



USING COMPETITION ASSESSMENT TO ACHIEVE BETTER REGULATION

Competition, regulation and economic growth

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Competition Division, OECD



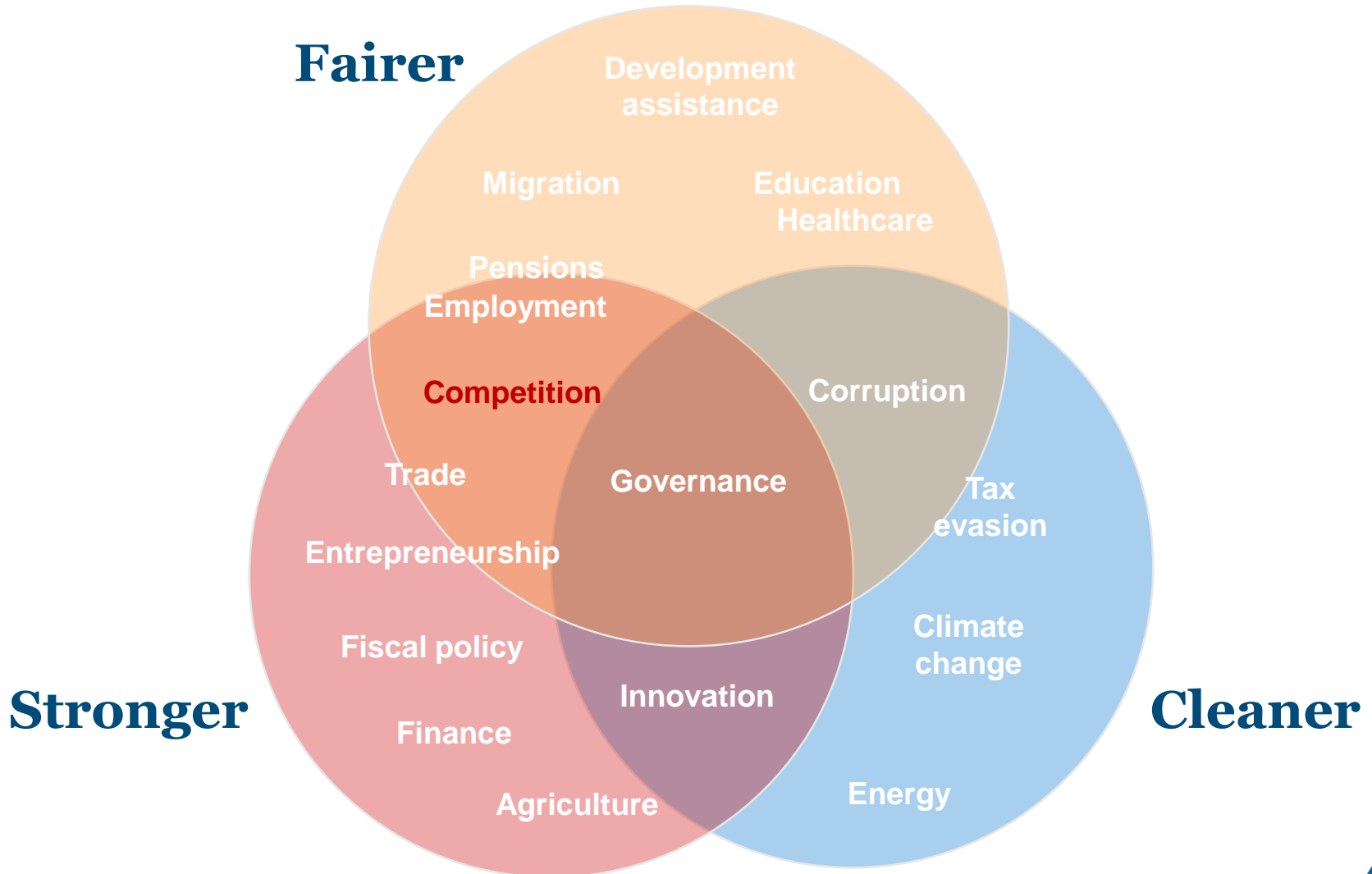
OECD Key Facts



- Established: **1961**
- Headquarters: **Paris**
- OECD Centres: **Berlin, Mexico City, Tokyo, Washington, Jakarta**
- Members: **34 countries**
- Secretary-General: **Angel Gurría (Mexico)**
- Secretariat staff: **3000**
- Annual budget: **354 € million (2013)**
- Official languages: **EN – FR**
- Publications: **250 new titles per year**
- Work participation: **Nearly 300 expert committees and working groups with participation of +100 countries**
- www.oecd.org/about/



OECD Better policies/lives from every angle





Committee: Raison d'être

- **Objective & mandate:**

To protect and promote competition as an organising principle of modern economies, based on the knowledge that vigorous market competition boosts growth and employment and makes economies more flexible and innovative

- Bring together **leaders of the world's major competition authorities**; chief international forum for dialogue on main competition policy issues
- Issue **best practices and standards** for better competition policies
- Promote **market-oriented reforms** by actively encouraging and assisting gov't decision-makers to tackle anti-competitive practices and regulations
- Assisted by the **OECD Competition Division**: analytical and advisory support. Promotes its reforms and policies around the globe



Agenda for today's discussion

- Benefits of competition for consumers
- Benefits of competition for firms
- Why do we regulate?
- Can regulation kill?
- Why do we need competition (impact) assessment?
- Competition assessment fundamentals
- The OECD Competition Assessment Toolkit
- Competitive neutrality (if time)



Benefits of competition – consumer side

Competition leads to substantial reductions in consumer prices

Competition provides greater choice

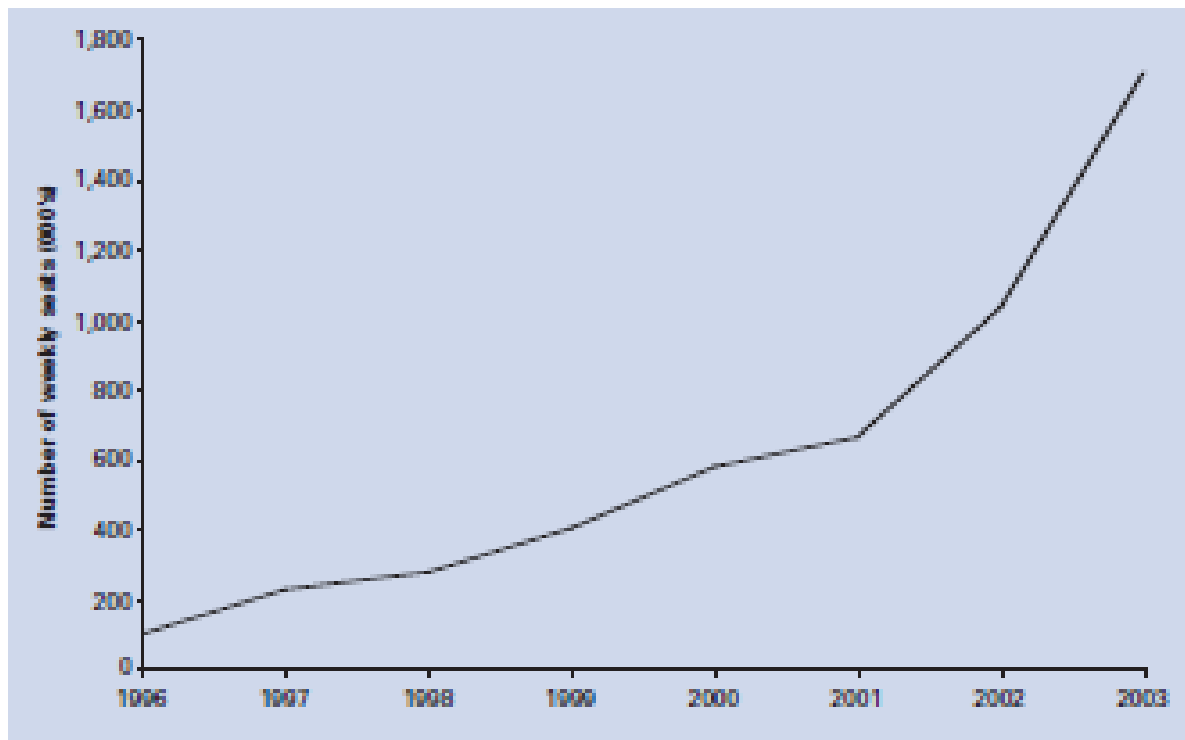
Competition fosters investment that leads to better quality products



Passenger Flights in Europe

Market liberalisation in 1993 led to more intense competition and entry of low-cost carriers (e.g. EasyJet, Ryanair)

Figure 5.2 Number of Weekly Seats (000's) on European Low-Cost Airlines 1996-2003



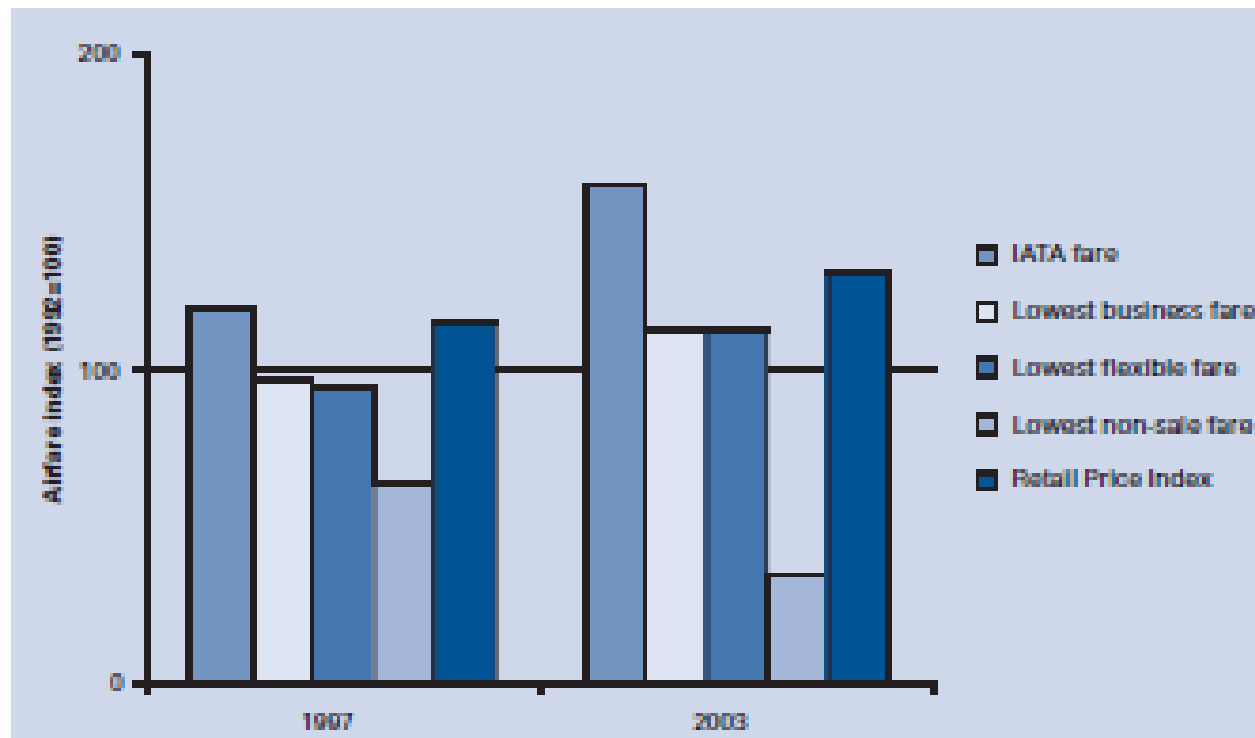
Source: OAG Scheduler Data



Passenger Flights in Europe

Price of the lowest priced carrier had fallen by 36% by 1997 and 66% by 2002

Figure 5.3(b) Lowest Priced Carrier's Average European Airfares (1992=100)



Source: CAA



Benefits of competition – the firm side

Drives firms to improve their internal efficiency and reduce costs



Provides incentives to firms to adopt new technology



Provides incentives to firms to invest in innovation



Reduces managerial inefficiency



Competition spurs productivity and growth

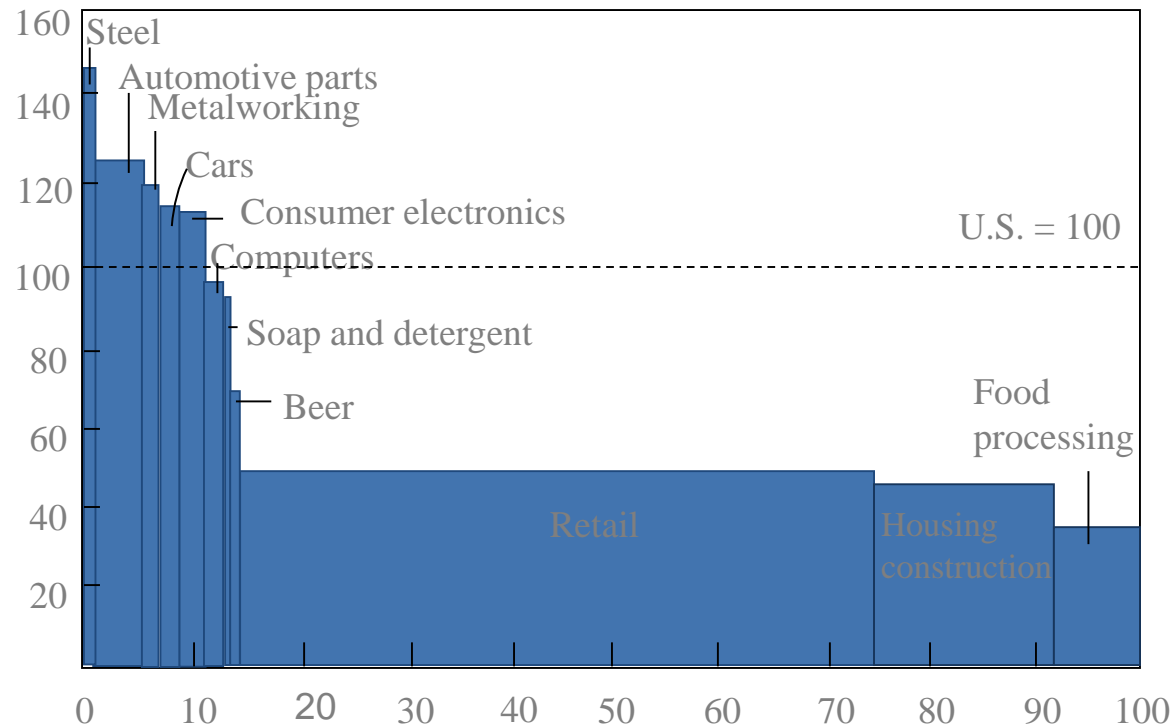
- More competitive industries have higher productivity *rates* and higher productivity *growth*
 - Competitive industries enjoy higher annual productivity growth (Nickell finds 2% gap)
- Virtuous Circle: as products became cheaper and better, consumers buy more and firms' turnover increases
- Leading to higher productivity and economic growth
 - EU single market increased productivity
 - Countries with stronger competition frameworks have higher growth (World Bank)



Competition and Productivity -- Japan's Dual Economy

Relative productivity levels

Index U.S. = 100



Employment

100% = 12.5 million employees

Source: McKinsey Global Institute



WHY DO WE REGULATE?

A look at a regulation, why we need it,
and why it may sometimes be an
impediment to competition and growth



Regulation



- Markets do not always operate efficiently, need for state intervention = regulation
- Correctly designed regulation has very important beneficial effects for society (protection for consumers & environment, health & safety, etc.)
- Rules and regulations typically have desirable socio-economic objectives
- BUT
 - **badly designed regulation can also distort competition**



Regulations and their impact on markets

- In specific circumstances, rules and regulations have the potential to **cause harm to the efficient functioning of markets**, by preventing new firms entering a market or altering the ability and incentives of firms to compete

- We do not question the socio-economic values

- **Our objective:** assess the effects of the regulations on
 - Extent of competition in the markets
 - Incentives for firms to engage in innovative activity
 - Potential for growth of the markets
 - The usefulness or purpose of the regulation itself



Regulations and their impact on markets

- ✓ For example, medical and other professional associations routinely impose several restrictions
- ✓ In the name of setting standards, medical associations restrict the number of medical schools, require stringent certification standards, and requirements to practice
- ✓ We do not question the need to set standards
- ✓ What we are concerned about is **whether the standards are set too high** as this very likely will
 - Erect barriers to entry and reduce the number of professionals (true for most professions)
 - Increase prices and burdens on starting a businesses
 - Lower the incentives for the professionals to compete in other dimensions such as quality and variety of care and services
 - Potentially be harmful to consumer welfare in the long run



Regulations and their Impact on Markets

- Some of the harmful effects that may arise from the rules and regulations relate to
 - Unduly high cost burden on firms
 - Asymmetric costs across different types of firms
 - Erecting barriers to entry (stringent or unreasonable licensing rules, for instance)
 - Difficulty in marketing new products, hampering innovation
 - Removing incentives to compete
- Regulation can sometimes go horribly wrong...



Can pay regulation kill?

- Nurses' pay in England is set centrally with little local variation
- Hospitals in high cost areas like London struggle to recruit and retain staff
- As a result: they treat fewer patients and have lower quality outcomes – for example, much higher fatality rates among patients admitted with emergency heart attacks
- These effects are not trivial: a 10% increase in the gap (NHS vs. private sector) raises the fatality rate of people admitted with a heart attack by about 5%
- (Propper and van Reenen, Journal of Political Economy, 2010)

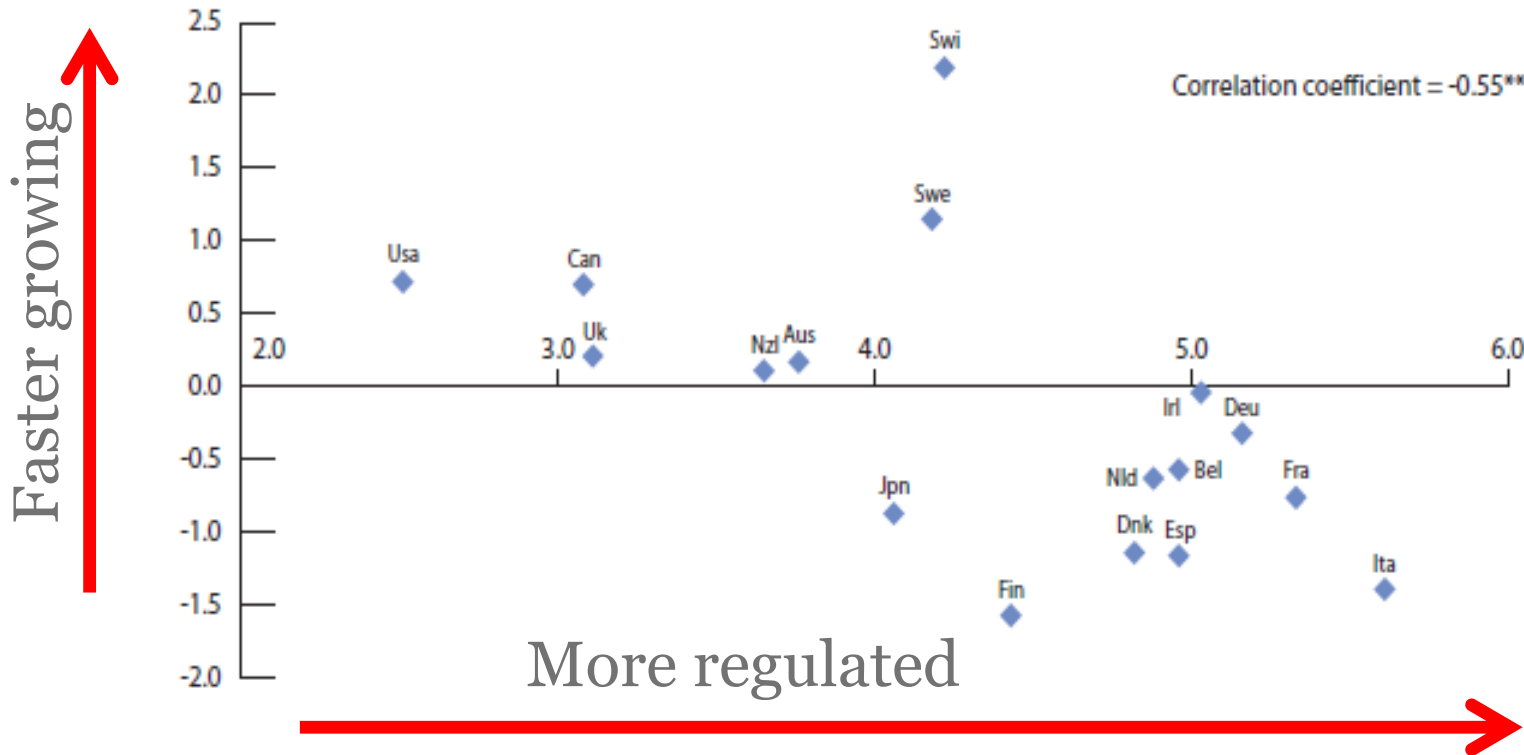


Why do we need Competition Assessment?



Regulation can stifle growth by hampering productivity

Increase in multi-factor productivity compared to regulatory stance

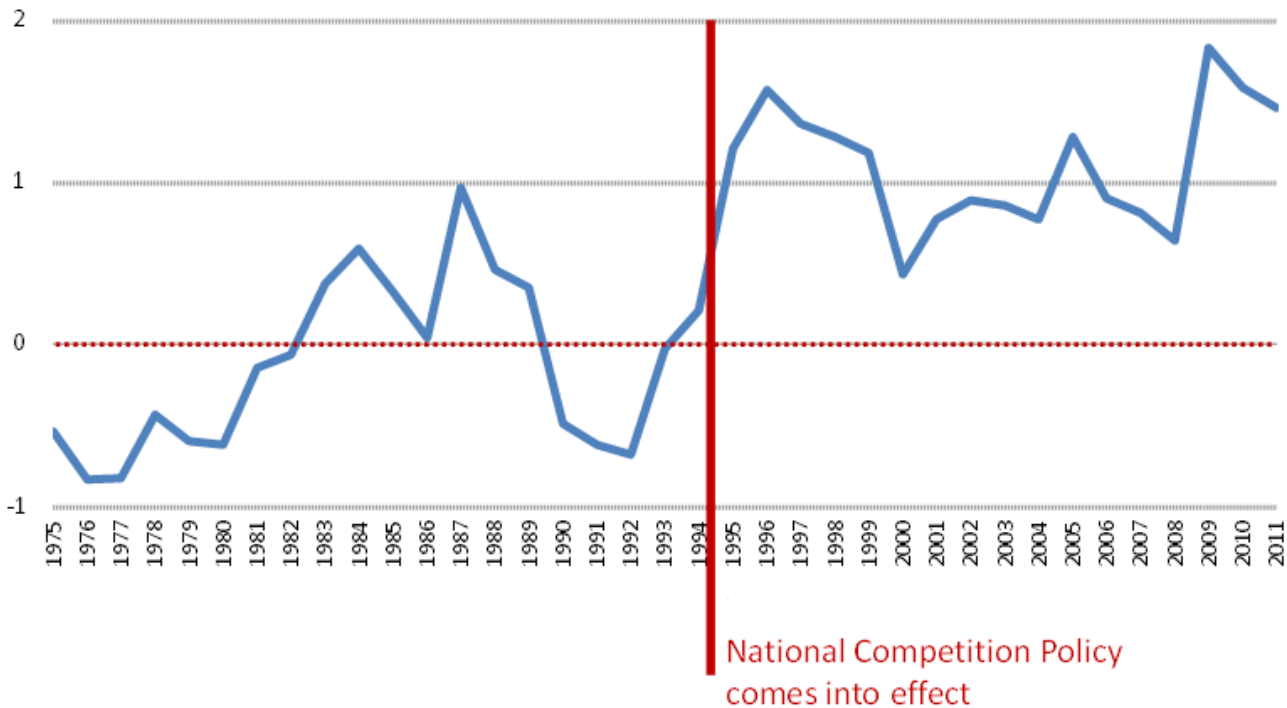


Source - Arnold, J., Nicoletti, G. and Scarpetta, S. (2011). "Does anti-competitive regulation matter for productivity? Evidence from European firms". IZA Discussion Paper No. 5511.



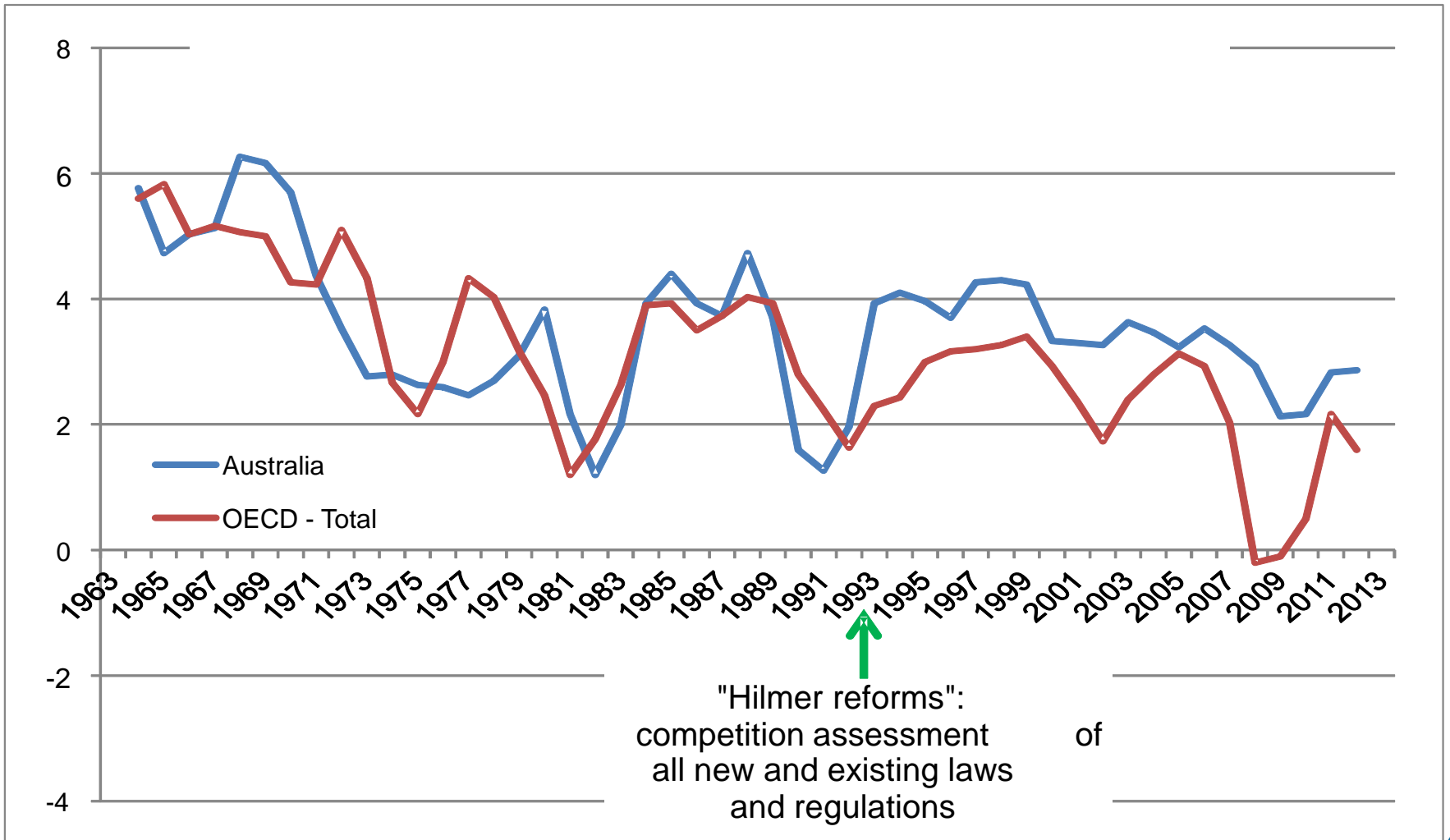
Pro-competitive reform can help

Difference, Australia GDP growth to OECD average





Competition and growth after reform



Source: OECD. Three-year moving average



Competition helps economic recovery and employment

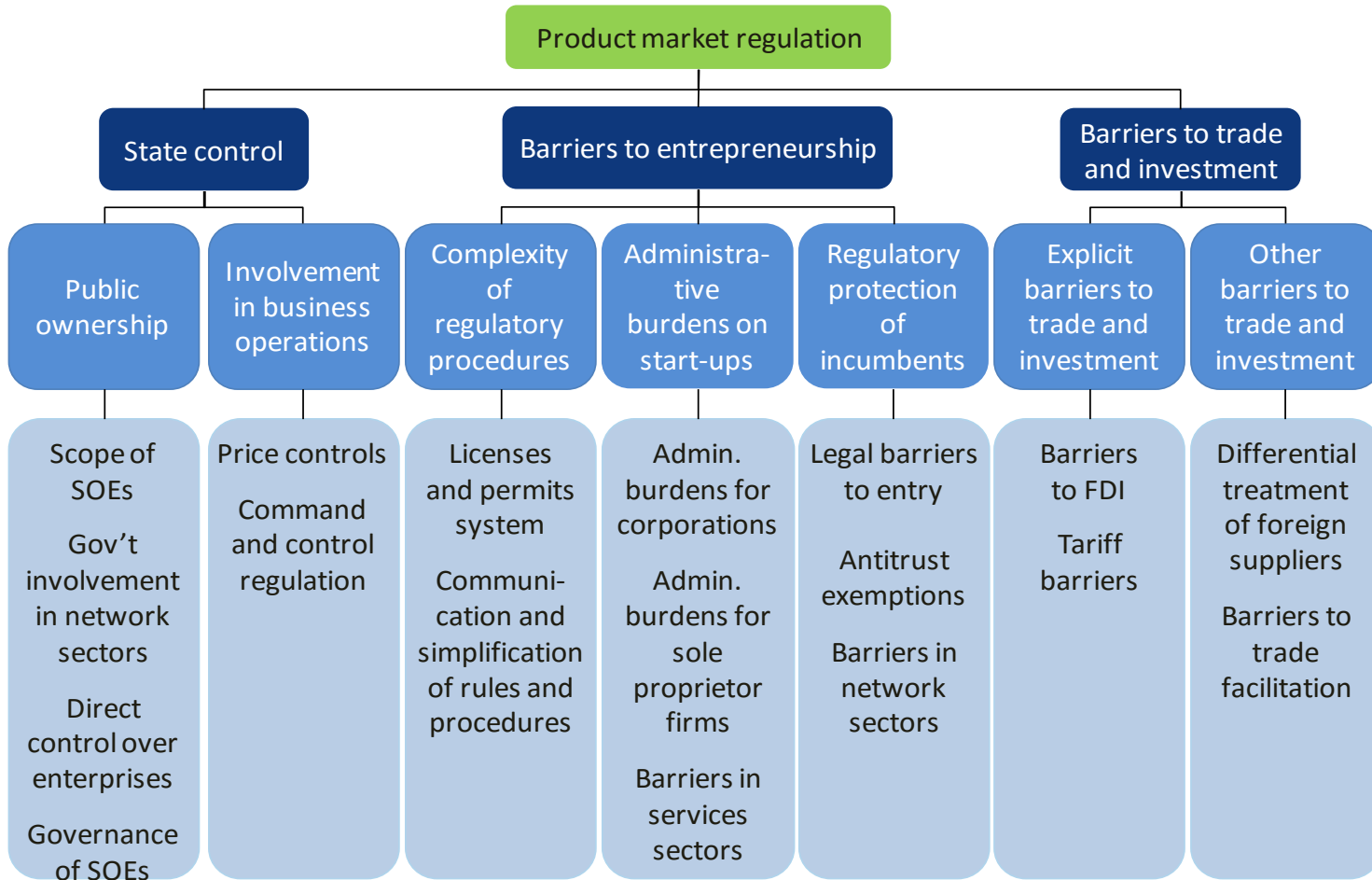
- Reducing entry barriers increases employment, e.g.:
 - Retail employment in France would be 10% higher without zoning restrictions according to a study by Bertrand and Kramarz (2002)
- Competition also supports the purchasing power of consumers
 - When a Wal-Mart store is opened in a city, its prices are between 10 % and 25 % lower for the same products than in other large retail chains.



Product market regulation and competition issues



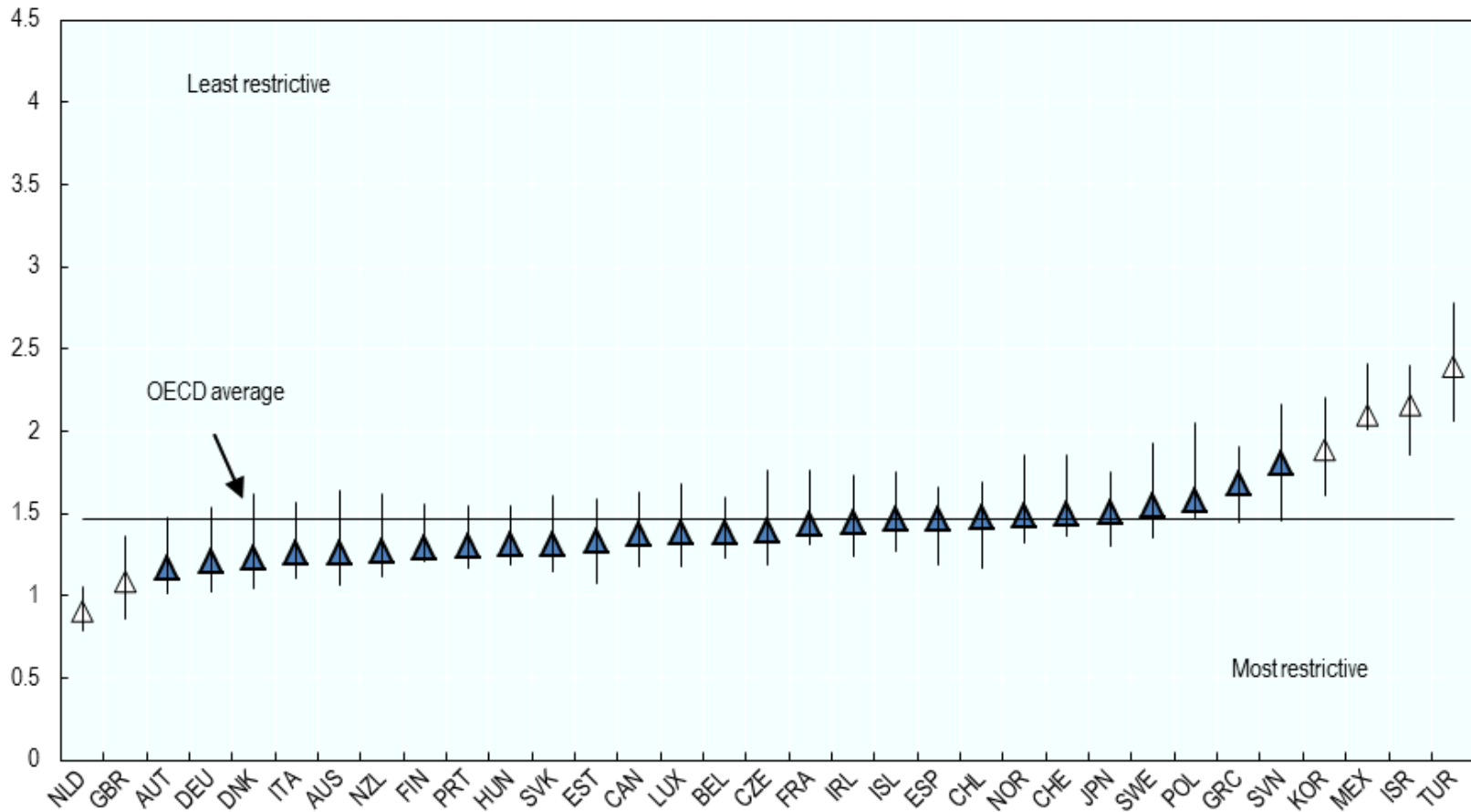
OECD Product market regulation index





PMR Index – 2013

Index scale 0 to 6 from least to most restrictive
A. OECD countries



Source: Economic Policy Reforms 2014: Going for Growth Interim Report - © OECD 2014

Data by theme Popular queries

Find in Themes **Reset**

Public Sector, Taxation and Market Regulation

- Public Sector, Taxation and Market Regulation
 - Government at a Glance
 - Taxation
 - Fiscal decentralisation
 - Market Regulation
 - Economy-wide regulation
 - Product Market Regulation 2013**
 - Sectoral regulation

Product Market Regulation 2013. ?

 Customise  Export  Draw chart  My Queries

	→ Indicator	PMR: Product mar
	→ Year	1998
→ Country		▲ ▼
Australia		1.7
Austria		2.1
Belgium		2.3
Canada		1.9
Chile		
Czech Republic		2.6
Denmark		1.6
Estonia		
Finland		1.9
France		2.3
Germany ?		2.2
Greece		2.7
Hungary		2.6
Iceland		2.0
Ireland		1.9



Data extracted on 02 Dec 2015 23:54 UTC (GMT) from OECD.Stat



Why **competition** assessment?

- The objective is to assess **the effect** of regulation on
 - Extent of competition in the markets
 - Incentives for firms to engage in innovative activity
 - Potential for growth of the markets
 - The (unintended) effect on consumers
- A different way of stating the objectives
 - We want to avoid restricting competition when making policy
 - Better to address concerns related to competition and innovation before a policy is enacted
 - Vested interest-groups may make later corrections rather difficult

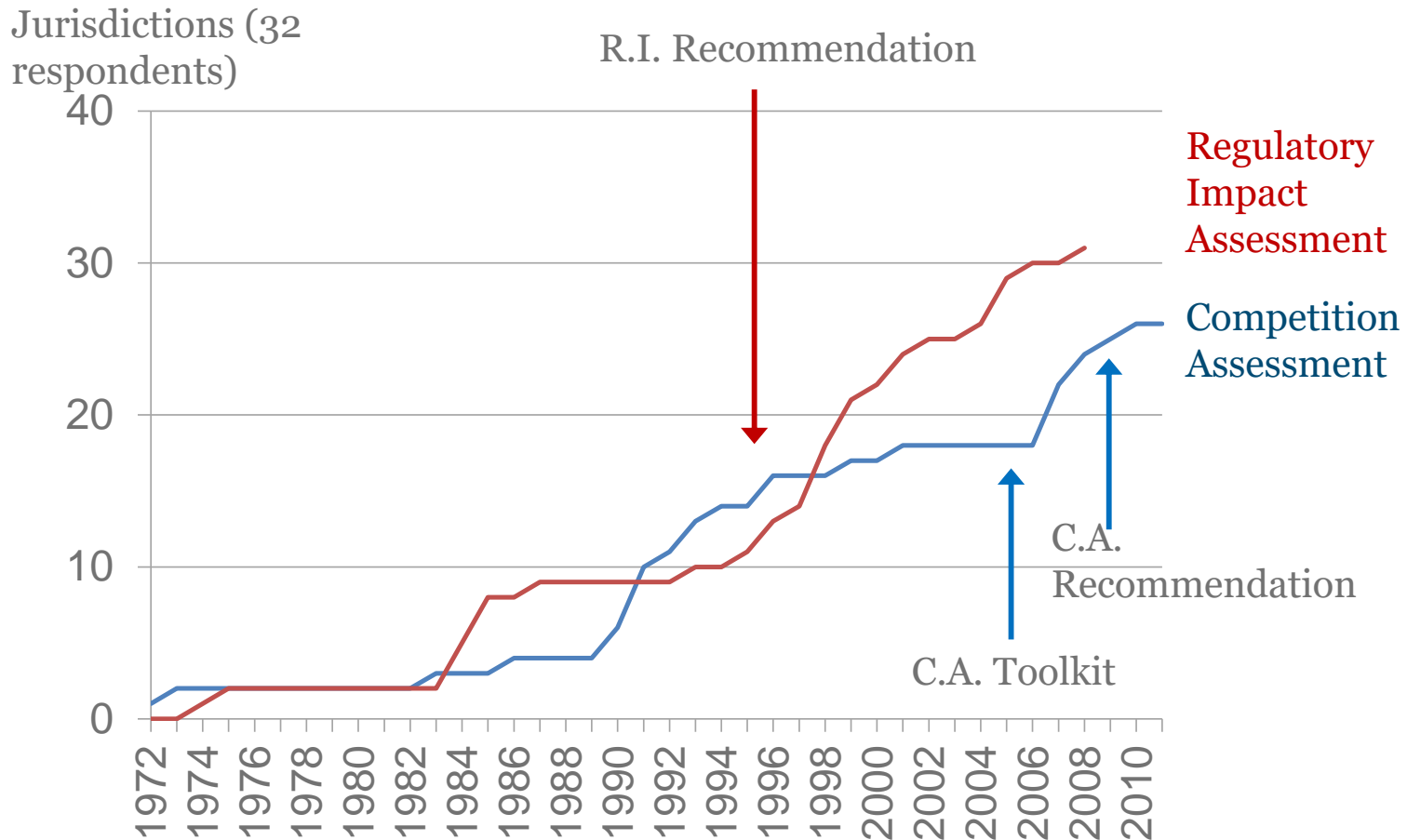


Why the emphasis on **assessments**?

- Some of the factors relate to
 - Increasing realisation that markets may work reasonably well in many industries that traditionally have been heavily regulated
 - Change in technology and market conditions warrant re-evaluation of many types of regulations
 - Improved quality of regulations may lead to national economies becoming more competitive and innovative, and domestic firms being in a better position to compete globally
- The assessment process involves revision and improvement and should lead to positive change



2011 survey : widespread use of CA in OECD and non-OECD countries





OECD has developed a Toolkit



THE COMPETITION ASSESSMENT TOOLKIT

"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*

Applied in

✓ Mexico

✓ Greece

✓ Romania



Competition assessment: examples

Review of existing legislation in Mexico

- Multi-year project to improve competitiveness in cooperation with the OECD
- 4 sectors with widespread impacts on competitiveness selected for review
- 11 sectors with significant consumer expenditure selected for review
- 4 additional areas of cross-sectoral regulation with a high impact on competitiveness also examined.

Australia review of laws and regulations resulting in substantial restrictions on competition

- Over 1800 laws and regulations reviewed over 5 years

Greece Competition Assessment

- Approximately 1000 pieces of legislation touching 4 sectors (food processing, retail trade, building materials, tourism) were reviewed



Reviewed 4 sectors in Greece, totalling 21% of GDP, in 2013

Sector:	Food processing	Retail trade	Building materials	Tourism	Horizontal legislation	Total
Pieces of legislation examined	100	210	46	132	67	555
Recommended for change	54	129	32	76	38	329



OECD Recommendations for reform valued at €5.2bn annually for Greece*

Issue	Annual Benefit	Number of provisions affected	Value, €m
“Fresh” milk	€33m (consumer benefit/year)	2	33
Levy on flour	€8m-11m (value of levy/year)	1	8
Sunday trading	€2.5bn (annual expenditure), plus 30,000 new jobs	3	2 500
Sales and discounts	€740m (annual turnover)	9	740
Over the Counter pharmaceuticals	€102m (consumer benefit/year)	23	102
Marinas	€2.3m (annual turnover)	10	2
Cruise business	€65m (annual turnover)	4	65
Advertising	€1.8b (consumer benefit/year)	14	1 800
<i>Everything else</i>	???	263	???

* Based on available data at the time of the project.

Total: €5.2bn + ???



The Competition Assessment Toolkit

- With this in mind, we
 - Outline the OECD's Competition Assessment Toolkit and methodology
 - Highlight some potentially problematic categories of regulations
 - Work through the Competition Assessment Toolkit's Checklist
 - Look at examples of laws and regulations through the lens of the Checklist evaluation process



OECD Competition Assessment:
Checking-up on Policies and Regulations



Coming up:
Competition
Assessment Toolkit and
Fundamentals



OECD Competition Assessment Toolkit

www.oecd.org/competition/toolkit

- ✓ There are often several ways to achieve a **specific public goal**, and some policies restrict competition more than others.
- ✓ Since consumers **benefit** from more rather than less competition it is useful to identify which restrictions to competition are not strictly necessary for the pursuit of public goals.
- ✓ OECD Competition Assessment Toolkit (CAT) provides a general methodology for identifying unnecessary barriers and developing alternative, less restrictive policies that still meet government objectives.



Competition Assessment Toolkit (CAT)

- Designed for government officials in decision-making roles and staff who will conduct the assessments
- The “Guidance” volume details the framework and the steps needed to implement competition assessments
- CAT aims to provide
 - Institutional options for competition assessments
 - Integrating competition assessments into regulatory impact analysis
- The CAT is a tool that is applied in several stages



OECD Competition Assessment Toolkit

- **Step One**: A competition assessment **checklist**
 - Designed as an initial screen to “**qualitatively**” assess rules and regulations that may be problematic
 - Structured to be conducted in short time frame
 - Framework is based competition policy and law enforcement, economic theory and on empirical work
- **IF** potential harm to competition is identified, then a more detailed review is recommended
- **Step Two**: Detailed competition assessment
 - Designed to fully and “**quantitatively**” **evaluate** rules and regulations that may cause significant harm
 - Propose alternative regulations to minimise harm to competition



Competition Assessment Checklist

Initial Screening Based on the Checklist

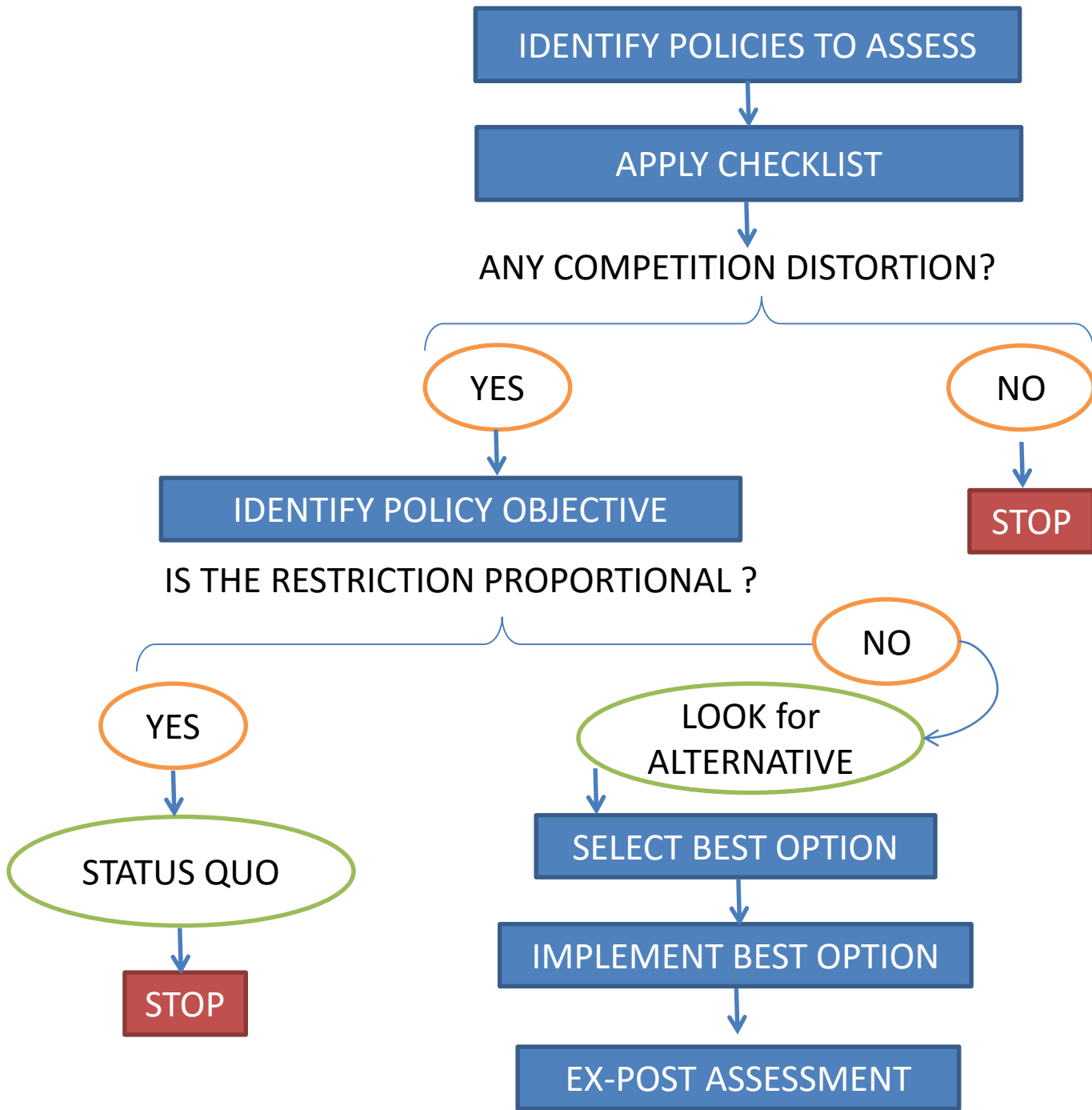
- The checklist consists of four core questions
 - A **YES** answer to any of the four questions would signal a competition concern
 - and warrant a detailed review of the rule or regulation under consideration



The check-list

4 basic questions with a yes/no answer

- Do the rules/regulations limit the number or range of suppliers?
- Do the rules/regulations limit the ability of the suppliers to compete?
- Do the rules/regulations limit the incentives for the suppliers to compete?
- Do the rules/regulations limit the choices and/or information available to the consumers?





Rules and Regulations – some examples

- Before we discuss the detailed review and assessment, it is useful to take a quick look at some selected categories of rules and regulations that have the potential to harm competition and innovation in markets

= red flags





Problematic regulation

- Some of the problematic categories include
 - Regulations that distort market prices
 - Regulations that limit advertising and marketing
 - Regulations that create entry and mobility barriers
 - Granting or extending exclusive rights
 - Restrictions on flow of goods, services and capital
 - Exempting specific businesses from competition laws
 - Rules that set standards and content
 - Grandfather clauses
- The CAT “Guidance” volume contains details on each



Problematic regulation

- Regulations that distort market prices
 - E.g., ceiling (cap) on prices for a product or service
 - May reduce firms' incentives to compete
 - May distort firms' incentives to innovate – reduced incentives to offer higher quality and bring more variety to the market
 - The effects on the “average” market price of the product or service is ambiguous
 - The quality-adjusted market price may still increase
 - E.g., the Government decides to publish prices of specific commodities or services to increase transparency
 - May reduce incentives to compete
 - May provide a *focal point* to sustain **collusion**



Problematic regulation

- Regulations that create entry and mobility barriers
 - E.g., local governments restrict entry into the taxi services market by limiting the number of licenses, and put caps on prices
 - The cap on the number of licenses very likely results in reduced supply, raising the value of the license
 - The ceiling on prices, does not allow taxi companies to adequately recoup the high cost of the licenses
 - These effects combine to erect considerable barriers to entry
 - Both prices and quality of services are likely to be affected
 - E.g., restrictions on various professions
 - The local or national licensing restrictions reduce competition
 - Consumers potentially face higher prices, and lower quality or reduced variety of services resulting from limited entry and mobility of these professionals



Competition Assessment Checklist

Initial screening based on the checklist

- Based on the previous examples we can see that some rules and regulations may entail
 - higher market prices
 - a reduction in quality and variety of goods and services produced and offered in the market
 - potentially lower innovation
- To assess these affects, we use the **Competition Assessment Toolkit**
- As noted earlier, it is designed as an initial screen to qualitatively assess the impact of rules and regulations on competition



Getting results: understand the reasons

- Important to understand the policy rationale
- There are important and valid policy objectives other than competition
 - and we can only advise on costs and benefits: nobody elected us
- Every expert with an interest in the status quo will say “this sector is different” ...
 - and occasionally they will be right.



STEP 2 – THE DETAILED REVIEW



Step 2 – The detailed review

The detailed evaluation would focus on the specific intervention and potential quantification of whether the rule or regulation might

- Impose barriers to entry of new businesses
- Force certain types of businesses to exit
- Increase the prices of goods and services
- Reduce product or process innovation
- Significantly increase concentration in the relevant market

Also:

- How will the new regulation or standard affect different types of firms?
- What will be the nature of grandfathering clauses?
- How else could the policy goal be reached?

If upstream or downstream markets are affected:

- Evaluate effects on the related markets
- Initial review
- Detailed review

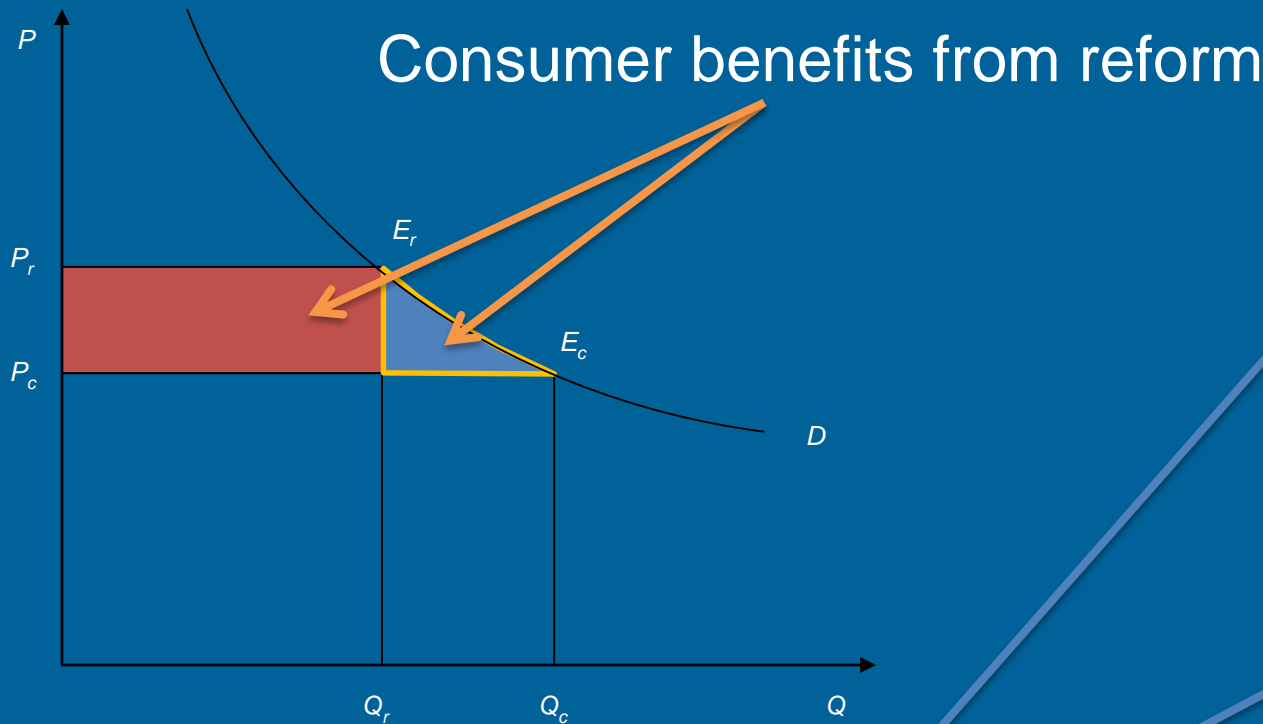


What is measured?

- Data commonly subject to measurement include consumer benefits, costs, employment, output, productivity and profitability
- Intangible measures of consumer benefits can be both important and difficult to assess
 - For example, a rule that raises the price or restricts access to hearing aids will affect the hearing of many people, their social, family and professional interactions will be affected
 - Placing a value on the losses from fewer interactions is inherently difficult



Estimating the benefits of regulatory change



Default value for price change may come from range of published estimates of price impacts for that type of checklist restriction

May find elasticity estimates from comparable products/other countries, if not locally available

With percent price change ρ , elasticity ϵ and sector revenue R , can approximate consumer benefits (CB) of change

$$CB = \left(\rho + \frac{1}{2} |\epsilon| \rho^2 \right) R_r$$



What is the expected price change?

E
X
T
R
A
C
T

Mean price change (ρ) (absolute value in ratio of price decline)	Range	Number of results	Category and sub-category of regulatory restriction
0.21		115	(A) Limits the number or range of suppliers
0.23	-0.9 to -0.006	35	1 Grants exclusive rights for a supplier to provide goods or services
0.12	-0.31 to -0.003	10	2 Establishes a license, permit or authorisation process as a requirement of operation
0.17	-0.416 to -0.040	15	3 Limits the ability of some types of suppliers to provide a good or service
0.24	-0.75 to -0.002	41	4 Significantly raises cost of entry or exit by a supplier
0.13	-0.36 to -0.04	10	5 Creates a geographical barrier to the ability of companies to supply goods services or labor, or invest capital
0.18		68	(B) Limits the ability of suppliers to compete
0.20	-0.80 to -0.10	29	1 Limits sellers' ability to set the prices for goods or services
0.21	-0.65 to -0.01	12	2 Limits freedom of suppliers to advertise or market their goods or services
0.11	-0.308 to -0.001	13	3 Sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that some well-informed customers would choose
0.28	-0.70 to -0.069	11	4 Significantly raises costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants)



Where do these figures come from?

	A	B	C	D	E	Ot
1	Author, Year, Title	Description	Price effect	Output effect	Cost effect	
215	B2 Limits freedom of suppliers to advertise or market their goods or services					
	Vita, Michael. (2000) Regulatory Restrictions on Vertical Integrations and Control: The Competitive Impact of Gasoline Divorcement Policies.	This paper suggests that vertical integration of gasoline refiners and gasoline retailers is a source of economic efficiency that is foregone when integration is restricted or proscribed. Vita found that divorcement regulations (regulations that prohibits or restricts the number of stations that a refiner can own and operate directly) increased a retail price of unleaded regular gasoline by more than 2.6¢ per gallon. He suggests that if divorcement policies were imposed via national legislation, the annual consumer welfare loss come approximately \$2.5 billion per year.				
216	Clifford, Winston (2006). "The United States: Private and Deregulated", in Jose A. Gomez-Ibanez and Gines de Rus, editors, Competition in the Railway Industry: An international Comparative Analysis	This article provides an overview of the effects of the Staggers Rail Act 1980 (aimed at deregulating the railroad industry) on the US railroad industry. Deregulation enabled the industry to substantially cut its operating costs per ton-mile which have fallen 69% as of 2002. Secondly, given the intensity of competition in surface freight transportation, rail passed on some of its costs savings to shippers in lower rates which declined 65% since deregulation.	(-) 65%. In a more competitive scenario.		(-) 69% in rail operating costs as of 2002.	
217	Shimpo, S. and Fumihira, N. (1996). Economies of Density and Regulatory Change in the U.S. Railroad Freight Industry.	This paper analyses the effects of the Staggers railroad Act of 1980, the Railroad Revitalization Act and the Regulatory Reform Act of 1976 on the railroad industry, the conclusions presented suggest that the combined effect of such regulations enabled railroads to substantially increase their route density (over 34%).		(+) 34% route density. In a more competitive scenario.		
218						

We welcome suggestions for additional case studies!



OECD's Competition Assessment Toolkit



- 2007: Toolkit published to assist officials in competition assessment of new or existing laws and regulations
- 2009: OECD Council Recommendation, endorsing use
- 2010: updated
- Now available in two volumes, in 17 languages
- 2015: Volume 3 approved for release, updated volumes 1 & 2



Materials

- All OECD Competition Assessment Toolkit related materials in 17 languages can be found here: <http://www.oecd.org/daf/competition/assessment-toolkit.htm> , including reports from Greece and Mexico and updates on Romania
- Soon to be published: revised and updated version and a *new vol. 3 – Operational Manual*
- ICN Recommended Practices on Competition Assessment
<http://www.internationalcompetitionnetwork.org/uploads/library/doc978.pdf>



THANK YOU FOR YOUR
ATTENTION!