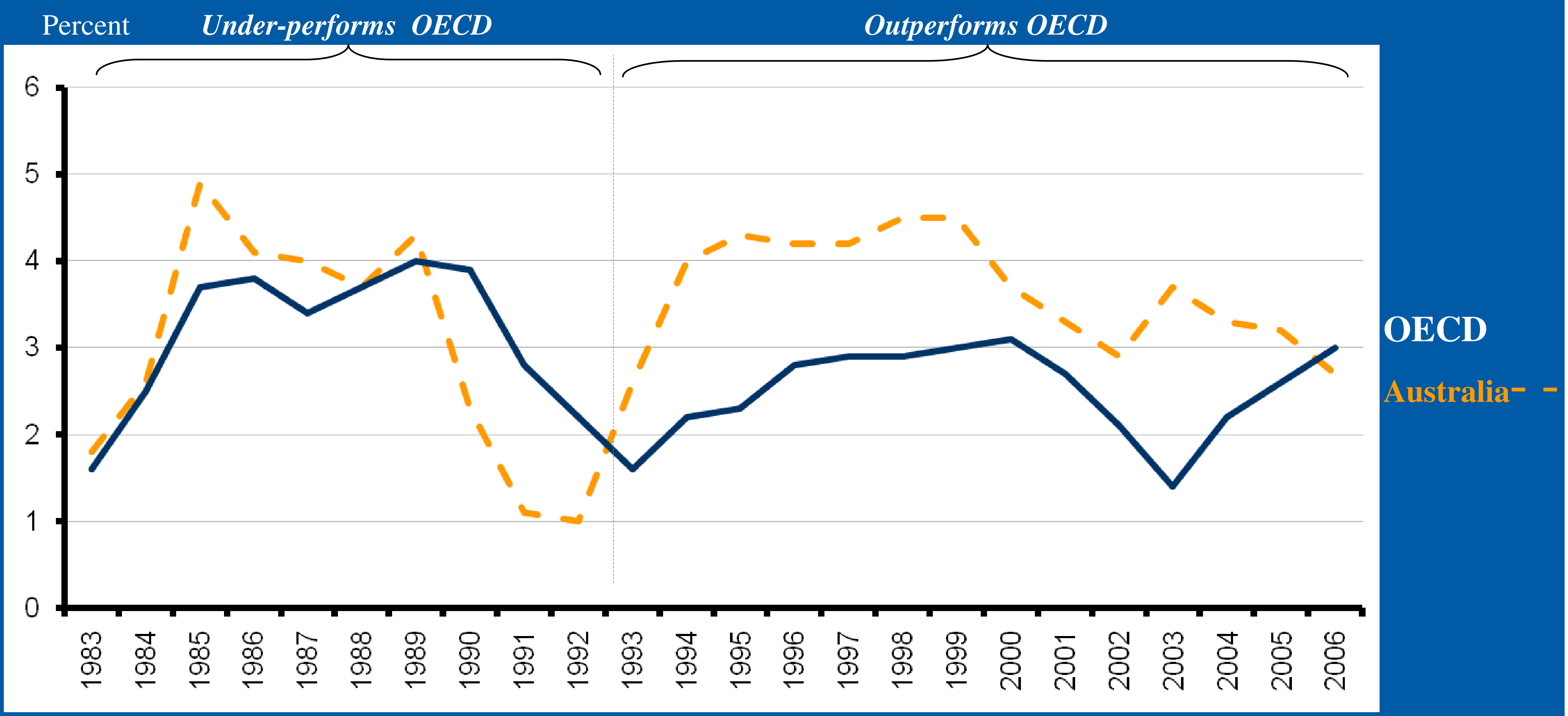
•Inflation within the target range

•A long stretch of fiscal surpluses, general government net debt eliminated.

•Living standards steadily improved since the beginning of the 1990s, now surpass all G7 countries except the United States.

•**Wide-ranging reforms, particularly to promote competition, were instrumental**. --- OECD, 2006

Australia versus OECD—real GDP growth*



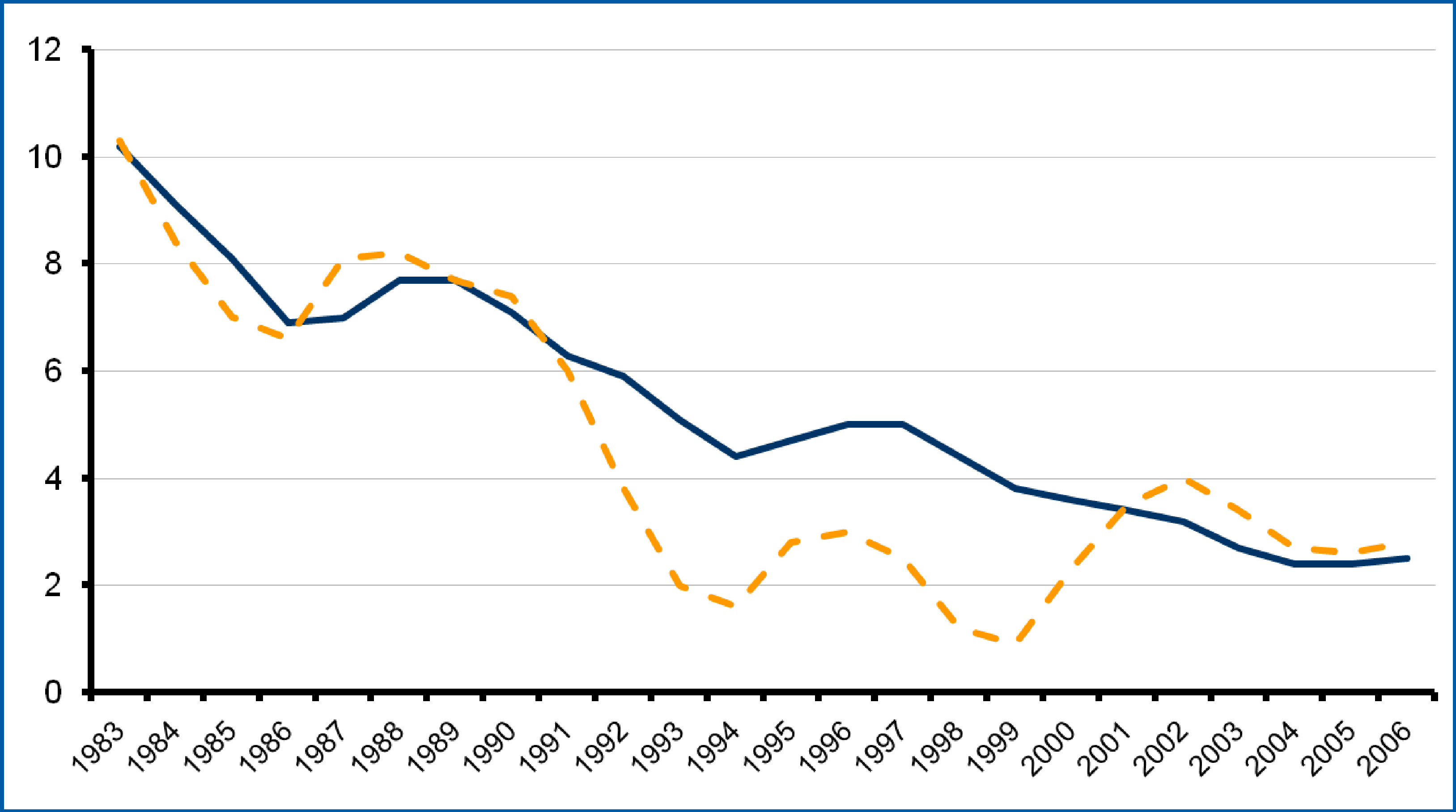
* 3-year moving average

Source: Fred Hilmer, University of New South Wales, OECD Stat Gross Domestic Product (output approach), Volume Index

Australia versus OECD CPI*

Percent

CPI trends



Australia - -

OECD

* 3-year moving average

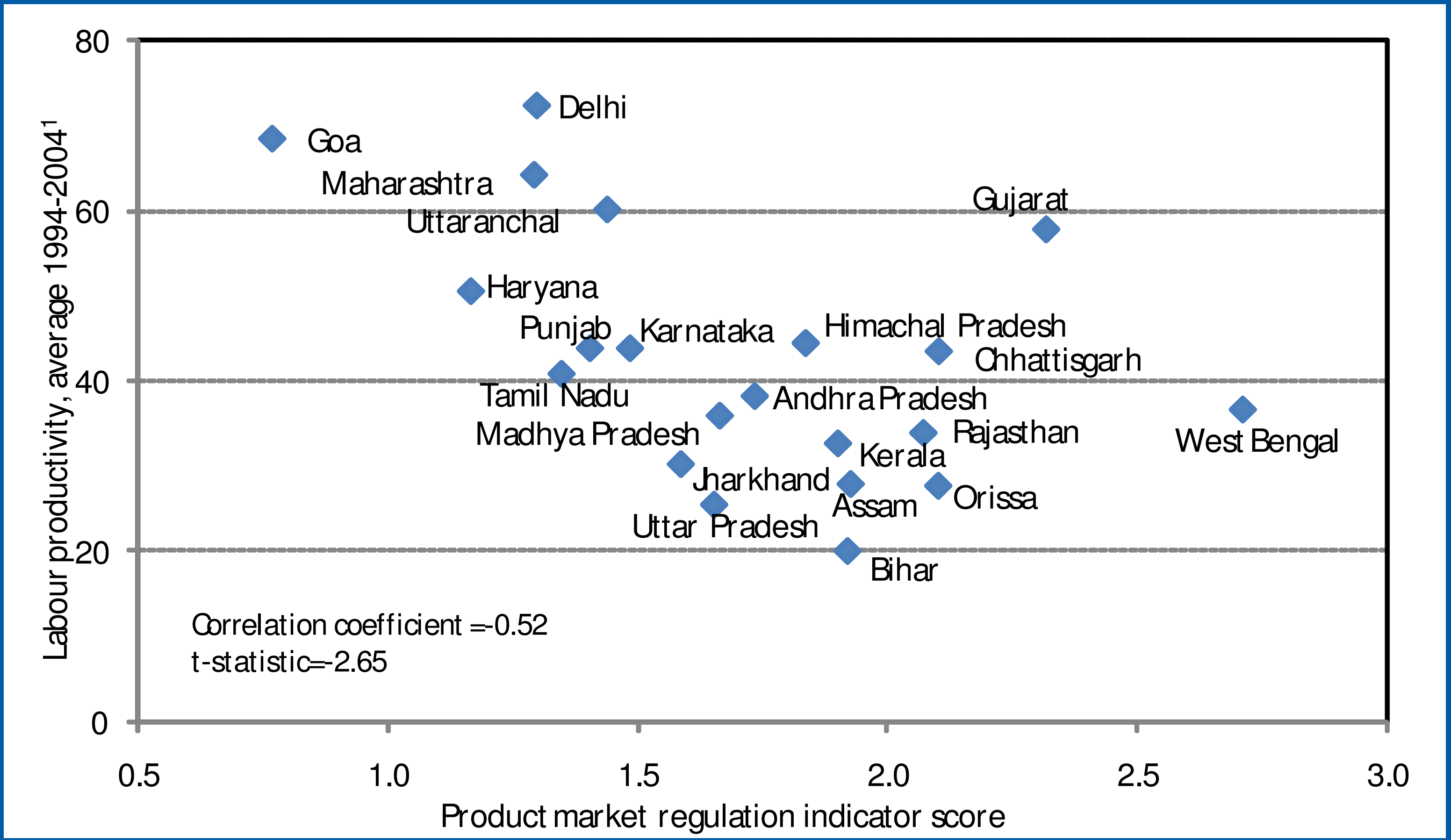
Source: Fred Hilmer, University of New South Wales, OECD Stat Consumer Prices (all items) Australia versus OECD Total

Recent Evidence from OECD Shows Impact of Reducing Burdensome Regulation in India

- Per capita income has been diverging in Indian states over recent decades – the rich states are becoming relatively richer.
- Since mid-90s, labor productivity growth has been the primary driver of growth in GDP per capita in the majority of Indian states
- “Differences in product market regulation, as captured by the OECD’s PMR indicators, do appear to have a significant impact on productivity performance at the level of a aggregate state economies. Over the period of 1994 to 2004, there is a clear negative relationship between the restrictiveness of product market regulation and average labor productivity.”

Source: Conway, Herd and Chalaux, March 2008, “Product Market Regulation and Economic Performance Across Indian States,” OECD Economics Department Working Papers No. 600

Product Market Regulation and Labour Productivity in Indian States, Manufacturing and Services



Source: Conway, Herd and Chalaux, March 2008, "Product Market Regulation and Economic Performance Across Indian States," OECD Economics Department Working Papers No. 600

Competition Assessment Toolkit

- Inspired by the success of Australia's National Competition Policy.
- Designed to help evaluate whether a law or regulation unduly restricts competition.
- The goal is to identify ways to achieve the objectives of laws and regulations with the least harm to competition.
- Can be used in a process to streamline large numbers of existing laws and regulations, review proposed new ones.
- Can be used at national, regional and local levels

Competition Checklist

- Goal of checklist is to create a filter that can be applied by non-specialists to effectively identify whether a law or regulation raises competition issues requiring further analysis.
- Initial Review: Does the law or regulation:
  - Limit the number or range of suppliers?
  - Limit the ability of suppliers to compete?
  - Reduce the incentive of suppliers to compete vigorously?
- A <u>positive</u> answer to <u>any</u> of the items noted in the Competition Checklist will warrant a more detailed competition assessment of the law or regulation.
  - Level of detail as warranted by circumstances, to avoid unnecessary paper burden, and often minimal.

Limit the number or range of suppliers?

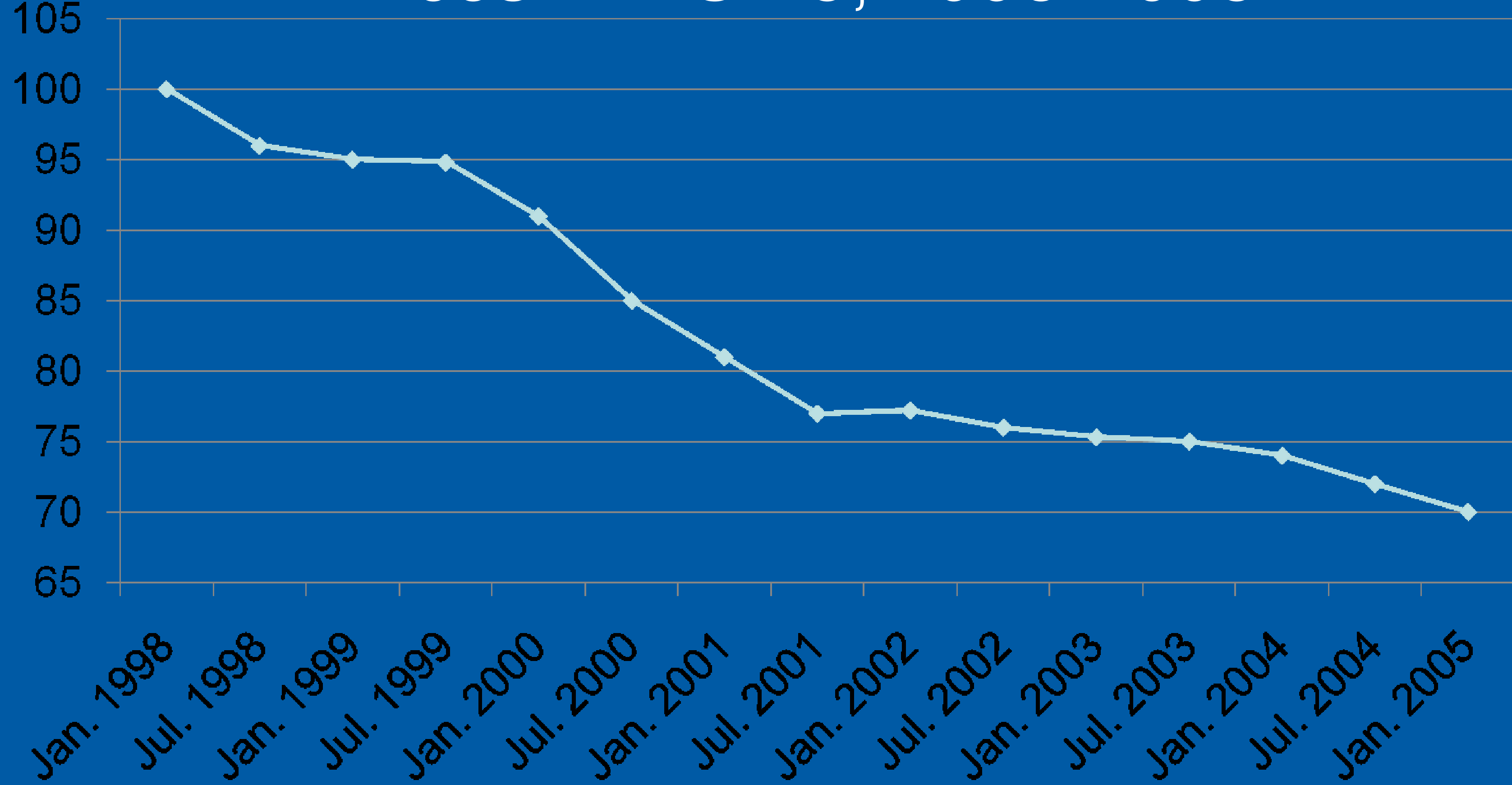
- This is likely to be the case if the law or regulation:
  - Grants exclusive rights for a supplier to provide a good or service
  - Establishes a license, permit or authorisation process as a requirement of operation
  - Limits the ability of some types of suppliers to provide a good or service
  - Significantly raises cost of entry or exit by a supplier
  - Creates a geographical barrier to the ability of companies to supply goods or services, invest capital or supply labour

Example: Telecommunications Deregulation in the EU

- In 1998, free competition among voice telephony providers was introduced in the EU
- By 2001, the last of the old Member States' exemptions from this directive were removed
- March 2002, European Parliament and Council adopt a new framework for electronic communications networks and services.
- Competition has become the rule rather than the exception. Sector-specific regulations are now only used in particular areas, such as access to the fixed-line

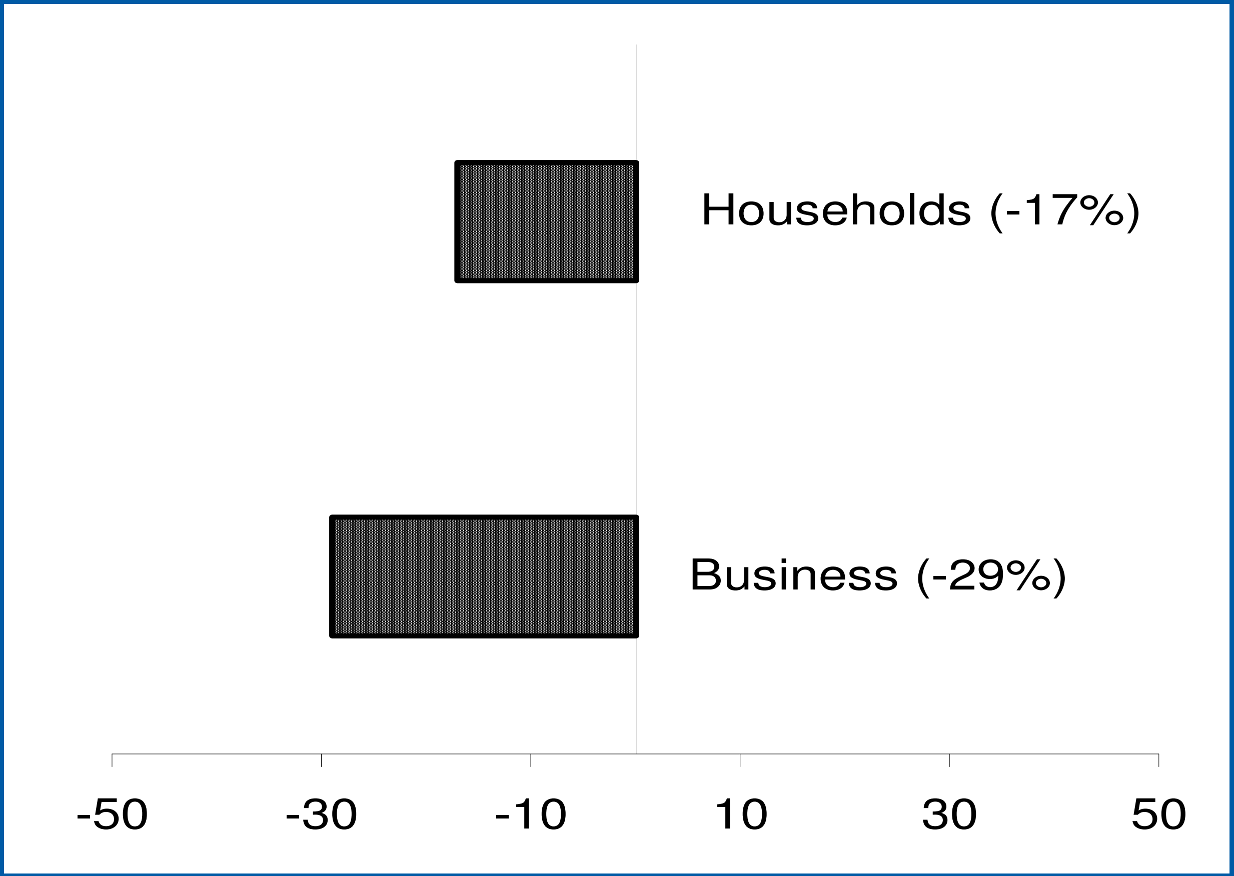
Source: Martin, Roma and Vansteenkiste "Regulatory Reforms in Selected EU Network Industries," ECB Occasional paper 28, April 2005.

Telecommunications Price Index Relative to Overall Harmonized Index of Prices in EU 15, 1998-2005



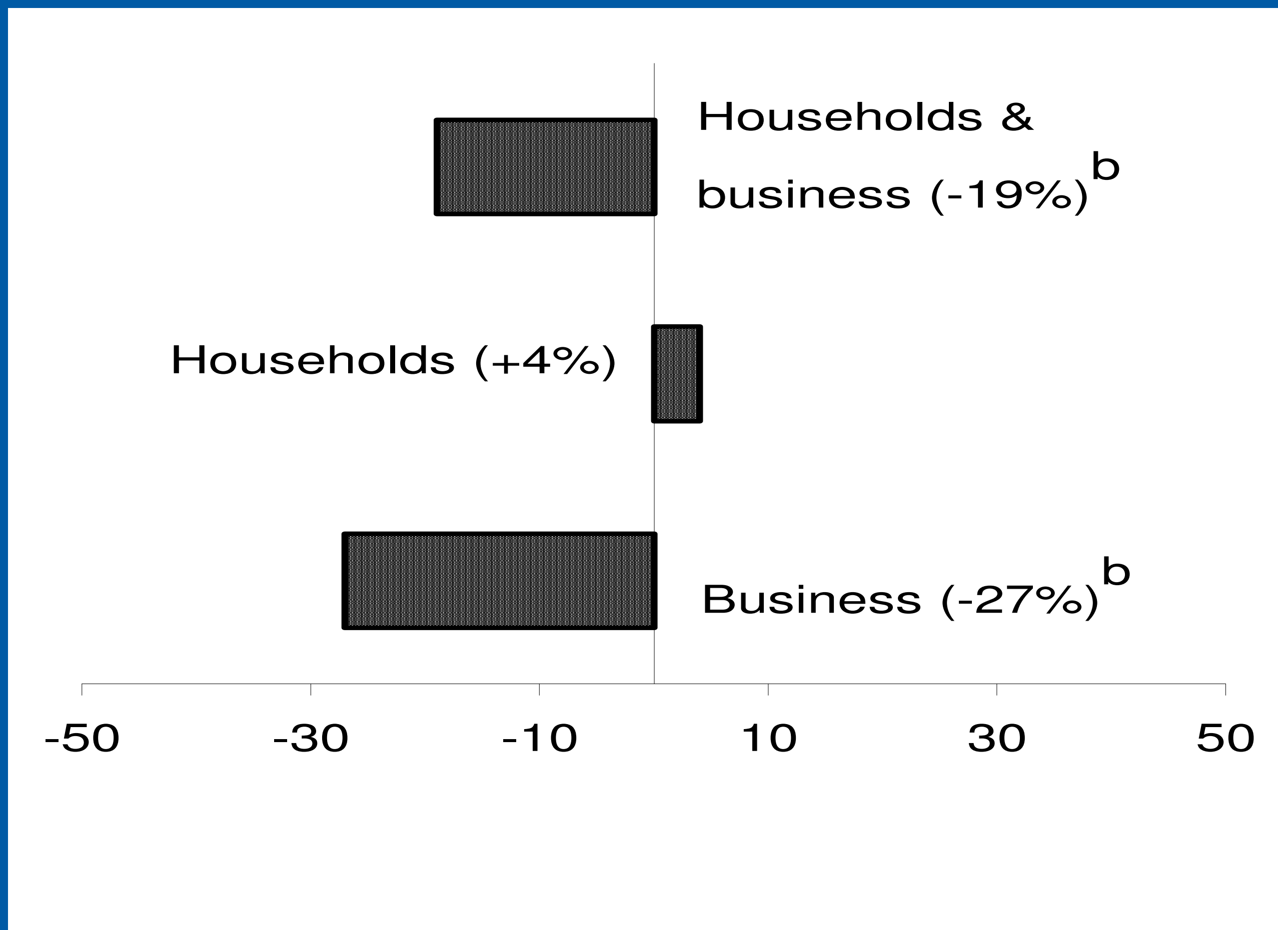
Source: Martin, Roma and Vansteenkiste "Regulatory Reforms in Selected EU Network Industries," ECB Occasional paper 28, April 2005

Real price changes in Australian Telecom, 1996-97 to 2002-03



Source: Productivity Commission 2005, Review of National Competition Policy Reforms

Real price changes in Australian Electricity, 1990-91 to 2003-04



Source: Productivity Commission 2005, Review of National Competition Policy Reforms

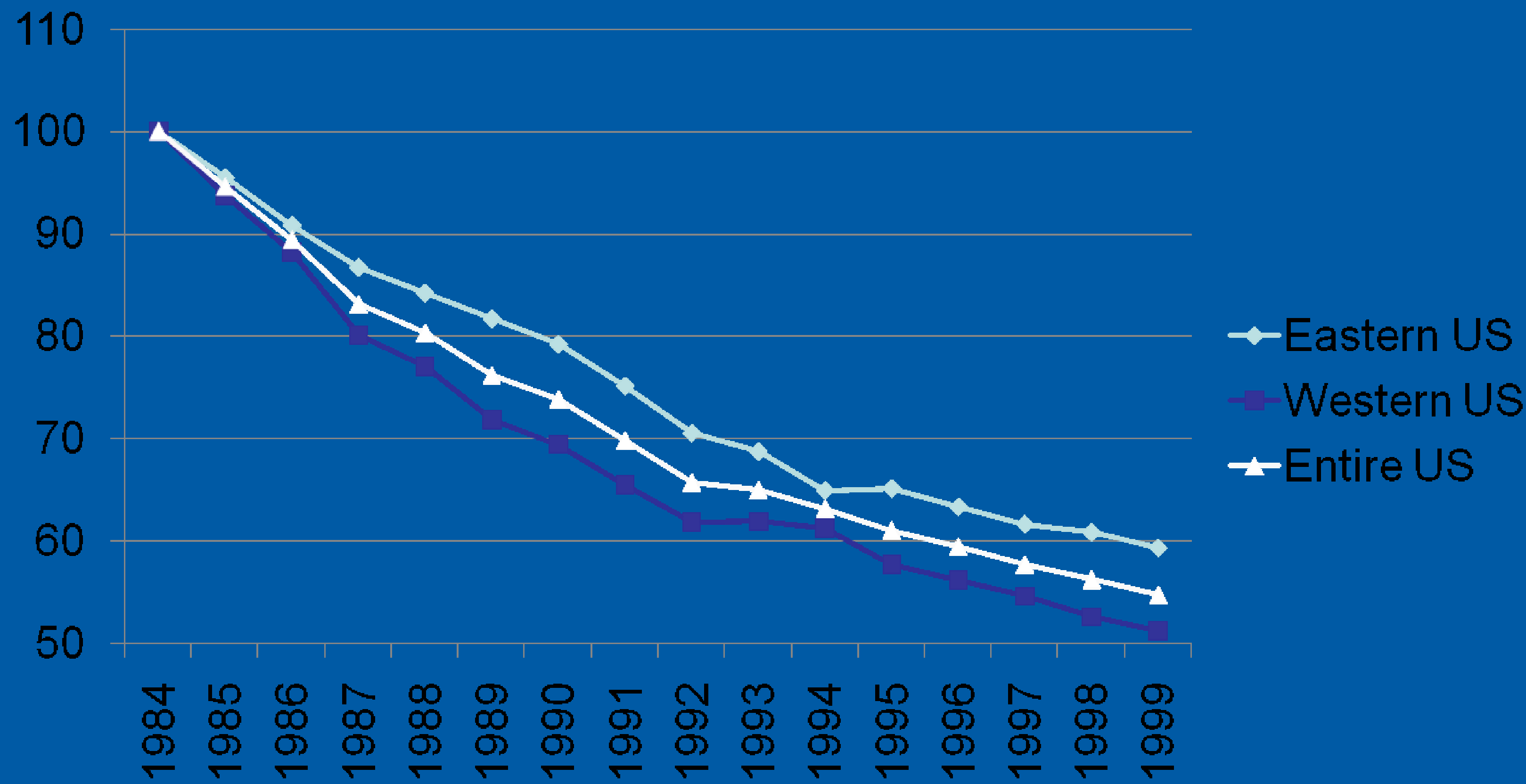
Limit the ability of suppliers to compete?

- This is likely to be the case if the law or regulation:
  - Controls or substantially influences the prices for goods or services
  - Limits freedom of suppliers to advertise or market their goods or services
  - Sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that many well-informed customers would choose
  - Significantly raises costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants)

Example: Railroad Deregulation

- The Staggers Act in 1980 reduced regulatory oversight of the railroad industry in the United States. Prior to the Staggers Act, rail rates were administratively rather than competitively set
- The Staggers Act granted greater pricing freedom and rolled back restrictions on ownership
- In the nearly 30 years since deregulation, rates have uniformly fallen while productivity has risen

U.S. Rail Rate Index (Inflation Adjusted), 1984-1999



Source: Surface Transportation Board Office of Economics, Environmental Analysis, and Administration, December 2000, "Rail Rates Continue Multi-Year Decline"

U.S. Railroad Productivity Since Staggers Act

	1980	1985	2003
Net Ton Miles per Train-Hour	40,392	56,353	60,356
Revenue Ton Miles per Gallon of Fuel	235	282	405
Revenue Ton Miles per Employee Hour	863	1,196	3,805

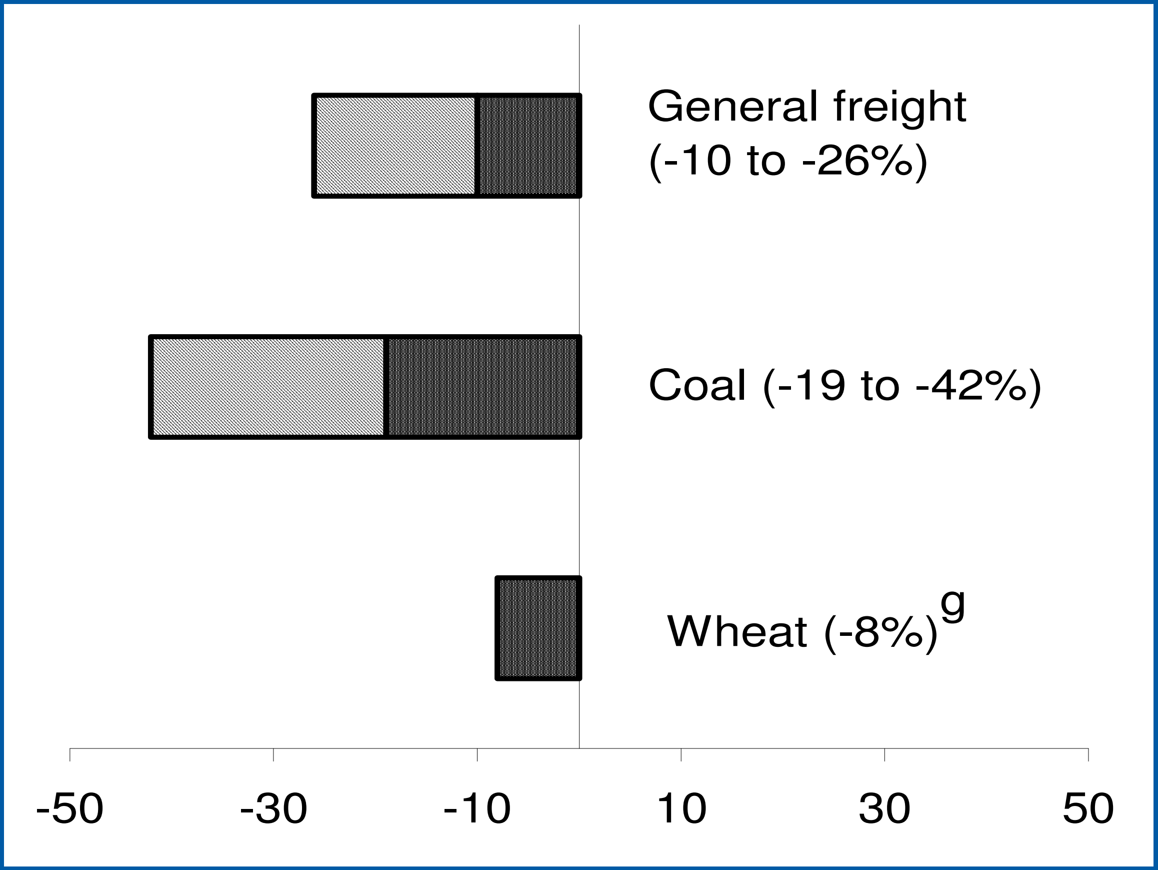
Source: Association of American Railroads, "Railroad Facts," October 2004, pp. 38, 40, 41

Deregulation also improved railroad investment and safety

- The U.S. Department of Transportation recently reported that: "In the 30-year period before 1980, railroad market share measured in revenue ton-miles declined by 33 percent, from 56.1 to 37.5 percent. Market share in the post Staggers era became stable and has increased to 41.7 percent… Between 1980 and 2002, the railroads have expended $364 billion in capital improvements and maintenance of track and equipment. Prior to 1980, the rail plant was in poor repair. The industry also showed remarkable safety improvements since Staggers with train accident rates declining by 68 percent."

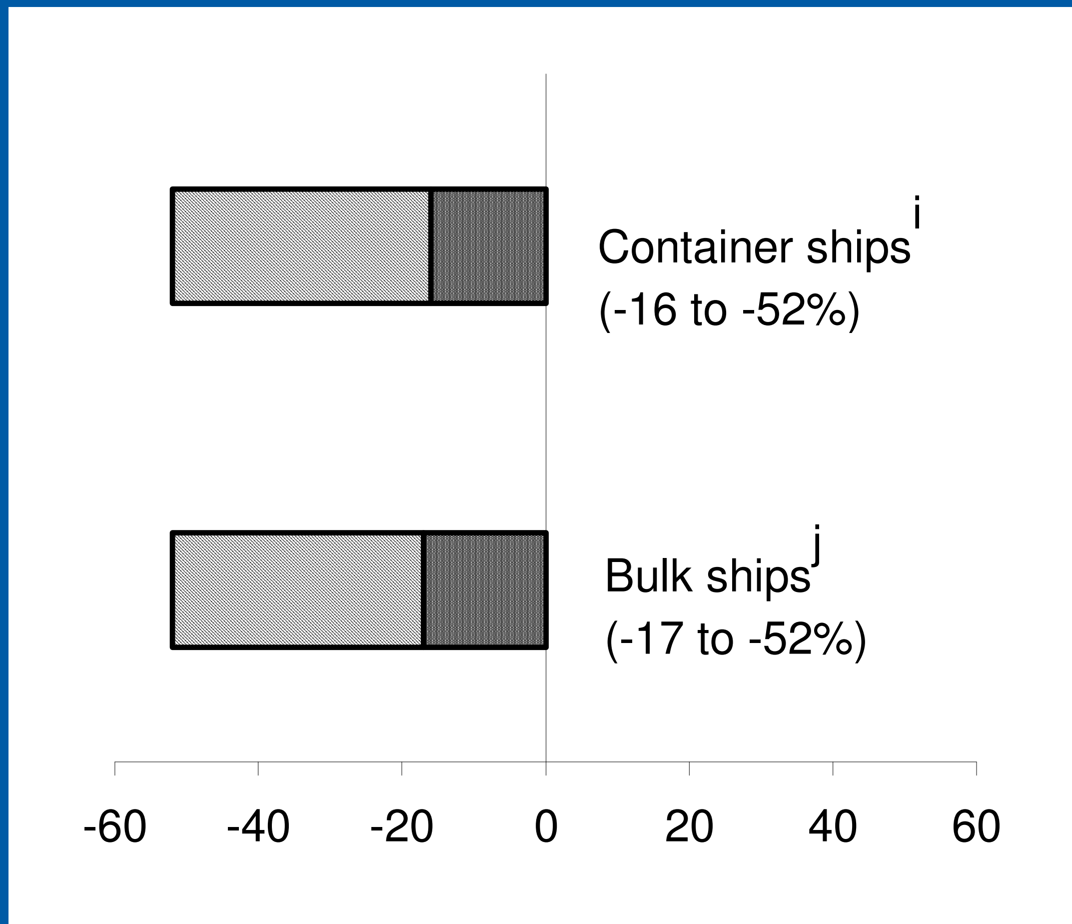
Source: U.S. Department of Transportation: IMPACT OF THE STAGGERS RAIL ACT OF 1980

Real price changes in Australia rail freight, 1995-96 to 1999-2000



Source: Productivity Commission 2005, Review of National Competition Policy Reforms

Real price changes in Australian ports, 1990-91 to 2000-01



Source: Productivity Commission 2005, Review of National Competition Policy Reforms

Reduce the incentive of suppliers to compete vigorously?

- This may be the case if the law or regulation:
  - Creates a self-regulatory or co-regulatory regime
  - Requires or encourages information on company outputs, prices, sales or costs to be published
  - Exempts the activity of a particular industry or group of suppliers from the operation of general competition law
  - Reduces mobility of customers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers

Effect of Switching Costs in EU Retail Banking

- Recent reports by the European Commission find a negative effect on bank profits of customer (consumer and small-medium enterprise) switching, and a positive effect of customer longevity on bank profits.
- Evidence indicates that measures to reduce switching costs could increase competition and decrease prices in retail banking.

	Profit Rate Effect of Increase
Consumer Churn	**-1.05**
SME Churn	-0.04
Consumer Longevity	1.64
SME Longevity	**3.00**

Source: EC Submission to OECD Roundtable on Competition and Regulation in Retail Banking, DAF/COMP (2006)33

Example: Retail Banking in EU

The European Commission's reports on payment systems point to a range of possible measures to facilitate customer mobility:

i. Focusing on switching arrangements, whether regulatory or established by banking industry;
ii. Reducing the extent of forced tying, by which customers often have to take out a current account when receiving a mortgage;
iii. Promoting better information and disclosure; and
iv. Eliminating closing charges.

Source: EC Submission to OECD Roundtable on Competition and Regulation in Retail Banking, DAF/COMP (2006)33

Jurisdictions making progress with competition assessment

Jurisdictions	Progress
Australia	Adopted OECD competition assessment checklist for reviewing impact of new regulations
Canada	Competition authority is running a pilot of the OECD competition assessment methodology
Korea	Competition authority is reviewing select new regulations with the Competition Assessment Toolkit
Mexico	Started a large project to review and revise regulations with competitive impact
United Kingdom	Pioneered a formalized competition assessment process, applying the OECD checklist methodology
European Commission	Has included a call for competition assessment in its development of new regulations

The pending microeconomic transformation in Mexico

COLABORADOR INVITADO

La transformación microeconómica pendiente

EDUARDO SOJO

Los últimos años se han caracterizado por la apertura de los mercados en el comercio internacional. Esto ha permitido elevar la calidad de vida de cientos de millones de personas en el mundo e incrementar la productividad, el crecimiento económico y el intercambio de bienes, servicios y capitales.

Sin embargo, también ha puesto al descubierto los riesgos de tener mercados ineficientes y poco competitivos, así como la necesidad de llevar a cabo cambios para modernizar la economía, que permitan garantizar que los frutos de la apertura se obtengan y distribuyan de la mejor manera.

México ha estado inscrito en este proceso de apertura económica mundial especialmente desde la firma del TLCAN, al cual siguieron muchos más tratados. Y crecientemente otros países han aprovechado también las ventajas del libre comercio, por lo que la competencia económica mundial se ha intensificado.

Por ello, hoy como nunca, México tiene que acelerar su proceso de transformación: fortalecer su mercado interno, atraer más inversiones, generar más y mejores empleos. Tiene que convertirse en una economía que, como bien ha dicho el Presidente Felipe Calderón, no sólo sea capaz de competir, sino de ganar. De ahí que su Gobierno esté impulsando desde diversos frentes una economía más flexible, con menos trabas, que fortalezca la innovación, la inversión y el crecimiento.

Desde el ámbito de la Secretaría de Economía buscamos un acuerdo con la Organización para la Cooperación y el Desarrollo Económicos (OCDE) para incorporar en México las mejores prácticas internacionales en la implementación de un "Proceso para el Fortalecimiento del Marco Regulatorio para la Competitividad".

Este Proceso Marco, como le hemos llamado de manera abreviada, incluye la evaluación del impacto del marco regulatorio sobre la competencia y un programa para mejorar la calidad regulatoria que reduzca el costo del cumplimiento para las empresas.

El 15 de junio del 2007, la Secretaría de Economía firmó una carta de intención con la OCDE y unos meses después un memorando de entendimiento con las bases técnicas del apoyo de dicha organización en la instrumentación del Proceso Marco, tanto en su rama de mejora regulatoria como en la de competencia económica.

Las propuestas que surjan del Proceso Marco buscarán transformaciones en la forma de operar de los diferentes mercados, sentando las bases para una mayor y más justa competencia en todos los sectores y empresas, así como una depuración y rediseño de la regulación económica de México, lo que deberá contribuir a una atracción importante de inversión y a un crecimiento sano y sostenido, con la consecuente generación de empleo que tanto se requiere.

Este proceso no tiene precedentes en México. En su diseño fueron tomadas en cuenta las mejores prácticas y experiencias de otros países que ya han implementado procesos similares. De este análisis, quedó claro que para que una iniciativa de semejantes dimensiones sea exitosa, se requiere de la cooperación y voluntad de muchos actores sociales.

Conclusions

- Eliminating unneeded government restrictions on competition is essential for India's growth. Competitive markets drive productivity.
- Competition ssessment methodology is one way to identify and then eliminate harmful laws and regulations.
- Australia and the UK provide current examples of competition assessment processes
- Experience shows that officials performing assessments must be trained in the value of competition and to identify restrictions

Conclusions (2)

- "Increasing productivity is by far the most important ingredient in economic development. It solves almost all other economic problems. From the vast amount of economic experience in countries all over the world for the past 50 years, we have learned without doubt that **the most important condition necessary for rapid productivity growth is fair and intense competition in all the sectors of an economy.**"

  – William W. Lewis, Founding Director, McKinsey Global Institute, Author of *The Power of Productivity*