SEE countries: Middle income convergence trap and the role of competition policy

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Setting the scene

- Economic growth as the holly grail of economics
- Yet there are still *Mysteries of Economic Growth* (Helpman, 2004)
- The theoretical framework has been set in 1990s as Schumpeterian endogenous growth theory – theory of vertical innovations (Aghion and Howitt, 1992)
- It is rent-driven innovations that are creating technological progress which is the only source of the economic growth in steady-state

All growths are equal?

- Seminal contribution of Acemoglu, Aghion and Zilibotti (2003) on several engines of growth
- At the low level of income (less developed countries) growth is predominantly based on accumulation of production factors and imitation
- At the high level of income (developed countries) growth is predominantly based on innovation and productivity growth
- Economic growth undermines its foundation

One size fits all?

- Growth based on accumulation of production factors (extensive growth) demands other economic institutions and policies compared with the intensive growth
- Incentives to invest are crucial – protection of investment returns (rents) is desirable for extensive growth
- Competition is not good for the returns, destroying rents, increasing efforts, no quite life
- Monopoly rent as a dream of (almost) all

Competition is bad for growth?

- Could be, in some circumstances, the theory says (Aghion and Griffith, 2005)
- Policies against competition: infant industry protection, export subsidies, R&D subsidies, informal policies, „national champions“
- Not necessary based on the insights from the economic theory, more often they are produced by a political economy mechanism
- Protection for sale. i.e. special interest policies (Grossman and Helpman, 2001)

Middle income trap

- Growth based on factor accumulation boosts the country to the development (middle income) level at which growth engine runs out of steam
- Growth is not sustainable, growth rates goes down – no convergence to the developed countries
- Economic institutions and policies that were good for growth are now obstacle to it
- Competition becomes good for growth, innovations based one

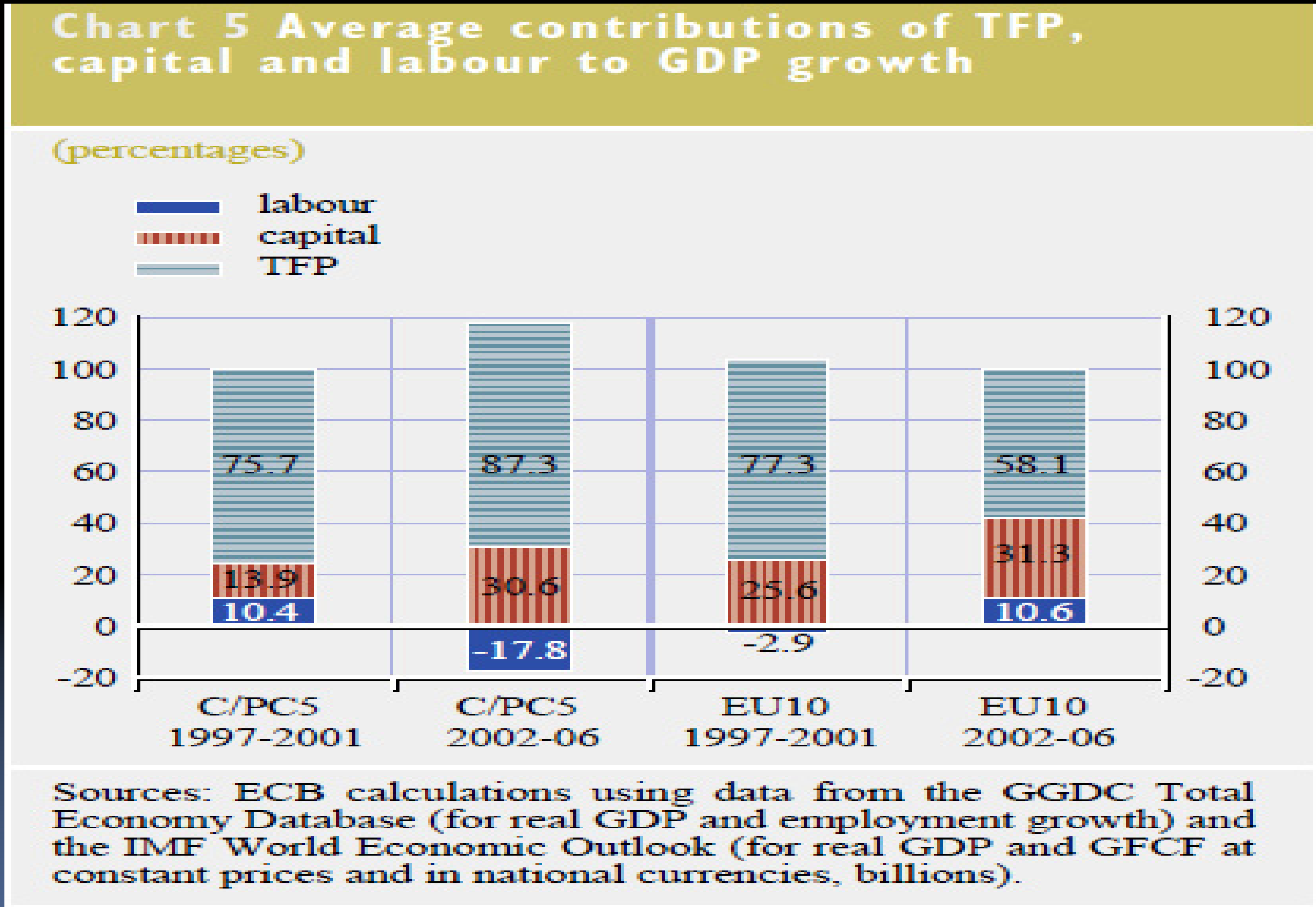
Thorough policy reform

- It is paramount to introduce, maintain and protect competition and competitive pressure to all undertakings
- Competition policy and law become a priority for economic growth
- Advocacy function can provide fast results in removing entry barriers
- Not to soon – the danger is to undermine growth based on factor accumulation
- Not to late – the danger of suppressing innovation based growth

The information problem

- Is growth crises that a countries experiences is the crises of the growth model?
- Is a country in the middle income convergence trap?
- What is the engine of growth of SEE countries? Are we in the middle income convergence trap?
- Growth accounting could provide us some answers: decomposition of the growth to its components: capital, labour and TFP increase (technological progress & efficiency)

Some basic answers



Source: Borys, Polgar and Zlate (2008)

Competition is good for the SEE growth

- Increase of the TFP is the main engine of growth if the transition economies, being they CEE (EU-10) or SEE (C/PC-5)
- Substantial part of the TFP increase is based on the increase of efficiency, due to the reallocation of resources (exits and entries) and increase of production efficiency
- Competitive pressure and freedom to entry are necessary precondition for both

Elements of competition policy for the SEE countries

- Removing barriers to entry, especially, but not only to foreign trade/import, hidden barriers are ubiquities
- Cost of doing business indicators & economic freedom indicators (Frazer Institute and WSJ & Heritage index)
- Curbing merger control, enabling restructuring of the firms by mergers and acquisitions
- The importance of advocacy, more than mare law enforcement

Nominal and effective competition law

- Econometric study by Ma (2011) included explanatory variables of nominal competition law (rules and regulations) and law enforcement practice of jurisdiction.
- Hylton & Deng (2007) for the rules; Kaufmann *et al.* (2009) for the enforcement
- 101 countries included
- Dependent variable was growth of GDP per worker 1990-2004

It is both what and how

- Statistically significant (1% level) estimates of the interactive term in both whole sample and rich countries sample
- Estimates of the nominal law independently from the enforcement are not statistically significant – no impact on growth
- Change from 5th percentile to 95th percentile of effective competition law increases average annual growth rate by 0.29%
- Increase of the growth rate is statistically significant and nontrivial

Guidelines for the SEE countries

- Institutional building of the competition authorities and courts is crucial for speeding-up economic growth.
- Advocacy in the area of removing barriers to entry is best cost effective activity of the competition authorities in SEE at initial stage
- Merger control should not be too stringent, mergers are still predominantly good for the economic growth
- Type I mistake (false positive) is better than Type I mistake (false negative)
- *Ceterum censeo*: Institutional building and advocacy (focused to the barrier to entry)