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Background note: **Competition and socioeconomic policy**

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Introduction

Competition policy has undeniable gains for society, increasing both consumer and producer welfare. At the micro level, competition leads to lower prices, improved quality, wider choices of goods and services and greater innovation. At the macro level, it promotes optimal and efficient use of resources, economic growth and improved productivity. These effects reinforce one another, leading to improved welfare in the long run.[1] It also has spillover effects on other policy areas, and it plays a crucial role in the design of economic policies and their enforcement.

The COVID-19 pandemic has had unprecedented consequences throughout the economy, and in response Governments have designed economy-wide recovery policies. Governments must therefore assess the possible intended and unintended consequences of such policies on other sectors and aspects of the economy, including competition. For instance, policies can result in market distortions, leading to changes in the entry and exit dynamics of firms and changes in their input/output choices. Such effects may extend to the macro level as well, leading to disruptions in trade.

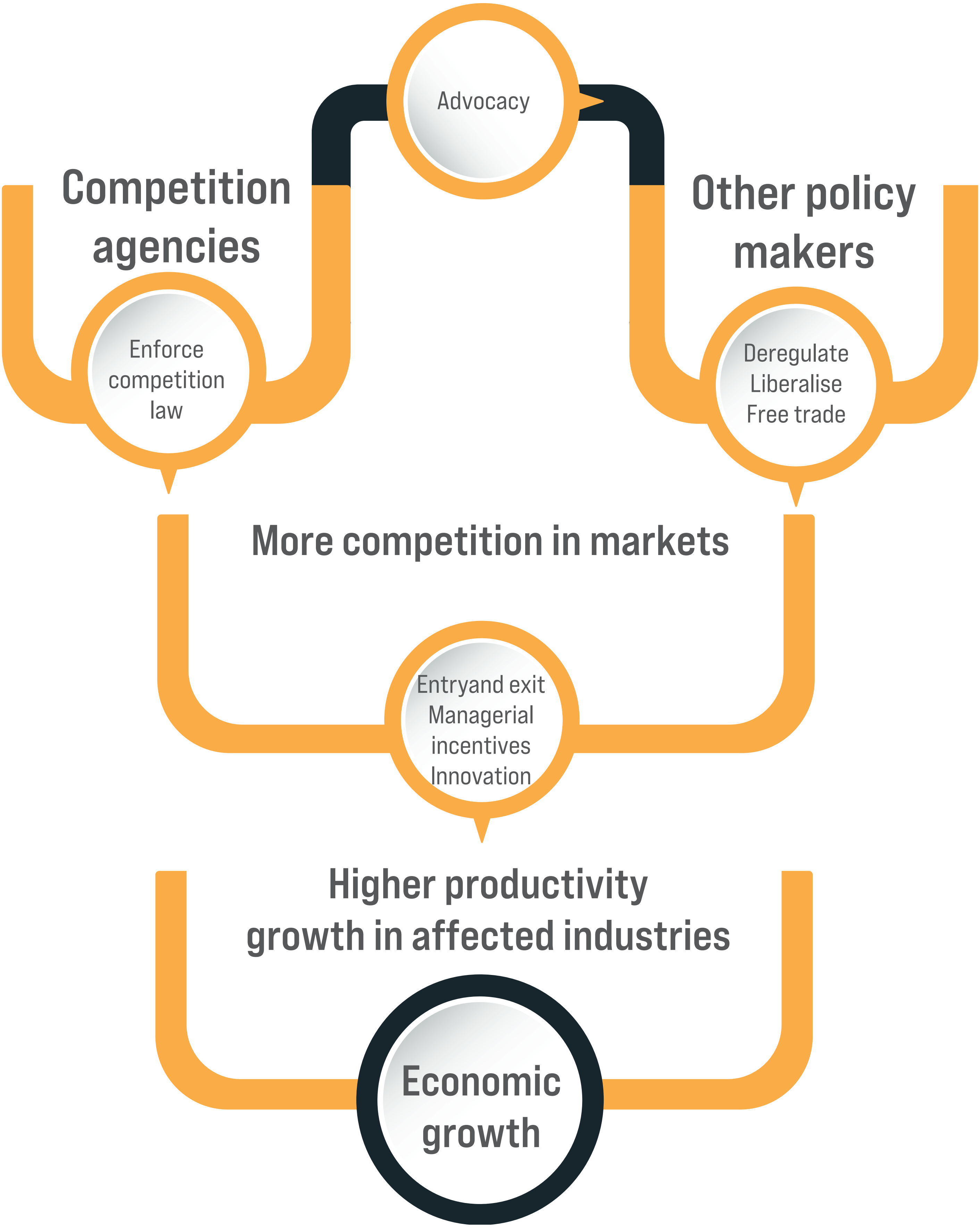
Against this backdrop, competition law and policies can provide major support and direction in the economic recovery of countries in all income brackets. Recovery requires coherence at the level of trade, industrial, fiscal and monetary policies, as well as in the interactions between such policies.

The present background note seeks to explore the impacts of competition policies on selected policy areas and social and economic outcomes of public interest.

Competition and productivity

Competition policy leads to increases in productive and allocative efficiency, and consequently improvements in productivity, by allowing the entry of efficient firms into the market, and the exit of less efficient ones,[2] thus driving productivity growth and GDP growth.[3] At the firm level, productivity also increases due to increased managerial performance because of the introduction of product market competition. From a dynamic efficiency perspective, productivity growth as a result of competition policy is also driven by improvements in innovation (figure below).

The impact of competition on productivity and economic growth



Source: Organisation for Economic Co-operation and Development (2014). Factsheet on how competition policy affects macro-economic outcomes. https://www.oecd.org/daf/competition/2014-competition-factsheet-iv-en.pdf.

In Jordan and Morocco, higher markup levels negatively affect productivity growth. Conversely, decreases in the shares of State-owned enterprises (SOEs) positively affect it in Egypt.[4] In Japan, industries which were subject to international competition prospered and exhibited high productivity growth, whereas those that did not experienced stagnation. In the 2010s, the productivity performance of the United Kingdom was weak compared to other European countries due to weaker competition.[5]

The effect of competition on productivity is not limited to only the sector directly affected. Competition in upstream sectors also leads to improved productivity in downstream sectors.[6] This emphasizes the importance of promoting competition in infrastructure and utilities since they help drive the productivity of the entire economy. For example, the productivity of the manufacturing sector is adversely impacted by limiting competition in financial services.[7]

Box 1. **Competition and economic growth**

Increases in productivity are directly associated with economic growth, and competition policy plays a major role in economic recovery. In fact, competitive markets have been proven to mitigate the negative impacts of macroeconomic shocks.

Following the Great Depression, the United States reduced restrictions on anticompetitive practices in several sectors through the National Industrial Recovery Act (NIRA), which is estimated to have delayed the recovery in the United States by 7 years.[a] It caused wholesale prices to increase by 24 per cent in 1935, pushing inflation upwards. Consumption and investment were 14 per cent lower than they would have been otherwise.[b]

Increasing competition in Tunisian markets by decreasing price-cost margins by 5 percentage points results in increasing labour productivity by 5 per cent, expanding GDP growth by 4.5 per cent per year and creating 50,000 additional jobs every year.[c]

The slow economic performance of Japan in the 1990s is attributed to how competition was governed in protected sectors. The Government's approach inflated prices and reduced productivity and investment, which lost Japan significant business opportunities and impacted overall economic performance.[d]

A model examining the impact of competition laws on 179 countries from 1971 to 2012 shows a significant impact on GDP growth: between 2 and 3 per cent.[e]

Sources:

- [a] Cole, Harold L., and Ohanian, Lee E. (2004). New Deal Policies and the Persistence of the Great Depression: A General Equilibrium Analysis. Journal of Political Economy, vol. 112, No. 4, pp. 779-816. https://www.journals.uchicago.edu/doi/abs/10.1086/421169.
- [b] OECD (2020). The Role of Competition Policy in Promoting Economic Recovery. https://www.oecd.org/daf/competition/role-of-competition-policy-in-promoting-economic-recovery.htm.
- [c] World Bank (2014a). The Unfinished Revolution: Bringing Opportunity, Good Jobs, and Greater Wealth to All Tunisians. Washington, D.C.: World Bank. https://www.worldbank.org/en/country/tunisia/publication/unfinished-revolution.
- [d] Porter, Michael E., and Sakakibara, Mariko (2004). Competition in Japan. Journal of Economic Perspectives, 27-50. http://www.jstor.org/stable/3216874. Fukao, Kyoji, and Hyeog Ug Kwon (2006). Why Did Japan's TFP Growth Slow Down in the Lost Decade? An Empirical Analysis Based on Firm-Level Data of Manufacturing Firms. Japanese Economic Review, vol. 57, No. 2, pp. 195-228. http://onlinelibrary.wiley.com/doi/10.1111/j.1468-5876.2006.00359.x/abstract.
- [e] Gutmann, Jerg, and Voigt, Stefan (2014). Lending a Hand to the Invisible Hand? Assessing the Effects of Newly Enacted Competition Laws. http://ssrn.com/abstract=2392780.

Competition and investment

A favourable business environment with well-enforced competition law and policy facilitates a level playing field between all enterprises, public and private, which is an essential market condition to attract investors' interest. Good competition law and policy drive investment for a number of reasons, including by supporting business confidence and providing trust in reduced corruption, particularly in developing countries.[8]

In the Arab region, SOEs have for decades dominated vital industries such as oil, gas, electricity and telecoms. This has concentrated investment in these sectors, which are dominated by large enterprises receiving preferential treatment in the form of tax deductions or exemptions.[9] Such advantages create trade barriers and market entrance barriers for less established firms and start-ups, which further shrinks the extent of market competition, investment and the vibrancy of the private sector.

The private sector in Arab economies is mainly composed of micro, small and medium enterprises (MSMEs), which account for 90 per cent of all businesses in the region.[10] However, certain market dynamics render MSMEs particularly vulnerable when competing with larger enterprises. In particular, their limited access to credit and low regulatory knowledge and the restrictive business environment lead to an uneven playing field and prevent many firms from entering the market and investing in innovative projects. Facilitating a competitive business environment through effective competition policy would encourage investment in smaller enterprises and attract the interest of foreign investors.

Competition and trade

Competitive and well-regulated markets enhance trade openness and increase overall competitiveness scores of countries, diversify and advance products and services, and create an opportunity to advance investment flows and reduce trade deficits. These welfare gains are compromised in cases of imperfect competition,[11] where market power and anticompetitive practices prevent the full benefits of trade policy from being enjoyed. Competition law and trade openness form a cycle, with each one reinforcing the other. This makes them complementary policies in markets, and not alternatives.[12]

Box 2. **Empirical studies on the interaction of competition and trade policies**

Several studies have shown that the interactions of competition and trade policies lead to welfare gains by reducing prices, specifically by decreasing the price-cost margin.[a] Opening trade in the manufacturing sector in Taiwan resulted in greater competition and lower markups. This led to a 25 per cent higher level of consumption and decreased distortions in labour and investment.[b]

Sources:

[a] Gomez, P.B. and others (2017). Effects of market competition and competition policies. Washington, D.C.: World Bank Group. https://elibrary.worldbank.org/doi/epdf/10.1596/978-1-4648-0945-3_ch2.

[b] Edmond, Chris and others (2011). “Competition, Markups, and the Gains from International Trade”. Federal Reserve Bank of Minneapolis.

Competition and employment

The enforcement of competition law can lead to increases in net employment in both the short and long runs. The implementation of competition policy limits markups, which leads to lower prices. In turn, this encourages consumer demand and increases firms’ supply. To increase supply, firms have higher incentives to innovate, resulting in increased productivity and employment. The combined effect of such changes stimulates an increase in GDP.[13] Since competition policy affects the supply-side efficiency of the economy, it positively impacts employment levels in the medium and long run.[14]

On the other hand, the productivity gains and cost savings due to competition policy result in decreased employment and layoffs. However, this impact is similar to the impact exhibited on employment as a result of any technical progress. The long-run effect of competition policy offsets the short-run increase in unemployment. The positive effect has been studied extensively. In addition, the unemployment-reducing impact of competition policy is strongest in countries with strong labour unions.[15]

Box 3. **Examples of spillover effects of competition policy on employment**

While creating employment is not the explicit goal of competition policy, several countries have adopted competition policies known to have spillover effects on job creation, with one example being South Africa. Additionally, the promotion of competition in the European single market reduced unemployment by 0.5 per cent.[a]

Sources:

[a] UNCTAD (2013). The impact of cartels on the poor. https://unctad.org/system/files/official-document/ciclpd24rev1_en.pdf.

Competition, poverty and inequality

Welfare loss due to the concentration of market power appears to be felt more severely by the poor. Competition is an essential preventive tool against cartels and antitrust activities that lead to price fixing and price gouging, consequently affecting real purchasing power and consumer welfare. This result is clearly shown in the consumer goods and services markets. Essential sectors, such as food products and primary service sectors, are more often prone to anti-competitive practices. Generally, poorer households allocate a larger proportion of their income to basic goods and services than wealthier households.[16] As such, competition policies regulating markets and limiting market power will have direct poverty-reducing effects.[17] This applies in several markets of goods and services, and across both developed and developing countries.[18] The promotion of competition in the Zambian telecommunications sector decreased prices by 70 per cent compared to when the industry was State-owned.[19]

Conversely, relaxing competition laws and restricting competition enhances market power. This leads to a huge loss in social welfare, as profits are mainly captured by a few, and the adverse impacts at the level of prices and quality of goods and services are felt by many. In Mexico, the welfare loss was 150 per cent higher for the poorest rural decile compared to the richest urban decile.[20] Due to low levels of competition in the telecommunications sector in Mexico, the loss of consumer surplus between 2005 and 2009 is estimated to be $25.8 billion/year, 1.8 per cent of the GDP of Mexico.[21] Such policies not only result in increased prices, but also in reduced quality and variety of the goods and services produced.

Competition and gender

Markets marked by gender inequality are less efficient and less competitive. In competitive markets, inefficient firms are driven out of the market by more efficient ones. Firms with gender discriminatory preferences tend to be more inefficient because of their misallocation of talent. As such, competitive markets can help promote gender equality by out-competing discriminatory firms.[22]

Competition policy can be used as an instrument to promote gender equality and empower women. Competition authorities should develop policies to promote competition in markets in which women provide a substantial proportion of unpaid labour. In fact, applying competition law and policies will result in reducing gender inequality, even without designing competition laws with this specific objective. This in turn will stimulate women to join the formal labour market, resulting in a "double dividend": increased market efficiency due to competition and empowerment of women in society.[23] In addition, a significant share of female employment is in the informal sector, through either part-time employment or unpaid work. Informal employment better compliments other duties asked of women in different societies under prevailing gender norms. By easing barriers and facilitating formal employment in specific sectors, competition policy can contribute to women's economic empowerment.

Conclusion

While the interlinkage between competition and other policies is widely studied, mechanisms need to be developed to ensure coherence when designing and implementing economic policy. To promote policy coherence and maximize the benefits of policies across sectors, technical dialogue and exchange of experiences and information between policymakers, Government officials, experts and stakeholders are needed.[24]

The relationship between competition and other policies is bidirectional. Competition policies can support national policy agendas by redirecting competition to key priority sectors identified by the Government, for example. On the other hand, key policy areas can be tailored to sectors in which market conditions or structures need to be supported. Designing policies with spillover effects enhances policy coherence, advances national policy objectives and increases the overall efficiency of Governments.

This being said, no uniform policy coherence mechanism can be applied to all countries. National and regional contexts must be considered when developing policy agendas, and the Arab region is no exception. Arab States need to consider the market structures and the significance of State-regulated sectors to their national economies when designing competition policies.

Endnotes

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