THE MARKETS AND COMPETITION POLICY ASSESSMENT TOOLKIT

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ACKNOWLEDGEMENTS

This toolkit was developed by the World Bank's Markets, Competition, and Technology Unit, building on over fifteen years of collaboration with various global and regional teams across the World Bank Group. The development of this toolkit was led by Martha Licetti, Practice Manager of the Markets, Competition, and Technology Global Unit, with essential contributions from Tania Begazo, Soulange Gramegna, Graciela Miralles Murciego, and Sara Nyman to prepare this version.

The toolkit was inspired by two World Bank Group competition policy programs: one focused on subnational issues in Mexico, and the other on regional competition concerns in Africa. The MCPAT methodology was first applied in Oaxaca, Mexico, then piloted in two additional states, Tabasco and Mexico, and finally integrated into the national program for subnational reforms. In Africa, the methodology was tailored to specific industries and adapted to less mature competition environments, in partnership with the African Competition Forum. In both cases, the need for a systematic framework and toolkit to analyze markets, identify competition barriers, and advocate for reform became clear. This prompted the team to consolidate various competition diagnostic tools and findings from across countries, ultimately leading to the development of the MCPAT framework. The team also acknowledges the invaluable support of directors and managers at these stages, including Anabel Gonzalez, Pierre Guislain, Cecile Fruman, Klaus Tilmes, and Marialisa Motta.

The toolkit addresses the development community's historically narrow focus on the enactment of competition laws as the primary tool for promoting competition. While important, competition laws are only one element of the broader policy toolbox. Many challenges in developing countries arise from distortions caused by unintended consequences of government intervention in markets. Additionally, it is clear that numerous government bodies—ranging from sector regulators and line ministries to agencies supporting innovation and small and medium enterprises—design policies that impact market dynamics. Their actions and policy interactions significantly influence market outcomes and development results. The toolkit provides a method to analyze this complex ecosystem of institutions, enabling policymakers and stakeholders to identify, assess, and improve policies and interventions that enhance market functioning or foster market creation. It also supports the capacity-building efforts of market institutions and strengthens their ability to implement effective policies.

The application of the toolkit in diverse countries and policy contexts was crucial for refining its approach. In this process, the contributions of competition champions and institutions were pivotal. Notable examples include the Africa Competition Forum, the Competition Authority of Kenya, Mexico's Better Regulation Authority, Peru's National Institute for the Defense of Competition, and Romania's Competition Council, all of which played key roles in the early stages of this initiative. The support of various task team leaders at the World Bank and the International Finance Corporation has been invaluable in emphasizing the importance of market and competition policy for development. Their efforts to apply the toolkit in policy dialogue, technical assistance, and operational activities are greatly appreciated.

This consolidated version of the MPCAT toolkit builds on the original MCPAT methodology, which was developed through a collaborative effort by the Markets and Competition Policy team between 2013 and 2016. The contributions of various team members at different stages of the process are gratefully acknowledged. Notably, Martha Licetti and Lucia Villaran played a key role in developing the initial methodology applied at the subnational level, while Tania Begazo and Sara Nyman developed the initial sectoral applications. Subsequent contributions from Tanja Goodwin and Graciela Miralles were critical for the finalization of the MCPAT core approach. The toolkit also draws on valuable insights from colleagues analyzing competition constraints across World Bank Group diagnostic reports, including Seidu Dauda,

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MOTIVATION

How many of you are government officials or development practitioners focused on achieving key development objectives, such as guiding a country toward middle- or high-income status, implementing industrial policies to transform the economy, and ensuring that micro, small, and medium enterprises (MSMEs), workers, and consumers benefit from economic growth? As you may have observed, the effectiveness of government interventions—whether through rules (laws, regulations, and policies) or the allocation of public resources—largely depends on how businesses, consumers, and markets respond to them.

Imagine a country where road transport is controlled by local monopolies or economic agreements between competitors to supress competition (referred to as "cartels"), and trade restrictions limit the import of food products, giving preferential treatment to one or two local manufacturers, including a state-owned enterprise. In such a country, wholesale food markets are dominated by a few firms, and retail markets face strict regulations on store locations and operating hours. How do these conditions affect food security and hinder the development of a competitive food manufacturing industry with the potential to thrive internationally? This is not a theoretical scenario; the World Bank's analysis has identified similar challenges in various regions. So, how can these issues be identified, understood, and addressed to help the government achieve its policy goals?

The Markets and Competition Policy Toolkit (MCPAT) was originally created to help readers understand the critical role competitive markets play in development, identify the barriers that can prevent markets from functioning effectively, and develop government interventions to address these challenges. Each topic covered in the toolkit is complex enough to warrant its own publication; however, MCPAT provides a concise summary of this knowledge. Beyond competition law, the toolkit emphasizes practical approaches for incorporating competition and market-driven principles into economic policies. The current publication—MCPAT 2.0—builds on the original, offering an updated version that incorporates insights gained from its application in diverse contexts.

This toolkit is globally applicable, drawing from years of successful pro-competition policy reform across various countries, sectors and policy areas. It combines theoretical foundations with practical examples and lessons from successful identification of market distortions and reform implementation in over sixty countries in the past ten years. Its aim is to amplify the impact of competition policy in government development strategies and development financial institutions' programs. Most importantly, it is designed to empower competition practitioners, international development practitioners, public officials, and policymakers to make markets work for inclusive and sustainable development, worldwide. This means fixing markets where they fail and creating markets that work.

What led to the creation of the MCPAT framework? For many years, governments and multilateral organizations, including the World Bank, focused on supporting the enactment and approval of competition laws as the key to enabling efficient market dynamics. Yet, market distortions persisted, especially in less developed economies. First, sector-specific or economy-wide constraints created by government policies limit entry or affect firms' capacity to compete on their merits. Second, ineffective enforcement of competition rules allows for anticompetitive business practices. Enacting competition laws is a necessary but not sufficient condition, as technical and implementation capacity needs to be developed over time, including proper governance to build independent, transparent and functional market institutions. Thus, the global team of the WBG working on markets and competition policy adopted a broader approach to building effective policy frameworks for promoting competition based on the acknowledgment that competition agencies are part of a broader ecosystem of market institutions. This approach emphasizes three elements that are key for proper market functioning: (i) facilitating entry to markets to discipline incumbents, (ii) ensuring that prices and other product characteristics reflect market signals, and (iii) ensuring that all businesses interact on a level playing field.

What is the purpose behind sharing this consolidated toolkit?

- **The MCPAT is a valuable tool for development economists, policymakers, and government officials, offering principles that help diagnose and address both macroeconomic and microeconomic issues.** For example, collusive agreements can undermine well-designed public procurement frameworks, resulting in price overcharges for critical goods and services that drain public resources and harm taxpayers. Underperforming State-Owned Enterprises (SOEs), which operate under soft budget constraints, can lead to increased fiscal expenditure. E.xport promotion, to alleviate balance of payments concerns, is often hindered by government interventions or anticompetitive conduct.. Additionally, competition issues in markets for clean energy products can undermine climate change mitigation policies by making such products unaffordable. By applying the MCPAT framework, we can identify specific policy areas at the market level that have the potential to alleviate these macroeconomic pressures.
- **The MCPAT framework broadens the focus from firm capabilities to encompass market- and sector-level dynamics within an institutional setup influenced by political economy.** The MCPAT"s diagnostic function informs reform implementation, a challenging task for various reasons. The framework includes stakeholder mapping and reform prioritization based on impact and feasibility, serving as a roadmap for the reform agenda. It also recognizes that reforms are a dynamic and sustained process, often requiring a gradual, step-by-step approach: starting small to build support for more comprehensive reforms.
- **The MCPAT examines the unintended consequences of policies and offers principles for designing alternative policy solutions.** Government interventions that distort markets are often put in place to address specific policy concerns. For example, restrictions on truck movements to and from a port may be implemented to manage traffic congestion, or regulations on professional services may be introduced to ensure quality standards. The MCPAT recognizes these issues and provides guidelines for proposing alternative interventions that minimize market distortions while still addressing the underlying concerns the original regulations were meant to solve.

We have witnessed the practical impact of this tool and hope it can become a public good, helping us all conduct diagnostics that lead to microeconomic reforms capable of transforming markets for the better, addressing one distortion at a time.

ABBREVIATION

ACCC	Australian Competition and Consumer Commission
ACF	African Competition Forum
BOS	Business of the State
BTI	Bertelsmann Stiftung's Transformation Index
CAK	Competition Authority of Kenya
CMA	Competition and Markets Authority
CPSD	Country Private Sector Diagnostic
EBRD	European Bank for Reconstruction and Development
ECA	Eastern Europe and Central Asia
EIU	Economist Intelligence Unit
ES	World Bank Enterprise Survey
ESH	Efficient Structure Hypothesis
EU	European Union
FDI	Foreign Direct Investment
FOREX	Foreign Exchange
GATT	General Agreement on Tariffs and Trade
GCI	Global Competitiveness Index
GDP	Gross domestic product
GPA	World Trade Organization Government Procurement Agreement
HHI	Herfindahl Hirschman Index
HIC	High Income Countries
HS	Harmonized System
ICN	International Competition Network
ICP	International Comparison Program
ICT	Information and Communications Technology
IMF	International Monetary Fund
INACA	Indonesian Airlines Association
ISIC	International Standard Industrial Classification
ITU	International Telecommunication Union
LAC	Latin America and the Caribbean
LIC	Low Income Countries
M&A	Mergers and Acquisitions
MCPAT	Markets and Competition Policy Assessment Toolkit
MIC	Middle Income Countries
MNO	Mobile Network Operators
MVNO	Mobile Virtual Network Operator
NACE	Nomenclature of Economic Activities
NEIO	New Empirical Industrial Organization
OECD	Organization for Economic Cooperation and Development
PCF	Politically Connected Firm
PCM	Price-cost margins
PEP	Politically Exposed Person
PMR	Product Market Regulation
PPP	Purchasing Power Parity
PPP	Public Private Partnership
R&D	Research and Development
RPD	Relative Profit Difference
SBC	Soft Budget Constraint
SBS	Structural Business Survey
SCM	Subsidies and Countervailing Measures
SIC	Colombian Competition Agency
SME	Small and Medium Enterprise
SOB	State-Owned Bank
SOE	State-Owned Enterprises
SSNIP	Small significant non-transitory increase in price test
STE	State Trading Enterprises
WDI	World Bank's World Development Indicators
WTO	World Trade Organization

EXECUTIVE SUMMARY

The Markets and Competition Policy Assessment Toolkit (MCPAT) is a guide for understanding how policy can positively shape markets and address market failures that ultimately affect micro- and macroeconomic development issues. The MCPAT aims to support policymakers, competition authorities, and development finance institutions in realizing the advantages of competitive and well-functioning markets by setting the right conditions for firms to improve their economic performance and for markets to allocate resources efficiently. Competitive and well-functioning markets do not just benefit consumers, – they benefit entire economies as they promote productivity, innovation, efficiency, and consumer choice. The goal is not simply to increase the number of firms in a market or to restrict market power but to create an environment where competition can thrive, firms can innovate, and markets can function optimally. The core elements of the MCPAT are summarized in Figure 1.

FIGURE 1: THE MCPAT AT A GLANCE

Source: Authors' own elaboration

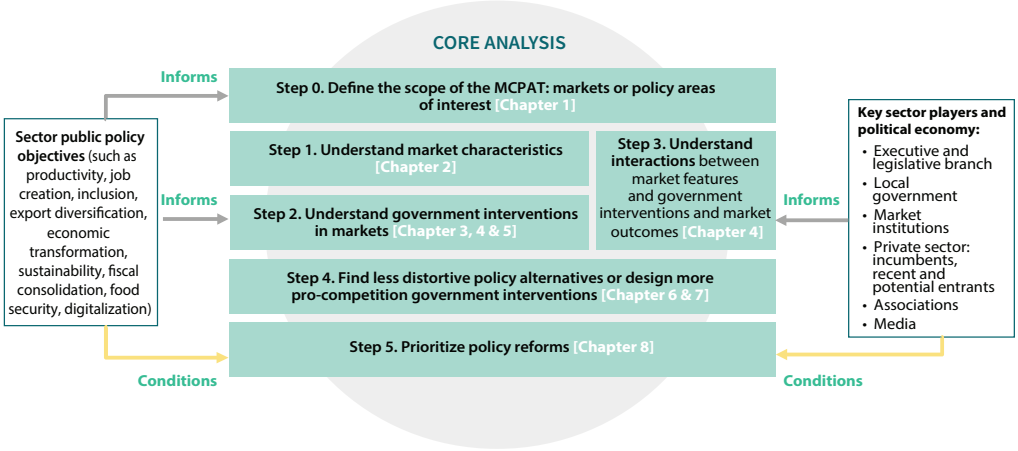
The MCPAT is applicable across countries of all sizes and development levels, enabling the identification of problems in any market. The MCPAT relies on the application of microeconomic principles rather than on the existence of a competition law or a competition authority. Therefore, it can be applied to both countries with developed market institutions and existing competition policy frameworks, as well as countries with weaker institutional frameworks. This updated version of the MCPAT gathers experiences from various countries at diverse stages of development, sectors and policy areas. It is worth noting that each topic or problem area can be handled with greater depth; the MCPAT provides a summary of this knowledge.

The MCPAT can identify government interventions that purposely or unintentionally restrict competition across various policy areas. Examples include the management of foreign exchange (forex) that favors incumbents, locally developed standards that exclude smaller competitors, financing at preferential rates available to selected enterprises, and price controls based on suggested prices by producers. Depending on the development question that the policymaker is attempting to answer, the MCPAT can help analyze national, subnational, regional, and global markets.

A range of entry points could present opportunities for an MCPAT analysis. For instance, in some cases, a policymaker might be interested in understanding how outcomes in a particular sector (such as agriculture, digitalization, or transportation) could be improved. In other cases, the focus might be on designing industrial policy more effectively to minimize potential market distortions in a country, boosting investment, creating more and better jobs, or enhancing food security for the poor. The toolkit can be used in two ways: it can either be applied step-by-step to conduct a holistic MCPAT analysis (this is preferable where resources allow as it enables the most accurate diagnosis); or specific modules can be applied where the user requires more rapid inputs on a specific aspect of the toolkit.

The structure of this toolkit follows the steps to conduct an MCPAT analysis in a specific sector or market, as presented in Figure 2. Part I provides an overview of key concepts that set the basis for conducting the MCPAT analysis and covers the first step of the MCPAT. This step involves identifying the market or market segments to be analyzed based on the development policy objective. Part II focuses on diagnosing market issues. This involves understanding market characteristics – such as the degree of concentration and business ownership structures – and market outcomes in terms of prices, productivity, investment, etc. (Step 1 in Figure 2). It also includes identifying whether government interventions are correcting or exacerbating market failures (Step 2 in Figure 2). Importantly, it is the interaction of market characteristics and government interventions that ultimately results in better or worse market performance and Part II discusses how to assess these interactions (Step 3 in Figure 2). Part III is about how to fix markets. This section provides tools to design less distortive alternatives for government intervention (Step 4 in Figure 2) and to prioritize reform alternatives based on impact and feasibility, considering the political economy (Step 5 in Figure 2). Depending on the nature of the development objective, selected steps can be applied with more depth than others. For example, to identify regulatory reforms to unlock competition in a particular sector, the focus would be on Steps 1, 2, and 3. To evaluate a government-proposed reform or new regulation, Step 2 would be the most important. Steps 4 and 5 apply in both situations.

FIGURE 2: KEY STEPS IN APPLYING THE MCPAT



Source: Markets and Competition Policy Team

PART I. INTRODUCTION: WHAT ARE MARKET AND COMPETITION POLICIES AND HOW ARE THEY RELEVANT FOR DEVELOPMENT?

Chapter 1 demystifies competition analysis. It outlines key principles and debunks myths around markets and pro-competition policy. First, markets are the "unit of analysis" for any competition assessment. Markets are the basic building blocks of value chains, sectors, and the economy, and therefore, their performance directly affects macro- and microeconomic outcomes. Market concentration is often mistakenly considered equivalent to competition, but competition involves a confluence of factors beyond concentration and market structure as the forthcoming World Bank report "From market power to markets that power growth" will show. Generally, no single set of measures can provide a quick, definitive answer to the question of how competitive markets are in a country. We must look at a wide range of indicators and risk factors for competition to understand whether significant competition distortions exist. To do so, competition authorities are often the agents of first resort when they are in place, but it is essential to remember that there is a broader ecosystem of market institutions – sector regulators and other government bodies, both national and subnational – that set and enforce rules and deliver public resources to create better-functioning markets. Overall, competition law is insufficient to solve the development issues at hand, and other policies are needed. Broader market and competition policies are a lever that can reignite productivity growth and efficiency and, by doing so, contribute to addressing other development challenges. This chapter provides guidance on where to focus a market and competition policy assessment to help governments achieve development policy goals (MCPAT Step 0 in Figure 2).

PART 2. WHAT ISSUES AFFECT MARKETS AND COMPETITION?

Chapter 2 provides tools to better understand market dynamics and outcomes. Once a market of interest has been identified, it is essential to understand what it looks like: does it have many or few players? Are these players concentrated? If so, could it be due to economies of scale? Are players vertically integrated along the value chain? Or are they part of larger conglomerates that participate in different markets of the country? The answers to these questions will help us understand what type of government interventions would be appropriate to foster competition. Moreover, these are factors that play a role in determining market outcomes, which must also be assessed: are prices relatively high? How have they evolved? What about productivity? In this chapter, the reader will find qualitative indicators that can be used to assess market characteristics and state intervention, quantitative measures that can be used to gauge the level of competition, and their pros and cons and data requirements. Ideas of possible competition analyses that could be conducted based on years of experience applying the MCPAT in different country contexts are also presented (MCPAT Step 1 in Figure 2).

Chapter 3 explains how governments shape markets through rules and the allocation of public resources. The most common reason governments play a role in markets is to address market failures that undermine the achievement of policy objectives. Market failures occur whenever the outcome of a free market system (i.e., economic actors following their self-interest without intervention from the government) is not equivalent to the socially optimal outcome. Government intervenes in markets by setting rules under which markets operate and allocating public resources (acting as a buyer through public procurement, supplier through state-owned enterprises, and provider of business support measures). The market rules that the government sets pursue two objectives: (1) designing government interventions to foster competitive markets and (2) tackling anticompetitive firm behavior. This chapter provides an overview of how and why governments influence markets, highlighting examples of market failures and legitimate government interventions to address those market failures (MCPAT Step 2 in Figure 2).

Chapter 4 identifies types of government interventions based on their effects on markets. Government interventions include rules designed in a specific way, how these rules are implemented, or even a lack of rules when needed (i.e., when a market failure calls for regulation, but this is not in place). Any government body can set those rules (from Parliament and ministries to a sectoral agency or a subnational authority) or even private actors through allowed self-regulation or co-regulation. The MCPAT aims at identifying rules that have anticompetitive effects on markets, categorized as i) rules that restrict entry or reinforce dominance, ii) rules that facilitate collusion, restrict firms' choice of strategic variables, or increase the costs of competing, and iii) rules that create an unlevel playing field or provide undue advantages to certain

firms. Industrial policies that involve the strategic transfer of resources to enterprises are also part of this set of government interventions and, when not properly designed, can risk distorting markets. Government interventions can also take the form of public procurement or state-owned enterprises (SOEs) when the government participates as a market player. In the latter, in many cases, SOEs compete against private firms while enjoying preferential conditions or protections. This chapter provides guidance for the identification of rules and policies that distort markets and restrict competition, including industrial policy; highlights the potential impact of SOEs on market dynamics; and explains how public procurement rules can affect competition in markets. (MCPAT Steps 2 and 3 in Figure 2)

Chapter 5 explains what rules are needed to prevent and stop anticompetitive conduct or enterprise consolidation that can harm competition. The chapter focuses on the government's role as market referee, or enforcer of the competition law. Concerns regarding weak competition arise when enforcement is insufficient to discipline market players, including incumbents and members of agreements between competitors to supress competition (referred to as "cartels"). This chapter gives an overview of different types of anticompetitive behavior and merger transactions that might have anticompetitive effects. The focus is on cartels because they are considered the most harmful anticompetitive practice, as they inflict substantial economic harm to consumers – especially those at the bottom of the income distribution – and slow productivity growth. Cartels are business arrangements aimed at restricting competition between firms in certain markets by either fixing prices, quantities sold or bought, or dividing markets between firms (also known as hard-core cartels). A particular form of cartel is bid rigging, which occurs when bidders collude in tendering processes to extract more significant gains from a tender or auction; this practice is particularly relevant for public procurement. In addition, the chapter explains abuses of dominance by discussing what market dominance is and clarifying that the existence of dominant firms is not a problem per se, but these firms have a special responsibility not to abuse their dominant position. Finally, the chapter discusses when enterprise consolidation (mergers and acquisitions) can be anticompetitive. (MCPAT Step 2 in Figure 1)

PART 3. HOW DO WE HELP FIX MARKETS AND BOOST COMPETITION?

Chapter 6 explains how to design government interventions to foster competitive markets. While Chapter 4 provided tools to identify distortive government interventions, this chapter presents tools to design the least distortive policy alternatives to attain the expected public policy goals. This requires understanding the trade-off between the observed government intervention and potential unintended consequences as well as recognizing that such government intervention is not always necessary – or the best option – to solve market imperfections or address institutional failures. This chapter provides guidance on designing pro-competition policies that minimize potential distortions on domestic and international markets, including those related to SOE participation in markets (from applying the competitive neutrality framework to moving towards privatization) and designing pro-competition public procurement procedures. (MCPAT Step 4 in Figure 2)

Chapter 7 explains how governments can tackle anticompetitive firm behavior. While Chapter 5 explains what the most concerning anticompetitive firm practices are, this chapter gives an overview of tools to tackle certain types of anticompetitive behavior and to control mergers to limit anticompetitive effects. Competition laws typically enable government authorities to (i) identify, sanction, and deter business practices that restrict, distort, or prevent competition (particularly cartels and abuse of dominance); (ii) review mergers and acquisition of firms to prevent anticompetitive concentrations; and (iii) advocate for pro-competition policies and antitrust compliance and pro-competition policy design and implementation (known as competition advocacy). This chapter outlines the basic elements of a competition law framework, explains key tools used in a cartel investigation, and suggests steps to strengthen enforcement and prioritize efforts. Overall, the chapter provides guidance on how governments can strengthen anticartel enforcement and deter cartel formation, introduces key principles to tackle abuse of dominance, and outlines the key elements for effective merger control, highlighting considerations for merger notification and review (MCPAT Step 4 in Figure 2).

Chapter 8 provides guidance on implementing pro-competition reforms. After conducting a proper market diagnostic, identifying government interventions that distort market dynamics, and designing least restrictive alternatives, the following step informs the strategy to successfully advocate for and ultimately implement competition reforms. Being able to prioritize which reforms to pursue typically requires a balance between impact and feasibility. In some cases, it may be necessary to start with small, achievable reforms (such as in certain rules, products, and regions) to show proof of concept and use this as a basis for scaling up reforms. Moreover, if the first-best solution to a market restriction is not feasible, looking for second or third-best options may be necessary. At the same time, this pragmatic approach should be balanced against the risk of overfocusing on reforms that may be feasible but are ultimately toothless or ineffective. Understanding the ecosystem of market institutions is necessary as any or several of these institutions may champion or contribute to pro-competition reforms. Competition authorities are a key element in supporting the effective implementation of competition policy, but they need appropriate institutional designs, adequate competition laws, and resources to maximize their impact potential. Identifying parties interested in or affected by a competition reform and understanding who the winners and losers of reform are constitute essential elements of the feasibility assessment. A particular source of concern is politically connected firms, which often receive preferential treatment from government actors and may resist reform efforts. This chapter provides guidance on prioritizing potential reforms, understanding market institutions, mapping interested and affected parties, understanding winners and losers from reforms, as well as insights on implementing SOE-related reforms (MCPAT Step 5 in Figure 2).

PART I
INTRODUCTION

1. INTRODUCTION: WHAT IS MARKET AND COMPETITION POLICY AND HOW IS IT RELEVANT FOR DEVELOPMENT?

Before delving into the step-by-step application of the Markets and Competition Policy Assessment Toolkit, this section clarifies key concepts.

1.1. Demystifying competition analysis

Competition takes place in markets – not sectors, industries, or economies

Competition is a market-level phenomenon. It is not possible to measure or understand competition at a country or even a sector level given that competition occurs between products that rival each other – and of course, not all products in a sector will rival each other. This is not trivial: when thinking of competition, it is important to consider all products that impose a competitive constraint on firms (and only those products). This could include products that would not intuitively be considered equivalent to each other at first glance. A relevant market is simply a set of products that effectively constrain each other's pricing or other dimensions of competition (quality, innovation).[1]

Sectors are often complex and can include several distinct markets. Separate distinct markets may exist within the same value chain, industry, or sector. To draw soundly based conclusions on the level of competition and identify existing threats to competition, it is advisable to analyze separate markets individually. The state of competition might vary significantly even between similar or closely related markets. The same sellers may interact in several markets yet face a different competitive environment in each of them. This may be due to different regulatory provisions, the presence of other competitors offering only some products, or different demand conditions. To identify existing threats to competition, it is generally advisable to focus the analysis on a sufficiently narrow set of products and geographic areas where firms do effectively compete with each other.

Identifying the market is the first step for a competition analysis. Recognizing the boundaries of a market involves assessing factors such as the products or services being offered, the geographic area in which they are sold, and the consumers or businesses involved. Market shares – a usual indicator of the relative importance of firms – can be calculated only after the market has been identified. When considering the potential for new entry, it is necessary to identify the market to correctly understand barriers to entry. Different market definitions may lead to different conclusions about the market power of firms.

Defining a relevant market from a competition perspective covers two dimensions: a set of products and a set of geographic areas. Usually, one can define the relevant product market first and then define the relevant geographic market. In defining the relevant product market what matters is the characteristics of the products and buyers' ability or willingness to switch from one product to another in response to changes in relative prices (i.e., the substitutability of the products for consumers). The geographic market is the area in which firms operate in the same conditions of competition for the relevant product/service. In practice, practitioners use a mix of quantitative and qualitative analysis to determine the relevant market.[2]

The approach used to identify a market for analysis varies depending on the objective. Defining a relevant market is critical for antitrust cases since decisions on competition law infringements usually depend on it. In this case, the starting point is the affected market by a lodged complaint or the business practice that is investigated, or the products involved in a merger transaction. The market can be as narrow as a type of vehicle in a specific geographic area and as broad as the global market for a mineral commodity. For market studies or assessments of regulatory impact on competition, markets are generally defined more broadly depending on the competition concern that motivates the study or the policy goal of the regulation. Formally defining relevant markets as for an antitrust investigation is generally not needed in the context of the MCPAT application. However, the product and geographic dimensions of markets need to be considered – including factors such as the degree of product substitution, geographic location of both producers and consumers, transportation costs, and even local market conditions (see Box 1 for examples of complex market definitions).

While in practice, standard industrial classification codes can be used to gain a general understanding of market characteristics, findings need to be interpreted with caution since they usually represent a collection of markets. Classifications of economic activities or products used for other purposes (such as ISIC, NACE, or HS codes) generally do not allow a clear identification of a relevant market for the purpose of enforcing competition rules. Firm-level or survey data is often disaggregated at the 4-digit ISIC level, but this disaggregation is often too broad to define a market (or may sometimes be too narrow a definition). The degree of geographic segmentation or integration, as well as the products' characteristics, are relevant factors in determining whether markets are subnational, national, regional, or global. Notably, however, markets cannot be defined by national borders if exported products compete with international producers for market share. This can be relevant, for instance, in the context of regional trade agreements. Thus, market definition needs to be adapted depending on the set of products and the geographic dimension.

BOX 1: EXAMPLES OF COMPLEX MARKET DEFINITIONS

- *Subnational markets:* Given issues with storage and transportation, a wholesale market for fresh produce in a developing country likely only faces competitors in its local subnational area.
- *Markets beyond national borders:* An Indian producer of fertilizers that are consumed in Africa may be competing with a North American producer.
- *Markets beyond formal players:* Retail markets in many developing countries are characterized by informal retailers, these would not appear in official statistics.
- *Markets for differentiated products or segments of users:* Where there is a large degree of differentiation, setting boundaries on which products compete with each other may be especially difficult – a street stall and a luxury restaurant do not compete, but a fast-food restaurant and a local family-run restaurant may compete. Due to price discrimination, different types of users or consumers could face different competition conditions and, therefore, be part of separate markets.
- *Multi-sided markets:* Digital platforms offer services to various groups of users (such as MSME sellers, individual consumers, and advertisers), and indirect network effects link these various groups. To understand a platform's market power, practitioners can consider all the different services/products offered to different consumers or analyze each group of users separately.
- *Highly innovative markets:* When enterprises compete through R&D to create new products, products that are not yet in the market but in the pipeline could also be considered part of the market.

TOOLKIT ITEM 1

Indicators based on industry or product codes may be helpful for an initial screening of market characteristics, but they must be combined with analysis of other variables that are specific to the product and geography of interest. Ideally markets should be more accurately delineated before conducting more conclusive analysis.

Complementary resources:
- Glossary of key terms (Annex A.1)
- Market definition in digital markets (Annex A.2)
- Market power (Annex A.3)

How markets function affects macro- and microeconomic outcomes, but it is not possible to define the level of competition at the country level

Markets are a fundamental institution in an economy. They bring together investors who allocate capital, individuals who decide to work and invest in human capital, and individuals, enterprises (private and public), and the government as buyers and/or sellers. Markets influence firm-level decisions that affect future growth (innovation, technology adoption, inputs mix, investment, marketing, and sales strategies). At the same time, they articulate the links between markets within sectors, along value chains, and across the overall economy.

Given that competition is a *market-level* phenomenon, each market in a country will have its own dynamics depending on the conditions in those markets. Of course, some common national or local factors might affect several markets simultaneously, such as the overall size of the economy, the general level of transport costs, the strength of competition law enforcement to tackle anticompetitive conduct, the extent to which pro-competition principles are embedded in the procurement law, etc. But there is often no single answer to the question of how much of an issue lack of competition is across an entire economy or country: some markets will be more competitive than others. Instead, we must take a more nuanced approach to applying the MCPAT to address specific development challenges.

At the macroeconomic level, market functioning affects productivity and, consequently, GDP growth, while at the microeconomic level, it affects firm-level incentives to invest and innovate. Competition is a key driver of aggregate productivity growth because it boosts within-firm upgrading, induces better resource allocation across firms and markets, and, in the end, ensures that only the most productive firms compete in the market. It is also an important determinant of investment because it encourages investments in intangibles, infrastructure, and technology that can enable the firm to compete, expand its market presence, or enter new markets. There is also a consensus that contestability is essential to incentivize innovation, but competition is not the only determinant. For example, competition is one of the main factors that encourage enterprises to adopt improved technologies in developing countries, as expressed by 40 percent of enterprises surveyed in 2020-2022 in 11 countries[3] (Comini, Cirera and Cruz 2022).[4] In addition, greater competition provides consumers access to lower-priced and better products, thus allowing them to either buy more of the same products or other products elsewhere in the economy and boosting aggregate consumption levels. Competition also drives exports by inducing exporters to become more efficient and enhancing their competitiveness in international markets, so they export more.

TOOLKIT ITEM 2

While the intensity of competition can only be accurately assessed at the market level, its effects can be identified at the firm, sector, value chain, or country levels. See Figure 7 for the key components of understanding market characteristics.

BOX 2: WHAT IS THE DIFFERENCE BETWEEN COMPETITION AND COMPETITIVENESS?

The concepts of competition and competitiveness are often discussed interchangeably. However, while they are linked, they are different ideas. Competition is the process of rivalry between firms which determines the level of market power of a firm and gives rise to firms' incentives to improve their efficiency, reduce prices, or develop new products.

Competitiveness can have different meanings depending on the context. It generally refers to the ability of an enterprise, sector, or country to perform better than its peers. The competitiveness of an enterprise would be the ability of a firm to compete successfully with its commercial rivals. Competitiveness of a sector or a country is the ability of enterprises in such sector or country to compete successfully in exports of traded goods and services, investments (foreign direct investments), and human capital.

It is often argued that competition policy can come at the expense of policies designed to boost the international competitiveness of a country's firms. Industrial policies that support specific firms to become internationally competitive can hinder competition on the merits as they create an unlevel playing field. However, there is much evidence that competition enhances competitiveness (Goodwin and Pierola, 2015). There is also evidence that industrial policies that incorporate principles of competition (such as where subsidies are awarded through competitive processes and in more competitive markets) can make those industrial policies more effective (Aghion et al. 2015).

Complementary resources:

- The importance of competitive markets for growth and development (Annex A.4)

Market outcomes are not merely driven by market structure – more concentration does not mean less competition

Concentration measures the degree to which market share is distributed across firms. In other words, it provides a quantitative indicator for the structure of a market. The main advantage of concentration measures – and the reason for their popularity – is that they are relatively straightforward to compute. They can therefore be an interesting entry point for understanding how markets work. However, for these measures to provide a sound understanding of competition in a market by itself, one would need to assume that there is a clear relationship between the structure of a market and the ability of firms to exercise market power – and that relationship would need to work in one direction only (i.e. when concentration increases, the degree of competition decreases, and never vice versa). Unfortunately, there are several issues with these assumptions.

Concentration measures often do not provide an accurate reflection of market dynamics and market power, especially where there is a degree of product differentiation. The competitive constraints upon each firm and thus market power depend on several factors: the degree of substitutability between products in the market, the existence of barriers to entry, the strategic behavior of firms, and the degree of buyer power. These are not always related directly to the structure of the market.

BOX 3: EXAMPLES OF MARKET CONCENTRATION THAT IS NOT INDICATIVE OF COMPETITION INTENSITY

- Even a firm that operates as a monopoly can hold relatively low market power if the market has low barriers to entry and there is a significant threat of entry from potential competitors – that is, if markets are contestable. For example, think of a local bakery that is the only provider of a specific type of pastry in a small town. While the bakery may initially have a monopoly on that particular pastry, the barriers to entry are low—other bakers can easily start their own businesses and offer similar products.
- Some high-innovation markets with economies of scale and winner-takes-most-dynamics appear concentrated but can have low market power where there are sufficiently low barriers to entry and firms compete for the market, rather than in the market.
- A market with relatively low concentration could still have firms exercising a high degree of market power if the firms are colluding with each other. This has been the case in many atomized markets where associations can facilitate collusion, such as for taxi services.
- In bidding markets, the result of a competitive process is one firm providing a product or service. In those cases, concentration would be the highest although in fact the winner competed with other firms and proved that it was able to provide the expected good or service at the lowest price. Thus, the firm competed for the market. Common examples include the selection of a private partner for infrastructure PPP projects and public procurement.

The interpretation of concentration indicators can also be misleading since more concentration is not always bad. Concentration indicators are not monotonic in competition, i.e. increases (reductions) in those indicators do not always translate into reductions (increases) in the intensity of competition. For instance: stronger competition may lead to larger, more productive firms gaining market share over less productive, smaller counterparts, resulting in higher concentration (see Box 3 for more examples). In this case, concentration would be good. It is important to differentiate between good and bad concentration by understanding other factors that affect competition and market outcomes.[5]

The computation of concentration indicators should be done after delineating the market of interest and understanding the limitations of available indicators when there are data gaps. The MCPAT is generally applied to selected markets (or segments in a value chain) that are relevant to pursuing a public policy objective of interest or where there are concerns about market functioning. For MCPAT analysis, a product and a geographical market are identified, and available indicators are analyzed. In some cases,

indicators are calculated at the standard economic activity level or product level for the whole country given limited disaggregated data that matches the delineated market. These concentration indicators need to be interpreted with caution and together with complementary information.

TOOLKIT ITEM 3

Concentration indicators can provide an entry point for understanding markets, but they are not sufficient for understanding competition in a market. To reach sound conclusions on competition intensity, we must look beyond the level of concentration at a point in time and consider its evolution together with a confluence of other (also imperfect) indicators of competition intensity. See Chapter 2 for guidance on competition indicators.

Complementary resources:
- The concept of market power (Annex A.3)
- Commonly used measures of competition (Annex A.5)

Understanding markets requires a holistic approach – there is no unique competition indicator

When examining competition at the market level, we must examine the evidence from a confluence of factors. There is generally no single set of measures that can provide a quick definitive answer to the question of how competitive markets are in a country. We must look at a range of indicators of, and risk factors for, competition to understand whether they point to significant competition distortions or reform opportunities. Understanding markets requires a mix of analysis of quantitative indicators and qualitative assessment of other market features and rules that affect market power. Market outcomes are the result of firm decisions given the rules of the game.

The first key component is indicators linked to market characteristics and performance. In addition to market structure indicators such as concentration or recent entry, we can examine changes in output, price, or quality, and try to infer to what extent those changes are attributable to changes in competition over time. Where there is sufficient firm-level data available, we can also look at behavioral measures of competition such as price mark-up and margins. Relatively high and increasing price-cost margins or mark-ups may also indicate weak competition. We can also examine other types of strategic behavior by firms, such as merger and acquisition (M&A) activity, the use of exclusive contracts, and the building of spare capacity. Moreover, we can also look at conglomerates and assess multi-market contact across sectors and countries in a given region. It is important to note that the MCPAT cannot ascertain collusion or abuse of dominance in breach of a competition law, this can only be done through a determination by the competition authority.

The second key component is regulations and other government interventions that weaken the competitive process. Without proper regulation or supervision, market failures can lead to weak competition outcomes (high prices, low quality, low innovation). We can look at measures of how restrictive or supportive regulations are to competition. This can be done either by using indicators like the Product Market Regulation (PMR) indicators or by examining whether key pro-competition regulatory provisions are in place or whether any major anticompetitive government interventions are in place. We can look at the political connections of firms and whether this has any influence on how regulations are set or enforced.

TOOLKIT ITEM 4

Both market characteristics and the rules and government interventions in markets affect the intensity of competition and must be analyzed together.

Complementary resources:
- Examples of sectoral competition issues and areas of analysis (Annex A.6)
- Measuring competition (Chapter 2)

1.2. Demystifying policies to boost competition

Competition policy is not the same as competition law enforcement

Competition policy encompasses a broad set of tools aimed at boosting competition in markets – this includes competition law but also goes beyond. Competition policy tools are those that create incentives for firms to improve their performance relative to their actual and potential rivals. This spans a range of government interventions that, when well-designed and implemented, can (1) foster efficient entry, (2) lower the costs of competing and make collusion less likely, or (3) create a more level playing field. Implementing a competition law is one possible policy tool that can be used and might work depending on the country context. Specifically, it is used to referee markets and address anticompetitive firm behavior after it has occurred (by combating anticompetitive agreements and abuse of dominance) or to prevent potentially anticompetitive mergers. But it is far from the only policy tool for promoting competition. Sector regulations, licensing and certification requirements, investment laws, investment incentives frameworks, trade policies, procurement policies, and Public Private Partnership (PPP) frameworks are all examples of instruments that impact competition. A competition policy ensures that these instruments are designed in a way that does not unduly hinder competition or that actively boosts competition where needed.

Competition policy can be implemented even in contexts where competition law enforcement is not fully operational and by government institutions beyond the competition agency. Although at least 163 countries have a competition law in place as of October 2023, many competition authorities face constraints to pursue enforcement efforts. Nevertheless, a government's approach to competition policy can focus instead on reforming other laws, regulations, frameworks, procedures, and practices to unlock restraints to competition. This can either focus on just a few key markets or can be economy wide. Some countries have moved to implement more holistic national competition policies, including Australia, Korea, India, and the Philippines. The focus of these is to drive pro-competition microeconomic reforms across sectors, working with a host of agencies across government to implement these policies.

TOOLKIT ITEM 5 Competition policy is broader than competition law enforcement. The former refers to any policy that seeks to boost the level of competition in a market, and the latter focuses on preventing business behavior from undermining the competitive process.

Complementary resources:
- Designing government interventions for competitive markets (Chapters 6 and chapter 7)

Building an institutional ecosystem for competition policy goes beyond competition authorities

Besides their role as market referee to enforce competition law, governments reshape markets through good or restrictive regulation and allocating public resources when they act as suppliers (SOEs), buyer (public procurement), and providers of financial and non-financial resources to support firms. Governments carry out different roles: acting as a market regulator (i.e. sectoral regulators, international rule-maker, market referee) and as market developer or creator (i.e. government as buyer, as supplier, as financier). Governments can also apply competition principles to minimize market distortions stemming from social, and sustainability and environmental policies.

Given the broad spectrum of market regulators and rules that affect market functioning, competition authorities are essential but not sufficient to set and enforce pro-market rules that ensure free entry, prices reflecting market signals, and a level playing field. Competition authorities are often seen as agents of first resort by policymakers intending to boost competition. However, they are part of a broader ecosystem where market institutions need to be strengthened. Other authorities – from sector regulators to public procurement agencies and state aid control agencies – need to integrate market and competition principles as well. These principles involve the improvement of regulations and administrative procedures by government bodies to increase contestability (i.e., threat of entry, firm rivalry), allow selling conditions (prices, quality, product sophistication) to reflect market conditions, and ensure equal opportunity and competition on the merits to firms (level the playing field).

Competition law enforcers do not always operate in a supportive ecosystem. Regulatory restrictions and the overall environment can undermine their achievements. Part of the environment involves the political economy of market players (such as business of the state,[7] linkages with top foreign firms and domestic economic groups) that can influence rules and even institutional design. Brazil, Türkiye, and South Africa are examples of middle-income countries (MICs) with the best competition authorities[8] and the most restrictive product market regulations within each enforcement level group. Other external factors such as risks related to vested interest and cronyism can further affect markets and add to issues related to effective competition law enforcement and effective pro-market regulations.

It is therefore critical to empower a range of agencies including regulators and line ministries to be able to assess, or at least acknowledge, the competition impact of their interventions. In some cases, it may also be helpful for one government institution to have a higher-level role to coordinate and encourage pro-competition reforms by other agencies, and to provide technical inputs where necessary. This could be a competition authority (if the authority has sufficient resources and political clout to play such a role). However, it could also be a central ministry with overall responsibility for the functioning of the economy and the growth agenda, such as a Ministry of Finance or Ministry of Economic Planning. In other cases, there may be a special commission or council set up with backing from the highest levels of government to provide the political push needed for reforms.

TOOLKIT ITEM 6

Competition policy can be implemented even in countries that lack competition authorities. Other agencies without a competition policy mandate may also affect competition. For instance, sector regulators, ministries of economy, ministries of trade, and other line ministries can design and implement competition policies. as they make public policy decisions that influence market dynamics – for example, issue licenses, enact sectoral regulations, adjust taxes for specific products, or allocate subsidies.

Government interventions to address market failures can have unintended negative effects and alternative policy options need to be considered

Whenever governments intervene – even if it is for a necessary and justifiable reason – there is always a risk of affecting how the market functions beyond the failure the intervention intended to fix. There may be cases (1) where the market failure is misdiagnosed, (2) where an intervention to address market failure is ill-designed, or (3) where the intervention is put in place due to capture. Understanding the type of intervention (Box 4) will become particularly important when discussing the process of making recommendations and understanding the political economy of reform.

BOX 4: EXAMPLES OF GOVERNMENT RULES AND INTERVENTIONS WITH NEGATIVE MARKET IMPACT

- A government may impose price controls on a product to reduce price volatility or to set a minimum price received by producers, but this could inadvertently reduce the competitiveness of downstream industries that rely on that product as an input, or it could facilitate collusion between producers.
- A government may impose very strict standards on a construction input to improve safety but if those standards are set higher than needed, they may restrict entry, compromise consumer choice, and raise prices unnecessarily.
- A government may grant an exclusive mining license to a private firm for exploration and mining to encourage investment but if the exclusivity period is set longer than necessary to induce the investment in exploration, it can reduce the threat of entry in the future and lead to entrenched market power from the firm.

Complementary resources:
- Examples of how government interventions can unintentionally lead to market distortions (Chapter 4)
- Process of making recommendations and understanding the political economy of reform (Chapter 8)

Industrial policies provide an example of government interventions that may be justified but are frequently designed and implemented in ways that have unintended consequences on market dynamics and competition. While different definitions of industrial policy abound, for the purpose of the MCPAT application we define industrial policy as the channeling of public funds (including forgone public funds from tax breaks) to benefit certain parts of the economy.[9] The way that industrial policies are designed and implemented could lead to distortions to markets and competition (Box 5).

BOX 5: INDUSTRIAL POLICY AND USUAL MARKET DISTORTIONS

Industrial policies can include special benefits for certain technologies, sectors, locations, types of firms, (such as small businesses, or large firms that are considered too big to fail), socio-economic groups, or even specific individual firms (including public enterprises). These public funds could include tax exemptions, loan guarantees, grants, government resources provided at prices below market level (such as land, spectrum, or water), cash transfers, accelerated depreciation allowances, and capital injections, preferential public procurement, among others.

Examples of different types of industrial policies include:

- Government support for roll-out of ICT infrastructure with subsidies to firms to invest in specific regions or technologies, such as for broadband roll-out in rural areas and roll out of 5G mobile networks, for roll-out of essential facilities to enable a digital start-up ecosystem.
- In countries that largely participate in low value agricultural activities, special zones have been set up to focus on higher value agricultural activities including agroprocessing. Firms that can locate in these zones typically benefit from tax and customs privileges, as well as improved access to basic infrastructure and inputs. The objective is to agglomerate activities within areas of high agricultural potential, boost productivity, and promote exports.
- Governments often provide export credits to support domestic exporters. These credits are financial support (such as direct financing, guarantees, insurance or interest rate support) to foreign buyers to assist in the purchase of goods from a national exporter. This can be implemented in a way that either supports all firms within a sector or a range of sectors, or in a way that targets specific national exporters.

There are several stumbling blocks in the way that industrial policies are designed and implemented which could lead to distortions to markets and competition if not properly designed or implemented:

1. Industrial policies often do not correctly identify – or are not correctly targeted at – the market failure it is trying to address.
2. There are inherent risks in picking winners – either firms or sectors.
3. There is high potential for capture given the advantageous nature of these policies – which exacerbates risks around not targeting the policy correctly.
4. It is difficult to withdraw public support once it is provided – even when it is no longer needed and becomes distortive.
5. There is an opportunity cost to providing public funds in terms of potential alternative measures that could be taken to reach economic and strategic goals in a less distortive way.

Complementary resources:
- Industrial policies and market distortions (Chapter 4.2)
- Applying pro-competition principles to industrial policies (Chapter 6.2)

State participation in markets provides another example of government interventions that may be unjustified or justified but are frequently designed in ways that have unintended consequences on market dynamics and competition. The presence of SOEs per se does not translate into market distortion. Where SOEs operate under the same conditions and similar objectives as private firms, and are treated on a level playing field, there is no reason that they should have negative impacts on markets. There are markets in which the likelihood of distortion potentially caused by SOE presence is minimized because the economic rationale for SOE presence is higher (such as electricity transmission, and railway infrastructure) due to market failures that reduce economic incentives for private operators to enter and operate in the market.[10]

BOX 6: SOEs AND MARKET DISTORTIONS

Market distortions arise through four (4) Ps:

1. ***Preferences***: When principles and policies *applied at the SOE level* provide the SOE with advantages over competitors.
2. ***Protections***: When market rules and policies *applied at the market level* protect the SOE's market position (even if this protection is unintended, such as the policy has other objectives).
3. ***Policy mandate***: When SOEs cause market distortions through their actions in the market driven by their policy role / do not solve a market failure in the least distortive way.
4. ***Political patronage***: When SOEs cause market distortions through their actions in the market driven by use of the SOE for political patronage (by state capture).

TOOLKIT ITEM 7 Government regulation and interventions, including industrial policy and SOEs, can be designed and implemented in ways that can promote competition as they pursue their policy objective.

Complementary resources:
- The State as a supplier (Chapter 4.3)
- Reducing distortions from SOEs (Chapter 6.3)

Competition is not enough but competition policy can make other policies more effective

Of course, there are many cases where markets simply cannot solve the development issue at hand and other policies are needed. Social welfare systems and policies are needed to help the poorest and most vulnerable in society. Emergency responses are required in the case of natural disasters and pandemics. Health and education policies provide basic human rights as a public good. In these and other similar cases, markets may play a role in the delivery or impacts of these policies, and we must ensure that they function in a way that allows them to effectively complement these pro-development policies. Similarly, information asymmetries and other market frictions mean that specific innovation policy interventions are needed to boost research and development and the adoption of more productive technologies including by smaller firms (Box 7).

BOX 7: COMPETITION POLICY AND POLICIES FOR INFUSION AND INNOVATION

The interaction between competition and innovation is not straightforward: many theoretical and empirical studies find relationships in different directions, that depend as well on differences in definitions and indicators used to measure competition and innovation. Schumpeter's hypothesis was that market power encourages firms to innovate as they endeavor to earn monopoly rents (Schumpeter 1942), while Arrow's theory, the "replacement effect", predicts that market power discourages innovation as firms are already earning monopoly profits pre-innovation and incurring costs to innovate may not generate as much additional profit as for firms in a competitive market (Arrow 1954). A seminal paper (Aghion et al. 2005) advocated for an inverted-U relationship between competition and innovation, which aims to resolve the conflicting Schumpeterian and Arrowian views. The inverted-U hypothesis suggests that, at low levels of competition, more competition will encourage innovation effort as firms try to "escape competition". At the heart of this phenomenon is the idea that frontier and laggard firms face different incentives to innovate when faced with changes in competition (laggard firms will be discouraged from innovating) and that there is a higher proportion of laggard firms at higher levels of competition. In practice, policies to boost competition are rarely targeted at markets where there is already intense competition and are more likely to be aimed at introducing some competition in markets where competition has been limited. Thus, competition policy would generally support more innovation.

To boost innovation, policy makers may want to consider complementing competition policy reforms with pro-innovation policies, particularly targeted at firms that face reduced incentives – or other barriers – to adopt technologies and innovate as competition increases. If there is a risk that less technologically

advanced firms could fall behind, policy makers may want to determine whether these firms should be supported (based on criteria such as whether these firms support vulnerable populations, whether they have strong spillover effects in terms of employment, or if they are active in strategic sectors) and how measures could be targeted to incentivize or support them. Policy makers would ultimately need to assess the identity and characteristics of less advanced firms, the market in which they operate and the criteria to merit potential support on a case-by-case basis when designing and implementing innovation reforms.

Nonetheless, competition policy can support other policies. This is the case of poverty reduction policies. In addition to combating agreements between competitors to supress competition (referred to as "cartels") in essential food products, ensuring that vouchers for conditional cash transfers are used in more retailers reduced prices and improved perceptions of quality (Busso and Galiani 2019). Competition authorities have intervened in many instances in the face of emergency situations – such as natural disasters or the COVID-19 pandemic – to disseminate information about prices to enable consumer choice and to prevent cartel formation. Competition policy can support industrial policy too. Industrial policies in competitive sectors or that foster competition are more effective in affecting productivity growth (Aghion et al 2015). First, competition policy can contribute to least-distortive designs of industrial policy instruments by providing guidance on the type of market failures and limitations to competition that should be addressed, and on the design and implementation approaches to minimize negative effects on market functioning. This is a tool readily available in countries with state aid control frameworks but can also be part of the competition advocacy efforts of competition authorities. Effective competition law enforcement is also important to prevent cartels in the targeted industries, abuses of dominance by incumbents to hinder entry or innovation, or cooperation frameworks and alliances and mergers that can undermine competition. This has become increasingly relevant in the context of climate change and sustainability agreements, as firms need to cooperate to drive industry-level changes (OECD 2024).

TOOLKIT ITEM 8 Competition policy is not a silver bullet, but it can help other policies be more effective by relying on the power of markets to drive productivity and growth.

1.3. Linking market and competition assessments with development objectives

The selection of the scope of a market and competition policy assessment must respond to government policy goals. The sector, market, geographical area, or policy area of focus in a market and competition policy assessment is important, as resources for conducting competition assessments are limited and governments have competing needs. Government institutions (including competition agencies), researchers, civil society organizations, and development institutions face constraints in terms of financial and human resources and timelines to carry out these assessments. Furthermore, implementation of or advocacy for competition or microeconomic structural reforms requires strong policy dialogue. It is critical, therefore, to focus efforts and resources on the sectors or topical areas that are most relevant for the economy – directly, or indirectly through spillover effects.

The analysis of markets and competition policies can help address constraints in achieving government goals. Policy goals can be varied including general economic growth, enabling private investment, inclusion, job creation, or more specific policy goals such as competitiveness and industrial development, digitalization, technology adoption, or fiscal consolidation. Since the achievement of policy goals depends on how markets function and firms, households, and individuals behave, the MCPAT can be applied to help governments achieve their goals. See Annex A.4. for a framework and a summary literature review on the links between competition and competition reforms with outcomes linked to government policy objectives.

TABLE 1: GOVERNMENT POLICY GOALS AND MCPAT CONTRIBUTION

Policy goal	Examples of MCPAT's findings to inform actions that ease the achievement of the policy goal
Economic (productivity) growth	Constraints to competition in key input sectors (such as telecommunications, financial sector, transport) and in main output markets that drive productivity (such as specific manufacturing sectors).
Enabling private investment	Barriers to entry and expansion that deter investment in key sectors (such as infrastructure, agribusiness, manufacturing) including due to the operation of favored state-owned enterprises; investment incentives that create market distortions and deter investments by non-beneficiaries
Inclusion and poverty reduction	Enablers for potential anticompetitive practices or regulatory restrictions that increase the cost of essential food products.
Job creation	Restrictions in product markets that reduce job opportunities or potential of anticompetitive practices that harm workers.
Climate change mitigation and adaptation	Competition issues in the design of business support programs for green transition; competition issues in key markets for adaptation (such as resilient seeds, construction).
Competitiveness and industrial development	Constraints to competition in upstream markets (such as network industries and services) that undermine productivity and export competitiveness; competition concerns in the design and implementation of industrial policies.
Digitalization	Constraints to competition in telecommunications markets, weak procompetition regulation of digital markets.
Fiscal consolidation	Enablers for bid rigging in public procurement or gaps in anticartel enforcement; operation of loss-making enterprises with state participation in industries where private participation is possible.

Source: Authors' own elaboration

The criteria for selecting relevant economic sectors or policy areas to conduct competition assessments take into account potential restrictions to competition that affect the achievement of government development objectives. The idea underpinning the sector/market selection is that the more important a sector is for the economy, the greater the need to ensure that it is operating properly and, hence, the greater the returns to a policy intervention that remedies its problems (European Commission 2007).

Six main criteria can be applied for selecting the priority sectors or markets that could be subject to competition assessments. The identified sector must comply with at least one criterion under each of the two categories: "relevance of the sector/market" and "market failures and distortive outcomes" (Table 2).

TABLE 2: CRITERIA TO SELECT PRIORITY SECTORS OR MARKETS FOR A COMPETITION ASSESSMENT

Category 1: Criteria on the relevance of the sector	Category 2: Criteria on market failures and distortive outcomes
1. Make a significant contribution to GDP, productivity, investment, or jobs; 2. Be a source of essential inputs for businesses with spillover effects on other sectors, including on climate change mitigation and adaptation, productivity and competitiveness; or 3. Contribute goods or services that account for a significant share of consumer spending; or, through its improvement, contribute to alleviating poverty.	1. Present potential or actual anticompetitive practices or government interventions that can create barriers to private sector development; 2. Present economic characteristics that result in markets that are more concentrated (with a leading incumbent) or where collusion is more likely; or 3. Provide preliminary evidence of significant market deficiencies that result in low productivity, high prices, or poor quality of products or services, among other issues.

Source: Authors' own elaboration

NOTES

[1] A relevant market, a notion specific to competition law, is the smallest portion of trade on which one or more undertakings can effectively exert substantial and durable market power. The term refers to the group of goods or services most buyers regard as being close substitutes when relative prices change. The Hypothetical Monopolist (HM) test is the conceptual framework underpinning market definition.

[2] For example, the Hypothetical Monopolist or Small but Significant Non-transitory Increase in Prices (SSNIP) test defines the relevant market by determining whether a given increase in product prices (typically 5 percent for 12 months) would be profitable for a monopolist in the candidate market. For recent guidance on market definition including in the context of digital markets, innovation-intensive industries, and fast-paced changing markets that require a forward looking assessment, see the guidelines published in February 2024 by the European Union: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_6001

[3] Bangladesh; Brazil (only the state of Ceará); Burkina Faso; Ghana; India (only the states of Tamil Nadu and Uttar Pradesh); Kenya; Korea, Rep.; Malawi; Poland; Senegal; and Viet Nam.

[4] The evidence for developing countries typically shows a positive relationship between competition and innovation See for example: Canare and Francisco (2021), Crowley and Jordan (2017), Carlin et al (2004), Gorodnichenko et al (2010), Buthe and Cheng (2017). In terms of the trade liberalization literature, Teshima (2009), Goldberg et al (2010), Bustos (2011) find positive impact of trade liberalization on innovation in Mexico, India, Argentina respectively. However, it is possible that the channel of effect here is not just the impact of competition but also the knowledge embedded in imports.

[5] See this paper on US industries for an illustration: Covarrubias, M., Germán Gutiérrez, and Thomas Philippon. 2020. "From Good to Bad Concentration? US Industries over the Past 30 Years." NBER Macroeconomics Annual 34:1– 46. https://www.journals.uchicago.edu/doi/10.1086/707169

[6] Note we cannot come to conclusions on whether firms are colluding or abusing their dominance (in breach of a competition law) without this being determined by a competition authority.

[7] Refer to World Bank. The Business of the State (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/099025011282357844/IDU06292f8750d6f10488b0b4af0bc626733838c

[8] As rated by GCR. GCR Rating enforcement measures the effectiveness of competition authorities. The ranking is constructed using the survey data in combination with expert judgement based on statistical indicators and interviews. The ranking evaluates the use of resources, legal powers and influence to promote competition and address anticompetitive harm.

[9] This definition is in line with Tirole, Jean, (2017) Economics for the Common Good, Jean Tirole. Princeton University Press.

[10] For more information on SOEs and state enterprises with minority state shareholding operating across sectors, refer to "World Bank. 2023. The Business of the State (Overview booklet). © Washington, DC: World Bank. http://hdl.handle.net/10986/40343 License: CC BY 3.0 IGO."

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PART II
WHAT ISSUES AFFECT MARKETS AND COMPETITION?

2. UNDERSTANDING MARKET DYNAMICS AND OUTCOMES

Chapter 2. What's in this chapter…

- Overview of qualitative indicators that can be used to assess market characteristics and state intervention
- Overview of quantitative measures that can be used to gauge the level of competition, along with their pros and cons, and their data requirements
- Guidance on qualitative and quantitative assessments of competition along value chains
- Ideas of possible competition analyses that could be conducted depending on the objective and data availability

Assessing market dynamics and outcomes is an essential first step of the MCPAT. Once a market of interest has been identified, it is important to understand what this market looks like: does it have many or few players? Are these players concentrated? If so, could it be due to economies of scale? Are players vertically integrated along the value chain? Or are they part of larger conglomerates that participate in different markets of the country? It is also important to understand how firms behave: Have new companies entered or exited the market? Are the incumbent or the leading companies losing market share? The answers to these questions will help us understand what type of government interventions would be appropriate to foster competition. Moreover, these are factors that play a role in determining market outcomes, which must also be assessed: are prices relatively high? How have they evolved over time? What about market productivity? All these three categories of competition factors – (1) market structure and firm behavior, (2) regulations and other government interventions, and (3) market outcomes – will provide evidence on whether the market is behaving competitively.

Finding an indicator that measures competition precisely is challenging. The degree of competition is not an observable variable or transaction-measured indicator such as trade and investment but rather the process and mechanism through which economic agents interact. Furthermore, competition is ultimately influenced by policy variables or constraints at both the economy-wide and sectoral levels. Nevertheless, proxies that gauge the extent of competition are useful to understand the outcomes associated with the degree of competition in markets. Once proxies for competition have been estimated, it is possible to examine the key drivers of competition as well as how the degree of competition relates to macroeconomic and firm-level outcomes. Further, given that regulation can create distortions that are transmitted through idiosyncratic prices and costs generating a misallocation of inputs between firms, new econometric approaches have been developed to establish a causal relationship between regulation and market power as well as outcomes such as productivity (Sampi et al. 2021).

This chapter presents tools that can provide a general sense of market dynamics and perceptions of competition intensity and constraints in a country and impacts on market outcomes. This chapter is structured as follows: First, qualitative indicators of competition and market characteristics are discussed. Second, quantitative measures of competition are presented as well as issues regarding data availability. The third section explains how both qualitative and quantitative analyses of markets can be used to analyze competition issues along value chains. Fourth, types of possible analyses are presented through examples based on the level of data intensity required.

Comparisons of competition measures across countries should be conducted with caution. Since the firm-level data that allows us to calculate measures of competition are often not comparable across countries, these measures (at least in their level form) are generally not comparable unless the data source and collection methodology are the same. Changes in these measures' levels over time may be more comparable but caution is still required since market conditions may vary across countries – such as market size, consumer preferences, and efficient operating costs. To provide a general overview, measures based on comparable data sources such as the Economist Intelligence Unit (EIU) data, World Bank Enterprise Survey data, and Product Market Regulation (PMR) scores can be used for cross-country comparisons.

TOOLKIT ITEM 9 Qualitative and quantitative indicators – that gauge the extent of competition are useful for understanding the outcomes associated with the degree of competition in markets. See Table 3 for qualitative indicators and Annex A.5 for quantitative indicators.

2.1. Qualitative indicators for a country-level overview

There are several indicators that can be used for an initial assessment of competition factors. Indicators aggregate information both at the sector- and economy-wide levels. They range from perception-based assessing outcomes in markets to those focused on enacted market policies (such as PMR). Table 3 provides an overview of available qualitative indicators.

Perception-based indicators allow us to gauge on a preliminary basis whether there are concerns that markets are underperforming and/or leading to non-competitive outcomes. Perception-based indicators – such as from the Global Competitiveness Index and the Economist Intelligence Unit Risk Tracker – are particularly useful in country contexts where there is limited micro-level data available. However, they come with several caveats and should only be used as an entry point for a more in-depth qualitative assessment. Perception-based indicators may suffer from selection bias, incentives to misreport, context-specificity, and risks of capturing other factors not related to competition. Values in levels may be difficult to interpret, and therefore, the focus tends to be on broad trends. Given the issues inherent in using perception-based measures to understand competition, these indicators should not be used in isolation from other measures built on more comprehensive data and with more robust methodologies.

The PMR Indicators are comprehensive measures of market restrictiveness based on enacted rules and policies. The indicators are not designed to capture informal regulatory practices or the effective enforcement of regulations. The PMR indicators can be analyzed economy-wide and for specific policy areas and sectors (network industries, retail, and professional services). The PMR indicators are qualitative in nature. However, they can be used for empirical estimation, such as in simulation exercises showing that policy-enhancing reforms can have a positive impact on economic growth. A complementary measure of the general policy framework to preserve and enable well-functioning markets is the Bertelsmann Stiftung's Transformation Index's indicators on the presence of policies to enable market-based competition.

For each dataset and indicator identified above, it is important to put the country in context. The scores for the country studied should be compared to the average as well as the individual scores for (i) the top 5 performers for that indicator, (ii) structural peer countries at the same income level and/or population size, and (iii) aspirational peers, which serve as good examples of development for the country studied (to be identified on a case-by-case basis). See Example 1, 2, and 3 for illustrations of PMR indicators used in World Bank reports: Systematic Country Diagnostics, Country Economic Memoranda, and Country Private Sector Diagnostics. In addition, it is useful to examine changes to the indicators over time to get a sense of structural changes or regulatory reform that has affected market functioning.

TABLE 3: QUALITATIVE INDICATORS

Qualitative Indicators	Indicators/variables to analyze	Coverage
Bertelsmann Stiftung's Transformation Index (BTI): perception indicator based on in-depth assessments of countries to determine the strength of market-based competition, the extent of safeguards to prevent the development of economic monopolies and cartels, and competition enforcement.	The following two indicators, which are based on surveys of competition experts, should be consulted: • Market-based competition. • Effectiveness of anti-monopoly policy.	Survey includes 137 countries. The BTI excludes all countries that were members of the OECD by 1989 and excludes countries with fewer than 1 million residents except for Bhutan, Djibouti and Montenegro. Available annually since 2004.
European Bank for Reconstruction and Development (EBRD) Transition Indicators: The EBRD has developed an approach to tracking progress in countries deemed to be in transition, assessing developments along six qualities of a sustainable market economy, including "competitive".	Progress is captured by the set of "transition indicators", which combine information from a large number of indicators and assessments in a consistent manner. The "competitive" indicator focuses on dynamic economic structures that promote competition and diversification, widen choice, improve the quality of goods and services and provide fair prices.	The 2021/22 report includes 37 countries. Available annually since 2003 but the framework was changed in 2016.
World Economic Forum's Global Competitiveness Index (GCI): Perception-based indicator uses more than 100 relevant variables to assess the conditions of competition in countries along 12 pillars of competitiveness.	Relevant indicators in a high-level economy-wide assessment include: • Intensity of local competition; • Extent of market dominance; • Effectiveness of anti-monopoly policy; • Extent of price controls in the market; • Extent of unfair competitive practices; • Distortive effect of taxes and subsidies on competition; and • Competition perceptions at the sector level.	In 2020, 141 countries included in index. Available annually since 2004.
Economist Intelligence Unit Risk Tracker (EIU): collects data, among other things, on investor perceptions relating to the competition-related risks in doing business in countries (business risks related to weak competition).	Relevant indicators for the economy-wide analysis include sources of regulatory risks for business operations related to: • Existence of vested interests and cronyism; • Unfair competitive practices; • Discrimination against foreign companies; • Price controls.	Provides analysis for around 200 countries. Some indicators available annually since 1980.
World Bank Enterprise Surveys (WB ES): The World Bank's Enterprise Surveys include perception-based as well as quantitative data (on firm characteristics) collected through firm-level surveys, which provides a rich source of information about firms and the business environment in which they operate, including information on market structures and concentration.	Enterprise Surveys cover topics such as firm characteristics, the market environment firms consider themselves working in (monopoly, duopoly, or oligopoly markets), annual sales, costs of labor and other inputs, performance measures, access to finance, workforce composition, women's participation in the labor market, and many aspects of the business environment.	Currently, over 17 000 firms in 153 countries have been surveyed following the Enterprise Surveys Global Methodology. Since 2005-06, nearly all data collection have been centralized within the Enterprise Analysis Unit, where a Global Methodology was developed and applied. Surveys that deviate from the Global Methodology or were conducted prior to 2005 are also available, along with other raw data. Each country is surveyed every three to four years.

TABLE 3: QUALITATIVE INDICATORS

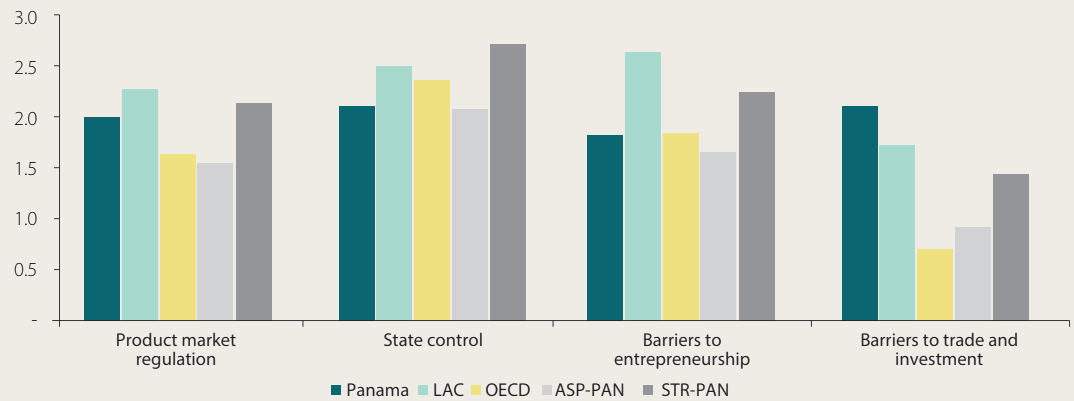
Qualitative Indicators	Indicators/variables to analyze	Coverage
OECD (World Bank) Product Market Regulation (PMR) Index: PMR indicators form a comprehensive and internationally comparable set of indicators that measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable. Initially built by the OECD for their members and OECD plus countries, the dataset has been extended in partnership with the WBG. The indicators rely on information collected through the OECD's regulatory indicators questionnaires. The PMR indicators are focused on enacted policies and not on outcomes, implying that they are "objective" in that they are not based on opinion surveys. PMR indicators focus instead on regulatory measures that affect the economy at large and can therefore be considered as comprehensive measures of regulatory restrictiveness.	High-level PMR indicators to assess intensity of competition in markets include: • Distortions Induced by State Involvement including sub-indicators: - Public ownership - Involvement in business operations; - Simplification and evaluation of regulations; • Barriers to Domestic and Foreign Entry: including sub-indicators: - Barriers to trade and investment; - Barriers in network and service sectors; - Administrative burden on start-ups.	The database covers up to 40 high income countries (HIC), 23 upper middle-income countries (UMIC) and 16 lower middle-income countries (LMIC). Available since 2013 and indicators are updated every 5 years, in some cases with changes in the methodology that reduces comparison over time. Backdated indicators for selected countries are also available since 1975 for certain indices.

Source: Authors' own elaboration
Note: The perception-based measures outlined here should only be used to give a preliminary entry-level view of how competition is perceived in a country. They should not be used in isolation of other more robust indicators described in this section.

EXAMPLE 1: PANAMA – USING PMR DATA TO ASSESS COMPETITION IN PRODUCT MARKETS IN A SYSTEMATIC COUNTRY DIAGNOSTIC

In 2016, overall pro-competitive regulation in Panama's product markets was more conducive to competition than in LAC and its structural peers (STR-PAN), but it lagged relative to OECD and its aspirational peers (ASP-PAN), due to higher barriers to trade and investment. In 2016, Panama had lower state control and lower barriers to entrepreneurship compared to many of its peers.

FIGURE 3: BENCHMARKING OVERALL PMR AND ITS SUBCOMPONENTS WITH PEERS



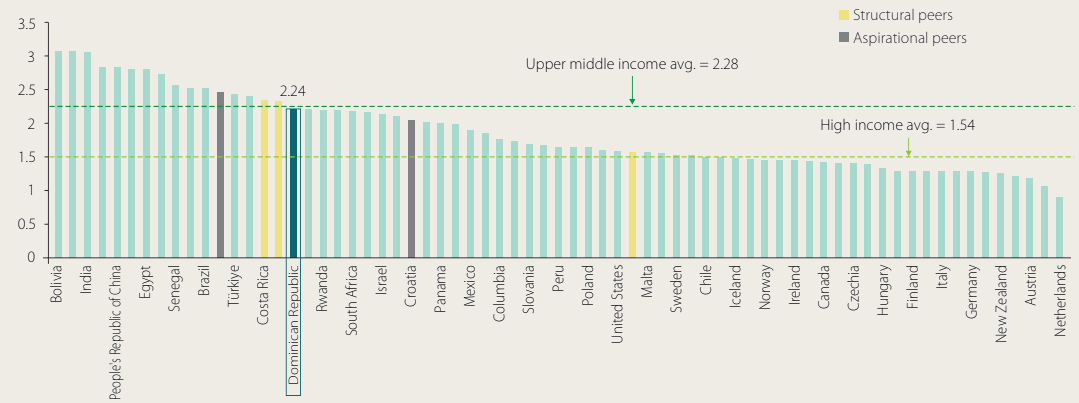
Source: OECD Product Market Regulation (PMR). Lower values indicate lower barriers. Latest PMR data for Panama was available in 2016

Source: Extracted from World Bank 2023 Panama Systematic Country Diagnostics update

EXAMPLE 2: DOMINICAN REPUBLIC – REVIEWING PMR INDICATORS AND SUB-INDICATORS IN A COUNTRY ECONOMIC MEMORANDUM

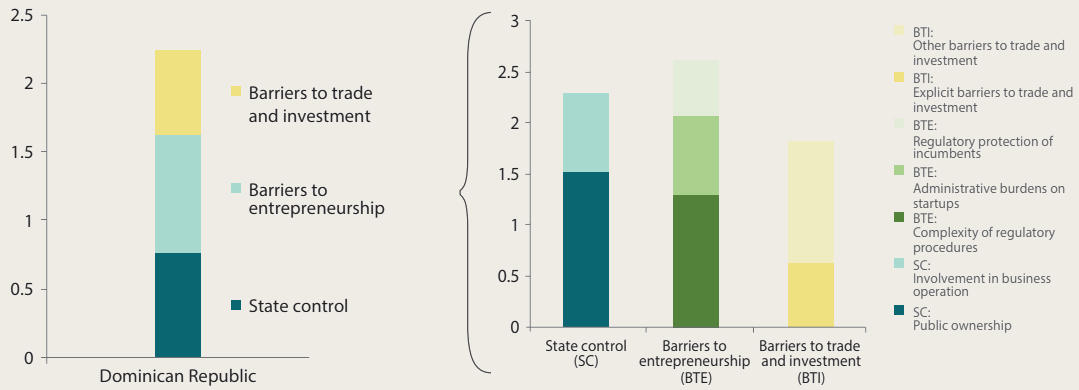
According to PMR data, the Dominican Republic had more restrictive product market regulations than most countries analyzed, albeit below the LAC average. The PMR shows that potential entrants and incumbent firms in DR faced more regulatory restrictions than aspirational peers such as Croatia and Bulgaria, although less so than in structural peers as Costa Rica. This in turn limits the extent of competitive pressure and contestability in key Dominican markets. The regulatory constraints are even more noticeable when the Dominican Republic is compared to the best-performing OECD countries: the economywide product market regulations are almost twice as restrictive than the top 5 OECD countries' average.

FIGURE 4: PMR INDICATOR – OVERALL SCORE



Source: PMR questionnaire for the Dominican Republic and OECD and WBG-OECD Product Market Regulation Database, 2013- 2017
Note: Absolute values from 0 to 6. Higher values are associated with more restrictive regulations.

FIGURE 5: DECOMPOSITION OF PMR SUB-INDICATORS FOR DOMINICAN REPUBLIC



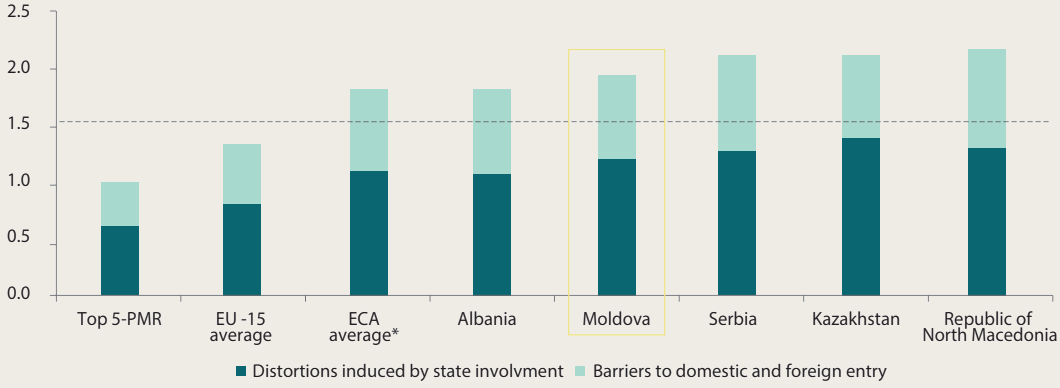
Source: PMR questionnaire for the Dominican Republic and OECD and WBG-OECD Product Market Regulation Database, 2013- 2017

Source: Extracted from World Bank (2023) Dominican Republic Country Economic Memorandum: Sustaining Economic Growth

EXAMPLE 3: MOLDOVA – USING PMR DATA TO ASSESS COMPETITION POLICIES AND REGULATIONS THAT RESTRAIN PRIVATE SECTOR INVESTMENT IN A COUNTRY PRIVATE SECTOR DIAGNOSTIC

In Moldova, indicators consistently point to weak competition. Moldova's environment poses substantially higher operational risks to private firms than other Eastern European and Central Asian (ECA) countries, emanating from the combination of the anticompetitive practices of market players and restrictive state policies (such as discrimination against foreign companies, price controls, and distortive state aid). A recent analysis of competition and government interventions, with a focus on Product Market Regulations (PMRs), shows that the regulatory framework is more restrictive and lags behind the ECA and EU-15 averages. Figure 6 shows that overall regulatory restrictiveness is mainly driven by *"Distortions Induced by State Involvement"*, indicating State interventions/SOE presence in markets where private sector participation and competition are typically viable (i.e. energy generation vs. transmission), while there are also several remaining *"Barriers to Domestic and Foreign Entry"*, especially in the case of barriers in service and network sectors, where Moldova underperforms compared to OECD and EU 15 averages.

FIGURE 6: MOLDOVA'S ECONOMY-WIDE PRODUCT MARKET REGULATION SCORE AND COMPOSITION ACROSS BENCHMARK ECONOMIES



Source: Markets and Competition Policy Team, Investment Climate Unit Finance, Competitiveness and Innovation Global Practice, World Bank Group- May 2020. Note: Top 5 performers are Australia, Belgium, Canada and Chile. ECA countries included in the average Albania, Belarus, Czechia, Hungary, Kazakhstan, Latvia, Lithuania, Moldova, Republic of North Macedonia, Poland, Serbia and Türkiye

While some reforms have been undertaken to align the legal and regulatory framework with EU regulations, the creation of a pro-competitive policy framework and the reform of SOEs remains an unfinished agenda. For instance, Moldova adopted new competition and state-aid laws in 2012 aligned with international standards. The new legal framework set up an independent competition agency reporting to the Parliament that began to operate in 2014. The government also introduced basic governance arrangements for state and municipal enterprises through new laws and concentrating their ownership in a specialized central agency that oversees state enterprises.[1]

Source: Excerpt from World Bank (2021), Concept Note for Moldova CPSD

2.2. Quantitative measures of competition across sectors

There are various measures to analyze whether a market is competitive. The metrics used to measure competition can be classified into the traditional Industrial Organization literature (structure-conduct-performance indicators) and the New Empirical Industrial Organization (NEIO) literature (based on disaggregated information on prices, quantities, number of players, and product characteristics assuming specific theories of imperfect competition). Traditional industrial organization indicators are generally used for MCPAT analyses. NEIO techniques can be used if there is enough data – including proprietary data in some cases – and the policy question focuses on a specific industry or market. For example, NEIO techniques are used to analyze mergers, collusive behavior, and auctions and have been applied to the study of various specific industries, mainly in the US and other high-income economies.[2]

Traditional competition measures focus on market structure, including the number of firms, entry barriers, and concentration measures. Concentration ratios (CR) and the Herfindahl-Hirschman Index (HHI) are the two most common estimates.[3] These measures should be analyzed over time to understand market dynamics. Firm entry and exit rates may indicate whether new challenger firms enter the market and force the exit of less efficient producers, which is another dynamic measure of market structure. As competition may exist between incumbent firms without high levels of entry or exit in the market and given that some markets might be contestable, entry and concentration need to be analyzed together with complementary information, including restrictive product market regulation (PMR). Analyses on a cross-section of industries focus on understanding the relationship between an industry concentration measure and an outcome such as accounting profit margins. However, these relationships are not causal unless appropriate instruments are used.

Measures of market structure can be analyzed together with measures that assess the conduct or strategy and performance of firms (pricing behavior or market power). Under perfectly competitive conditions, prices will equal marginal cost (i.e., marginal cost pricing will prevail) and all firms will earn normal profits. Under imperfect competition, firms will possess market power, so they can maintain prices above marginal cost. The exact magnitude of a firm's market power – tied to the gap between the output price and its marginal cost – would depend on the nature of the residual demand curve the firm faces. The higher the price the firm can charge for residual market demand, the larger the degree of market power. It is important to note that market power can be rightfully earned by a firm or enabled by the business environment, including weak competitive pressures. The most frequently applied measures are price-cost margins, mark-ups, the Lerner index, the Boone indicator, and the Panzar and Rosse model. The Boone indicator examines competition in terms of rivalry while the other measures focus on firm performance (instead of market structure). See Annex A.5. for more details on these indicators.

TOOLKIT ITEM 10

Understanding the intensity of competition means identifying the degree of market power considering:

1. Potential competitors and their ability to enter the market, not just actual competitors.
2. Demand and supply side conditions.
3. Entry barriers. These underlie many of the sources of market power. Regulation plays a role in addressing many of these by ensuring government interventions do not unnecessarily restrict competition and addressing certain strategic behaviors by firms. Regulation can also help to overcome the effects of some natural features such as economies of scale, network effects and information asymmetry.

Complementary resources:

- Product Market Regulation (PMR) Indicator
- Factors that shape market power (Annex A.3)
- Commonly used measures of competition, their relation to competition or empirical estimation, pros and cons associated with each measure, data required and usefulness of the measure (Annex A.5)
- Examples of common sectoral issues and options for analysis (Annex A.6)

Data requirements and availability

- *Firm-level data.* **Firm-level data on revenues is necessary for estimating measures of market structure, and firm-level data on revenues and costs is necessary for estimating markups and other performance measures of competition.** Since firm-level microdata is not as readily available as household survey data, it constrains the ability to estimate competition indicators. Sources of firm-level data include industrial census data, tax data, and Orbis data. Trade databases or exporter dynamics databases are potentially an additional source of data given their level of disaggregation. It is also more easily available than firm-level data that includes information on costs and sales. However, trade databases generally only include exporting firms which does not give a complete indication of market size. Importantly, most methodologies rely on data gathered based on standard industry classification

systems (ISIC, NACE, etc.). Even the most granular codes will likely be far broader than any product market. This makes it hard to draw direct conclusions about competition in a particular market, even if firm-level data at the ISIC 4-digit level is used.

- *Price data.* **Price data may also be a helpful indicator to show whether markets are working well. It is often unavailable, and where it is, some considerations need to be made.** There are several complications when comparing prices across different countries or regions, and over time. International price comparisons need to consider product comparability, exchange rate fluctuations, taxation, and cost differences across countries. Sectoral price trends should consider factors other than competition that may result in a change in price such as regulation, the cost of inputs, and demand for a product. If the prices being analyzed are retail prices, they will include distribution costs which will depend on multiple factors like transportation costs and labor costs (rather than simply competition in the product market). Sources of price data include the EIU, International Comparison Program (ICP), Numbeo as well as sectoral price data from the International Telecommunication Union (ITU) for telecommunication services, Food and Agricultural Organization and World Food Program for food products. Additionally, local statistical offices may be able to provide price data collected for the calculation of consumer or producer price indexes.

BOX 8: WHY IS IT DIFFICULT TO COMPARE PRICES OVER TIME AND ACROSS COUNTRIES?

The Law of One Price says that identical goods sold in different countries must sell for the same prices (when those prices are expressed in terms of the same currency and after considering shipping and distribution costs). However, the Law of One Price does not hold in practice because retail prices have four components – manufacturing cost, transport costs, distribution costs and profit margins – and the latter three tend to vary significantly across countries.

Comparing prices around the world is complicated for two reasons:

1) Practical reason: accessing comparable data on detailed product/service prices across countries is hard.
2) Theoretical reason: explained by different factors:
    - The Balassa-Samuelson effect refers to the tendency for consumer prices to be systematically higher in more developed countries than in less developed ones because of higher productivity, which affects wages and prices in non-tradable sectors (i.e., distribution and transport services).
    - Import duties and tax policies vary across countries.
    - Consumer preferences (willingness to pay, demand elasticity) vary across countries, influencing the companies' market power.
    - Prices are relative to income levels.

Source: Philippon 2019

2.3. Qualitative and quantitative measures of competition along value chains

When specific sectors or value chains are analyzed, various qualitative and quantitative indicators can be used to assess competition, but first, it is crucial to define the scope of the assessment. Ideally, the assessment would need to be conducted at the market level since market dynamics and the effects of government interventions differ across markets (Box 9). The delineation of the market of assessment is important to have a full understanding of the factors that affect market power. Furthermore, markets are connected through purchases from suppliers and sales to intermediaries, so that market outcomes in final product markets depend on how markets work along the full value chain.

BOX 9: FRAMING MARKETS FOR COMPETITION ASSESSMENTS

There are distinct markets within a type of product. For example, several different markets exist within the beverages (production) industry, such as bottled water, juices, sodas, and beer. These markets have different structures and players who face different sources of competition.

A single value chain generally encompasses multiple markets. An agribusiness value chain may serve as an example. Starting with the upstream market, the analysis could focus on the trading of inputs to farm production. Inputs to farm production include land, seeds and feeds, fertilizers, chemicals, and services (for example, credit and irrigation), among others. Indeed, each input is traded on a separate market. Farmers assemble inputs (plant and tend to the crops) and sell their produce downstream; this is a different market. At the wholesale level, the analysis could focus on the market where aggregators collect output from farmers and resell it to processors. It is worth noting that – depending on the circumstances of the market and the specific regulations – processors may bypass aggregators and compete with them in the acquisition of crop produce. A separate market could be identified downstream for crop processing and sale. Finally, the analysis could focus on the specificities of the retail market or the export market.

Close markets with different competitive environments. Consider the banking sector – or, more specifically, retail banking and corporate banking. At first glance, the two markets may appear similar. In both cases, the same banks may be collecting deposits while providing payment services and issuing loans. However, significant differences may exist that would point to the need to analyze the two markets separately. First, while some banks may serve both types of clients, others may focus on one group only. Hence, the number of competitors and their respective market shares may vary between the two markets. Second, specific regulations may apply to consumer loans that do not apply to corporate loans. Furthermore, buyers' preferences and their level of sophistication differ significantly, leading to different strategic interactions.

A sector typically consists of one or more value chains with several functions, activities, and actors that make up the various markets in the sector. A function leads to the delivery of the final product or service of interest and can consist of various activities or services conducted by different actors. For example, in an agricultural setting, the function of processing may consist of the activities of drying, peeling, sorting, roasting, etc., all of which can be performed by different actors or by one integrated actor. It is essential to identify functions, technological platforms, activities, and actors to understand which markets are key for the competition analysis.

The MCPAT has been applied in over 20 sectors. The most common sectors of application cover manufacturing, retail trade, agriculture, transport, telecommunications, and professional services.[5] More specific examples include groundnuts, rice, and onions in agriculture, pharmaceuticals, fertilizers and cement in manufacturing, bus, road cargo, railways and sea transport, and fixed and mobile services in telecommunications.

BOX 10: GUIDING QUESTIONS TO IDENTIFY MARKETS ALONG VALUE CHAINS

- **Functions**: What are the specific functions along the chain that lead to the delivery of a product or service?
- **Activities**: What are the activities performed under each function?
- **Actors**: Who are the actors performing each function? (suppliers or providers of a product or a service)
- **Markets**: Which functions or activities are competitors to each other? (for tradeables, import and domestic production would be competitors but are different functions). Define the product markets: those comprising all products and services regarded as substitutable by the consumer and where market players effectively constrain each other's pricing or other dimensions of competition (quality, innovation). In some cases, it may also be necessary to delineate between geographic markets if there is a high degree of geographic segmentation (in the transport sector, this could include delineating different transportation routes as being different relevant markets).

  Examples in agriculture: To what extent do different varieties or grades of a product compete with each other? To what extent do products from different value chains compete (such as palm oil as a substitute for groundnut oil)? To what extent do subsidized channels compete with non-subsidized channels?

  Examples in ICT: To what extent do different services or technologies compete when they serve a similar purpose, such as mobile voice calls and Whatsapp voice calls?

  Examples in transport: What are the equipment needs of the goods being transported? What is the value of the good being transported compared to the transportation cost? Is unimodal or multimodal transport required?

Once markets along the value chain have been identified, it is important to understand key market characteristics. This refers to characteristics that cannot be directly reformed or cannot be altered in the short to medium term. The purpose of this step is to:

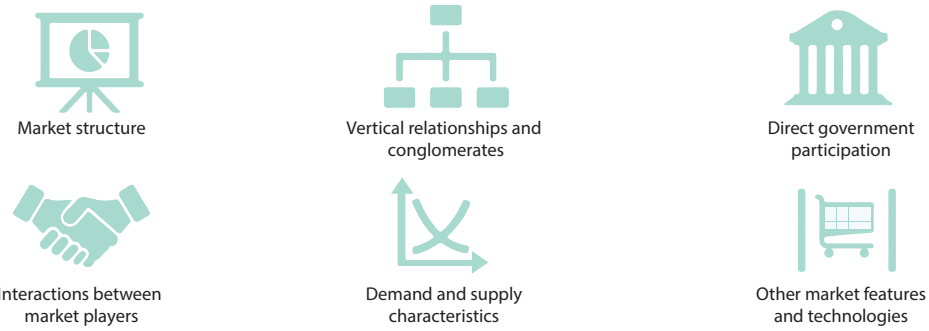
i) Understand the structure of the market, who are the market players (including the degree of state participation as a supplier), and the way market players interact; and

ii) Identify inherent features of the market that shape its dynamics (such as natural or structural barriers to entry) using industry data and comparisons across countries when relevant.

The critical components of this assessment include (Figure 7):

- **Market structure:** Analyzed dynamically complementing concentration indicators with information on entry and exit in each relevant segment of the chain. This provides an initial indication of the degree of rivalry between firms (through the degree of movement in market shares and frequency of exit) and the prevalence of barriers to entry (by observing recent entry).
- **Vertical relationships along the chain and conglomerates.** Although vertical integration can generate efficiency gains, it could also potentially restrict competition, for example, by leading to exclusionary practices when there is a dominant upstream or downstream firm. The control of essential facilities by one or a few firms can also affect their market power in connected markets. Identifying whether firms offer other complementary products as part of an ecosystem or are essential in other markets of the economy is also useful to understand if market power can be transferred from other markets.
- **Presence of enterprises with state shareholdings.** Checking for government participation can provide information about the importance of competition on the merits between market players since state players can be subject to advantages that are not available to private players.
- **Interactions between market players and strategic behavior by firms.** To understand the prevalence of spot purchases or long-term contracts that can lock in suppliers or buyers, actions to build excess capacity, and investment in advertising and branding to create differentiated products. These shape dynamics between market players, and some may (in certain circumstances) act as strategic barriers to entry.
- **Demand and supply characteristics.** To understand the existence of economies of scale given the size of local demand, the evolution of capital investments and investments in intangibles that affect production capacity or the ability to create new products, and the degree of product homogeneity that affects consumer switching and contestability (potential competition). All this information helps to understand various elements that shape competition dynamics, such as the prevalence of natural barriers to entry, the efficient market structure, elasticities of demand and supply, and network effects within and across groups of users.
- **Other market features:** This includes understanding any other market features that might lead to market failures and affect competition dynamics, such as information asymmetry on quality, reliance on scarce resources, negative or positive externalities from production, public goods, current lack of commercial viability, and historically heavily protected or regulated markets.

FIGURE 7: KEY COMPONENTS OF UNDERSTANDING MARKET CHARACTERISTICS



Source: Authors' own elaboration

Comparing these market characteristics with comparator countries can be helpful in some cases. For example, the level of state involvement, the degree of vertical integration, and how players interact could be compared across countries. Comparator countries would be best chosen for having similar overall characteristics, such as the size of the market and whether the country is an exporter or importer. A comparator country is not necessarily one with an efficiently structured or well-functioning value chain. Still, country comparators are intended to provide an idea of alternatives for structure and dynamics along the value chain.

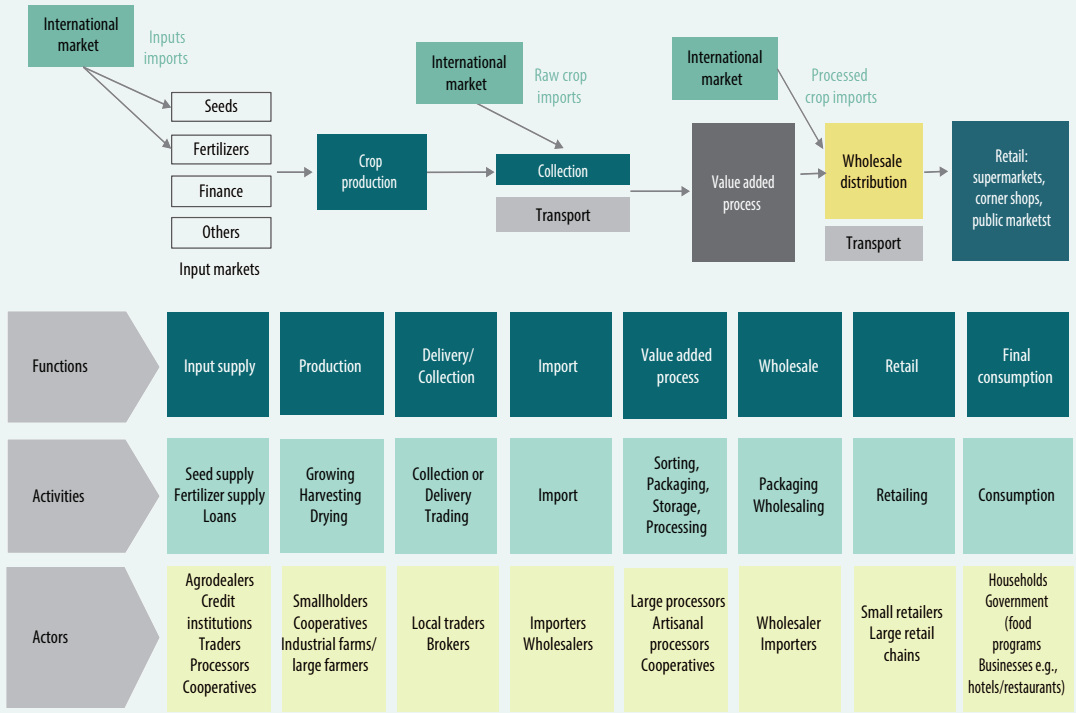
To analyze market characteristics, underlying information can be obtained using a combination of:

- **Desk research** utilizing information from government websites, laws and regulations, published government plans and regulators reports, media reports, and previous third-party sector analysis, industry statistics, and firm websites; and
- **Where possible, in-person interviews with key stakeholders**, including different types of firms (of different sizes and roles, as well as both incumbents and those that would like to enter the market), industry associations, policymakers, regulators, and consumer associations.

BOX 11: ILLUSTRATION OF MARKETS ALONG AN AGRICULTURAL VALUE CHAIN AND QUESTIONS TO IDENTIFY MARKET CHARACTERISTICS

The following figures contain generalized value chains for agricultural sectors (local consumption) and guiding questions to understand market structure, and demand and supply characteristics.

FIGURE 8: A GENERALIZED LOCAL CONSUMPTION AGRICULTURAL VALUE CHAIN



Source: Authors' own elaboration
Note: The user can also look at auxiliary sectors such as finance, warehousing and transport in more detail. In case the user wants to analyze any of the before mentioned auxiliary sectors, it can refer to the sector specific MCPAT template.

FIGURE 9: AGRICULTURAL SECTOR – SAMPLE QUESTIONS TO UNDERSTAND MARKET STRUCTURE IN AGRICULTURE

Input supply	Production	Delivery/collection	Value added process	Import	Wholesale	Export
• How many players are active in the market?	• What is the share of commercial vs smallholder farming?	• How many players are active in the market?	• How many players are active in the market?	• How many companies import the relevant product?	• How many players are in each of the existent market mechanisms?	• How many companies export the relevant product?
• What is the share of the largest firm?	• What is the share of the largest commercial farm?	• What's the average number of collectors per geographic location?	• What's the share of the largest players?	• What is the share of imports: In terms of consumption? under subsidy? under tender?	• What's the share of the largest player?	• What is the share of the largest exporter?
• What is the degree of firm symmetry?	• What is the share of cooperatives?	• What are their market value shares?	• What's the degree of firm symmetry?	• What is the share of the largest importer?	• Have shares remained stable in the past 3 years?	• What is the degree of firm symmetry?
• Have shares remained stable for the past 3 years?	• Has there been any structural change in the market in the past 3 years?	• How many access the market on a yearly basis?	• Have shares remained stable for the past 3 years?	• What is the degree of firm symmetry?	• Has there been market entry/ exit in the past 3 years?	• Has there been market entry/exit in the past 3 years?
• Has there been market exit/ entry in the past 3 years?		• Do players meet in different product or geographic markets?	• Has there been market entry/ exit in the past 3 years?	• Market entry/ exit in the past 3 years	• Do players meet in different markets?	• Do players meet in different markets?
			• Do players meet in different markets?	• Do players meet in different markets?		

Source: Authors' own elaboration

FIGURE 10: AGRICULTURAL SECTOR – SAMPLE QUESTIONS TO UNDERSTAND DEMAND AND SUPPLY CHARACTERISTICS IN KEY MARKETS ALONG THE VALUE CHAIN

Input supply	Production	Delivery/collection	Value added process	Input	Wholesale
• Are there economies of scale in production/ distribution? • How does minimum efficient scale compare to market size? • Is the product homogenous? • Are there economies of scope between inputs? • Network economies for distribution?	• Is the product homogenous? • Can farmers switch wholesalers / retailers /processors? Are they restricted by input conditionalities? • To what extent have producers access to market information? • How perishable is the product?	• Is the service homogenous? • To what extent do intermediaries also provide inputs? • How perishable is the product? • How high are transport and storage costs for the products compared to its value?	• Is the product homogenous? • Do players hold long term relationships with intermediaries or producers? • What's the minimum efficient scale for a processor, considering the size of demand? • How distant from farmers and each other are processors located? • What's the approx. needed investment amount to enter this market?	• What is the minimum efficient scale for an importer, considering the size of demand? **Export** • Are there economies of scale? • To what extent do local processors/ distributors to the local market also export?	• Do players hold long term relationships? • Are transactions regular/ frequent? • Do wholesalers need to buy inputs from (or sell outputs to) specific producers / retailers because of conditionalities? • Is it easy to switch suppliers? • What's the degree of firm symmetry? • What's the degree of format differentiation? • Are there economies of scale or scope? • Are business associations present in the market? • Do players meet in different product or geographic markets? • How perishable is the product? • How high are transport and storage costs for the products compared to its value?

Source: Authors' own elaboration

TOOLKIT ITEM 11 When analyzing a sector or value chain, before delving into competition indicators, it is crucial to identify the markets the assessment will focus on (the scope of the MCPAT analysis). For instance, this could be a given market or a sectoral value chain which is comprised of many markets.

2.4. Examples of analyses based on data availability

This section provides examples of quantitative competition analyses using different levels of data intensity. Since all the indicators are proxies, any empirical estimation of concentration indices, price-cost margins, and markups should be complemented by qualitative analysis to understand better supply-side and buyer characteristics of markets as well as identify and assess the potential competition effects of government regulations and intervention in the market.

Complementary resources:
- Common quantitative competition analysis that can be undertaken depending on data availability (Annex A.7)

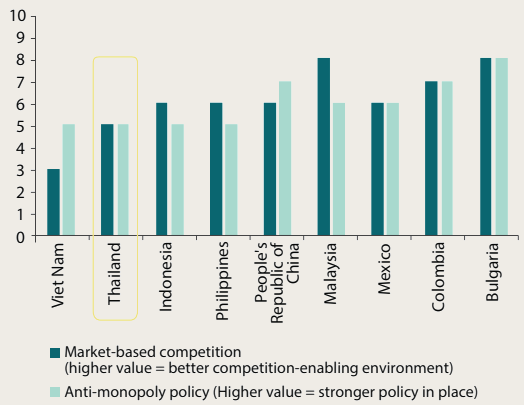
Examples of using "low intensity" data to measure competition

Perception of market functioning and characteristics. Competition-perception indicators can suggest that a lack of market competition and inefficient anti-monopoly policy are obstacles to increased competitiveness and well-functioning markets. This information can be corroborated by other survey data (such as World Bank Enterprise Surveys). See Example 4.

EXAMPLE 4: THAILAND – EXAMPLE OF "LOW INTENSITY" DATA TO MEASURE COMPETITION

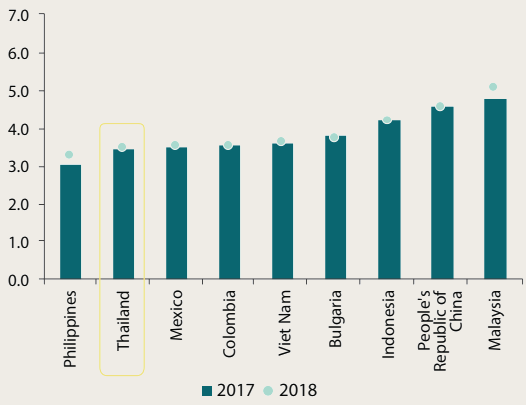
According to the Bertelsmann Stiftung's Transformation Index indicators (BTI, 2018), the fundamentals of market-based competition – i.e., regulatory interventions that enable competition – are perceived to be less developed in **Thailand** compared to its peers, and competition laws to prevent structures and conduct that thwart competition also appear to be weak and lack effective enforcement (Figure 11). There is also a greater extent to which business activity in Thai markets is perceived to be dominated by relatively few players compared to peers (Figure 12), with little progress made over the 2017-2018 period. Globally, Thailand ranks 96th out of 140 countries in terms of the extent of market dominance, according to the Global Competitiveness Report 2018.

FIGURE 11: ORGANIZATION OF THE MARKET AND COMPETITION



Source: Authors' elaboration based on data from BTI (2018), Thailand Manufacturing Firm Productivity Report (2016) by World Bank Group and Bank of Thailand
Note: The BTI is a perception indicator based on in-depth assessments of countries and is managed by the Bertelsmann Stiftung.

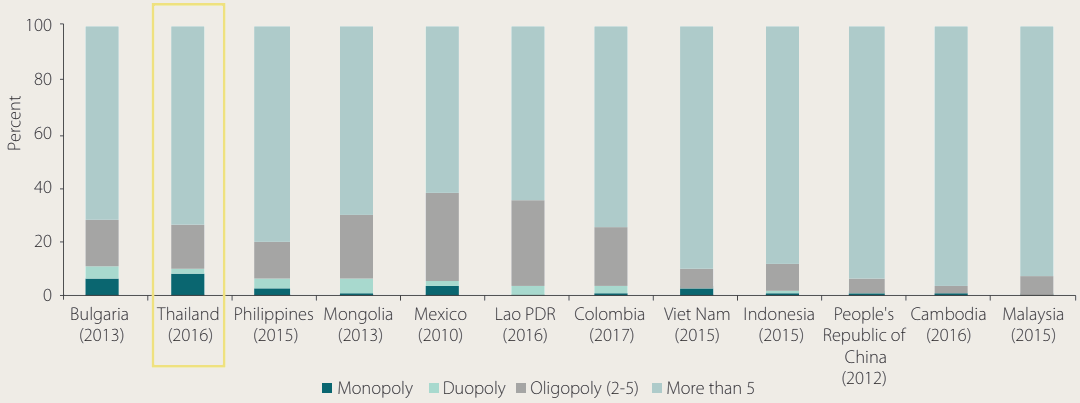
FIGURE 12: EXTENT OF MARKET DOMINANCE, 1-7 (BEST)



Source: Authors' elaboration based on data from the Global Competitiveness Report, World Economic Forum, 2017-2018, Thailand Manufacturing Firm Productivity Report (2016) by World Bank Group and Bank of Thailand

Enterprise Survey data confirmed a significant presence of monopoly or duopoly market structures in industries typically characterized by low market concentration, such as those in manufacturing. The proportion of Thai manufacturing firms that consider that they operate in monopoly or duopoly markets appear to be relatively high (about 10 percent) when compared to regional and structural peers (Figure 13). Although concentrated market structures may be consequences of natural barriers, small market size, or firms being more efficient because of scale economies, government regulations and interventions that disrupt the marketplace by limiting entry, facilitating dominance, or unleveling the playing field may also cause market structures to be relatively more concentrated.

FIGURE 13: MANUFACTURING SECTOR MARKET STRUCTURES



Source: Authors' elaboration based on data from the World Bank's Enterprise Survey data for most recent years, Thailand Manufacturing Firm Productivity Report (2016) by World Bank Group and Bank of Thailand
Notes: The shares reflect the percentage of responding establishments that answered "None", "One", "2-5" or "More than 5" to the question "For fiscal year [indicated in parenthesis], for the main market in which this establishment sold its main product, how many competitors did this establishment's main product/product line face?", respectively. Such as "None" was coded as "Monopoly" and "One" as "Duopoly". Establishments with no answers to the question and establishments whose main market for its main product line is international are excluded.

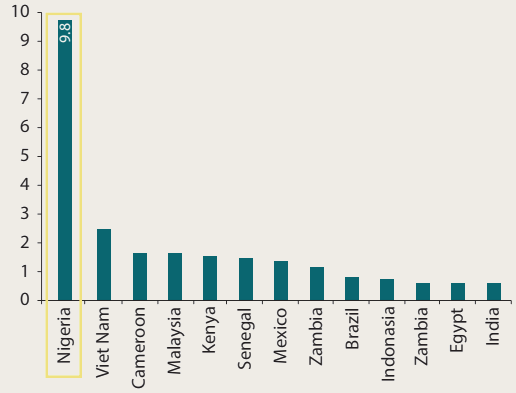
Price comparisons across peer economies. Boosting competition in basic good markets could make staple products more affordable, boosting consumer welfare, particularly for households at the bottom of the income distribution who consume disproportionately more of such goods. In comparing prices across peer economies, it is important to control for many factors, including GDP per capita, import costs, the status of logistics, and local tax rates, which can be sourced from several databases. Prices can be sourced from the Economist Intelligence Unit database (as per the Figure below) as well as Numbeo, and for robustness, a parallel analysis should be undertaken using a similar list of products to check whether results are consistent across databases.

EXAMPLE 5: NIGERIA – EXAMPLE OF PRICE COMPARISON

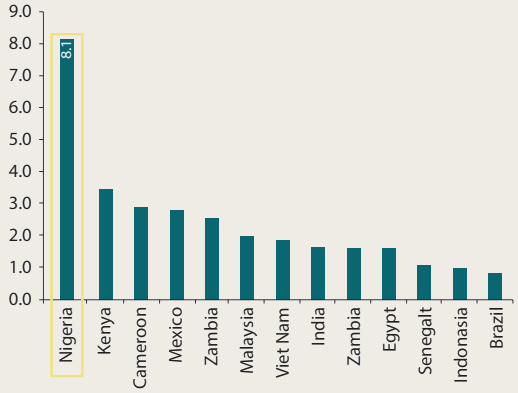
In Nigeria it was found that retail prices are generally higher in Lagos than in other major cities when controlling for other factors. Prices for a specific basket of goods were, on average, approximately 14 to 18 percent higher than in other economies around the world (Nyman et al., 2022). As an example, Figure 14 shows that prices of basic goods such as flour and rice are disproportionately higher in Lagos than in cities in peer countries. This potentially reflects weak competition in these product markets.

FIGURE 14: CONSTRAINTS TO COMPETITION MAY BE CONTRIBUTING TO HIGHER PRICES IN NIGERIA RELATIVE TO OTHER ECONOMIES

Prices of white flour in major cities (2020; US$ for 1kg)



Prices of white rice in major cities (2020; US$ for 1kg)



Source: Authors' elaboration based on Economist Intelligence Unit (EIU) data, Inputs on Competition Policy for Nigeria CEM (2022) by Nyman et al. Notes: Cities: Lagos, Nigeria; Hanoi and Ho Chi Minh City, Viet Nam; Douala, Cameroon; Kuala Lumpur, Malaysia; Nairobi, Kenya; Dakar, Senegal; Mexico City, Mexico; Harare, Zimbabwe; Rio de Janeiro and Sao Paolo, Brazil; Jakarta, Indonesia; Lusaka, Zambia; Cairo, Egypt; New Delhi and Mumbai, India.

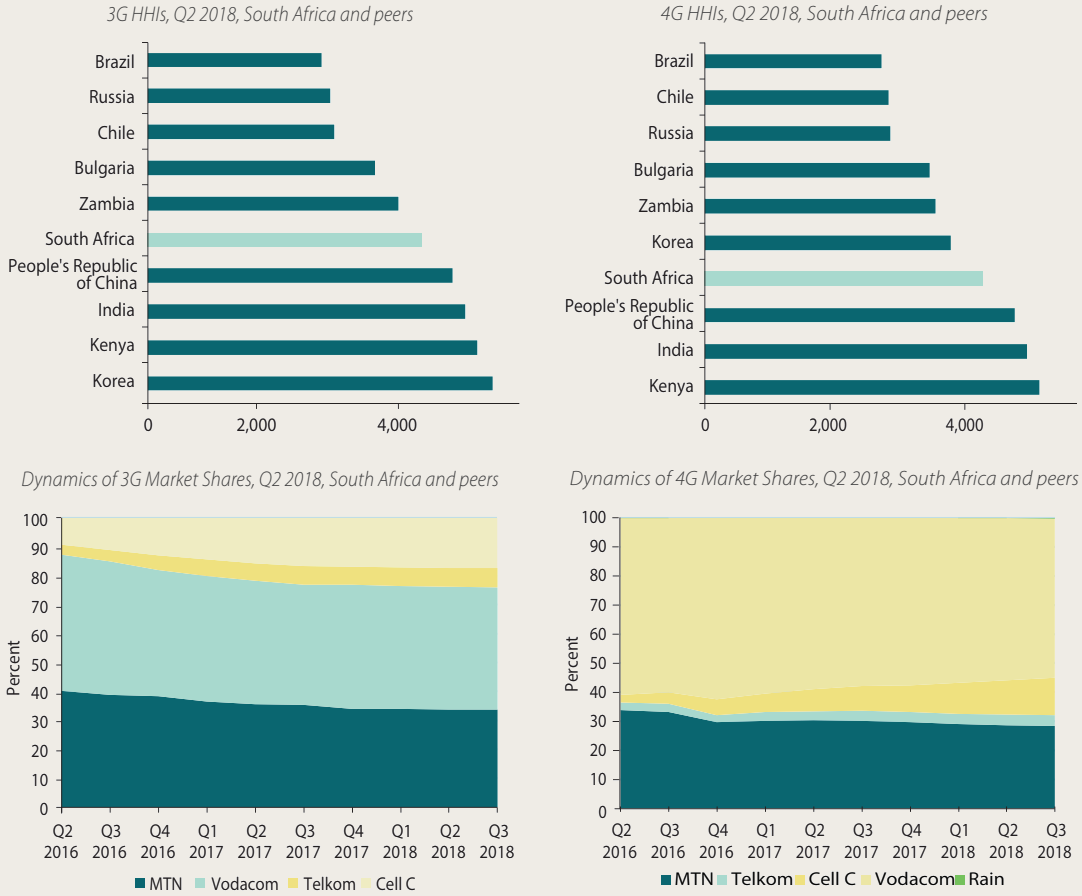
Examples of using "medium intensity" data to measure competition

Measuring market concentration. Measuring concentration can be a helpful indicator of market structure but should always be considered alongside other measures to understand competition dynamics fully. It is also essential to remember that (i) markets should be identified appropriately to carry out the exercise, and (ii) concentration measures are most valuable when considered in a dynamic context, which includes examining market shares over time and analyzing firm entry and exit. For example, in examining telecommunication markets, instead of considering mobile services as a whole, concentration measures can be estimated for 3G, 4G, and mobile virtual network operator markets (MVNO) markets over time, and these can be compared to peer countries. See Example 6 for an example in South Africa.

EXAMPLE 6: SOUTH AFRICA – MEASURING MARKET DYNAMICS IN MOBILE TELECOMMUNICATIONS

A diagnostic in South Africa, for instance, found that 3G was in line with peers in terms of concentration measures (Figure 15). 4G was relatively more concentrated, and the recent entry was highly context-specific, not at a significant scale, and not easily replicable. MVNO shares in the overall mobile services market were not out of line with international experience, but there was room for greater growth – particularly given the South African government's focus on services-based competition.

FIGURE 15: EXAMPLES OF ANALYSIS USING MARKET SHARES (RELATIVE TO PEER COUNTRIES AND OVER TIME) AND HHI (RELATIVE TO PEER COUNTRIES) FOR 4G AND 3G MARKETS IN SOUTH AFRICA



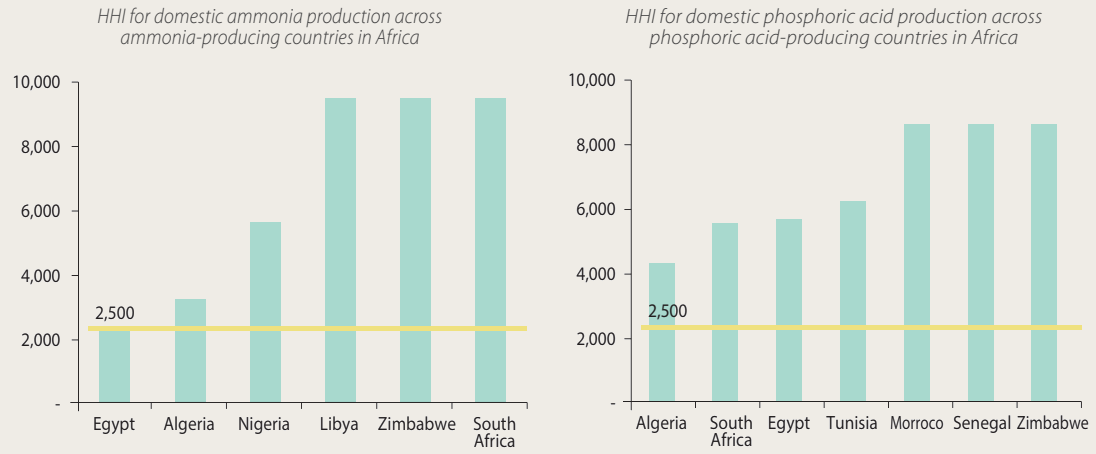
Source: Diagnostic of Markets and Competition in South African Telecommunications Markets (2019) by Nyman et al.
Note: Market share is calculated as 3G connections at the end of the period, expressed as a percentage share of the total market.

HHI levels can be compared to standard thresholds to determine whether a market has a low, moderate, or high concentration. HHI approaches zero when a market has a large number of firms of relatively equal size and reaches a maximum of 10,000 where there is a monopoly. The US Department of Justice and the US Federal Trade Commission consider markets with an HHI higher than 1,800 as highly concentrated.[4] A highly concentrated market where HHI has increased by 100 points to potential lessening of competition. In the case of fertilizers in Africa, HHI based on production is high (Example 7).

EXAMPLE 7: AFRICA – CONCENTRATED PRODUCTION OF FERTILIZERS

In understanding industry dynamics that shape competition in fertilizer markets in Africa, it was found that production of primary materials is concentrated in relatively few market players partly due to scarcity of natural resources, with HHIs above 2500 in all but one country for which data was available (Figure 16). For the assessment, the market was split into fertilizers based on the resources required, specifically ammonia and phosphoric acid production, since these likely constitute different relevant markets. However, a limitation of the figure below is that, since it is based only on production data, it would not reflect competitive pressures from imported fertilizer.

FIGURE 16: CONCENTRATION OF PRODUCTION OF INTERMEDIARY PRODUCTS AND FERTILIZER ACROSS AFRICAN COUNTRIES



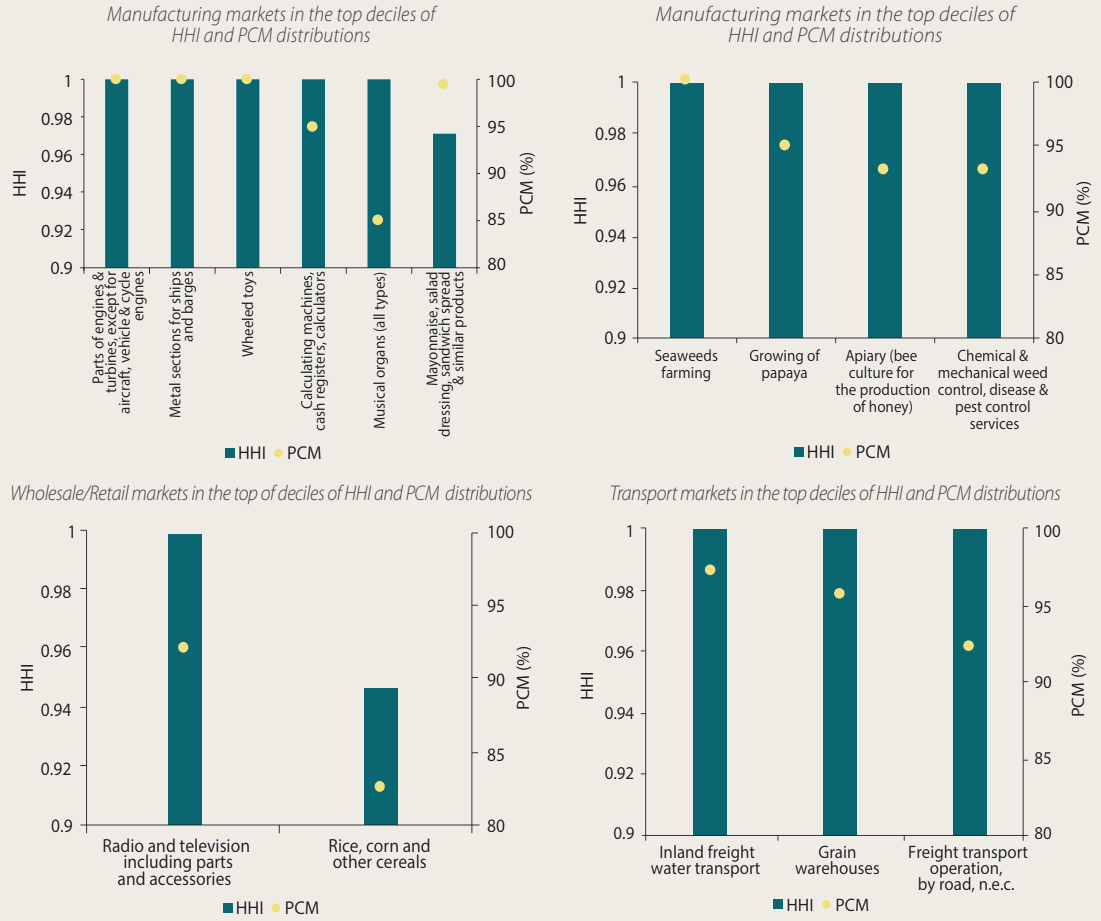
Source: Authors' elaboration based on data from UN Comtrade, World Bank 2016
Note: The horizontal yellow line depicts the threshold for highly concentrated markets based on the 2010 US Merger Guidelines

When additional firm-level information is available, measures of market structure can be analyzed together with firm performance data. In the Philippines, HHI analysis was combined with PCM estimates to understand whether concentrated industries are also those in which firms can raise prices above marginal cost (Murciego et al. 2018) (Example 8).

EXAMPLE 8: PHILIPPINES – MARKET CONCENTRATION AND PRICING POWER

The analysis used the 2012 Census of Philippine Business and Industry. Figure 17 indicates markets in the top 20 percent of the HHI or PCM distribution for the sector. The analysis further identified restrictions in sectors that were particularly concentrated based on PMR surveys, such as restrictions on entry. For example, in the road freight industry, national, state or provincial laws or other regulations restrict the number of competitors allowed to operate a business in freight transport by road. In addition, the regulator, through licenses or otherwise, has the power to limit industry capacity. Foreign firms have no cabotage and face restrictions for picking up freight (such as if they have only been delivered in the country).

FIGURE 17: MARKETS THAT LIE IN THE TOP 20 PERCENT OF THE HHI OR PCM DISTRIBUTION FOR THE SECTOR IN THE PHILIPPINES



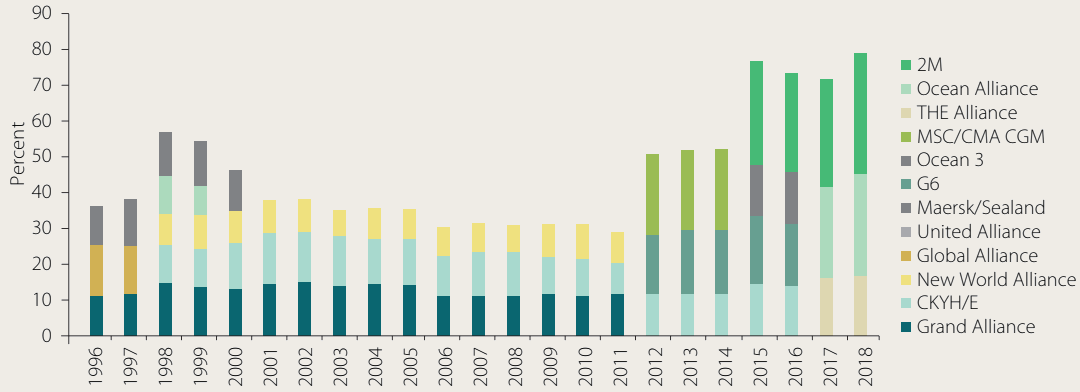
Source: Authors' calculations using the 2012 Census of Philippine Business and Industry. Murciego et al (2018)

Market shares. They can also be used to examine the strategic behavior of firms. For example, the importance of alliances or associations over time in the maritime sector – including the risks they create given coordination among competitors – can be assessed using market shares (Example 9).

EXAMPLE 9: MARITIME SHIPPING – EVOLUTION OF MARKET SHARES OF ALLIANCES

Shipping alliances in the **European Union (EU)** adopted a Consortia Block Exemption Regulation (Commission Regulation [EC] No 906/2009), allowing shipping companies to operate joint liner shipping services until 2024 without the risk of breaking antitrust rules. The EU regulation conditioned the exemption to consortia whose combined market share does not exceed 30 percent for two consecutive calendar years and whose joint behavior does not lead to the (a) fixing of prices when selling liner shipping services to third parties, (b) limitation of capacity or sales, or (c) allocation of markets or customers. Although direct price fixing, quantity limitation, and market allocation are not exempted, a significant degree of information exchange and coordination is required. As a result, coordination has been a critical feature of the maritime shipping industry. In recent years, three main shipping alliances – 2M, Ocean Alliance, and THE Alliance – have emerged to dominate the market, accounting together for the vast majority of the container shipping market in terms of capacity (Figure 18) (OECD 2019). Several jurisdictions, such as the United States, Europe, Australia, Japan, India, Malaysia, and Singapore, also have block exemptions for the container shipping industry in their competition laws, with some countries even exempting all agreements, including on prices (OECD 2021).

FIGURE 18: MARKET SHARE BY TEU ALLIANCE



Source: Data from OECD (2019), Global Supply Chain Disruptions: Competition Policy Implications (2022) by World Bank
Note: TEU= twenty-foot equivalent unit.

Policy simulations and the impact on economic growth. Simulations can be employed to show the potential gains of addressing restrictions to competition. Empirical evidence suggests that removing regulatory restraints to competition in crucial network sectors could benefit growth (Barone and Cingano 2011, Conway et al. 2006, and Arnold, Nicoletti, and Scarpetta 2011). Simulation analyses using data from the OECD-WBG PMR indicators database and input-output tables[6] suggest that undertaking competition-enhancing reforms by reducing the level of regulatory restrictiveness in key service sectors – i.e., energy (electricity and gas), communications (telecom and post), transport (road, rail, air, and water), and professional services (legal, accounting, engineering, and architecture) – could boost economic growth. Following the results of Barone and Cingano (2011), a multiplier effect of 0.75 percentage points can be assumed in downstream sectors with above average intensity across all named service sectors due to reforms across these selected sectors. These simulations have been applied in different countries (Example 10).

Notably, this approach does not account for complex inter-relationships between reforms and spillover effects that might be considered in a general equilibrium analysis. There may also be omitted variable bias, so the results must be viewed in the context of other findings on the sector. In addition, there is no estimated coefficient for developing countries, so one has to assume the coefficient is the same for developing and developed countries over time (Barone and Cingano 2011).

EXAMPLE 10: MULTIPLE COUNTRIES – SIMULATIONS OF POTENTIAL GDP GROWTH DERIVED FROM COMPETITION REFORMS

The following findings point to the growth benefit of reducing regulatory obstacles in key upstream service sectors, particularly for sectors that rely on such services more intensively as input.

- A simulated scenario in which **Romania** undertakes reforms by reducing regulatory restrictiveness in service sectors implies a potential gain of 0.2 percentage points to the observed GDP growth in 2017, all else equal (World Bank 2020).
- If **Argentina** were to reduce regulatory restrictiveness in service sectors, such as electricity, communications, transport, and professional services (legal, accounting, and architecture), the simulation suggests this would boost annual GDP growth by up to 0.6 percent (Licetti et al. 2018).
- Procompetition reforms could enhance **the Philippine's annual GDP by 0.2 percent, adding US$0.6 billion** (World Bank 2018).
- In **Ukraine**, a potential gain of 0.015 percentage points was expected, which is nontrivial given that the annual GDP growth rate averaged 2 percent over the previous two years preceding the simulation (Pop et al. 2019).
- In **Senegal**, network sector reforms would have translated into up to 0.5 percent additional annual GDP growth (World Bank 2018).
- For countries in the **Western Balkans**, pro-competition reforms in the network and professional services sectors could generate, on average, between 0.14 to 0.23 percentage points of additional annual GDP growth ranging from a minimum of US$ 0.01 billion to a maximum of US$ 0.06 billion of value added in one year.

Examples of using "high intensity" data to measure competition

Firm-level markups and productivity. The rarity of firm-level price data and data on marginal costs generally makes direct measurement of markups challenging. Where sufficient data exist, however, it may be possible to estimate firm-level markups and thus gain additional insights into industry-specific competition indicators. Furthermore, the link between pricing power and productivity or labor outcomes can also be evaluated. Analyses conducted for People's Republic of China, Romania, and South Africa illustrate how additional measures of market functioning can be assessed with firm-level data, particularly census data (Example 11).

EXAMPLE 11: PEOPLE'S REPUBLIC OF CHINA, ROMANIA, SOUTH AFRICA – FIRM-LEVEL DATA ANALYSIS OF MARKET FUNCTIONING, PRODUCTIVITY AND LABOR OUTCOMES

Applying the methodology developed by De Loecker and Warzynski (2012), Iootty and Dauda (2017) provide an estimation of markups in the Chinese manufacturing industry using data from the Chinese Industrial Enterprises Database (CIED) collected by the National Bureau of Statistics (NBS) for 1998-2013. This approach (the "production approach") does not require assumptions on how firms compete in the market; there are no restrictions on underlying consumer demand, and only firm production data (on inputs and outputs) are needed, which can be easily extracted from firms' financial statements. Analysis showed that SOEs owned solely by the state had significantly higher markups (a proxy for the level of competition) than other firms, even after controlling for other firm characteristics.

Iootty, Pop, and Pena (2020) conducted a similar analysis of markups in Romania between 2008 and 2017 using firm-level data from the Structural Business Survey (SBS) for 2008–17. The Romania study showed that ownership is the most relevant in explaining differences in markup performance among firm characteristics. State-controlled companies tend to exert the highest markup premiums when compared to domestic privately-owned companies across the economy and especially in the manufacturing sector: 29 percent higher for minority state-owned companies and 20 percent higher for wholly state-owned. Capital intensity and export activity are also particularly relevant.

Analysis using the De Loecker and Warzynski (2012) methodology on South African tax administrative data for 2010–14 also indicated that competition is positively related to productivity growth (Dauda, Nyman, and Cassim 2019). The results suggest that higher markups – and, by extension, lower competition – negatively impact productivity growth. The results are highly significant across model specifications and show that a 10 percent reduction in average markups in manufacturing industries is associated with a 0.1 percent increase in productivity growth. This productivity gain would have taken South Africa's negative productivity growth for manufacturing industries into positive territory between 2010 and 2014. In addition, the analysis suggested that a lack of competition in product markets stifles employment in the long term or in aggregate. Specifically, a 10 percent reduction in average observed markups leads to a 0.12 percent increase in employment growth. While the impact on employment growth may seem small, it represents more than a doubling of mean employment growth in manufacturing industries (of 0.07 percent) between 2010 and 2014.

NOTES

1 The final CPSD was published in February 2023. Creating Markets in Moldova: From a Remittances-Driven Economy to Private Sector-Led sustainable Growth. URL: https://www.ifc.org/content/dam/ifc/doc/2023-delta/cpsd-moldova-en.pdf

2 For a more detailed explanation of empirical industrial organization and its applications, see Aguirregabiria, Victor. 2021. "Empirical Industrial Organization: Models, Methods, and Applications." Available at: http://aguirregabiria.net/wpapers/book_dynamic_io.pdf

3 HHI is calculated as the sum of the squares of the market shares while concentration ratios are the sum of the market share of the largest firms. CR4 means the sum of market shares of the top 4 firms.

4 See U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines (2023) that replace the 2010 guidelines. Available at https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf. According to the previous guidelines, markets with HHI between 1,500 and 2,000 were considered moderately concentrated; and markets with HHI greater than 2,500, highly concentrated.

5 A list of relevant publications covering these sectoral assessments can be found in the WBG Markets and Competition Policy webpage: https://www.worldbank.org/en/topic/competition-policy

6 Input-Output tables which include information on numerous specific markets are used to find intensity of usage of input sectors. The Barone and Cingano (2011) coefficient is then applied to those sectors with intensive use.

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3. UNDERSTANDING HOW GOVERNMENTS SHAPE MARKETS

A complementary step to assessing market dynamics and outcomes is identifying what government interventions (or lack thereof) might weaken market competition. These interventions could exist at the market, sector, or economy-wide level, as well as at the subnational, national, and even international level. Interventions must not be assessed in a vacuum. It is essential to look at the interaction between the competition dynamics created by market characteristics and the effects of government interventions in markets to understand observed market outcomes.

Chapter 3. What's in this chapter…

Governments intervene in markets by setting the rules of the game under which market players operate and allocating public resources (as a buyer or seller of goods and services and financier through business support measures). Many of these interventions are justified and necessary but can also enhance or distort competition. Since the level of competition has impacts on a range of economic outcomes (investment, productivity, economic transformation, growth, and welfare), it is vital to understand whether government interventions and institutional set-ups are enhancing or distorting competition, as well as assess what impact they are having on their economy. This will help develop alternative policies and institutional tools to boost competition (Part III of this toolkit).

This chapter is structured as follows: First, it provides an overview of how and why governments influence markets, highlighting examples of market failure and legitimate government interventions to address those market failures. Second, it describes how government interventions address these market failures using instruments grouped into two competition policy pillars (pro-competition government interventions and competition law enforcement). It is complemented by chapters 6 and 7, which delve deeper into the two pillars of competition policy.

TOOLKIT ITEM 12 Governments intervene in markets by setting the rules of the game under which market players operate and by allocating public resources (as buyers or sellers of goods and services and financiers through business support measures). Many of these interventions are justified and necessary (i.e., due to market failures) but can also enhance or distort competition.

3.1. Rationale for government intervention: Addressing market failures

The most common reason governments play a role in markets is to address market failures and help ensure economic efficiency, leading to the best social outcomes. Market failures occur whenever the result of a free market system (i.e., economic actors following their self-interest without intervention from the government) is not equivalent to the socially optimal outcome. Examples include natural monopolies, information asymmetry, and externalities (See Box 12 for examples and Annex A.8 for more details). There are government interventions that can correct each market failure. Figure 19 provides examples.

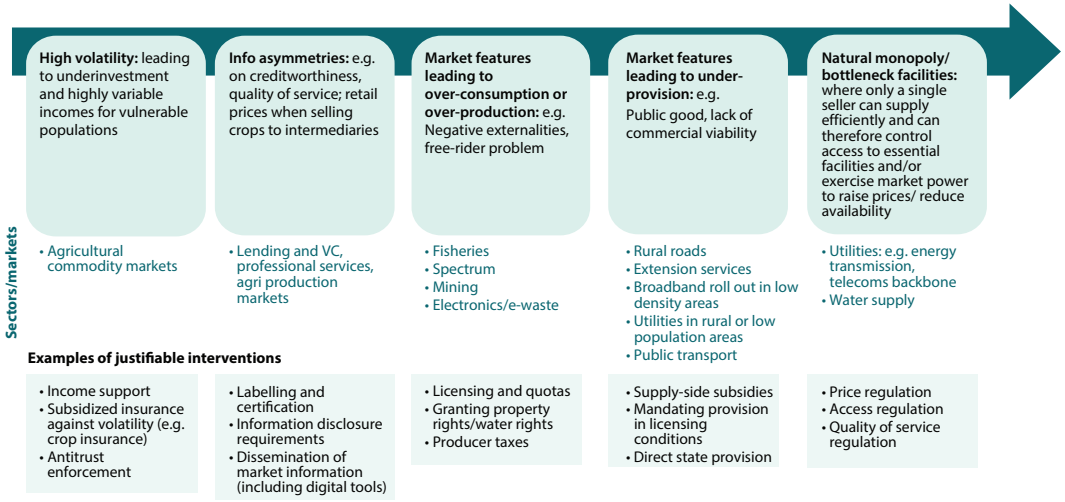
BOX 12: EXAMPLES OF MARKET FAILURES

Subadditivity of costs at the relevant output level (due to high economies of scale and scope) is a market failure resulting in a natural monopoly. In this situation, only one firm can efficiently enter and operate in a market. Without government intervention, the monopoly firm could exercise excessive market power. Thus, regulation is needed. For example, natural monopolies like ports, electricity transmission and distribution, or essential facilities in telecom are regulated such that a government agency sets price caps and service and access conditions and supervises that these are being adequately met. In contexts where regulation is lacking, monopoly operators tend to abuse their market power. An MCPAT application in the port industry found that port operators that are vertically integrated tend to exclude competitors by restricting or delaying entry to port facilities, as well as by charging higher prices (Begazo Gomez, Goodwin and Gramegna Mesa 2018).

Information asymmetry is another example of a market failure, where not all players have access to the same information simultaneously, leading to imbalances in bargaining and transactions between market actors. Imagine highly technical professional services. Governments typically worry about information asymmetry from a consumer perspective: what if a bad attorney or doctor provides services and charges high fees for wrong diagnostics or recommendations? In response to this concern, governments typically intervene by regulating entry to these service markets or how to provide the service. However, excessive regulation may lead to suboptimal entry levels and overall low productivity. This was the case in Croatia, where more than 300 professions faced this type of regulation compared to around 200 in the European Union, resulting in lower opportunities for workers and higher rates and lower quality of services (World Bank Group 2020).

In the context of climate change, a widely known market failure is the presence of externalities. Coal, oil, and cement production is positive for firms that supply these goods and for firms and consumers that demand them. However, it also imposes an indirect cost on society by polluting the environment. Without government intervention, producing firms would continue operating without incorporating the social cost of pollution in their profit maximization problem, as has been the case for decades. Government interventions – such as setting emissions limits or supporting the adoption of green technologies needed for production – incentivize companies to incorporate the externality and thus assume the cost of minimizing it.

FIGURE 19: EXAMPLES OF MARKET FAILURES AND GOVERNMENT INTERVENTIONS THAT PLAY A LEGITIMATE ROLE IN ADDRESSING THOSE FAILURES



Source: Authors' own elaboration

Of course, when governments state their objectives, they are not often couched in the language of market failures but rather in the language of economic, social, and strategic goals and objectives. Underlying these goals are usually market failures that need to be addressed – especially when the goals are economic or social. However, there may be situations where a government has strategic goals, such as national security or geopolitical goals. These goals are often not driven by market failure. Nevertheless, policies to achieve them may have market consequences, which should be considered when designing them.

Complementary resources:

- Examples of market failures and their implications for market outcomes without government intervention (Annex A.8)
- A taxonomy of key competition risks in markets according to their underlying features (Annex A.9)

3.2. Competition policy pillars: embedding competition principles in government interventions and tackling anticompetitive behavior

Governments influence markets by allocating public resources to support markets and setting rules. Figure 20 summarizes these different channels, the market failures that the government typically addresses in each of these roles, and the role of competition policy and the MCPAT in each area. Competition policy consists of two pillars to help governments ensure that government interventions that aim to address market gaps foster or preserve competition.

Governments carry out different roles depending on their channel of intervention. The government acts as a market developer or creator when it provides public resources (i.e., the government as a buyer, a supplier, or a financier) and as a market regulator when it sets the rules of the game (i.e., sectoral regulator, international rule-maker, market referee). The government is important as a *supplier*: based on a novel database of 76,000 firms with state ownership covering 91 countries (the Global BOS database), it is found that almost 70 percent of BOS operate in competitive markets (i.e., where there is no clear rationale for direct state participation). Their domestic revenues are equivalent to at least 17 percent of GDP on average and more than 40 percent in seven countries.[2] Government public procurement is significant, too; it can represent 12 percent of GDP.[3] Finally, *subsidies or business support programs are relevant as well.* Fossil fuel subsidies alone represented US$7 trillion or 7 percent of global GDP in 2022 (IMF 2023). In 2018, ad valorem equivalents of subsidies averaged 15 percent for agriculture and 8 percent for manufacturing (World Bank Group 2023b). As an international rule maker, the government determines the country's exposure to global markets (through trade rules and FDI rules and commitments in bilateral

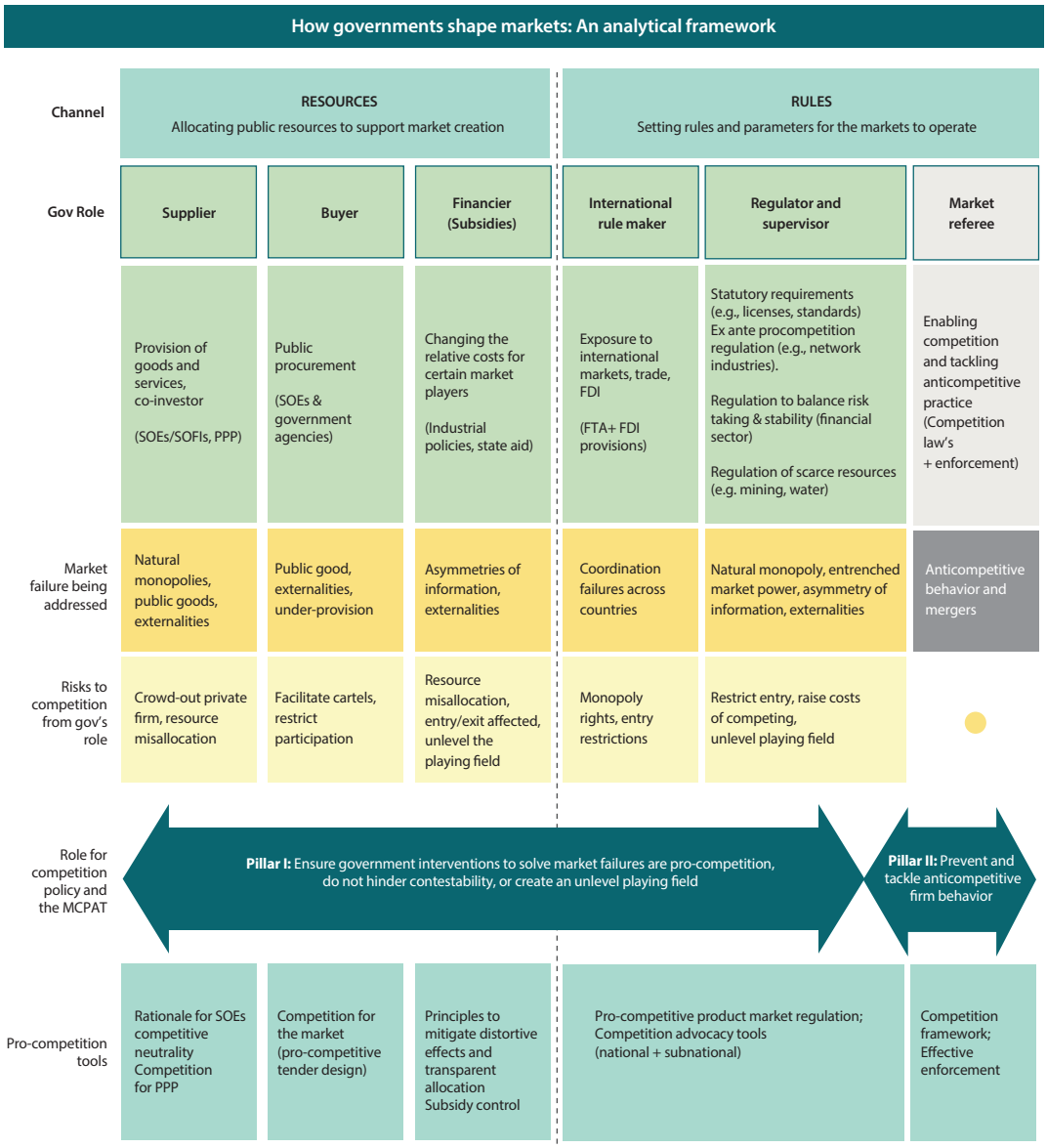
or regional agreements on the treatment of SOEs and enforcement of rules related to competition, SOEs, public procurement and subsidies to ensure a fair play between companies from different countries. As a regulator and supervisor of markets, the government sets rules to address market failures in specific sectors (such as infrastructure, utilities, financial sector, mining, and extractives) and economy-wide, such as consumer protection, data protection, and intellectual property rights. Finally, as a market referee, the government enforces competition law to tackle firm' anticompetitive behavior and prevent mergers likely to harm competition.

For all these roles, there are risks to competition that can arise from the government's role. In the case of market referee, a lack of effective implementation of rules can also create risks to competition. These government roles respond to their desire to address market failures. For instance, direct state participation in markets is needed for the provision of public goods (such as roads) or to address underprovision, which typically occurs in rural areas where there is no business case for private firms to enter and invest. However, when these roles do not target a specific market failure, they could lead to market distortions, such as restricting entry, facilitating cartels, unleveling the playing field, and crowding out private investment, ultimately leading to resource misallocation. The market referee role – and the role of competition policy – can be treated slightly differently since it is designed to prevent and tackle firms' anticompetitive practices directly. Thus, this intervention itself does not hold unintended risks for competition.[4]

The role of competition policy (and the MCPAT) is to minimize these risks. By integrating competition principles in government interventions, competition policy aims to ensure that the government interventions that solve market failures are pro-competitive, do not hinder contestability, or create an unlevel playing field. By effectively enforcing competition law, competition policy aims to prevent and tackle anticompetitive firm behavior. These roles of competition policy comprise the two pillars of the MCPAT: (1) designing government interventions for competitive markets and (2) tackling anticompetitive firm behavior. An ample set of tools is available to achieve these goals, including competition principles applicable to SOEs and PPP, principles to minimize the risk of market distortions, competition advocacy tools, and competition law enforcement, among others.

While both pillars are necessary to optimize market outcomes, less developed countries may wish to take a phased approach to designing government interventions for competitive markets where institutional resources and capacity are limited. Pillar I may be a more natural and potentially urgent place to start in these cases. Most governments will be active in setting market rules and policies, regardless of the level of development. Therefore, steps taken to embed competition in these rules will have an immediate impact. Pillar II, on the other hand, requires more resources and specific skills for enforcement against anticompetitive behavior. For those countries that decide to embark on Pillar II, there are certain aspects that lower-income countries can prioritize to make this effort more immediately impactful. For example, anticartel enforcement to tackle the most harmful form of anticompetitive behavior, merger review to avoid consolidation in critical markets for recovery (like digital markets) and building market institutions to ensure there is a solid basis to implementation and to foster links with Pillar I through advocacy.

FIGURE 20: A CATEGORIZATION OF GOVERNMENT INTERVENTIONS IN MARKETS AND THE ROLE OF COMPETITION POLICY IN ADDRESSING RISKS



Source: Authors' own elaboration building on Tirole 2017 and OFT 2009

Considerations on the subnational assessment of regulation

We should assess not only policies and regulations at the national level but also at the subnational level to obtain a complete picture of how government interventions affect markets. Powers to intervene in the market under Pillar I, including concerning regulation but also state ownership at the municipal/subnational level, are often devolved to subnational governments. In contrast, the policies and regulations that tackle anticompetitive firm behavior under Pillar II (the competition law and antitrust enforcement activities discussed in the next section) will more likely apply at the national level, and separate subnational assessments on these issues will probably not be as necessary.

In many countries, regulations and government interventions at the municipal level impose an overwhelming burden on new market entrants or firms attempting to challenge the power of incumbents. Some regulations impose minimum distances between outlets, enable incumbents to coordinate prices and deny entry to new firms, or grant incumbents exclusive rights that protect their dominant position. Significant obstacles to interstate trade, local monopoly rights, and even regulated price-fixing schemes inhibit the entry of new firms, prevent smaller firms from expanding, and artificially inflate consumer prices. Individually, each barrier is limited in its scope, but together, they can hinder overall productivity and growth potential. Schiffbauer and Sampi 2019 compiled evidence regarding the elimination of regional regulatory barriers between 2013 and 2014 in 1,800 Peruvian municipalities and concluded that businesses located in municipalities that had eliminated regulatory barriers experienced increased productivity when compared to similar municipalities where these barriers were not eliminated.

EXAMPLE 12: MEXICO AND PERU – OBSTACLES TO COMPETITION AT THE SUBNATIONAL LEVEL

The MCPAT was applied across Mexico's 32 federal states in cooperation with the country's Better Regulation Authority (CONAMER in Spanish), identifying over 2,400 restrictions. A 2013 World Bank Group (WBG) report on competition in Mexico highlighted the constraints on competition imposed by state and municipal regulations (World Bank 2013)[5] For example, subnational regulations on the production of corn flour and tortillas, retail fuel sales, retail commerce, and the licensing of overland passenger transportation services risked restricting the entry of new firms, facilitating cartel behavior, or discriminating against certain groups of firms. As of June 2018, CONAMER had completed the MCPAT analysis in all 32 federative entities, identifying 2,417 anticompetitive restrictions.

The MCPAT has also been applied in Peru's Piura region, where over 50 restrictions were eliminated even though Peru is a unitary government. A pilot application was conducted in the Piura region in cooperation with the Technical Secretariat for the Elimination of Bureaucratic Barriers (SRB in Spanish), which sits in the Competition Authority (World Bank 2023a). Peru has a relatively high level of pro-competitive rules compared to the region, especially at the national level. Its business environment is being undermined by subnational regulations, actions, or provisions, which significantly affect local markets. Although regulatory powers in Peru are concentrated at the central level, the application of the administrative powers of regional and municipal governments can be equally decisive for market entry and continuity.

The pilot application of the MCPAT in Piura region identified over 200 regulatory barriers affecting competition in manufacturing, trade, transportation, telecommunications, hospitality and tourism, and natural gas. By the end of July 2023, the SRB was able to successfully manage the removal of fifty-one (51) bureaucratic barriers. In the telecommunications sector, sixteen (16) barriers were removed that were increasing infrastructure installation costs, making market entry difficult. An important contribution of the MCPAT, which by design includes both regulatory (de jure) and operational (de facto) restrictions, was to strengthen the SRB's identification of "action" bureaucratic barriers in addition to legislative ones.

Source: Based on Goodwin, Tanja K.; Martinez Licetti, Martha; Villaran, Lucia; Gramegna Mesa, Soulange Fatima (2018), Promoting Competition in Local Markets in Mexico: A Subnational Application of the World Bank Group's Markets and Competition Policy Assessment Tool (English). Washington, D.C.: World Bank Group; World Bank (2023). Promoviendo Competencia en Mercados Locales en el Perú: Una Aplicación Subnacional de la Herramienta de Análisis de Mercados y Política de Competencia del Banco Mundial: Piloto en Piura (Spanish).

Addressing the complex web of regulatory barriers to competition at the local level requires a systematic approach. The MCPAT should be applied at the subnational level to reflect the country's legal and constitutional arrangements. In some countries, subnational governments have the power to issue laws and regulations, and the MCPAT can help identify potential reforms in priority sectors. Among more heavily centralized governments, where local authorities primarily implement laws and regulations issued at the national level, the MCPAT can both promote pro-competition regulatory reform by the central government and assist subnational authorities in improving the efficiency and impartiality of regulatory implementation. In both cases, the MCPAT can help identify which reform opportunities will have the most significant impact at the local level.

NOTES

1 Firms with at least 10 percent ownership by any government organization as businesses of the state (BOS).

2 World Bank. The Business of the State Dashboard (accessed in May 2024). Estimated with 2019 data for 97 countries.

3 https://blogs.worldbank.org/en/developmenttalk/how-large-public-procurement.

4 Except in the case that the policy tool is used in a way that is corrupt or subject to high degree of external influence.

5 For a detailed competition analysis, see Goodwin, Tanja K.; Martinez Licetti, Martha; Villaran, Lucia; Gramegna Mesa, Soulange Fatima (2018), Promoting Competition in Local Markets in Mexico: A Subnational Application of the World Bank Group's Markets and Competition Policy Assessment Tool (English). Washington, D.C.: World Bank Group.

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Goodwin, Tanja K., Martha Martinez Licetti, Lucia Villaran, Soulange Fatima Gramegna Mesa. 2018. *Promoting Competition in Local Markets in Mexico: A Subnational Application of the World Bank Group's Markets and Competition Policy Assessment Tool (English)*. Washington, D.C.: World Bank Group. original footnotes omitted)

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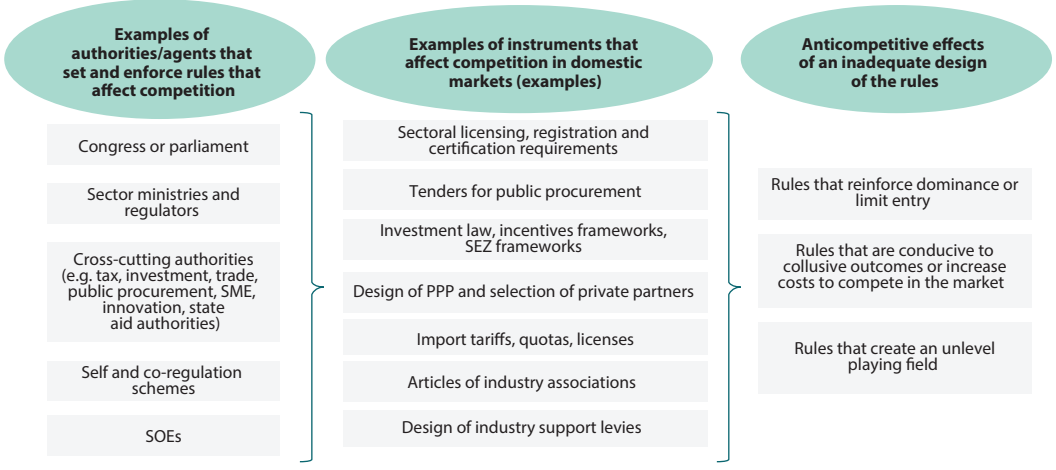
4. GOVERNMENT INTERVENTIONS IN MARKETS – PILLAR I

Anticompetitive effects can be generated through the rules themselves, the way rules are implemented, or by a lack of rules – and those rules can be set by any government agency or even by private actors (Figure 21). Any government agency can issue rules or adopt decisions that affect competition dynamics. This includes national and subnational governments, sector ministries, regulators, parliament or congress, SOEs, public procurement agencies, or cross-cutting authorities like trade, tax, or investment authorities. Private agents can also restrict competition through co-regulation or self-regulation schemes. A desirable process of setting any rules that affect the markets should be transparent, participatory, and involve all relevant stakeholders. In addition, it is not just what is "on the books" that matters; how rules are implemented also affects competition. For example, where rules are implemented with a high degree of discretion, they can give some players an advantage. In some cases, a lack of appropriate regulations can also generate anticompetitive effects, such as a lack of regulation on access to essential facilities.

FIGURE 21: EXAMPLES OF ACTORS AND INSTRUMENTS THAT CAN AFFECT COMPETITION AND MARKET DYNAMICS



Source: Authors' own elaboration

Focusing on Pillar I of the MCPAT, this chapter examines government interventions in markets through allocating public resources and setting rules as a market regulator. It guides the identification of rules that distort markets and restrict competition, including industrial policy. This chapter highlights the potential impact of SOEs on market competition and explains how public procurement rules can affect market competition.

Chapter 4. What's in this chapter…

4.1. Government as a regulator: restrictive regulations undermining market functioning

Market rules imposed or supported by governments that may restrict competition and distort markets can be categorized by their effects on the market. Policymakers and users of the MCPAT can identify rules that restrict competition by asking the following questions:

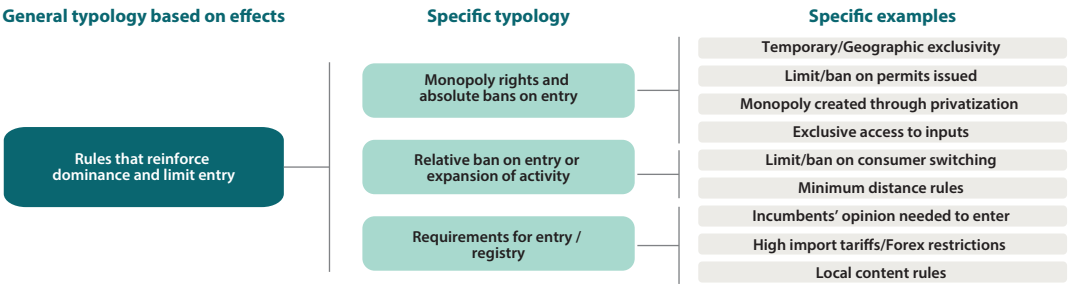
A. Does the rule limit entry or reinforce dominance?
B. Does the rule facilitate collusion, restrict firms' choice of strategic variables, or increase the costs of competing?
C. Does the rule create an unlevel playing field or provide undue advantages to certain firms?

Annex A.10 provides examples of these restrictions, found by applying the MCPAT in dozens of countries over the past decade. Table 4 provides a checklist to facilitate the screening of rules.

Rules that restrict entry or reinforce dominance

Entry, or the threat of entry, are essential factors that discipline incumbents (i.e., exert competitive pressure on existing suppliers). Meanwhile, firms with a dominant position can exclude rivals from the market or exploit consumers or sellers (for example, farmers in agriculture markets or MSMEs in wholesale or retail trade). Policies or regulations that directly prevent entry or reinforce the dominance of existing players are likely to reduce the competitive pressure existing suppliers (or buyers) face, with potential adverse effects on prices, quality, or range of products or services. Restrictions on consumers' ability to switch providers also reinforce dominance.

FIGURE 22: EXAMPLES OF RULES THAT RESTRICT ENTRY OR REINFORCE DOMINANCE



Source: Authors' own elaboration
Note: This diagram maps each regulatory example to its direct effect on a market outcome (principal association). However, it is important to note that secondary effects can also derive from some of these regulations.

EXAMPLE 13: KENYA – ENTRY RESTRICTION BY INCUMBENTS IN THE TEA SECTOR

Anticompetitive Regulation

The licensing requirements for new tea factories, as set by the Tea Board of Kenya (TBK), were potentially restrictive. A critical condition established by the TBK was that existing factories must provide a "no objection" before a license can be issued to a new factory. This condition effectively allowed market incumbents to control the entry of new tea factories, thereby giving them a significant degree of discretionary decision-making power.

In addition, prospective licensees for green-leaf tea must provide proof of establishing a minimum of 250 hectares of mature tea bushes to obtain a license. These excessive requirements may negatively impact competition, as they create significant barriers to entry.

Harm to Competition

In a concrete example of the harm to competition, a private investor filed a complaint with the Competition Authority of Kenya in October 2012. The investor alleged that tea factories affiliated with the Kenya Tea Development Agency (KTDA) had objected to its entry into the market and that the TBK (the tea sector regulator) was, therefore, objecting to its licensing. The investor further claimed that the incumbents had raised unreasonable objections to its application to construct a Specialty Tea Factory and that the regulator did not have valid grounds to decline the license.

Procompetitive Solution

Potential actions to enhance competition in the tea sector include:

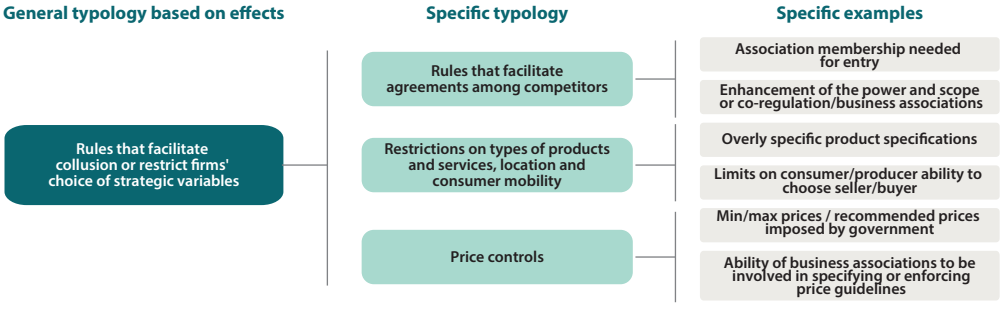
- The TBK could allow market forces to determine the allocation of resources in the tea sector without the involvement of incumbents in entry decisions in situations where such markets are contestable.
- The National Tea Policy, developed by the Ministry of Agriculture, could refrain from containing rules or requirements that unreasonably restrict competition.
- The Tea Act and draft Tea Regulations could be reviewed to remove unrealistic requirements on farm size and factory licensing, which effectively create barriers to entry and impose costs that outweigh such restrictions' benefits.

Source: CAK Internal Information

Rules that facilitate collusion, raise the cost of competing, or restrict firms' choice of strategic variables

Competition between suppliers may focus on price, quality, service, or innovation. Policies or regulations that make it easier for competitors to collude on market parameters or restrict how suppliers compete with each other can inhibit competition between those suppliers. These regulations also increase operational risks for businesses.

FIGURE 23: EXAMPLES OF RULES THAT FACILITATE COLLUSION OR RESTRICT FIRMS' CHOICE OF STRATEGIC VARIABLES



Source: Authors' own elaboration
Note: This diagram maps each regulatory example to its direct effect on a market outcome (principal association). However, it is important to note that secondary effects can also derive from some of these regulations.

EXAMPLE 14: INDONESIA - REGULATIONS ENDORSING PRICE FIXING BY THE AIRLINE ASSOCIATION

Anticompetitive Regulation

In Indonesia, the airline industry consists of several state-owned enterprises and private businesses. Airline tariffs are regulated by two Decrees of the Minister of Transportation. One of these decrees previously provided that the Indonesian Airlines Association (INACA) – which, at the time of writing, consisted of 15 member airlines – could establish scheduled passenger tariffs on domestic economy class routes.

The pricing mechanism used by INACA involved gaining the consensus of all its members before consulting with the Minister of Transportation. Members then used the INACA price as a reference when setting the airlines' tariffs.

Harm to Competition

The INACA price was generally set above the market price, thus raising prices for consumers.

Following an investigation by the Indonesian Commission for the Supervision of Business Competition, the delegation of the price mechanism to INACA and the agreement among its members were found to constitute a "collusive agreement.

Procompetitive Solution

The Ministry of Communication and Transportation abolished INAC's right and authority to establish tariffs through a regulation revision. In parallel, the sector underwent further deregulation to enhance fair competition in the airline industry.

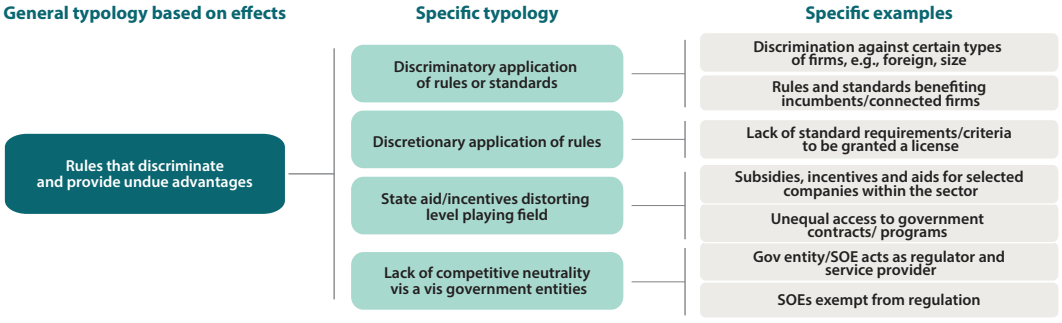
Due to the above actions, airlines' tariffs fell drastically by around 50 percent. The airline industry became more competitive, and utilization levels increased due to increasing demand.

Source: Iwantono, S. 2003; Competition Authority of Kenya 2015.

Rules that create an unlevel playing field and provide undue advantages to certain firms

A level playing field between market players is crucial to enable the most efficient and innovative firms to thrive. This category encompasses rules that establish or create conditions resulting in unjustified discriminatory treatment that discriminates against some firms and reduces competitive neutrality between firms.

FIGURE 24: EXAMPLES OF RULES THAT CREATE AN UNLEVEL PLAYING FIELD AND PROVIDE UNDUE ADVANTAGES TO CERTAIN FIRMS



Source: Authors' own elaboration
Note: This diagram maps each regulatory example to its direct effect on a market outcome (principal association). However, it is important to note that secondary effects can also derive from some of these regulations.

EXAMPLE 15: EGYPT – PROPOSALS TO LIMIT PRIVATE PARTICIPATION IN SHIPPING SERVICES IN EGYPT

Anticompetitive Regulation

In 2013, a reform bill to the Maritime Law was proposed. The bill contained provisions prohibiting foreign companies and imposing significant limits on domestic players' participation in the shipping market.

Harm to Competition

The Egyptian Competition Authority identified these anticompetitive restrictions and highlighted to the Ministry of Transport that the reform would effectively exclude state-owned shipping agency services from competition.

Procompetitive Solution

The Competition Authority's action prevented the promulgation of these provisions, and foreign and private actors remain in the market for shipping services.

Source: World Bank. 2014a

Exploring interactions between market characteristics and regulations

Market characteristics and government interventions shape market outcomes. Step 3 of the MCPAT is to understand the potential and actual anticompetitive effects and market outcomes associated with the interaction between market characteristics identified in Step 1 (Chapter 3) and regulatory restrictions identified in Step 2 of the MCPAT.

The severity of a competition constraint from a government intervention will depend on the underlying market characteristics. Exploring interactions between market characteristics and government interventions is a step toward identifying how both affect market outcomes. For example, industry associations allowing for information exchanges can hold more significant risks when economies of scale mean only a few large firms are in the market. These associations then risk becoming fora for collusive agreement on prices, output, or other market parameters. In the case of ICT, for countries that have few mobile network operators in the market because of a lack of spectrum assignment, it becomes even more critical to ensure there are rules in place to boost access to wholesale markets and competition in the last mile, such as rules on network sharing and access for MVNOs. Examples of such interactions in agriculture, ICT, and transportation can be found in Figure 25, 26, 27.

FIGURE 25: AGRICULTURAL SECTOR – EXAMPLES OF INTERACTIONS BETWEEN MARKET CHARACTERISTICS AND GOVERNMENT INTERVENTIONS

Examples	Agricultural processing	Seed distribution	Farmers, intermediaries, processors	Fertilizer markets
Market characteristics	• Economies of scale in processing restricting the number of firms that can operate efficiently	• Presence of an important upstream operator (e.g. seed multiplication) • Vertical integration from multiplication to distribution	• Long term relationships between farmers and intermediaries/processors e.g. contract farming arrangements	• Lack of commercial access to finance for farmers to purchase fertilizer
+	+	+	+	+
Government interventions	• Information exchange mechanisms - such as industry associations - allowing exchange of info on price or quantities	• Upstream restrictions on entry into multiplication	• Restrictions that reduce ability of farmers to switch e.g. mandatory registration with processor • Geographic restrictions on where agriculture producers can sell	• Government credit schemes that are conditional on procurement of fertilizer from certain players • Import restrictions that reduce the number of players in the fertilizer market
=	=	=	=	=
Market outcomes	• Raised risk of collusion between processors	• Raised risk of exclusionary behavior in wholesale by the integrated multiplier	• Restrictions ability of farmers to switch out of long term contracts • An inability of new processors to access inputs	• Increased risk of negative outcome from advantages to certain fertilizer players (particularly due to restrictions on alternative suppliers even outside the government schemes)

Source: Authors' own elaboration

FIGURE 26: ICT SECTOR – EXAMPLES OF INTERACTIONS BETWEEN MARKET CHARACTERISTICS AND GOVERNMENT INTERVENTIONS

Examples	Spectrum policy	International gateways	Access networks	Final services to consumer
Market characteristics	• Presence of dominant market operator	• Landlocked country	• Few MNOs due to spectrum scarcity	• Digital ID/other government services associated with an individuals' phone number, meaning there is a high risk of losing a phone number
+	+	+	+	+
Government interventions	• Lack of spectrum caps	• Monopoly rights to handle international gateway • Lack of regulation of access to essential facilities	• Absence of wholesale network sharing obligations • Lack of rules that allow for Mobile Virtual Network Operators	• Regulatory restrictions on number portability (no mandatory number portability, high cost of porting a number, delays in implementing portability and services interruption
=	=	=	=	=
Market Outcomes	• Likelihood spectrum becomes concentrated with one or a few players leading to market in mobile/broadband markets	• Lack of competition in international connectivity provision leads to higher prices to ISPs reflected in extremely high prices for final consumer	• Risk of collusive behaviour between MNOs (collective refusal to deal with MVNO). higher access prices, less entry and unattended demand	• Consumers find it hard to switch to new operators even when they offer better services /prices, enhances dominant position of incumbent MNOs

Source: Authors' own elaboration

FIGURE 27: TRANSPORT SECTOR – EXAMPLES OF INTERACTIONS BETWEEN MARKET CHARACTERISTICS AND GOVERNMENT INTERVENTIONS

Examples	Access to ports (or multimodal node)	Market entry in road transport	Price setting in road cargo transport
Market characteristics	• Scarce resources (infrastructure) • Vertical integration	• Economies of scale	• Excess capacity • Powerful industrial associations
+	+	+	+
Government interventions	• Lack of open and non-discriminatory access regulation	• Pre-existing rights • Incumbents can participate in the decision to grant new licenses	• Association or subnational governments involved in setting price guidelines
=	=	=	=
Market Outcomes	• Increased risk of exclusionary abuse of dominance	• Reduced entry and smaller number of market players • Lower investment	• Increased risk of collusion

Source: Authors' own elaboration

4.2. Government as a financier: business support programs and risks to competitive markets

When the government acts as a financier, it transfers resources to individual firms to support market development and achieve specific policy goals. Governments often intervene to address market failures through business support programs[1] to incentivize firms to engage in certain behaviors. They are used across various policy areas, including for the following objectives: support the development (competitiveness) of specific industries, enable the provision of essential services (such as transport, energy, telecommunications) for underserved groups or in geographical areas, foster investment in fixed capital, research and development, innovation, and skills building, aid economic recovery and firms in financial difficulty, and enhance fairness (such as boosting lagging regions). Industrial policy generally includes business support measures that imply transfers of government resources to foster economic transformation. Table 5 summarizes different types of business support measures based on their objectives and Table 6 presents examples of different instruments.

Complementary resources:

- Examples of market rules that may restrict competition and distort markets (Annex A.10)

TOOLKIT ITEM 13 When acting as a regulator, governments can (many times, inadvertently) create rules that restrict entry, facilitate anticompetitive practices, and discriminate between players. It is possible to check whether government interventions could have these effects by asking the set of questions outlined in Table 4.

TABLE 4: A CHECKLIST TO SCREEN FOR RULES THAT CAN RESTRICT COMPETITION AND DISTORT MARKETS

In any affected market, does the rule…
Limit entry or reinforce dominance?  *For example, does the rule…*
• Award exclusive rights to a supplier/buyer (this could be temporary or geographic exclusivity)?
• Introduce procurement from a single supplier or restricted group of suppliers?
• Introduce a fixed limit on the number of firms (quotas or bans)?
• Require the positive opinion/non-objection of incumbents to get an authorization or permit
• Create geographical barriers to companies' supply or purchase of goods or services, e.g., minimum distance requirements?
• Establish license, permit or authorization processes or requirements for operation that are more restrictive than necessary?
• Limit the ability of some suppliers to provide a good or service or the ability of some types of buyers to purchase goods or services?
• Create higher costs of entry or exit for firms?
• Eliminate the possibility for consumers (producers) to switch suppliers (buyers)?
Facilitate collusion, restrict firms' choice of strategic variable, or increase the costs of competing?  *For example, does the rule…*
• Limit the extent to which market forces define prices for goods or services? E.g., set minimum or maximum prices or recommended prices
• Increase scope for self-regulatory or co-regulatory regimes to affect entry conditions negatively, the ability of firms to set prices individually, or other market variables? E.g., Allow business associations to enforce pricing guidelines
• Introduce requirements that information on firms' outputs, prices, sales, purchases, or costs be published or exchanged among competitors?
• Exempt the activity of a particular industry or group of firms from the operation of the competition law?
• Limit the freedom of firms to advertise or market their goods or services?
• Set standards for product quality above the level that some well-informed customers would choose?
• Limit the scope for innovation to i) introduce new products; ii) supply existing products in new ways (using different marketing channels or different sales formats, for example); or iii) purchase products in new ways (using different procurement channels, for example)?
• Require firms to belong to an association to enter the market?
• Limit the ability of consumers (producers) to decide from whom they purchase (to whom they sell)?
• Reduce mobility of consumers (producers) between suppliers (buyers) of goods or services?
• Reduce the information available to buyers (producers) to allow them to purchase (sell) effectively?
Create an unlevel playing field or provide undue advantages to certain firms?  *For example, does the rule…*
• Introduce discriminatory application of rules against certain types of firms (entrants, foreigners, small firms, private firms)
• Set standards for product quality that provide an advantage to some firms over others?
• Provide unequal access to government contracts/programs to some firms?
• Allow for discretionary application of rules to market players (lack of objective requirements or criteria, reduced accountability)?
• Introduce subsidies, incentives policies, and access to limited resources (e.g., land, water, spectrum) that distort the level playing field?
• Allow government entities/SOEs that provide goods or services also to regulate the market?
• Does not provide for clear and effective access policies to bottleneck facilities (e.g., non-discrimination, clear conditions, cost-oriented fees) to essential facilities?

Source: Authors' own elaboration

TABLE 5: EXAMPLES OF BUSINESS SUPPORT MEASURES BY OBJECTIVE

<table>
<tr><th>Sectoral</th><th>Competitiveness</th><th>Climate and energy</th><th>Crises and companies in difficulty</th><th>Social welfare and redistribution</th></tr>
<tr><td rowspan="4">Sectoral support, including:
• Culture and heritage conservation (tourism or creative industries)
• Agriculture, forestry, rural areas
• Fisheries, aquaculture
• Manufacturing
• Extractives (mining, oil, gas)</td><td>Research, development, innovation</td><td>Environmental protection</td><td>Natural disaster compensation</td><td>Regional development</td></tr>
<tr><td>Training</td><td>Energy saving</td><td>Mitigating economic disturbances</td><td>Regional transformation</td></tr>
<tr><td>Digital transformation</td><td rowspan="6">Energy transition</td><td>Rescue measures</td><td>Employment</td></tr>
<tr><td>Export promotion, internationalization</td><td>Restructuring support</td><td>Employment of disadvantaged or disabled workers</td></tr>
<tr><td rowspan="4">Services of general economic interest (such as transport, energy, communications)</td><td>Small and medium enterprises, including risk capital</td><td>Closure mitigation</td><td rowspan="3">Social support to individual consumers*</td></tr>
<tr><td>Industrial policy</td><td rowspan="2">COVID-19 support</td></tr>
<tr><td>Investment</td></tr>
<tr><td>Capital growth</td></tr>
</table>

Source: Buts and Maes 2024, based on the classification of state aid measures used by the European Commission, as reported in the State Aid Scoreboard, and complemented by other international examples (European Commission 2023)

Note: *In some cases, social support measures for individual consumers can also benefit companies or incentivize specific behaviors. Examples include exemptions from aviation departure tax for residents on islands, social support for maritime transport of passengers between islands, support to citizens of overseas territories, and support to low-income households for broadband connections.

TABLE 6: EXAMPLES OF BUSINESS SUPPORT MEASURES BY TYPE OF INSTRUMENT

<table>
<tr><th>Subsidies</th><th>Loans</th><th>Tax measures</th><th>Equity[1]</th><th>Other[2]</th></tr>
<tr><td>Direct grant</td><td>Guarantee</td><td>Tax advantage or exemption (tax holiday)</td><td>Equity instrument</td><td>Land, infrastructure, or access to natural resources at less than the market price</td></tr>
<tr><td>Matching grant</td><td>Interest subsidy</td><td>Tax allowance</td><td>Debt write-off</td><td>Market privileges</td></tr>
<tr><td>Reimbursable grant</td><td>Soft loan</td><td>Tax deferment</td><td>Recapitalization</td><td>Information, education, research and development, and infrastructure</td></tr>
<tr><td rowspan="6">Subsidized services</td><td>Risk capital</td><td>Tax base reduction</td><td>Hybrid capital instruments (such as convertible bonds)</td><td>Special economic zones, free zones, freeports, and export processing zones</td></tr>
<tr><td>Subordinated debt</td><td>Tax rate reduction</td><td></td><td>Mixed instruments</td></tr>
<tr><td>Loan or repayable advance</td><td>Reduction in social security contribution</td><td></td><td></td></tr>
<tr><td rowspan="4">Interest rate subsidy</td><td>Super deduction</td><td rowspan="4"></td><td rowspan="4"></td></tr>
<tr><td>Accelerated depreciation</td></tr>
<tr><td>Other tax advantage</td></tr>
<tr><td>Other fiscal measures</td></tr>
</table>

Source: Buts and Maes 2024, based on the classification of state aid measures used by the European Commission, as reported in the State Aid Scoreboard, and complemented by other international examples (European Commission 2023)

Notes:

1. Equity interventions are a specific type of business support measure; these may, for example, entail the provision of liquidity to a company in difficulty in exchange for shares in the business.
2. Favorable regulatory interventions and simplified administrative procedures can also support specific firms or sectors but are not considered part of the government's role as a financier.

Subsidies to businesses to achieve development goals may be justified; however, if too narrowly designed and selective, they can harm productivity, create advantages to dominant firms, facilitate anticompetitive behavior, and drive efficient players out of the market. This is more likely in markets with more significant influence of SOEs or politically connected firms. Moreover, subsidies affecting regional trade may be prohibited in regional blocs, and those involving international trade could be prohibited under WTO's GATT and Subsidies and Countervailing Measures agreements.

Business support measures (such as investment incentives, loans at preferential rates, or grants) can negatively affect competition through two channels. First, they can facilitate anticompetitive behavior by creating or protecting dominant players in markets, unduly incentivizing firm consolidation (which increases the risk of cartel formation), and creating barriers to entry that prevent future competition. Second, they can generate market inefficiencies in that incentives can discourage beneficiaries from enhancing productive efficiency and innovating and can drive more or equally efficient firms that do not benefit from the incentive scheme out of the market.

Industrial policy is the primary expression of the government's role as a financier. While different definitions of industrial policy abound, here we define industrial policy as channeling public funds (including forgone public funds from tax breaks) to benefit specific parts of the economy. This might include certain technologies, sectors, locations, types of firms (such as small or large firms that are considered too big to fail), socio-economic groups, or even specific individual firms (including public enterprises). These public funds could include any of the instruments included in Table 6 above.

Industrial policy is sometimes described more broadly as any government intervention that aims to support specific firms, industries, or geographical areas or to spur economic transformation, including trade measures and regulatory protections. However, in the MCPAT, we use the narrower definition of industrial policy for two reasons. First, policies that involve some transfer of public funds have a particular significance as these involve a cost to the public budget – and an opportunity cost of the government intervention as those funds could otherwise be used to achieve other objectives (or support different industries, businesses, technologies). Therefore, the special significance of these types of intervention warrants heightened awareness of the potential costs and the implications of various instruments used. Second, the broader definition of industrial policy includes other policy tools used to support specific sectors, such as sector regulation, state ownership, or public procurement. In cases where a broader definition may be of relevance, the user can refer to these sections of the MCPAT (6.1, 6.3, and 6.4) in conjunction with the principles outlined in this section to understand how to design such policies in a pro-competitive way and minimize distortions.

When appropriately designed, every industrial policy should address a market failure. For example, subsidies can correct market failures caused by informational asymmetries in specific markets. High-tech firms and firms that perform R&D activities may face credit constraints in the market in the absence of government R&D subsidies (Takalo and Tanayama 2008). Moreover, industrial policy targeted at SMEs can help to increase competition in markets with high barriers to entry by, for example, subsidizing upfront set-up costs and supporting small and medium enterprise development.

Industrial policies and market distortions

Nevertheless, several stumbling blocks in how industrial policies are designed and implemented could lead to distortions in markets and competition. Because transfers of public funds under industrial policies can be highly targeted and tamper with market signals, they may cause two basic types of inefficiencies: productive inefficiency and allocative inefficiency.

1. ***Productive inefficiency*** occurs when the total output produced in the economy does not draw from a cost-minimizing combination of inputs because production by inefficient firms is encouraged. In lowering costs for some firms, subsidies distort operational decisions and incentives, influencing cost management and production, reducing productivity, and distorting prices. Subsidies correspondingly distort firms' ability to stay in the market despite lackluster productivity compared with that of their competitors. Different types of subsidies can have discrete effects. For example, if firms can count on

receiving bailout aid, this creates relatively soft budget constraints and may encourage riskier behavior. Likewise, the possibility of R&D aid may reduce the incentives for firms to innovate to reduce costs, improve quality, and become more efficient using private funds (Spector 2009).

2. ***Allocative inefficiencies*** result when resources are directed away from the economy's most efficient and productive firms. This creates capital misallocation and an inefficient dispersion of activity, which has knock-on impacts on total factor productivity (TFP) (Herrera, Lugauer, and Chen 2018; Restuccia and Rogerson 2017). These impacts can contribute to low-productivity firms gaining or maintaining higher market shares at the expense of others. Moreover, when aid is available, firms have a good reason to direct resources toward rent-seeking activities, such as lobbying, rather than for more productive uses (Spector 2009).

As a result of these dynamics, it is critical to assess both the direct effects of subsidies at the level of subsidy recipients and the indirect effects, which include spillovers to nonbeneficiaries, as well as impacts on competition outcomes measured at the market level. At the beneficiary level, direct effects are assessed by determining whether the subsidy induced the recipient to take a different course of action or induced additional activity compared with a scenario in which it did not receive the assistance (the incentive effect). At the market level, the spillover effects on nonbeneficiaries (such as crowding out of activity) and the indirect effects on competition outcomes, observed through markups and expansions in the market share of recipients at the expense of nonrecipients, are most relevant (Rotemberg 2019).

Industrial policy's potentially distortive effects must also be considered in international trade, mainly when subsidies are adopted. Multilateral rules under the World Trade Organization's (WTO) Agreements recognize that subsidies may harm international trade. Subsidies (including the use of public funds and revenue foregone, such as in the form of tax breaks) are subject to the disciplines of Article XVI of the General Agreement on Tariffs and Trade (GATT) 1994 and the WTO Agreement on Subsidies and Countervailing Measures (SCM). These disciplines regulate the provision of subsidies and the use of countervailing measures to offset the injury caused by subsidized imports. The SCM Agreement creates two basic categories of subsidies: those that are prohibited and those that are actionable. "Export subsidies" and "local content subsidies" (i.e., subsidies contingent on export performance and subsidies contingent upon the use of domestic over imported goods) are prohibited. Other subsidies specific to certain enterprises or industries or groups of enterprises or industries are "actionable" and may be subject to challenge in the WTO or to the imposition of countervailing measures by other WTO Members. In addition, subsidies provided concerning agricultural products are subject to the disciplines outlined in the WTO Agreement on Agriculture.

Industrial policy measures will generally cause more significant distortion when there is limited competition in the market or if the market is less contestable. For example, when the market is concentrated, where firms are of markedly different sizes, or where there are barriers that significantly restrict entry, the misallocation effects above are less likely to be mitigated through market forces (Box 13). Moreover, in markets where competition in innovation is vital (such as high-tech sectors), state support that focuses on supporting R&D and innovation by specific firms is more likely to harm the competition process. In markets where entry barriers and the cost of innovation to enter the market are less important, support that affects firms' variable cost of production is more likely to cause competition distortions than support that targets the fixed costs of production since variable costs are more likely to affect firms' pricing and ability to compete.

BOX 13: THE IMPORTANCE OF COMPETITION FOR INDUSTRIAL POLICY

Existing evidence suggests that industrial policies that have created the fastest growth have been those that aim to maintain competition in the market. Aghion et al. 2015) provide empirical evidence from the People's Republic of China that industrial policies (including subsidies, tax holidays, loans, and tariffs) in more competitive sectors, with beneficiary firms more dispersed in a sector or measures that encouraged younger and more productive enterprises had more significant effects on productivity growth. In the Tiger economies, the fact that pro-competition policies complemented their industrial policies is seen as a reason for their success. Korea offers another example; after experiencing issues with its industrial policies in the 1970s, South Korea developed a new philosophy for its industrial policies in the 1980s based less on protection and more on market mechanisms and competition for resource allocation. This included replacing industry-specific support with a 'functional support' system in which all industries were, in principle, treated equally and opening most of its industries to international competition through trade liberalization.

In Europe, less concentrated business support is linked to more effectiveness in terms of exports and innovation. In their analysis of the relationship between sector-specific state aid provided by 12 EU member states between 1995 and 2008 and their corresponding share of total EU exports, Aghion, Boulanger, and Cohen (2011) find that sectoral industrial policy can have a positive effect on export performance and innovation, but principally where the support is more decentralized across economies. However, it is worth acknowledging that the evidence on the efficacy of industrial policy is limited and mixed. If the rationale for industrial policy is to address a market failure, it should not protect firms from competition. Competition remains the lifeblood of productivity, innovation, and growth in markets where industrial policy is being implemented, so for industrial policy (which often has these outcomes as its objective) to be successful, distortions to competition must be minimized. Allowing for competition in the process also mitigates against some of the risks of "picking winners" as it means industrial policy can address where the market fails and then allow market processes to select those firms or technologies that are best suited to addressing the issue (of course to the extent interventions correct the market failure of one type of firm or technology and not another there could still be an element of picking).

Complementary resources:
- Examples of industrial policies and less distortive alternatives (Annex A.11)

TOOLKIT ITEM 14 Industrial policies should be properly designed to minimize risks of market distortions—unnecessary targeting that creates advantages for dominant firms, facilitates anticompetitive behavior, and drives efficient players out of the market—and in this way, enhance the effectiveness of the policy.

4.3. Government as a supplier: SOEs at the center of potential market distortions

The definitions of SOEs vary, but to understand their effects on market dynamics, it is crucial to identify SOEs that act as market suppliers. Countries have various definitions of SOEs, sometimes including regulatory agencies or other agencies that manage public investments or exclude subsidiaries operating as suppliers in different markets. Four specific criteria matter most to identify the relevant SOEs for MCPAT assessments: [5]

(i) the entity is controlled by government units or by other public corporations through shares, legal instruments, or any other means; [6]

(ii) the entity is recognized by law as a legal entity separate from its owners;

(iii) the entity can generate profit or other financial gain for its owners;

(iv) The entity is set up to engage in market production (i.e., to provide goods or services in exchange for monetary remuneration).

This toolkit focuses on these entities since not all publicly controlled entities affect market interactions. For example, government companies might provide public goods such as national defense and street lighting that are essential for society. However, private initiatives would not be viable in these contexts because of the limited capacity to provide these goods in a market setting.[7]

SOEs are important actors in domestic and global markets. SOE assets were valued at US$45 trillion in 2018, about half of global GDP. This represents a tripling from the size of SOE assets of US$13 trillion in 2000 (IMF 2020). Given their size, mission, and strategic objectives, well-governed SOEs could drive inclusive economic growth. The government frequently entrusts them to provide public services like education, health, telecommunications, or transport. In recent years, a renewed upswing in the use of state-owned companies has been observed to cushion the impact of the global financial crisis and the COVID-19 pandemic and to be part of national de-risking strategies.

Most SOEs operate alongside private firms. Almost 70 percent of the businesses of the state operate in competitive markets. Moreover, even in these competitive markets, firms with state ownership are often granted exclusive rights, protected by quotas, and exempted from economywide laws. As a result, firms with state ownership are generally less dynamic than comparable private firms. They often affect the overall performance of the sectors they operate in by reducing entry by new firms, thus weakening competition and long-term growth (World Bank 2023).

Governments often justify their direct involvement in markets through SOEs based on policy grounds (Table 7). For example, a 2017 survey of 41 state-owned banks (SOBs) in Europe and Central Asia found that most SOBs have mixed commercial and social mandates. In some cases, the policy mandate may be formalized (such as in the SOE's articles); in others, it may be due to a blurring of responsibilities between the SOE and its supervising agency. Addressing market failures is one commonly cited rationale for SOE participation, alongside industrial objectives, creating national champions, macroeconomic objectives, and acting as a model employer. While the latter are often discussed separately from market failure, they could, in some cases, involve a form of market failure, given that they represent situations where the free market does not allocate resources in a way that is considered socially efficient.

TABLE 7: COMMON TYPES OF SOE POLICY MANDATE

SOE Policy Mandate	Examples
1. Correcting market failure (where free markets would fail to allocate resources efficiently) through production, pricing, and procurement conditions	Addressing: • Market power, including the case of natural monopolies, such as water utilities, electricity transmission • Positive externalities, such as renewable energy, crop research, vocational training • Negative externalities and managing natural resources, such as mining, oil and gas, forestry • Asymmetry of information / incomplete information, such as agricultural inputs • Inequality and unequal distribution of resources, purchase of agricultural commodities from smallholders • High and unmanageable volatility, such as in agricultural commodities.
2. Industrial	• Promoting specific sectors of the economy (such as traditional industries, import substitution strategies) or certain types of players (such as domestic or small firms).
3. National champion/ international prestige and influence	• Developing large internationally relevant enterprises that will create international prestige and influence, such as airlines, Sovereign Wealth Funds.
4. Macroeconomic	• Raising employment in certain regions • Influencing wage levels • Providing model benefits and working conditions • Promoting certain skills.
5. Model employer	• Raising employment in certain regions • Influencing wage levels • Providing model benefits and working conditions • Promoting certain skills.

Source: Authors' own elaboration

SOEs and market distortions

Where the SOE has a policy mandate, it uses its market actions to drive market outcomes (such as through its production, procurement, pricing, and hiring decisions) in both product and labor markets. To this extent, the SOE might forgo a purely profit-maximizing objective. At the same time, the SOEs may also aim to earn positive returns for the state as shareholder. Indeed, most SOEs likely exist somewhere on the spectrum between purely pursuing policy objectives and purely profit maximizing. The greater the "economic rationale" for the SOE's participation (the more numerous or severe the market failures the SOE seeks to address), the more likely it is that the SOE will lean towards the policy end of the spectrum. At the same time, it is less likely that the SOE will be able to exercise independence from the government and policymakers.

The absence of a pure profit maximization strategy is not in itself an issue – but it can become problematic for market outcomes if it implies that the rate of return the SOE would expect to earn is below a commercial rate of return. Since having a policy objective will, in most cases, require an implicit subsidy to be delivered to *the market*,[8] in the absence of any subsidies (protections or preferences) from the government to *the SOE*, that subsidy would essentially be provided by the wedge between the profit-maximizing level of return and the actual return of the SOE. Suppose the SOE's rate of return still falls above a commercial rate of return. In that case, there is no reason to consider this immediately distortive of market outcomes (even if the SOE does set market parameters considering different objectives to its private competitors). An analogy would be to think of a private social enterprise that aims to meet social and profit objectives. If that firm is still operating at a level that could be considered commercial (such as where it could, for example, raise funds from commercial investors or creditors), this would not be considered market distorting. Thus, if the SOE operates above a commercial rate of return and does not rely on government subsidies (preferences and protections) to maintain its position, it may not be distortive. However, if the SOE's rate of return falls below a commercial rate, one might consider that the market parameters it sets are distortive. Other private firms without access to non-commercial support could not set those parameters and continue to compete in the market. Moreover, suppose the SOE's rate of return is below a commercial rate of return. In that case, it becomes more likely that the SOE will need to be supported through protections and preferences to allow it to continue operating.

The presence of the SOE is more likely to harm market competition, the more significant the subsidy implied in its policy role. This is so because the market parameters it chooses will need to be further away from their market level and because it is more likely that the SOE will need to receive preferences and protections to enable it to continue operating. Replacing elements of the policy role of SOEs with less distortive alternatives could be a first step in addressing the issue of SOEs' role in markets. In general, policies directly targeted at the intended beneficiaries or issue at hand are more efficient and less distortive than policies implemented indirectly through changes to market parameters. Table 8 provides examples of distortions to markets that can occur from the implementation of policy by SOEs, the subsidies required for this, and examples of policy alternatives. If there are less distortive alternatives for implementing the policy, implementing these and moving the SOE further towards the profit end of the profit-policy spectrum could reduce risks of market distortions – even without moving towards more private participation.

TABLE 8: EXAMPLES OF DISTORTIONS TO MARKETS THAT CAN OCCUR FROM THE IMPLEMENTATION OF POLICY BY SOES, REQUIRED SUBSIDIES, AND POLICY ALTERNATIVES

Policy objectives	SOE Role	Distortions to / Impact on market parameters	Subsidy required	Example of less distortive policy alternative (non-exhaustive)
Support upstream producer incomes	SOE buys inputs from upstream producers at artificially inflated prices	• Artificially inflated purchase prices for upstream products • Private sector buyers unable to compete • SOE rivals unable to procure inputs • More efficient competitors unable to enter and compete due to the inability to procure inputs.	If the return of the SOE is less than a commercial rate of return as a result of paying above market rates for inputs, a purchasing or operational subsidy will be required to compensate SOE for losses or reduction in return incurred.	Direct income support to upstream producers.
Support local downstream industries through the provision of low-priced inputs	SOE sells inputs to downstream firms in the chosen industry at below-market rates using administrative procedures to allocate inputs	• SOE receives artificially low prices for inputs • Private firms in SOE's market are unable to compete in sales to downstream firms • No mechanism to ensure that the most efficient downstream firms can procure inputs • Inefficient downstream firms in the supported industry can continue receiving inputs despite not being able to compete on cost in international markets – reducing the overall competitiveness of the downstream industry • Downstream firms in other industries are less able to procure important inputs putting other industries at a disadvantage.	If artificially low sales prices do not compensate the SOE for its costs, a subsidy will be required to cover those costs.	If there are strong fundamental reasons to support a specific industry, direct support can be provided to downstream firms in that industry: • Such as voucher schemes providing subsidies for purchase of specific inputs but allowing choice in where inputs are purchased.
Promote access to goods/services by consumers	SOE directly provides goods/services at below-market price	• SOE's private competitors unable to compete • Potential for reduction in quality or reduction in range of goods/services available.	• If the SOE cannot make a commercial rate of return on production/sale of the good/service, or cannot cover costs, it will therefore require a subsidy to continue operations • This is likely to be the case unless SOE costs are substantially below competitors' costs or unless existing private firms are exercising a very high degree of market power and charging very high markups.	• Direct subsidy to consumers to purchase the good/service from their choice of provider • Address underlying reasons for potential underproduction of the good/service, such as the firm's access to inputs, labor/skills, land, licenses, etc.
Promote employment in a particular industry or region	SOE over-employs workers (beyond an efficient level) at inflated wages (i.e., above a level that reflects the marginal product of labor)	• Low labor productivity/efficiency at the SOE raises prices paid by consumers (consumers therefore, subsidize employment/wages) • Private firms unable to compete for labor putting competing firms at a disadvantage and creating labor shortages in other sectors.	• Subsidies required to compensate SOE for artificially high labor costs • Consumers implicitly subsidize through higher prices for outputs.	• Direct income support to workers/households • Direct support to workers on skills, labor market matching, labor mobility • Address underlying reasons for lack of labor demand.

Policy objectives	SOE Role	Distortions to / Impact on market parameters	Subsidy required	Example of less distortive policy alternative (non-exhaustive)
Address a natural monopoly*	SOE sets price, quantity, and access at a level that does not exploit market power, while investing in the good or service over the long term.	• No inherent direct distortions compared to the case of a regulated private sector firm in theory • However, there will be indirect effects if the SOE suffers from: use for political patronage, SBC, or if there is a conflict-of-interest in the government's role as a regulator and market operator. • In these cases, protections and preferences may dampen incentives for investment in technical efficiency or result in setting prices, quantity or access in a way that is not socially optimal.	• None inherently required compared to the case of a regulated private sector firm • But protections and preferences may be provided due to political patronage, SBC, or conflict-of-interest.	• Allow an unconnected private firm to operate the natural monopoly with an independent regulator to regulate market parameters and investment.

Source: Authors' own elaboration
*Note: *This case differs from the others as, in theory, it does not involve an implicit subsidy delivered by the SOE that requires protections and preferences to cover. Nevertheless, there may be distortions through other channels.*

In addition to how the SOEs implement their policy mandate, certain features of SOEs lead to a greater likelihood of preferences and protections, creating an unlevel playing field and raising entry barriers for the private sector. These policies that tilt the playing field in favor of the SOEs and create undue competitive advantages can be split into two broad categories.

- **Preferences**: Policies applied to the SOE itself – and how these differ from the way that equivalent policies are applied to the private sector. Examples include credits, subsidies, tax exemptions, or land allocation granted to SOEs under favorable conditions.
- **Protections**: Policies, regulations, and rules in markets in which the SOE acts – which implicitly favor the SOE. Examples include tariff and price regulation, FDI restrictions, and import restrictions.

SOEs frequently receive preferences and absorb significant public resources, including subsidies, loans, and transfers from the State. In Cameroon, SOEs absorbed nearly 13 percent of the GDP in subsidies and transfers in 2015 (World Bank Group 2018). In Niger, the total debt and tax arrears related to SOEs operation accounted for 25 percent and 1 percent of GDP in 2017, respectively (World Bank 2019b). Unprofitable or loss-making SOEs can also require capital injections, transfers, or government-backed loans, often recorded as national debt. In many middle- and low-income countries, state-owned enterprises debt represents a significant share of the countries' debt securities issued externally. At the country level, the total SOE debt accounts for 7 percent of GDP in Angola and Mauritius and 12 percent in Cameroon.[9] Beyond the pressure this puts on the fiscus, it can also create an unlevel playing field when not designed to minimize discrimination and distortions. It represents an opportunity cost to public spending that could otherwise be used in more productive endeavors.

During the COVID-19 pandemic, SOEs benefitted from various support measures that need monitoring to minimize resulting distortions. The SOE policy measure tracker shows that more than 170 measures implemented across over 75 economies have been targeted toward companies where the government has ownership.[10] The most common form of support was capital injections, followed by share purchases, loans, and government guarantees.

An assessment of the effects of SOEs in markets should, at a minimum, check for red-flag distortions. Annex A.13 provides a checklist of red flags for distortions in markets with SOEs based on the preferences or protections provided. In the case of red flags for preferences, these are based on competitive neutrality principles. The checklist of red flags is relevant for markets with different economic characteristics, particularly markets that are competitive or partially contestable (see below). Beyond the checklists of red-flags given in Annex A.13, some further key policies and principles ought to be included in the regulation of natural monopoly sectors to avoid distortions, as will be developed in section 6.3.

Economic characteristics of the sector and the likelihood of distortions from SOEs

The impact of distortions from SOE presence also depends on the economic characteristics of the sector in which the SOE is present and the related rationale for the presence of the SOE. The three main categories of the taxonomy (Dall'olio et al 2022) are the following:

- **Natural Monopoly Sectors:** the economic literature identifies sectors in which it is not economically viable for more than one operator to provide the good/service. Typical examples are network industries (i.e., electricity transmission) characterized by sub-additivity in the cost structure which generates economies of scale. In other words, when provision by a single market player is the most efficient alternative, allocative efficiency cannot be achieved through profit maximization. This is the reason why the government might want to control the market power of the monopolist either through regulation or direct provision through SOEs.
- **Partially Contestable Sectors:** several sectors are characterized by some forms of market failures which could potentially be corrected through government ownership. Based on a comprehensive literature review, we identify three typologies of market failures that could potentially require corrective actions through state ownership: i) market power generated by structural barriers to competition, ii) under provision in the presence of positive externalities or uncertainty, and iii) risks connected to large/irreversible negative externalities.
- **Competitive Sectors:** these are sectors in which it is economically viable for multiple firms to compete to provide a good or service. Inherent market features, such as cost structure or demand characteristics, make entry into these sectors largely unproblematic. Furthermore, firms in commercial sectors are typically engaged in providing goods or services the consumption of which is either rivalrous or excludable. Given the competitive nature of these markets and private sector firms' ability to achieve economic efficiency without encountering significant market distortions, there is no strong economic rationale for SOE participation in them.

The contestability of the market in which the SOE operates affects the potential distortions it can create or exacerbate. From a regulatory perspective, the most significant difference will be between natural monopolies and sectors where some form of competition is viable.

- ***Markets where competition is viable:*** In competitive markets or contestable markets there will be private sector competitors (actual and potential) that can be affected by the presence of the SOE. Moreover, in some of these markets the level of market failure may be sufficiently minimal that (in the absence of anti-competitive behavior) private, profit-maximizing firms can reach a close-to socially efficient equilibrium.[11] In this case, the participation of SOEs may be more likely to create distortions through their direct interventions on market parameters. Priorities for assessment include:
  - Understand whether preferences and protections crowd out or create an unlevel playing field with actual and potential competitors.
  - Understand whether SOE interventions cause market distortions through their direct impact on prices, quantities, etc.

- ***Natural monopoly markets:*** In natural monopoly markets where social welfare is maximized when concentrating production in a single firm, the main policy objective of the government is to prevent the firm from unduly exercising market power and ensure it invests sufficiently in the good/service. These firms would need to be strictly regulated in a similar way no matter the ownership type.[12] There is also no private sector to crowd out of the market. Priorities for assessment include:
  - Understand whether the firm is adequately regulated to prevent the undue exercise of market power (adequate regulation is required regardless of the type of ownership but may be less likely to be adequately designed/enforced in the case of an SOE as the natural monopoly); and
  - Understand whether the SOE operates under the same conditions and incentives as a hypothetical unconnected private firm would in the same position (i.e., understand whether the SOE receives preferences relative to a hypothetical unconnected private firm).

TOOLKIT ITEM 15 SOEs are likely to create market distortions when their policy mandates constrain them from making commercial decisions, they benefit from preferences and protections, or are used for political patronage through SOE procurement. SOEs are particularly distortive when competing with private players in markets where private participation is commercially viable and there are limited market failures.

Complementary resources:

- What makes SOEs different from other firms (Annex A.12)
- Identifying common distortive preferences and protections of SOEs (Annex A.13)
- Examples of SOEs in markets in developing countries and reform opportunities (Annex A.14)
- Design of policy alternatives: Industrial Policies (Section 6.2); Competitive neutrality (Section 6.3)
- Implementing SOE-related reforms (Section 8.5)
- A Policy Toolkit for practitioners: Business of the State (BOS) and Private sector development (available here)

4.4. Government as a buyer: public procurement affecting markets

Public procurement (government purchases of goods and services – whether by SOEs or by other government institutions) is a common form of direct state intervention in markets. The size of public procurement as a share of GDP is around 12 percent of GDP across low-income, middle-income, and high-income countries.[13] That figure tends to be higher in large emerging economies: Brazil, Egypt, India, Pakistan, South Africa, Türkiye, and Viet Nam all procure over 20 percent of GDP (Bosio and Djankov 2020). In Russia, state purchases amounted to nearly 30 percent of GDP in recent years (IMF 2019b).

With the government being such a large buyer in the economy, the way that public procurement is carried out can greatly impact on markets and competition in several sectors. Indeed, governments can set tender rules to boost the chances of facing a competitive market. If not well designed, government rules for public procurement may restrict competition by:

1. Unnecessarily reducing the number and range of participants in a tender;
2. Creating an unlevel playing field for firms participating in a tender;
3. Making it easier for firms to collude in public procurement markets (otherwise known as bid rigging).[14]

Ensuring competition in markets where the state is the buyer is important for several reasons:

- **It improves the ability to deliver public services and value for money for the public sector:** A lack of competition in markets for selling to the state raises the price paid by the state and reduces quality, thus reducing the value extracted by public funds. This can have budgetary impacts and manifest as a lower ability for governments to deliver public goods and services. There is also a clear opportunity cost for scarce public funds where rents paid to firms with excessive market power affect the budget for essential goods and services or other productive uses.

- **It increases access for companies to procurement opportunities:** The market for sales to the government represents an important source of business and a pathway for development for several types of firms. Promoting competition in these markets can allow more firms to develop their capabilities and product offerings in an environment that encourages innovation. For example, for emerging solutions and technologies in the digital economy, selling to the government can be a vital part of developing local digital ecosystems (Digital Impact Alliance 2021). However, this requires that tender specifications and requirements are set so that new digital technologies can compete on a level playing field with more traditional solutions (for example, allowing for the delivery of services and goods).
- **Public procurement is often used explicitly to pursue socioeconomic policy objectives that may impact market dynamics.** Public procurement is often used as a policy tool to promote social, industrial, and environmental goals (such as enhancing domestic manufacturing capacity, supporting nascent renewable energy industries, supporting SMEs or disadvantaged groups, etc.). While there may be valid reasons for doing this, the procurement rules and conditions used to achieve these objectives typically also impact the range of players that can participate in the market and the level playing field. A prime example is the imposition of local content requirements, which specify that only locally produced goods, services, or works (or goods with a minimum threshold for local production and content) may be procured. Here we can think of public procurement being used as a form of industrial policy.

Public procurement policies that affect competition (either through bid rigging or restrictions on participation in tenders) can significantly impact the budget available to governments to increase access to essential infrastructure, goods, and services. A 2003 paper found that the resource savings that could be generated by only a conservative reduction in bid rigging (which they take as leading to a price reduction of 15 percent on 1 percent of government contracts in 2000) was greater than the average annual operating budget of the competition agency in several countries – including India, Kenya, South Africa, Tanzania, and Zambia – often by a factor of several times over. In the road sector, bid rigging on road contracts from 29 developing countries found that anticompetitive behavior increases the per-kilometer cost of building a road by as much as 40 percent on average (World Bank 2011). Agricultural input support programs can also be prime victims of procurement policies that encourage bid rigging or restrict entry and can ultimately harm the development of productive agribusiness sectors.

EXAMPLE 16: EGYPT, BURKINA FASO, MALI, AND ZAMBIA – COMPETITION ISSUES IN PROCUREMENT FOR AGRICULTURAL INPUT SUPPORT PROGRAMS

- In Egypt, public procurement of fertilizer is conducted through the agricultural development bank by direct order, rather than through a competitive process.
- In Burkina Faso and Mali, large partly state-owned cotton companies have a monopoly on fertilizer distribution. They procure fertilizer for distribution through a bidding system. However, these cotton companies are part-owned by large fertilizer producers, which also participate in tenders.
- In Zambia, two fertilizer firms were found to be dividing the market between themselves facilitated by bidding requirements in tenders. Annual public sector savings from ending the cartel were estimated at US$21 million in 2013.

Where procurement rules are used to achieve other policy goals, tensions and synergies may exist between competition and those policy objectives. On the one hand, some of these policies can help to boost competition. For example, procurement rules that provide advantages to small firms could help encourage participation by SMEs in tenders by overcoming the scale advantage that would otherwise be held by large firms, while also developing the capacity of small firms to provide more effective competition to large firms in the longer term. At the same time, some procurement rules may be more harmful to competition with fewer longer benefits. For example, local content rules reduce competition and choice in procurement markets and raise costs for the public sector, while the long-term effects on the productivity of the targeted industry are unclear (Lin and Weng 2020). Moreover, several studies highlight the long-term inefficiencies these rules impose on an economy (Stone, Messent and Flaig 2015). The debate on these issues is ongoing, but in any case – if these types of policies are going to work, it is important to at

least ensure a few safeguards are in place. For example, the impact of these policies should be monitored ex post to check their effectiveness and tweak their design if necessary. Sunset clauses should also be used if the government sees these as temporary measures and does not want to fall into the trap of perpetual protection.

Local content rules (and other policies that favor domestic firms over foreign firms in public procurement) are also seen as a major hindrance to international trade and regional integration. For that reason, trade agreements may include obligations by governments to open their public procurement opportunities to firms of their trade partners. Both the World Trade Organization Government Procurement Agreement (GPA) and EU directives contain binding obligations to publish information about open tender opportunities to companies of their trading partners. The GPA also contains obligations to report statistics about the procurements taking place to ensure access to information on opportunities. Trade agreements can be used to introduce and strengthen important procedures, due process, and transparency in public procurement practices. A recent analysis of Regional Trade Agreements in the Asia and Pacific region showed that provisions range from codifying the status quo on public procurement to an agreement to partially eliminate barriers to foreign bidders to creating a single market for government procurement contracts in goods and services.

SOEs and public procurement

SOEs represent a large part of the public procurement market in many countries and should follow rigorous rules for public procurement, just like all public institutions. However, in practice, some SOEs may not be subject to the public procurement rules that apply to the general government sector, given their incorporated status and application of company law. In some cases, SOE boards define their own procurement rules, and in other cases, specific SOEs have their own dedicated frameworks for their procurement (for example, in Kazakhstan, for many years, the sovereign wealth fund (Kazyna) has specific rules for its procurement). While it is understandable that public procurement rules might be too onerous for a public institution that carries out commercial activities, principles of transparency and value for money should be respected as SOEs manage public resources.

SOE's procurement practices, when used for political patronage, risk distorting markets. Exceptions from procurement rules for SOEs provide greater scope for SOEs to engage in less-competitive direct procurement (single source procurement), which restricts competition compared to open tenders and other methods. As with other forms of government procurement, open tender should be considered the default option for procurement by SOEs. However, there appears to be a high share of direct awards (single-source procurement). As well as reducing competition, direct procurement increases the chance that the SOE will be used for political patronage. Beyond political patronage, the use of SOEs (and their procurement) to pursue policy objectives means issues around balancing competition with achieving policy objectives (which may often require providing advantages to some groups of suppliers) also must be borne in mind. This becomes harder to do with direct awards rather than with open tenders.

EXAMPLE 17: EGYPT, JORDAN, KAZAKHSTAN, QATAR, AND RUSSIA – SOE'S PROCUREMENT AND RISKS TO COMPETITION

- Three key SOEs in Kazakhstan were found to have between 87 percent and 98 percent of their needs sourced through direct award – higher than the general state market.[15]
- In Russia, over 95 percent of SOE procurement was through non-competitive methods in 2017, and single-source procurement accounted for over 50 percent of total procurement (Di Bella, Dynnikova and and Slavov 2019).
- In Egypt, the 2018 public procurement law does not cover SOEs and permits direct agency-to-agency contracting with proper approval.
- In Qatar, Qatar Petroleum is excluded from the tender law. In Jordan, each SOE has its own tender rules; and in Algeria, SOEs are allowed to develop their own tender rules in accordance with freedom of access, equality, and transparency principles.

SOE subsidiaries may also have considerable independence within the procurement rules. Fragmented procurement between SOE subsidiaries – and the use of different procurement portals by different SOEs can also raise the costs and complexities for firms to access procurement opportunities. Small and medium sized enterprises are disproportionally disadvantaged, as these types of companies have fewer resources to monitor and handle many procurement portals. In this context, ensuring greater integration of procurement among SOEs and other public agencies could prove a useful measure.

Cooperation between SOEs and their subsidiaries in supplying goods and services poses additional hurdles to competition. Some SOEs have rules determining what items can and should be procured from their subsidiaries, and this can be done through direct procurement (without open tender). This prevents competition and access for suppliers from companies outside of the holding.

In some countries, there have been efforts to tighten rules on the role of SOEs in supplying to public sector institutions. In Denmark, SOEs are not permitted to participate in state-bidding contracts to avoid the risk of neutrality issues. In other countries, specific guidelines regarding the treatment of SOEs in public tenders are required: Australia, Israel, Kazakhstan, Korea, and Sweden. For example, in Australia, government businesses must declare that their tenders comply with competitive neutrality principles, whereas, in Sweden, abnormally low tenders can be excluded when they result from competitive advantages emanating from government ownership or support.

NOTES

1 The terms 'business support programs', 'subsidies to firms' and 'state aid' are used interchangeably in this toolkit although subsidies under WTO and state aid under the EU frameworks have specific legal connotations.

2 See for example IMF (2024) Industrial Policy Coverage in IMF Surveillance – Broad Considerations.

3 For example, subsidies intended to increase productivity, for example, are often found to have little to no significant effect in the long run and, if so, only under special circumstances. In some instances, subsidies even decrease productivity. Comparing Swedish companies that received state aid to companies that did not, Bergstrom (2000) finds that the productivity of subsidized firms increases in the first year after the support, but that in the long run productivity falls below that of firms that did not receive any support. Similarly, Van Cayseele, Konings, and Sergant (2014) find that state aid enhances productivity growth most for firms that are cash-poor, meaning that laggard firms (which are more likely to be financially constrained) experience more TFP growth than close-to-frontier firms when receiving state aid (this effect is driven mainly by the postcrisis years in the sample). Studies of Japan and Korea find that subsidies have no or only negligible impacts on productivity (Beason and Weinstein 1996; Lawrence and Weinstein 1999; Ohashi 2005).

4 Both competition policy and industrial policy seek to improve productivity and innovation, thereby contributing to economic growth.

5 The Business of the State (BOS) data base uses these conditions from Dall'Olio et al (forthcoming) for identification of SOEs. Generally, to assess the degree of "control" by the government on a corporate entity would require a firm-by-firm analysis. While a participation of 50 percent or more is sufficient to grant the state control over a corporate entity, this is not a necessary requirement. Control can be achieved through a much lower equity participation and is not even limited to equity. For example, in a number of countries, governments have golden rights with a minority participation with the power to outvote other shareholders and directly influence the decisions of a firm. To capitalize on the availability of shareholding information and since control cannot be measured ex-ante, the BOS database sets the threshold for state participation at 10 percent to proxy government control.

6 The WBG BOS database proxies this by a level of direct or indirect (i.e., through subsidiaries) participation of above 10%.

7 The private sector would not provide a good or service when a fee or price cannot be charged since certain consumers or groups of people cannot be restricted to access it (i.e. non-excludable condition) and the consumption of the good/service does not reduce its availability for others (non-rivalrous condition).

8 A key exception would be the case where an SOE's sole policy mandate is to address the potential for the exercise of excessive market power, in particular, due to the market being a natural monopoly. In this case, an SOE would be used as an alternative to regulating the price, quantity, quality, and investment decisions of a private firm. There would be no subsidy inherently required for this since the SOE can simply choose to produce at the level where a private firm would have been asked to produce under regulation (at the point where the average cost curve crosses the demand curve which allows the firm to cover average costs and earn normal profits). A subsidy would only be required if the firm is used to achieve other objectives like accessibility, coverage, and affordability and therefore must produce past this point.

[9] World Bank (2019), Sultan, S. (2014) State-owned enterprises in Southern Africa: A stocktaking of reforms and challenges. OECD Corporate Governance working papers.

[10] See World Bank, SOE policy measure tracker available at: http://wbgmssqlefip001.worldbank.org/Analytics/powerbi/Topic/MAT/SOE-COVID19

[11] Contestable markets refer to those where there are no barriers to entry or exit, all firms (incumbents and potential entrants) have access to the same production technology, there is perfect information on prices for all consumers and firms and entrants can enter or firms can exit before incumbent firms can adjust prices.

[12] In this case, sector regulation (such as price controls) is key to mitigating the potential abuse of dominance of the monopolist in the market and limiting the ability of the monopolist (either public or private) to exert market power and define unilaterally the market outcomes (such as prices, coverage, quality, etc.).

[13] In low-income the size of public procurement is an average of 13 percent of GDP, in middle-income countries it is 13.2 percent of GDP, and in high-income countries it is 14 percent of GDP.

[14] Some observed examples include: Political campaign donors being prioritized in Government tenders through prequalification of legally 'independent' companies but related through blood relationships. This is a form of bid-rigging from the pre-qualification stage facilitated due to political patronage.

[15] Samruk-Kazyna has the lowest share of direct awards with 86.5% of the entire procurement volume (2016). Baiterek follows closely with just under 88% (2017). KazAgro procures over 98% through direct awards (2017). All these shares are higher than the general state sector (OECD 2019).

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5. GOVERNMENT ENFORCEMENT TO TACKLE ANTICOMPETITIVE BEHAVIOR – PILLAR II

Focusing on Pillar II of the MCPAT, this chapter will give an overview of certain types of anticompetitive behavior and merger transactions that might have anticompetitive effects. It will focus on cartels given that they are considered the most harmful anticompetitive practice.

Chapter 5. What's in this chapter…

5.1. Cartels and collusion

Cartels are business arrangements that restrict competition between firms in certain markets by either fixing prices, quantities sold or bought, or dividing markets between firms (also known as collusive agreements or hard-core cartels). They are an anti-competitive business practice universally acknowledged to inflict substantial economic harm to consumers and the economy overall. Collusive agreements among competitors slow productivity growth, undermine economic efficiency, and hinder poverty reduction. Empirical estimates suggest that the price increases associated with hardcore cartels can be up to 49 percent, on average (Connor and Bolotova 2006; Connor and Lande 2008; Boyer and Kotchoni 2014; Connor 2014).

This can be especially harmful to poor households. At least 21 percent of the cartels detected in LAC operated in markets for essential consumer goods such as sugar, toilet paper, wheat, poultry, milk, and medicines. In LAC, cartels have typically increased prices by 5-20 percent, but in at least 4 percent of cases anticompetitive agreements doubled consumer prices. Evidence from South Africa suggests that public resources spent on anti-cartel enforcement could be as much as 38 times more effective in reducing poverty than cash transfers, as a significant share of cash transferred to eligible households is captured by cartels.

Unlike other forms of lack of competition, such as the market power wielded by individual firms, "hard-core" cartels offer no justifications in terms of efficiency and innovation; instead, they are unequivocally damaging to productivity and growth. Cartel activity has been associated with productivity differentials of 20 to 30 percent, and a failure to address cartel activity can limit total productivity growth across the economy. Cartelization can also harm export competitiveness by raising the cost of inputs, with negative implications for developing both domestic and international value chains.

International best practice is that "hard-core" cartel agreements should be prohibited categorically. Hard-core cartel agreements should be differentiated from other restraints on competition that may produce efficiencies. An essential distinction in modern competition regimes is between agreements

that restrain competition by "object" or "per se" and those that restrain competition but with arguable procompetitive justifications. Hard-core cartels – i.e., those that fix prices, quantities, rig bids, or divide markets – are restricted by object since the entire purpose of the agreement is to restrain competition among rival firms. Therefore, this practice should not be exempted either.

Other agreements are said to restrain competition only through their effects thus requiring the application of economic analysis on a case-by-case basis. Such agreements have objectives other than the restraint of competition and may often advance consumer welfare and efficiency but may also have the incidental effect of reducing competition. For example, a manufacturing joint venture between rival producers may create efficiencies and reduce the cost of production. However, it may also induce the joint venturers to compete less aggressively against one another. Such agreements are generally governed by a "rule of reason," which looks at the justifications for and effects of the agreement but does not condemn it categorically.

Factors that facilitate cartels

Firms collude when it is profitable for them and their competitors; they can coordinate with each other and maintain the stability of a cartel. When two or more competing firms believe that coordinating will yield higher profits, they weigh those benefits against the perceived probability of detection and the sanctions it would entail. Harrington (2015) identifies three necessary conditions for cartel formation. Cartels require stability, participation from competitors, and the ability for firms to coordinate.

Understanding the factors that have played a role in cartel formation and stability in a country or region can inform government strategies and tools for eliminating cartels. The conditions that facilitate cartels (by making it easier for firms to select a strategy, coordinate behavior, and punish deviations from the strategy) can either be structural market features, factors resulting from cartel member behavior, current anticompetitive government interventions, or a history of anticompetitive government interventions. Box 14 outlines the key factors that, based on international evidence, facilitate cartel formation and longevity.

TOOLKIT ITEM 16

Cartels are the most damaging anticompetitive practice. They can be especially harmful to poor households when cartelized markets are part of the domestic consumption basket, to industrial development when they affect the prices and availability of key inputs, or to fiscal accounts when they take place in public procurement (bid rigging).

Cartels are business arrangements that restrict competition between firms by fixing prices, quantities sold or bought, or dividing markets. The MCPAT helps identify structural, strategic, and regulatory factors that can facilitate cartels (Box 14).

This range of facilitating factors means that a multipronged approach to combatting cartels would be most effective. In addition to detecting and breaking up cartels through the competition law, governments can deter cartel formation by considering the impact of their interventions on the competitive dynamics of markets and addressing their interventions that facilitate collusion. On the flip side, in countries where levels of state control and regulatory barriers to competition have historically been high, the cartel formation risk is relatively high due to this legacy, even once those markets are opened. This pro-competition regulatory reform can be complemented by competition laws and authorities with the power and autonomy to detect and punish hard-core cartels. These two complementary approaches are summarized in Table 9 and Chapter 7 further focuses on tools to detect and punish cartels while exploring the complementarities by addressing the factors that facilitate cartelization.

BOX 14: FACILITATING FACTORS FOR CARTELS

Markets where collusion is likely are those that are characterized by the following factors:

Structural factors

- **High entry barriers and import barriers.** Entry or expansion by outsiders to the cartel – including importers - can undermine the strategy of the cartel (for example by undercutting the collusive price) and spark deviations from cartel members. Moreover, the success of a cartel in the form of high prices, in fact, increases the likelihood of entry over time. In a case study of 19 cartels, Levenstein and Suslow (2006) found that entry was one of the most common causes of cartel failure.
- **High market concentration and a small number of firms** reduce the number of negotiating partners, thus making it easier to reach an agreement. This raises incentives to collude by increasing potential profits per firm. A small number of firms also makes it easier to detect deviations from the collusive agreement (Fraas and Greer 1977).
- **Product homogeneity** facilitates the ability to reach a mutually agreeable price for the product and reduces the scope for competition in other dimensions, such as quality. Firms producing homogenous products are also more likely to have symmetric costs (Hay and Kelley,1974).
- **Inelastic demand.** This increases the potential profits from setting an agreed collusive price because consumers of such goods are less likely to shift consumption when prices rise.
- **A lack of buyer power.** Higher buyer bargaining power reduces cartel stability since, for example, large buyers will be more effective at encouraging members to deviate from the agreed price.
- **Regular and frequent transactions** increase the effectiveness of punishment threats by increasing the present value of the cost of future punishments.
- **Firm symmetry.** Symmetry in market size and cost structure amongst firms increases the ability to reach an agreement and monitor deviations.

Factors affected by the behavior of cartel members

- **Excess capacity.** Can be used as an entry deterrence mechanism and lends credibility to punishment threats by allowing firms to engage in predatory behavior or price wars (Lübbers 2009, Dixit 1979).
- **Multimarket contact, where firms meet in several different product or geographic markets**. This can increase firm symmetry across markets (see "firm symmetry" above) and allow market power to be spread across markets, making it easier to reach an agreement. Multi-market contact also makes it easier to punish defectors, as punishment can be implemented in different markets.
- **Cross-ownership and links with other firms.** Facilitates information sharing, making it easier to reach an agreement and coordinate. Cross ownership also reduces the incentive to deviate from the agreement.
- **Information exchange mechanisms:** Industry trade associations are the key example of this. The information collected and disseminated by these associations can help to ensure coordination and to monitor deviations. Between a quarter and a half of the cartels in the US cross-section studies report the involvement of trade associations in cartel organization (Levenstein and Suslow 2006). In South Africa, trade associations were found to have played a role in around a third of all finalized cartel cases between 2005 and 2015 (World Bank 2015).

Current anticompetitive government interventions

- **Public procurement policies and procedures** that restrict the number of firms bidding, are overly restrictive on product specifications (making it easier to coordinate around a particular price), specify reference prices, or increase transparency on bidders.
- **Price controls** or other price regulations, such as those that set minimum or maximum prices or margins, provide firms with a "focal point" and make it easier to reach an agreement on price. Moreover, in certain sectors such as agriculture and transportation, many governments still support or explicitly enable price-fixing agreements among competitors.

- **Narrow required product standards** make it easier for firms to collude around a certain quality or type of product and reduce the scope for deviating from the cartel with product differentiation.
- **Regulations and industrial policies that limit entry and protect incumbents reduce the number of firms in the market,** making it easier to reach and sustain an agreement and reducing the threat of disruption.
- **Government interventions that facilitate disaggregated information exchange or support industry associations that facilitate cartels.** For example, in Senegal, the government endorsed and acted as a secretariat for an association of groundnut traders and processors that acted to fix prices and other conditions for buying groundnuts from producers.

A history of anticompetitive government interventions

- Past limits on entry and protections for incumbents lead to fewer market players today.
- Historical price controls can continue to provide a "focal point" for cartel members even once they are removed.
- Historical regulatory division of regional markets among firms provides a precedent that can continue to be implemented even once the regulation is removed.

Source: Authors' own drawing partially on Motta (2004)

TABLE 9: TOOLS FOR DETECTING AND DISCOURAGING CARTELS

Detecting and punishing anticompetitive agreements	Addressing the factors that facilitate cartelization
• A pro-competition legal framework • Clearly defined investigative authority • Leniency programs, whistle-blowing programs and settlements • Appropriate fines and remedies • Whistle-blowing programs • Complementary antitrust tools (such as merger control) • Appropriate institutional arrangements.	• Advocacy strategies • Market studies • Regulatory reform to enable entry and competition • Pro-competitive public procurement systems • Market liberalization with proper competition Safeguards.

Source: Adapted from Licetti et al (2021) based on World Bank (2016)

Bid rigging cartels in public procurement

Bid rigging occurs when bidders collude in tendering processes. The objective is to extract greater gains from the public tender or auction. This is usually done through either the fixing of prices or any other commercial parameters of their bids, or through the division of the market (for example, Firm A agrees not to bid for one contract to allow Firm B to win, while Firm B agrees not to bid for a second contract so that Firm A can win). One mechanism used is distributing additional profits obtained among the conspirators (such as competitors who agreed not to bid or to submit a losing bid, receive subcontracts or supply contracts from the designated winner, or are compensated through payments). Common forms of bid rigging are summarized in Figure 28.

FIGURE 28: COMMON FORMS OF BID RIGGING

Cover pricing – bidders arrange for one or more of them to submit an artificially high bid, distorting the procurer's impression of the competitive price

Bid rotation – firms agree to take it in turns to submit the lowest bid

Bid suppression – one or more firms agree not to bid, or to withdraw their bids

Market allocation – bidders agree to carve up the market and not compete for certain customers or geographical areas

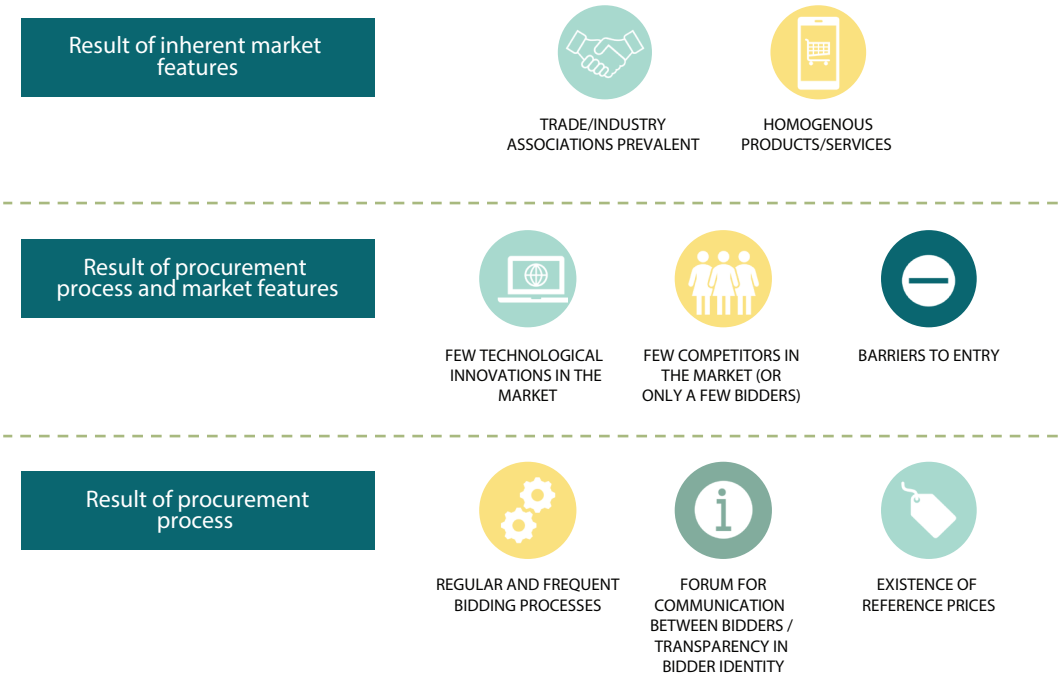
Source: Authors' own elaboration

What facilitates bid rigging?

Market conditions determine how easy or desirable it is for firms to collude – and this will depend on both the underlying market characteristics and the design of the procurement process. Figure 29 displays market conditions that can make bid rigging more feasible. Some of these factors result from inherent market features while some are affected by the procurement process. For instance:

- The existence of barriers to entry, a small number of bidders, and a lack of technological change can all make it easier for bidders to reach and sustain agreements amongst each other. The tender conditions, such as product specifications and bidder eligibility criteria, affect these factors. The use of e-procurement is generally a positive development in procurement. Still, in some countries, there have been concerns about a lack of remote connectivity and low levels of e-literacy among contractors, which might exclude some firms and, therefore, reduce the number of bidders in a tender. Finally, as discussed earlier, while division by lots could increase the potential number of bidders, it may nonetheless facilitate collusion through market sharing.
- Regular and frequent tenders increase bidders' ability to enter into agreements and monitor compliance with them. Varying the predictability and holding tenders less frequently can make collusion harder.
- Reference prices might be helpful for cost containment or to encourage quality optimization within the procuring entity's budget but can also facilitate collusion.
- Features of tenders that increase transparency or allow communication between bidders – such as pre-tender meetings – can also make it easier for them to reach collusive agreements.

FIGURE 29: MARKET CONDITIONS THAT CAN MAKE BID RIGGING MORE FEASIBLE



Source: Authors' own elaboration

What patterns of behavior are associated with bid rigging?

Procurement agencies should be alert to patterns of behavior associated with bid rigging. Effective detection of and enforcement against bid rigging is vital to a pro-competition procurement process. As part of the tender process, procurement agencies should be alert to signs of bid rigging. These can be flagged to the relevant competition authority to allow them to investigate and prosecute the bid rigging.

FIGURE 30: TYPICAL PATTERNS THAT MAY INDICATE BID RIGGING IN TENDERS

Bidders

- Likely bidder failing to submit a bid
- Lowest bidder not taking up the contract
- Bids that drop on the entry of a new or infrequent bidder
- Successful bidder later subcontracts work to a supplier that submitted a higher bid
- An apparent pattern of who wins bids across several tenders
- A bidder has knowledge of previous bids for which it was not a party
- Two or more companies submit a joint bid even though at least one could have bid on its own
- Certain firms submit tenders that win only in specific geographic areas for no apparent reason
- Bid submitted by a company incapable of successfully carrying out the contract

Documents

- Bids received at the same time
- Bid containing similar or unusual wording
- Bids containing less detail than expected
- Packaging of bid documents are similar or postmarks
- Bid documents indicate numerous lastminute adjustments

Pricing

- References to discussions or meetings with other bidders
- Justification of prices by reference to "standard" or "industry" prices or schedules
- References to not supplying in a particular area
- Statements indicating advance knowledge of competitors' pricing or bid details
- Use of the same terminology by various bidders when explaining price increases
- Bidders regularly socialise together or appear to hold frequent meetings
- Several bidders make similar enquiries to the procurer or submit similar requests
- A company requests multiple bid packages

Behavior

- References to discussions or meetings with other bidders
- Justification of prices by reference to "standard" or "industry" prices or schedules
- References to not supplying in a particular area
- Statements indicating advance knowledge of competitors' pricing or bid details
- Use of the same terminology by various bidders when explaining price increases
- Bidders regularly socialise together or appear to hold frequent meetings
- Several bidders make similar enquiries to the procurer or submit similar requests
- A company requests multiple bid packages

Source: Authors' own elaboration

TOOLKIT ITEM 17 Bid rigging in public procurement is a type of cartel. The MCPAT provides guidance on identifying factors that can facilitate bid rigging and spotting signs of potential bid rigging.

5.2. Abuse of dominance

Dominance itself should not be considered an offense, and dominant firms may compete on their merits. It would not be considered an abuse if a dominant firm's competitor cannot compete due to the superior efficiency of the dominant firm (even if that efficiency is driven by scale). However, dominant firms are considered to have a special responsibility to protect competition in the market. The focus of abuse of dominance provisions has typically been to protect the competitive process rather than specific competitors.

Most contemporary competition regimes have abuse of dominance or monopolization provisions designed to address a wide range of unilateral anticompetitive behavior. Specific types of this behavior include predatory pricing, price discrimination, boycotts, exclusive dealing contracts, tying, bundling, refusals to deal, margin squeezes, and abusive use of intellectual property rights.

The review of competition laws and their implementation across low- and middle-income economies using the MCPAT shows the following recurrent issues:

- Rigid rules regarding dominance based chiefly on static market share and concentration indicators, rather than on understanding market power.
- Use of abuse of dominance provisions to control prices of firms declared as dominant.
- Lack of clarity on analyzing efficiencies and theories of harm for abuse of dominance cases.

TOOLKIT ITEM 18 Being a dominant firm is not anticompetitive. Abusing the dominant position is. Specific types of this behavior include predatory pricing, price discrimination, boycotts, exclusive dealing contracts, tying, bundling, refusals to deal, margin squeezes, and abusive use of intellectual property rights.

It is important to note that some practices, such as exclusive dealing, can enhance efficiency. This is why they only qualify as anticompetitive if the firm is dominant in the market and they result in exclusionary effects (i.e., they impede other firms' operation in the market by closing entry or increasing their costs to operate).

5.3. Anticompetitive mergers

Mergers are not an anticompetitive practice like cartels and abuse of dominance, but a competition authority may prohibit them if they are likely to reduce competition. It is widely recognized that mergers, amalgamations, acquisitions, and other similar transactions (herein referred to as "mergers") are, in most cases, good for competition and consumers. They can allow firms to reduce costs and realize efficiencies that drive investment and innovation and ultimately reduce consumer prices. However, some mergers may significantly harm competition and facilitate firm conduct that harms consumers because mergers inherently lead to the consolidation of assets, a change in control of the target firm, elimination of competitors, and changes to market structure. Competition can be reduced by either strengthening the market power of the merged firm or by creating conditions where coordination between firms in the market becomes easier. In some cases, mergers can be used as an alternative to an agreement among competitors to decide on their prices, expansion, or innovation policies.

To the extent that they create an autonomous economic entity operating on a lasting basis, joint ventures are also considered mergers. The analysis of joint ventures for research and development, exchange of information and traceability, and production and distribution arrangements is becoming more important in the context of sustainability and industrial policies.

Experience in the application of the MCPAT in the last decade points to the following recurrent gaps in merger control in low- and middle-income economies:

- Broad definition of merger without considering local nexus and lack of thresholds or rules for mandatory notification of mergers that result in undue regulatory burden for the private sector and competition authorities.
- High merger notification fees and lengthy timelines for evaluation that delay or discourage private investment.
- Lack of risk-based procedures including fast tracks and two-phased analysis of mergers to focus resources on the analysis of mergers that present competition concerns.
- Analysis focused on market structure indicators rather than on theories of harm related to lessening competition.
- Lack of clarity in analyzing public interest considerations and competitive effects.
- Weaknesses in the ability to design and ensure compliance with remedies to preserve competition.

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PART III
HOW TO FIX THE MARKET AND BOOST COMPETITION

6. DESIGNING GOVERNMENT INTERVENTIONS FOR COMPETITIVE MARKETS – PILLAR I

Once there is a clear understanding of market characteristics, government interventions in place, and how these interact to influence observed market outcomes, the next step is to identify those government interventions that seem to be causing market distortions and design and ultimately implement the least distortive policy alternatives.

Without proper regulation or supervision or government intervention, market failures can lead to outcomes that do not maximize social welfare. In some cases, these market failures can, in fact, be the root cause of development issues. For example, markets can fail when they tend to monopoly or excessive market power in the hands of a few firms, which can lead to low affordability and accessibility of products. More pro-competition regulation may be needed to provide firms with incentives to compete. In general, where there is a market failure, the answer may not be deregulation but better regulation – better targeted to the beneficiaries and the underlying issue and better government interventions to allocate public resources – designed to target root causes and minimize market distortions. Well-designed policies that improve the functioning of markets – while creating or fixing markets – "increase the size of the pie" and maximize social welfare.

Focusing on Pillar I of the MCPAT, which aims to integrate competition principles across government policies, this chapter provides guidance on four areas. First, it explains how to design regulations to minimize negative effects on competition. Then, it provides advice on how to reduce distortions of industrial policies and SOEs and how to design pro-competition public procurement procedures.

Chapter 6. What's in this chapter…

Related content in Annex:

- Examples of less distortive alternatives or pro-competition reforms for usual rules or interventions that restrict competition (Annex A.12)

6.1. Government as a regulator: designing less distortive rules and policies

Identifying the least distortive policy alternative to attain specific social goals is not always evident. It requires understanding the trade-off between the observed government intervention and its potential unintended consequences. Furthermore, it is essential to recognize that such government intervention is not always necessary – or the best option – to solve market imperfections or address institutional failures.

The guiding principles below help identify the most appropriate solutions that remove – or reduce – potential anticompetitive distortions. In practice, each policy goal will match with many possible regulatory approaches. Thus, because of the complexities that will inevitably characterize each case, it is impossible to create a definitive match between current regulations and solutions. However, eight guiding principles can be applied across cases (Toolkit item 19). Table 10 provides examples of alternatives to the three types of anticompetitive rules described in section 4.1.

TOOLKIT ITEM 19

Eight guiding principles to design rules that minimize market distortions:

1. The most appropriate solution is the alternative that - among those that address the underlying policy objective - **minimizes competitive restraints**.
2. **Market-oriented and incentive-based approaches** are generally preferable to direct controls.
3. **Standards/regulations targeting performance or outcome** are generally preferable to those targeting design or inputs.
   - For example, in the case of environmental regulation, specifying or capping emissions outputs is likely to be more effective and less restrictive than specifying what techniques or inputs a firm should use.
4. Always start by understanding the precise bottleneck or the source of a market issue and **target that bottleneck or issue**.
5. It is **more efficient to tackle market failures in the activity in which they occur** rather than introducing additional restraints in another sub-segment of the market.
6. Consider who the intended beneficiary of a policy should be and **target support to that beneficiary directly** – rather than intervening in market parameters to reach the beneficiary.
   - For example, when aiming to support low-income households with the purchase of goods/services, it would be more effective and less distortive to provide those households with direct cash or voucher support to purchase certain goods/services – rather than attempting to intervene in the markets for those goods/services to lower their prices.
7. Design interventions to **maintain or maximize choice for consumers and firms** wherever possible.
   - For example, in a situation where firms are being provided with business support, such as to access training or consulting services, it would be desirable to give firms a choice of provider from whom to access this support.
   - In a situation where farmers are being provided with subsidies to purchase fertilizer, it would be better that they are provided with means to choose between different fertilizer suppliers (such as vouchers that are valid at different outlets) rather than being forced to purchase from one authorized seller.
8. Where market failures arise from inadequate or asymmetric information, remedies which **increase information available to market players** present the most effective means of correcting the failure, with an acknowledgement that some forms of mandated information sharing may increase the risk of collusive outcomes.

EXAMPLE 18: CROATIA, EGYPT AND INDIA - ACTIONABLE RECOMMENDATIONS FOR LESS DISTORTIVE POLICIES AND PRO-COMPETITION REFORMS

- **Professional services in Croatia:** Price controls and recommendations spanning 18 professions ranged from fixing prices outright (such as for notary services) to providing recommendations on work hours and staffing (such as for engineering services). While the objective might have been increasing transparency for consumers, the unintended consequences of these direct controls were limited price competition and low market growth. The least distortive alternative, in this case, would be removing the direct controls and increasing enforcement efforts to discipline market players.
- **Egypt's rice sector:** Export restrictions aim at discouraging the expansion of land under cultivation to save water. However, unintended consequences on market dynamics have been reported, such as the closure of several private mills focused on exports, and an increase in stockpiling and contraband trade. Assessed against the eight principles outlined above, export restrictions do not minimize competitive constraints and are not a preferable option because they represent direct controls that are not tackling the root cause of the issue of concern. Given this, the following least distortive measures to achieve water conservation could be proposed: (i) direct enforcement of restrictions on land cultivation or water usage, and (ii) support to farmers to transition into less water-intensive crops.
- **Onion sector in Maharastra, India:** The licensing criteria for onion producers was linked to the physical space in the government-owned wholesale market. While the objective might have been addressing capacity concerns, the unintended effect was restricted entry for new producers. A proposed least distortive alternative was introducing a direct marketing license allowing onion producers to sell directly to buyers rather than being obliged to sell to government-owned wholesale markets.[1]

TABLE 10: EXAMPLES OF LESS DISTORTIVE ALTERNATIVES OR PRO-COMPETITION REFORMS FOR COMMON RULES OR INTERVENTIONS THAT RESTRICT COMPETITION

Common rules / Interventions	Examples of less distortive alternatives to be evaluated on a case by case basis
Rules that reinforce dominance or limit entry	
Overly restrictive standards and specifications in regulations / tender rules	• Assess the level of restriction needed to meet minimum health, safety, and environmental standards. • Include flexibility in standards and specifications to allow for consumer choice. • Provide education campaigns to producers on optimal inputs use.
Excessive/ ineffective registration and certification	• Review requirements for registration/certification to ensure they are proportionate to objectives. • Ensure transparent procedures, standardized timelines, and harmonize procedures across firms and, where possible, with other countries. • Reduce testing requirements where a product has been tested in other countries with at least as high safety requirements/standards (e.g., in agricultural varieties in countries with similar ecological conditions, or pharmaceuticals that are licensed in certain countries, or cars that have passed safety standards in certain countries).
Import restrictions	• Phase out import restrictions to lower consumer prices and increase consumer welfare. • Simultaneously invest in other methods to boost local competitiveness, such as encouraging local extension services, capacity development in local production/processing.
Export restrictions	• Avoid export taxes (first best), or; • Ensure export tax incidence does not lie on greater value-added products (second best). • Reinvest income from export tax (if maintained) in the value chain, but in a competition-neutral way.
Limits on geographic area used for production	• Market-based mechanisms to disincentivize production beyond a socially optimal level. e.g., production taxes or sanctions based on the level of production. • Enhance ongoing monitoring of land use.

TABLE 10: EXAMPLES OF LESS DISTORTIVE ALTERNATIVES OR PRO-COMPETITION REFORMS FOR COMMON RULES OR INTERVENTIONS THAT RESTRICT COMPETITION (CONT.)

Common rules / Interventions	Examples of less distortive alternatives to be evaluated on a case by case basis
Rules that facilitate collusion or increase costs to compete in markets	
Controlled/regulated price levels	• Assess the root cause of undesirable price levels and tackle the bottleneck at its root, e.g., if high consumer prices are caused by import restrictions, consider reforming import restrictions. • Consider whether price setting mechanisms could be made more market based with a direct link to international and/or prices of key inputs, whether they could be time bounded to encourage a move towards price competition, or whether prices could be set independently of providers. • Monitor for potential anticompetitive behavior which may be negatively impacting price.
Excessive role of trade associations in setting market parameters and information exchange	• Rationalize the role of association in setting market parameters, especially where government is involved in ratifying the decisions of the association. • Limit information sharing to aggregate information and/or past figures rather than future projections. • Review membership of trade associations to ensure balanced representation between buyers and sellers. • Use competition advocacy to inform associations of their obligations under the competition law if applicable.
Allocation of inputs under subsidy schemes carried out by government or made in fixed amounts to specific players and/or in specific geographies	• Consider use of voucher scheme/demand-side interventions to allow for consumer choice in subsidy schemes thus facilitating competition between suppliers. • Consider the need for the division of geographic areas between suppliers in subsidy schemes and allow for competing suppliers in the same area.
Overly restrictive standards/ specifications raise costs of competing through innovation and facilitates collusion by increasing firm symmetry/ product homogeneity	• Consider the need for balanced representation of players in setting standards/specifications when necessary. • Explore less costly standards that achieve the same goals. • Complementarily, see recommendations on standards above.
Rules that discriminate or protect certain firms	

Lack of transparent/ competitive procedures to select firms as part of government tenders (generally for input support programs)	• Review the design of tender procedures to allow for sufficient competition, e.g.:
	  • Adopt clear and systematic public procurement rules in accordance with best practices (e.g. open, transparent, competitive) to ensure that the process is objective.s
	  • Only include technical specifications and requirements that are necessary and objectively justifiable in view of the required need expressed in the tender.
	• Ensure conditions for participation relating to track record and financial capacity are proportionate and necessary.
	• Launch tenders with sufficient notice to ensure a broad range of participants.

Discriminatory state support for certain processors or products	• Consider implementing existing state support to a broader range of players and products based on transparent criteria to minimize distortions. • Develop clear objectives for existing state support and monitor value for money/performance of state support.
Government bodies performing both regulatory and commercial functions	• Separate different functions. • Improve SOE governance. • Evaluate the need of government to refocus activities.

Source: Authors' own elaboration

Considerations to minimize the negative effects of price controls

Prices are essential for market dynamics and when prices are artificially defined, the information transmitted to stakeholders may distort efficient decision making. As governments deal with imperfect information regarding production costs and consumer preferences, price intervention can remove incentives to entry, invest and innovate; promote shortages, create dependency on government subsidies, stifle competition and productivity and lead to negative spillover effects throughout value chains, with economy-wide negative impacts. Price controls can act as a focal point for collusion and can lead to an inefficient allocation of resources and high costs for governments to sustain the policy. Price ceilings can lead to reductions in supply or to shortages that would harm consumers rather than be beneficial to them and may reduce quality or innovation. Minimum prices, on the other hand, prevent more efficient firms from competing in the price dimension.

In response to the various crises (pandemic, food, and energy crises), some authorities may be more inclined to intervene in markets to address price increases. Price controls can be effective when used to tackle specific market failures associated with market power and lack of competition, such as natural monopolies or temporary market power arising from external shocks (such as wars, natural disasters or epidemic outbreaks). However, in these cases they must be well targeted and designed to prevent longer term distortions. If there are circumstantial needs to intervene in these markets, for example due to short-term price hikes of socially relevant products, there are mechanisms to minimize potential distortions. Prices should be set independently from producers, be time-bounded, and be reviewed periodically. Policy makers should also assess less-restrictive alternative policies, such as targeted consumer subsidies rather than producer subsidies.[2]

TABLE 11: ECONOMIC CONSIDERATIONS TO MINIMIZE THE NEGATIVE EFFECTS OF PRICE CONTROLS

Situations where price regulation may be warranted	Guidelines for setting and reviewing price controls
• Natural monopolies (generally in network industries) • Short term issues in which competition cannot be relied upon to determine an efficient market price (such as supply shocks)	• Set independently of producers/service providers to avoid competing interests or facilitation of collusive agreements • Where possible, link to international prices • Analyze alternatives: Targeted subsidies and analysis of potential competition restrictions • Time bounded: Price controls should not be indefinite • Avoid controlling prices for a broad range of products – target the scope of products narrowly • Review periodically to determine whether levels are optimal • Analyze impact on price competition.

Source: World Bank (2016) Breaking Down Barriers: Unlocking Africa's Potential to Vigorous Competition Policies

Even though governments may have legitimate policy goals informing price regulation – such as guaranteeing access to basic goods to the poor – they carry a risk of distortions which may have the opposite effect in the medium term. Price controls are likely to promote inefficiency in workably competitive markets in which less distortive alternatives would typically be more effective to correct market failures (for example, by removing import restrictions, eliminating monopoly rights, or enforcing antitrust policy). Evidence suggests that even if price controls buffer the local economy from upward spikes in international commodity prices, these administered prices do not mirror downward trends of commodity prices in international markets. This results in an effect opposite to the intended policy since consumers do not benefit from lower international prices. In addition, price controls increase business risks and discourage entry of new players that could generate competitive pressure.

At the same time, the administration of price controls can occupy valuable time and resources of authorities. In some countries competition authorities indicate that one of their key roles is to monitor and regulate prices – which is also reflected in the legal framework. For instance, in Tunisia, the competition law

excludes key markets from its application, and, at the same time, provides for administrative price control of several goods and services. So, instead of focusing on detecting and deterring anticompetitive behavior and eliminating regulations that restrict competition, emphasis is placed on price control.

To identify what price regulations could be phased out and to create an effective strategy on how to do so, governments should apply a two-pronged test to every market affected by price regulation: Is there a market failure preventing markets from delivering competitive prices? If yes, is a price control the least distortive measure capable of correcting the market failure identified? If a price control imposed on a sector does not pass this test, a strategy should be created to phase out price controls. Key de-regulation steps include understanding the policy goal behind the undue price intervention and finding what alternative policies could be used to accomplish them while boosting competition and market dynamics. Examples of measures that promote the emergence of workable markets without price controls are industry restructuring (such as structural separation in network industries), removal of barriers to entry and operational restrictions, greater trade openness, and enforcement of the competition law.

6.2. Government as a financier: embedding pro-competition principles in business support programs

Given that industrial policy will continue to be a widely used part of the policy toolbox of most countries, embedding three guiding principles into the way it is designed and implemented can help ensure these policies foster competitive markets and are as effective as possible. The table below identifies actions that should be taken to achieve each of the three principles when designing industrial policy:

- **Principle 1: Appropriateness: is industrial policy the right solution?** Assess the need for industrial policy and the opportunity costs. Is there a market failure that cannot be addressed with economy-wide reforms? Are there less costly alternatives? Given the country context, do expected benefits justify the direct fiscal costs and the risk of potential negative spillovers?
- **Principle 2: Contestability by design.** If a targeted intervention is justified, its design should reduce unnecessary targeting, discrimination, or excessive discretion and maximize access by different types of firms to minimize the risk of negative distortions and favoritism.
- **Principle 3: Informed implementation for positive effects.** Regular monitoring and evaluation of industrial policy instruments are crucial for their effectiveness and to avoid capture and adverse spillover effects.

TABLE 12: KEY PRINCIPLES AND ACTIONS FOR EFFECTIVE INDUSTRIAL POLICY AND A CHECKLIST OF ACTIONS TO ACHIEVE THEM

Key actions	Checklist
Principle 1: Appropriateness. Is industrial policy the right solution?	
1. Understand whether industrial policy is the right solution	✓ Identify the objective of a proposed policy and understand whether there are externalities present that would justify changing the relative costs of certain market players through public funding. ✓ Identify the market failure and target design of the policy at that market failure.
2. Reduce the opportunity cost of public funds	✓ Favor measures that affect firms' fixed costs of production rather than the variable cost of production (targeting fixed costs is more likely to translate to new technologies or products). ✓ Of the possible forms of public support that can achieve the desired objective, choose the measure that is least costly for public funds - such as the provision of a long-term loan or the purchase of shares by the government rather than grants.

Key actions	Checklist
Principle 2: Contestability by design. Does the design minimize distortions of the level playing field?	
3. Reduce risks of market distortions	✓ Include rules that avoid recurrent subsidies to the same recipient. ✓ Involve the private sector in risk-taking. Where possible, ensure projects are co-financed by firms or the private sector. The willingness of the private sector to co-finance can be used as a signal of the project's viability. ✓ Consider rules to boost competition in (or avoid excluding competitors from) the markets where beneficiaries operate, such as access obligations in the case of broadband rollout. ✓ Where needed, condition support on pro-competition measures. ✓ Pay attention to the supply of capabilities to provide support services (such as research, incubation) as well as the demand ✓ Bear in mind how the structure of the economy and how market risks are evolving. ✓ Bear in mind WTO's GATT and SCM agreements to avoid implementing subsidies potentially distortive for international trade.
4. Reduce unnecessary discrimination in scheme implementation	✓ Check whether a less discriminatory measure might achieve the same policy objective. Only choose vertical policies where horizontal policies will not achieve the desired objective. ✓ Review award criteria to ensure that the only discriminatory elements are those necessary to achieve the policy's core objectives and address the targeted market failure. Remove those that are not necessary.
5. Improve decision making on which projects are supported and reduce room for discretion/bias	✓ Reduce the scope for discretion in how projects are selected, such as by developing objective criteria for selection and reducing dependence on decision-making by a single individual (such as a Minister). ✓ Limit the involvement of incumbents in target sectors in the process of designing industrial policy. ✓ Use independent and qualified experts to select project firms to receive public funding (including experts on VC or private co-financing).
6. Boost information to the public and encourage a broad range of applicants	✓ Ensure application processes and criteria are transparent, widely available, and account for the needs and constraints of different types of firms (such as online application processes may exclude firms of a certain size in developing countries). ✓ Ensure transparency on the recipients of incentives to limit special interests' ability to extract government support. Ideally, there should be a publicly available unified inventory of state support measures with their respective beneficiaries.
Principle 3: Monitoring and evaluation for effectiveness. Is the measure achieving its intended effect while minimizing costs?	
7. Understand performance and allow for improvements in design	✓ Track all the business support measures in place and map potential overlaps ✓ Monitor and evaluate the performance of industrial policy schemes, publish and use results to improve the policy design. Ensure that performance evaluation includes an assessment of the impact on the market as a whole – not just on the recipients of the scheme. ✓ Introduce rules that limit the magnitude and duration of public fund transfers. For example, include sunset clauses which ensure support can be withdrawn or changed if the policy is not working or is no longer needed. ✓ Ensure appropriate institutional design, technical capacity, and systems to monitor and evaluate business support measures.

Source: World Bank (2016) Breaking Down Barriers: Unlocking Africa's Potential to Vigorous Competition Policies

In practice, designing effective industrial policy will mean assessing whether the industrial policy targets the correct market failure, whether it is the option (among all the possible alternatives) that reduces distortions, and whether it abides by the principles outlined above. Consider the following examples:

1. **Industrial policy as the right solution.** If the issue is access to skilled labor force, granting overall tax exemptions to a sector or type of firms would be not as effective as broader human capital policy including facilitating movement of workers across borders and adult training. Interventions are less distortive if they address the root cause of market failures or institutional failures.
2. **Opportunity cost of public funds.** Among alternative measures to achieve the policy objective, those that are least costly for public funds and create incentives for firms to use the funds more efficiently and minimize distortions in other sectors are preferable (e.g., guarantees rather than subsidized loans and long-term finance instead of unconditional grants or perpetual tax exemptions). At least tracking the fiscal cost of support measures is useful, but various MICs (e.g., Egypt, ple's Republic of China, Nigeria, India, Viet Nam) do not publish information on granted subsidies systematically (data.imf.org/) and the level of disaggregation of tax expenditures is limited – for example, Mexico, Morocco, South Africa report one third or less of the total provisions (Redonda, Von Haldenwang, Aliu 2023).
3. **Minimization of market distortion risks.** On one side, effective competition policy (through effective sector regulation where needed and competition law enforcement) is an essential complement (Criscuolo et al 2022). Boosting competition in (or avoiding exclusion of competitors from) the markets where beneficiaries operate is necessary such as effective access to essential infrastructure in the case of support to broadband deployment, transparent allocation of land rights or mining rights for support to renewable energy and essential minerals value chains. Rules that avoid recurrent subsidies to the same recipient mitigate the risks of further enhancing recipients' market power. On the other side, involving the private sector in risk taking through co-finance would reduce the chances of pursuing white elephant projects that are not viable even with government support. Government support if ill-designed can displace private supply in connected markets such as finance, incubation, and training. It is important to monitor the performance of connected markets bearing in mind the evolution of the structure of the economy and market risks.
4. **Non-discrimination in instrument design.** In many cases, considering minimum firm age, minimum size, specific experience, or geographical origin can unnecessarily favor certain firms and restrict competition. Technology-neutrality is important to minimize potential discrimination.
5. **Unbiased selection of beneficiaries.** Having a consultative process (beyond only incumbents) to design industrial policy instruments, developing objective criteria for firm selection and using independent and qualified experts to select firms involving a collegiate body rather than relying on decision making by a single individual (such as a minister) are examples of measures to minimize distortions on the level playing field. For example, in Romania, the design and draft guidelines to apply for state aid to support clean energy capacity expansion is subject to public consultation.
6. **Openness and reach.** Participation increases when application processes and criteria are transparent, widely available, and account for the needs and constraints of different types of firms (e.g., online application processes may exclude firms of a certain size in developing countries). In the case of South Africa, a study conducted in 2018 found that among 134 active business incentive schemes, 44 percent were considered non-transparent given lack of standard approval time, publication of list of recipients or publication of impact assessment (Nyman 2018). Transparency on the recipients of incentives can limit special interests' ability to extract government support. For example, the Competition Council in Moldova maintains a publicly available unified inventory of state support with their respective beneficiaries (https://inventar.competition.md).
7. **Performance evaluation for improvements in design.** Monitoring and evaluating the performance of industrial policy instruments, publishing execution information and well as outcomes and impact on beneficiaries, non-beneficiaries and markets is essential to phase out or modify ineffective instruments. Romania implements the EU state aid framework to evaluate the direct and indirect effects of schemes – including on competition and trade, ensuring proportionality and appropriateness. An ex-post evaluation of SME and innovation support programs in Romania quantified spillover effects outside of direct beneficiaries (Pop et al 2021). In Chile, the Budget Directorate has the authority to evaluate business support programs in terms of their fiscal impact and achievement of their targets.[3]

The Philippine Fiscal Incentives Review Board conducted a cost-benefit analysis of the impact of the CREATE Act which provides tax incentives for investment and job creation.[4] Colombia's new policy mandates evaluation and monitoring of their implementation, including binding recommendations provided by the National Planning Department. And recently South Africa has embarked in a review of business incentives to improve its current oversight and implementation framework.

Where such mechanisms exist, proposed industrial policies could be subjected to a competition impact assessment prior to implementation. In several countries, state aid control is an important part of the toolbox to limit the potentially distortive effects of industrial policy. The EU state aid framework has a solid framework for the evaluation of direct and indirect effects of a scheme, proportionality, and appropriateness.[5] Rules that limit the magnitude and duration of public fund transfers (e.g., sunset clauses) facilitate withdrawal or adjustment of ineffective policy instruments. Especially when competitive neutrality is not feasible to achieve the desired industrial policy objective, interventions should be narrow, temporary, and monitored closely (OECD 2020).

BOX 15: STATE AID (SUBSIDIES) CONTROL TO MINIMIZE MARKET DISTORTIONS

Some jurisdictions implement frameworks to regulate the provision of support to businesses (also generally referred as state aid or subsidies) and ensure a level playing field. Because subsidies grant recipients a comparative advantage over their non-recipient competitors that is not necessarily associated with efficiency, many jurisdictions put in place a specific control framework to guide subsidy design and deployment to minimize market distortions. In addition to the European Union[6], the Economic Community of West African States, West African Economic and Monetary Union, and the East African Community have legal frameworks that incorporate state aid or subsidies control to preserve competition. Various countries in Central Asia and Eastern Europe have also established provisions to control state aid to firms. The level of implementation of state aid control varies considerably.

The EU framework, for example, establishes the conditions under which state aid[7] can be granted, the types of aid that are eligible, and the procedures for assessing and approving state aid measures. The framework requires that the way aid is designed and awarded favors competition and trade within the internal market. Under the EU state aid framework, state aid must pursue a legitimate objective, be necessary, proportionate, and appropriate, and balance positive against negative effects. Negative effects encompass spillovers such as weakening competition or distorting internal trade. State aid must also be implemented in a transparent manner. Therefore, the rules encourage a competitive and transparent process of allocation of aid. In addition to these general rules and specific guidelines and regulations for different types of state aid measures, it also requires ex-post evaluation of selected state aid measures. There is considerable practice in the application of state aid control across 27 countries, with state aid measures for a total of EUR 228 bn subject to this framework only in 2022.

The EU framework uses important concepts that can be applied to the design of business support measures in any jurisdiction (Butts and Maes 2024):

- **Necessity and incentive effect.** The measure should result in a better outcome than the market would have delivered on its own, and the measure is necessary to trigger this effect.
- **Proportionality.** A support measure must be as small as possible to still incentivize a certain behavior. If the same change in behavior can be accomplished with less support, the measure must be adjusted.
- **Appropriateness.** A support measure must be compared with other measures that can potentially achieve the same goal. No other measure or regulatory intervention should be able to accomplish the same objective in a less distortive way.
- **Balancing test.** The positive elements of the measure are identified: its common interest objective and its incentive effect to change the behavior of the beneficiaries. Negative effects involve potential distortions of competition and trade. A measure can have both direct and indirect effects: it can directly affect the beneficiary, but it can also indirectly affect the product market and the behavior of competitors, as well as upstream and downstream markets. The balancing test involves a qualitative analysis based on quantitative and qualitative information.

BOX 16: INITIATING AN ASSESSMENT OF BUSINESS SUPPORT MEASURES (SUBSIDIES) AND MARKET EFFECTS

As a first step to gain an initial idea of whether subsidies may be having a distortive effect in an economy:

(i) Determine the amount and type of subsidies granted in the last 5-10 years, including:
   a. Sector focus
   b. Size
   c. Duration
   d. Recipients, and
   e. Information regarding the grant process (such as discretionary vs. open qualification criteria and application process).

(ii) Determine whether a subsidy control framework exists (in law, regulations or guidelines) that provides for
   a. Transparency on qualification criteria, with limited discretion for granting authorities;[8]
   b. Methodologies to assess subsidy effects (ex ante/ex post)[9] and
   c. Systematizing and publishing information on granted aid and the cost for government.[10]

A further deep dive would be required to understand specific effects of subsidies but the above information will give a good sense of whether the way subsidies have been granted in practice leave room for distortions. It is also worth noting that subsidies' level of egregiousness can vary depending on the subsidy design (such as targeted segment in the value chain, benefitted agent).

Source: Author's own elaboration

TOOLKIT ITEM 20

Three guiding principles to design and implement business support programs or industrial policies:

- *Principle 1: Appropriateness. is industrial policy the right solution?* Assess the need for industrial policy and its costs in terms of fiscal sustainability, market distortions, and incentives for firm productivity.
- *Principle 2: Contestability by design.* If a targeted intervention is justified, ensure that its design reduces unnecessary targeting, discrimination or excessive discretion, guarantee transparency, and maximize access by different types of firms to minimize the risk of negative effects and favoritism.
- *Principle 3: Informed implementation for positive market effects.* Monitor and evaluate industrial policy instruments ex post: their effectiveness and indirect effects on markets, and consider the proportionality and appropriateness of the measure before continuing it.

6.3. Government as a supplier: Reducing distortions from SOEs

Levelling the playing field through competitive neutrality

Competitive neutrality is the principle under which all enterprises should face the same set of rules and where government's involvement in the market does not give any undue advantages to a particular firm (or potential entrant).[11] While there is no universal definition of this concept, there are accepted interpretations of this principle. For instance, according to the European Union, competitive neutrality should be "broadly defined and cover all forms of direct and indirect public interventions of whatever nature, which may provide public or private undertakings with undue advantages over their actual or potential competitors, thereby distorting the competitive process."[12]

In practice, the competitive neutrality framework can be used to identify where the presence of SOEs may put other firms at a disadvantage – and it provides a set of principles to mitigate these risks. The framework sets parameters within which public and private enterprises face the same set of rules. The aim of a competitive neutrality policy is to foster a level playing field in markets with state ownership and private sector participation (actual and potential), which allows resources to flow to efficient producers, regardless of whether they are privately owned or government owned.

BOX 17: COMPETITIVE NEUTRALITY AS A WAY TO GUARANTEE SOE FINANCIAL AND FISCAL DISCIPLINE

From a macroeconomic perspective, competitive neutrality principles provide governments with tools to strengthen the financial and fiscal discipline of SOEs, to reduce SOEs' preferential access to finance, and to manage the fiscal burden and potential fiscal risks associated with SOEs. Government policies that confer special advantages or benefits on SOEs in the form of direct and indirect support or that do not impose the discipline of capital markets can result in risk that is out of proportion to a company's financial returns. In addition, SOEs may accumulate contingent liabilities through political interference, operational inefficiencies, or poor decision making that remain uncorrected by market forces. A range of fiscal risks can arise that can affect the fiscal position of government.

In many jurisdictions, one of the key rationales for continued ownership of SOEs is that they tend to provide goods or services that would not be provided by the private sector or, if they were, would be provided on different commercial terms. The delivery of these public service obligations remains a compelling reason for some governments to maintain and support SOEs. Nonetheless, the reliance on SOEs to perform public service obligations (PSOs) can create fiscal risks for the government, as PSOs may impose funding requirements that fall outside the usual budget processes. In addition, as governments are the residual risk holder of SOEs, changes in the values of equities held in SOEs could also create fiscal risks. A credible hard budget constraint hinges on the notion that, in the face of poor financial performance by an SOE, the government might refuse to provide additional financing and let the SOE fail. However, if an SOE is fundamental to the delivery of essential government services, the threat of hard budgets may be compromised and thus weakened or nonexistent. For listed companies, poor performance can be addressed through capital market discipline – that is, poor performance will lead to asset price and ownership changes, which will lead to changes in management. But for SOEs, particularly those with noncommercial obligations, the threat of management change may be less strong.

Source: World Bank Group (2014) Corporate Governance of State-Owned Enterprises: A Toolkit

The main components of a competitive neutrality framework are shown in Table 8. An analysis of the regulatory framework that applies to an SOE against benchmarks for each of these principles and their application can help identify ways to make SOE operations more efficient from a financial and fiscal point of view, while ensuring a level playing field in markets. An example of the application of this framework to the case of Ukraine is provided in Figure 31.

The components of competitive neutrality can be divided into firm-level principles and cross-cutting principles. The application of *firm-level principles* first entails the separation of commercial and non-commercial SOE activities, this then allows for the identification of the costs of each activity and mechanisms for their clear allocation across activities to ensure public funds do not finance commercial activities in the market. SOE's rates of return on commercial activities can therefore be monitored to ensure they are in line with comparable businesses over a reasonable period (if there is no requirement for SOEs to yield a commercial rate of return private sector competitors can be undercut). And finally, any compensation paid by public authorities to the SOE for the delivery of public service obligations should be transparent and limited to the necessary (non-commercial) activities in order to avoid cross-subsidization.

The cross-cutting principles are embedded in cross-cutting regulatory frameworks and sectoral policies and should apply to any operator, be it SOE or private sector firm. These include tax neutrality, regulatory neutrality, debt neutrality and the prohibition of providing direct or indirect subsidies to SOE. A framework that ensures control of state support measures to SOEs would minimize distortions to competition as it

would help reduce support for inefficient production or outdated technologies that SOEs might sometimes use and also minimize barriers to entry for potential competitors associated with, for example, subsidies to investments to specific SOEs. Similarly, the access of the SOE to public contracts and their overall treatment during public procurement should be open, transparent, and non-discriminatory.

Click for further details on:

- OECD's Competitive Neutrality Framework (available here)
- WBG's The Business of the State. Chapter 6: A practitioner's guide on when (not) to use BOSs (available here)

TOOLKIT ITEM 21 The competitive neutrality principle aims to reduce potential distortions caused by undue advantages given to SOEs.

TABLE 13: COMPETITIVE NEUTRALITY PRINCIPLES AND SOES

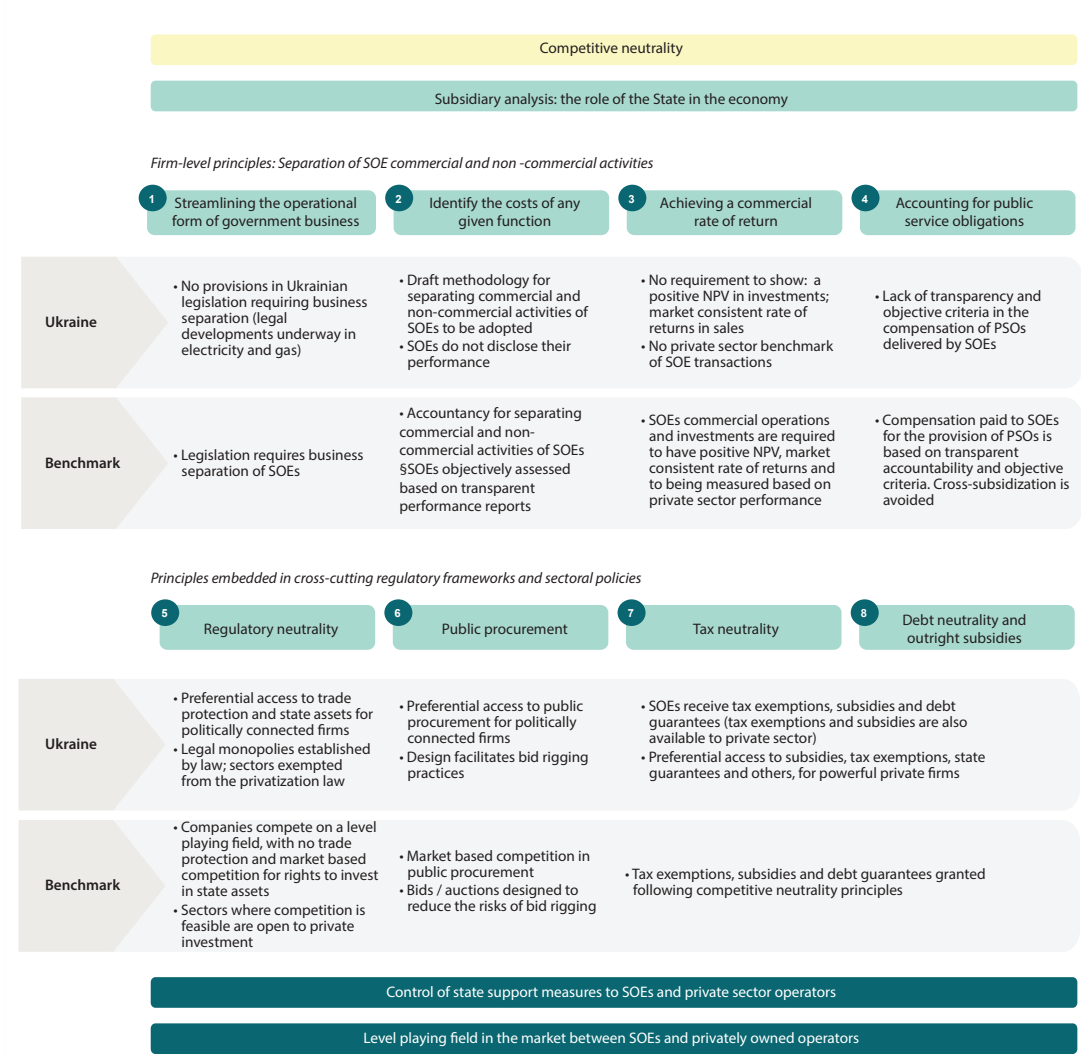
Competitive neutrality principle	Benchmark (Least distortive scenario)
	Firm-level principles
Separation of commercial and non-commercial activities	• Identify whether commercial and noncommercial activities should be structurally separated, and provide advice on vertical unbundling of accounts, functions, legal form, and/or ownership where feasible and efficient.
Cost allocation	• Determine whether there is a need for improved cost allocation mechanisms to ensure public funds do not finance commercial activities in the market. • Rigorous cost allocation methods are followed to avoid cross-subsidies between commercial and non-commercial activities, and SOE performance is objectively assessed based on financial indicators.
Achieving a commercial rate of return	• SOE commercial operations are required to earn a market-consistent rate of return of their assets and investments (positive NPV) that justify the retention of assets in the business and pay commercial dividends. • Assess whether SOEs achieve commercial rates of return in their operations. • Recommend strategies to enforce and monitor such a requirement.
Accounting for Public Service Obligations	• Assess whether compensation for the provision of public services is market based and transparent.
	Cross-cutting principles
Regulatory neutrality	• Determine the extent to which SOEs receive preferential treatment in the law, such as SOE exclusions from bankruptcy and antitrust enforcement. • Government and private sector businesses should as close as possible comply with equivalent regulations and legal obligations. In case of remaining differences, the legal requirements do not affect the ability to compete of the private sector.
Debt neutrality	• Evaluate whether SOEs have access to credit on the same terms as private operators. • Government business should be subject to similar borrowing costs and access to credit versus private peers.
Tax neutrality	• Identify any exemptions or preferential treatment of SOEs, such as reduced rates, rights of deferral. • Government business and private businesses should be treated equally or at least equivalently under the tax law such that SOEs do not receive tax exemptions or benefits that are not available under the same conditions to private competitors.

TABLE 13: COMPETITIVE NEUTRALITY PRINCIPLES AND SOES *(Contd.)*

Competitive neutrality principle	Benchmark (Least distortive scenario)
Public procurement	• Assess the public procurement framework in terms of transparency, competition, and rules that discriminate against private enterprises. • Procurement law and procedures should be applicable independently of the ownership of the provider. • Open, transparent and competitive bidding procedures should be in place to level the playing field between private companies and SOEs.
Access to state-aid	• Government subsidies and sector-specific support programs should not distort competition between public and private companies. • SOEs and private companies face similar costs of capital, labor, access conditions to inputs and infrastructure.

Source: Authors elaboration based on (OECD 2009), (OECD 2012), and iSOEF (World Bank 2019c)

FIGURE 31: COMPETITIVE NEUTRALITY GAP ANALYSIS IN UKRAINE



Source: World Bank (2018). Reducing Market Distortions for A Prosperous Ukraine: Proposals for Market Regulation, Competition and Institutions. Washington, DC: World Bank

EXAMPLE 19: BRAZIL, EUROPEAN UNION, ISRAEL AND SPAIN - IMPLEMENTING COMPETITIVE NEUTRALITY

- In Brazil, the competitive neutrality principle has been incorporated in the core of the Brazilian legal framework, including the Brazilian Constitution. The Brazilian Constitution expressly prohibits granting fiscal privileges to SOEs if such advantages are not available to the private sector as well. Therefore, the constitution can be used as the guiding principle to interpret other laws that might rest unclear with regards to the application of the competitive neutrality principle. In addition, this has been incorporated into the Brazilian Antitrust framework, while the Brazilian Constitution explicitly specifies that State Owned Enterprises shall be subject to antitrust laws just like any private company.
- In the European Union, the EU Transparency Directive provides for specific transparency requirements concerning the financial relations between public authorities and public undertakings in EU member states. The Directive also requires undertakings which enjoy exclusive or special rights, as well as undertakings which receive public service compensation for the provision of a service of general economic interest while having activities outside the service of general economic interest, to maintain separate accounts between their different activities. The objective is to prevent those undertakings from cross-subsidizing other activities with funds raised through activities reserved for them or from compensation to provide public service obligations. Public undertakings excluded from the Directive are those which do not affect trade between EU member states and those whose turnover does not exceed a specific threshold.
- In Israel, the ownership agency, the Government Companies Authority (GCA), has issued specific transparency and disclosure directives for government-owned companies. Depending on their legal form, these companies report according to internationally accepted accounting standards and are subject to the same transparency and disclosure practices as private sector companies. Some government companies may be required to provide further information concerning the company's performance in meeting its targets and objectives. Furthermore, SOE management is held accountable for any deviations from approved budgets where activities are required by law.
- In Spain, the use of public funds by public enterprises or private companies granted with special or exclusive rights, or operating services of general economic interest are subject to a four- to five-step supervisory process beginning with internal controls and ending with Parliament.

Moving towards greater private participation

There is no *one size fits all* solution to lessen the barriers to competition in the presence of SOEs, nor for moving towards greater private participation. There are various alternatives to reduce agency costs and introduce market discipline in markets with SOEs, ranging from regulatory reforms as discussed above (such as competitive neutrality) to moving towards forms of partnership with – or ownership of – the SOE which increase the role of the private sector in the running of the SOE. These include management arrangements (such as concession and management contracts), joint-ventures and PPPs, and partial or full divestiture. These options will be collectively referred to as "privatizations" for the remainder of this subsection. All these instruments can promote a more market-based dynamic if designed properly with competition principles in mind.

A key argument for privatization is that it reduces the agency costs associated with SOEs – largely by refocusing the firm away from policy implementation towards its commercial objectives. Alignment between the objectives of managers and shareholders is likely to increase for several reasons.[13] The primary reason is because company objectives should be re-focused towards profit.[14] This in turn means a range of market signals and mechanisms becomes available for monitoring the performance of the SOE's managers, including the information conveyed by stock prices, compensation schemes based on achieving commercial objectives (such as performance bonuses and stock options), which may help establish the correct sets of incentives for managers (these are usually unavailable to public managers with more complex non-commercial objectives), the threat of take-overs, and the threat of bankruptcies. For example, Cragg and Dyck (1999) relate the increased frequency of management turnover in British privatized firms to an increased sensitivity of owners to the failure by managers to reach established objectives.[15]

Privatization is not a silver bullet and there are several other factors which determine the outcomes of privatizations. Privatizations can fail at the implementation stage due to a lack of transparent criteria and mechanisms for selecting private firms. This can lead to legal battles, as well as political backlash where there are concerns that privatizations may be designed to benefit only selected private firms and

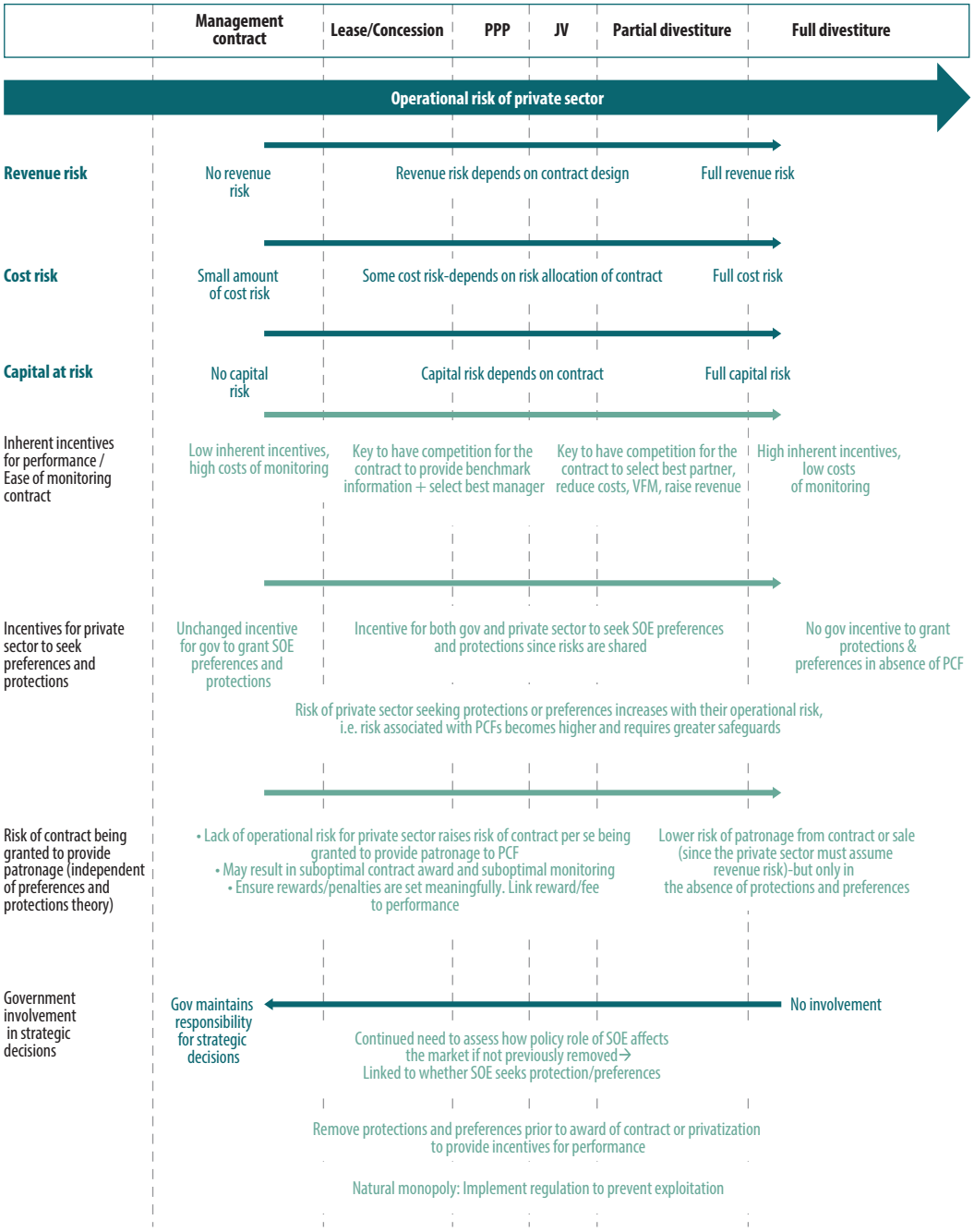
public officials in charge of their implementation. Even post-privatization, as noted by Shleifer and Vishny (1994): *"there is no magic line that separates firms from politicians once they are privatized".* Governments may remain influential as capital providers to the privatized firm and government representatives may become members of decision-making boards. They may thus still be able to influence private strategies to meet self-serving political objectives. In the case of natural monopolies, government will continue to play a regulatory role and distortions from policy objectives may still occur through this channel. For example, tariff regulation that tries to keep prices of utilities artificially low can lead to insufficient private investment and issues with availability and quality of service in the medium term. This reinforces the importance of incorporating competition principles into the implementation process, as well as ensuring that privatization is complemented with regulatory and institutional reform, and competitive neutrality principles. Some approaches are further explored below.

There are various options for privatization available to governments – including management contracts, Joint Ventures (JVs) and PPPs and divestiture. Each option is best used depending on market and political conditions and given the potential pitfalls from a market perspective. Nonetheless, competition principles are key to promote the successful use of each option.

These options differ in terms of the risks they transfer to the private sector and therefore the incentives they provide. Figure 32 summarizes how these incentives and risks change along the spectrum of privatization. For instance, management contracts pose no revenue or capital risk for private players and the amount of cost risk is relatively low. In contrast, private players take full risk in a scenario of full divestiture, while other contract designs – such as leases or concessions, PPPs, JVs and partial divestiture – allow for a range of risk taking in terms of revenue, cost and capital. Because management contracts pose no risk for firm profitability, they provide no inherent incentives for firm performance, thus increasing the governments' cost of monitoring. Full divestiture represents the opposite situation. Firms have every incentive to perform well because they assume all the risk, which minimizes the governments' cost of monitoring. In other contract designs it is essential to have competition for the contract to either provide benchmark information and select the best manager (e.g. leases or concessions and PPPs) or to select the best partner, reduce costs and raise revenue.

They also differ in the risk of the process being used for political patronage, and government's ongoing role in decision making. These factors in turn affects the ability of the privatization process to improve efficiency and address distortions to market outcomes. For example, incentives for private sector performance are higher with divestiture than with management contracts since the amount of risk transferred to the private sector is greater. This also means the ease of monitoring is greater for divestiture than management contracts. When it comes to incentives to seek preferences and protections, management contracts do not change the government SBC but the SBC should reduce as you move towards full divestiture as long as the former SOE no longer plays a policy role and as long as the acquiror of the SOE is not politically connected. Full divestiture also lowers the risk that the privatization process will be used to provide political patronage (since the risk transferred to the private sector is higher) – but, this is only in the case that protections and preferences do not continue to be granted. In all cases there is a need to continue to assess how any remaining policy role of the SOE affects markets.

FIGURE 32: INCENTIVES AND RISKS ALONG THE SPECTRUM OF PRIVATIZATION



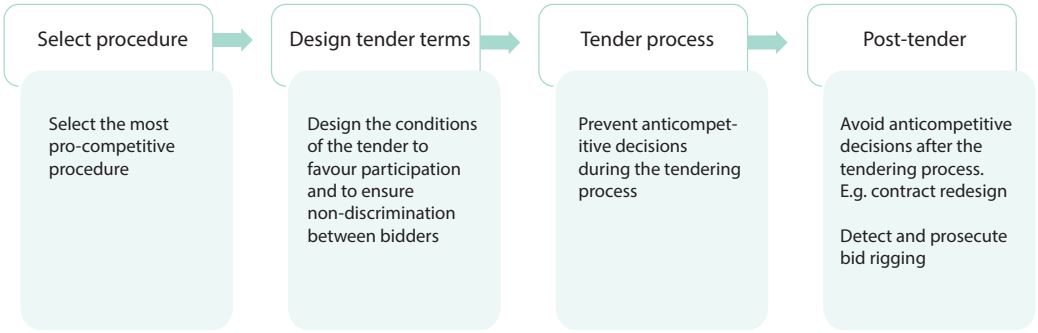
Source: Authors' own elaboration

6.4. Government as buyer: Embedding competition in public procurement

Embedding competition in public procurement needs a multi-agency and multi-layered approach implemented throughout the different stages of the public procurement process. It requires working at both a regulatory and institutional level, and with governance enforcement agencies (anti-corruption), monitoring and compliance auditors, public procurement agencies, main procuring entities, and competition authorities (where such an authority exists). Transparency should be enhanced, and auditing should be eased through automation, including using machine learning and artificial intelligence to support the detection of infringements to procurement and competition laws.

Competition can be fostered across several layers of the process (Figure 33). For example, making a single source an exception that requires justification and enhancing the transparency of tenders to increase participation is essential when selecting the procedure. Ensuring that eligibility criteria are adequate to avoid excluding capable bidders, that scoring parameters do not favor the incumbent holder of the contract, that the contract duration and size do not discourage participation, and that conditions regarding prices do not facilitate collusion are examples of critical areas at the design stage. Decisions regarding access to information on the tender, the use of sealed bidding, avoidance of pre-bidding meetings, and setting redress mechanisms will affect competition during the tender process. Even at the contract execution stage, contract modifications and rules regarding subcontracting can also affect competition. Tables A.12, A.13, A.14, and A.15 in Annex A.16 provide guidance on how to select the most pro-competitive approach along the various stages of the process.

FIGURE 33: EMBEDDING COMPETITION THROUGHOUT THE DIFFERENT STAGES OF THE PUBLIC PROCUREMENT PROCESS



Source: Authors' own elaboration

Complementary resources:
- Enforcement against bid rigging cartels (Sections 5.1 and section 7.1)
- Guidance on how to select the most pro-competitive approach for public procurement (Annex A.16)

NOTES

1 Market assessment of the onion supply chain in Maharashtra: Understanding how market characteristics and government interventions may affect vertical transmission of prices from farmgate to retail, 2017.

2 Guennette, Justin-Damien (2020) Price Controls: Good Intentions, Bad Outcomes. Policy Research Working Paper 9212. Word Bank Group.

3 This will likely not be easy since it requires some consideration of the counterfactual of how the market would have performed were it not for the industrial policy.

4 See reports available on https://www.dipres.gob.cl.

5 https://microeconomicevaluation.jrc.ec.europa.eu/evalsa

6 See Government of the Philippines, Corporate Recovery and Tax Incentives for Enterprises Act [CREATE], https://www.bir.gov.ph/images/bir_files/internal_communications_2/RMCs/2021%20RMCs/RMC%20No.%2042-2021%20RA%20No.%2011534.pdf; CREATE flyer: https://www.bir.gov.ph/images/bir_files/internal_communications_1/Advisory/2021%20posts/CREATE%20matters/Flyer_CREATE.pdf.

7 See https://www.dnp.gov.co/conpes/Paginas/default.aspx

8 Laws in the EU, some Eastern European and Central Asian countries and regional agreements in Africa (EAC, WAEMU and ECOWAS) provide for state aid control, such as see http://ec.europa.eu/competition/state_aid/overview/index_en.html.

9 Under the European Union (EU) framework, State aid is selective by definition and therefore excludes measures that apply to the economy as a whole, such as lower income tax rates for small and medium enterprises (SME).

10 See the Background note (by Darryl Biggar) for the OECD report "Competition Policy in Subsidies and State Aid" 2001, p. 33; also OECD, Recommendation of the Council on Improving the Quality of Government Regulation, OECD/LEGAL/0278.

11 For details on ex ante vs. ex post assessments, see: European Commission (2014), 'Common methodology for state aid evaluation', Commission Staff Working Document, 28 May.

12 This increases transparency and facilitates better assessment of the use and effects of subsidy schemes. For example, European Commission decisions on aid are published in the EU Official Gazette, including information about the granting authority, individual beneficiaries, aid amount, aid intensity, and expected benefits of the project.

13 OECD, Roundtable on Competition Neutrality, Issues paper by the Secretariat, 2015, p. 4.

14 Note by the European Union, Roundtable on Competition Neutrality, 2015, p. 2.

15 D'Souza et al. (2000) and Eckel et al. (1997) also find that enterprise restructuring (including changes in management and in monitoring devices) is an important determinant of post-privatization efficiency gains.

16 See for example, Schmidt, 1996; Shleifer and Vishny, 1997.

17 Estrin and Perotin, 1991.

18 Based on CNC Guide to Public Procurement.

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7. TACKLING ANTICOMPETITIVE BEHAVIOR – PILLAR II

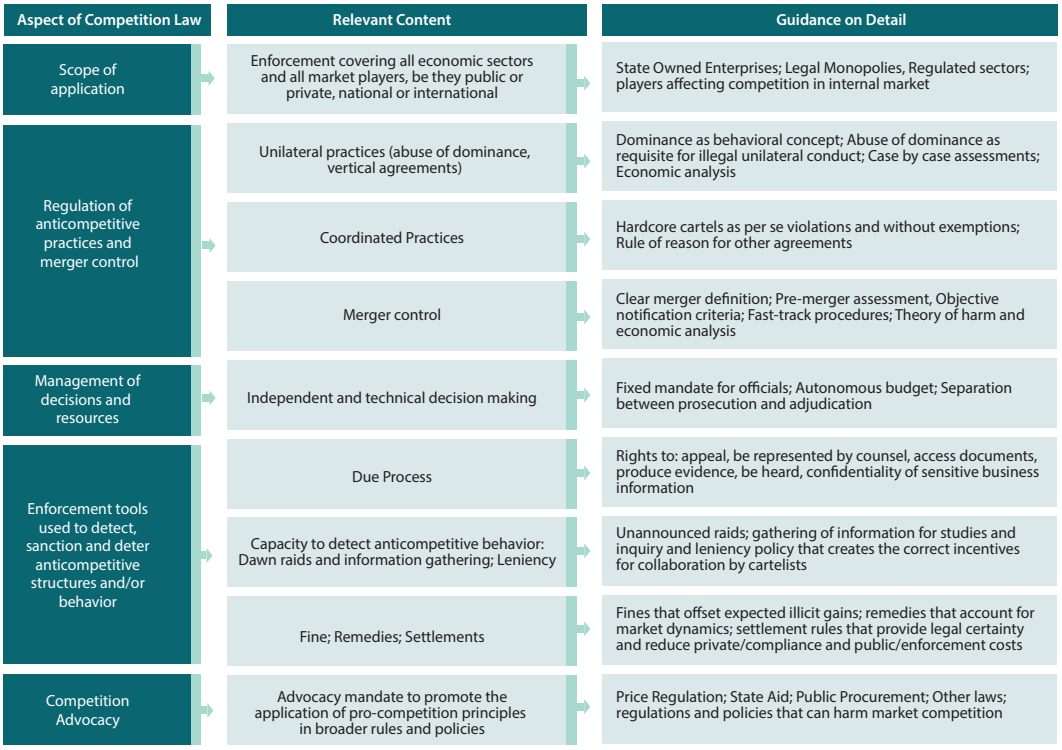
With a focus on Pillar II of the MCPAT, this chapter will give an overview of tools to tackle certain types of anticompetitive behavior and to control merger transactions that might have anticompetitive effects. It will focus on anticartel enforcement – given that cartels are considered the most harmful anticompetitive practice – but will also give an overview of tools to tackle abuse of dominance, as well as merger control.

Chapter 7. What's in this chapter…

Competition law enforcement is how governments referee markets: monitoring and addressing anticompetitive behavior of firms on the playing field. Empirical evidence supports the positive effects of effective competition enforcement on productivity growth and GDP growth. Competition laws typically enable government authorities to (i) identify, sanction, and deter business practices that restrict, distort, or prevent competition (particularly cartels and abuse of dominance); (ii) review mergers and acquisition of firms to prevent anticompetitive concentrations; and (iii) serve as advocates within the government and for the public regarding antitrust compliance and pro-competition policy design and implementation (known as competition advocacy). Complementing these mandates, competition law should include rules on which sectors and entities the law applies to, enforcement tools that help detect and sanction anticompetitive practices, tools to guarantee due process, and the institutional setup. The basic elements of a competition law framework are outlined in Figure 34.

The rationales behind the most important elements of a competition law and institutional framework are set out in Table 14. If this is a topic of particular focus in a country, an in-depth assessment can be carried out based on the dimensions outlined in this table.

FIGURE 34: BASIC ELEMENTS OF A COMPETITION LAW FRAMEWORK



Source: Authors' own elaboration

TABLE 14: UNDERSTANDING EFFECTIVE COMPETITION LAW AND POLICY

Issue and key questions	Rationale based on potential outcomes
Framework and main components: Is there a competition law in place? Does the competition legal framework include provisions that address horizontal and vertical agreements, abuse of dominance, merger control, anticompetitive regulation or competition advocacy, or actions of public officials that facilitate anticompetitive behavior?	Weak competition legal framework limits the ability to tackle anticompetitive behavior and anticompetitive regulation.
Exemptions: Are there economic sectors or enterprises exempted from the application of the competition framework (for example, SOEs, state bodies or agencies, professional associations)?	Exceptions may create or enhance privileges for economic sectors or enterprises.
Enforcement mandate: Is there a functional competition authority in place (that is, with executive regulations in place to implement the law, and endowed with staff and a budget)?	Weak enforcement capacity can limit the ability to tackle anticompetitive behavior and anticompetitive regulations.
Advocacy mandate: Does the competition authority have the mandate to issue opinions on government policies and draft legislation and regulations as part of its role in advocacy? Are the opinions binding or is there a mechanism to monitor their implementation?	Weak competition advocacy may limit the ability of the competition authority to identify and seek the removal of anticompetitive regulation, with potential for protecting certain interests.
Institutional set up and operational tools: Is the competition authority operational (in terms of funding and staff)? What is its staff and their capabilities? What is its level of independence, its operational structure, and the internal rules and procedures governing its activities? Does the competition authority have the necessary power and tools to uncover illegal practices (for example, case prioritization, adequate fines, leniency program, inspection powers)? Does it have the capacity and mechanisms to coordinate with sector regulators and other relevant agencies?	Weak enforcement capacity and institutional capacity may limit the efficiency and independence with which to tackle anticompetitive behavior of private and public operators.

Source: Authors' own elaboration

7.1. Anticartel enforcement

There is a large disparity in efforts to combat cartels across developing countries. Efforts to detect and deter cartels have accelerated rapidly in some countries but remain limited or nonexistent in others. For example, in LAC, the number of cartels detected in LAC increased by a factor of five between the 1980-2000 and 2000-2020 periods. However, that was concentrated in Brazil, Chile, Colombia, Mexico, and Peru, which were responsible for 82 percent of cartel detection. As of 2021, one-third of LAC countries do not even legally prohibit collusive agreements, and only one-third have ever sanctioned a cartel. In Africa, recent surveys suggest that almost all countries with competition law (42 countries) have provisions outlawing cartels, but few of these countries have implemented these provisions (World Bank Group and Africa Competition Forum 2016). In countries that lack a domestic competition law, competitors can agree to fix prices, bar smaller competitors from accessing certain markets, or inhibit the entry of high-productivity competitors with no legal recourse for affected firms, consumers, or entrepreneurs. Even in countries with a domestic competition law, the institutions tasked with identifying and addressing cartelization often have limited capacity.

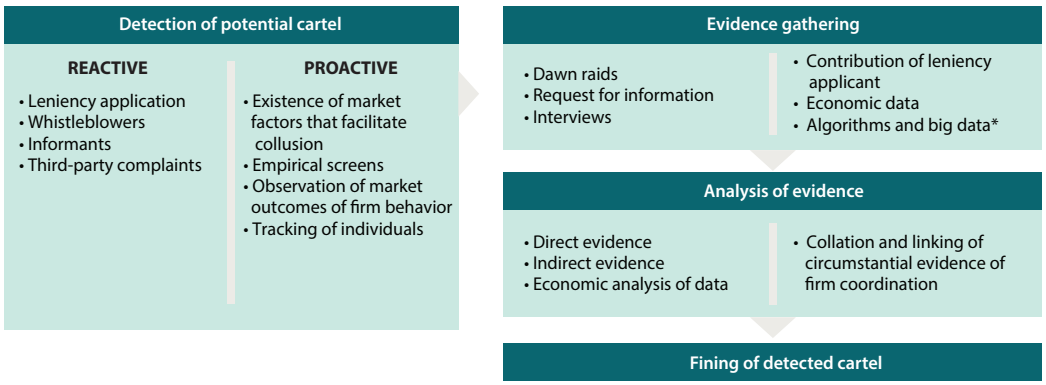
In some countries, price fixing is facilitated by public bodies themselves. For example, in Honduras in 2017, the Minister for Agriculture endorsed an agreement for firms to fix prices in rice markets. In Senegal, the government acted as a secretariat for an industry body that set prices in the groundnut sector. In Argentina, price agreements between firms and the national government have been common in milk and dairy products and were also a prerequisite for receiving state support. In 2007, the government published a resolution that individuals and firms selling dairy products had to provide evidence of buying raw milk at administratively determined prices. Moreover, this regulation created a program that granted state support to producers that charged prices consistent with those "agreed upon by milk producers and the National Government." [2]

While governments will never completely eliminate the existence of cartels, they can increase the likelihood of detection, destabilize agreements, and thus deter their formation. As previously mentioned, firms will collude when they believe that the increased profit from collusion outweighs the potential costs based on the probability of detection and the sanctions it would entail. Through effective anticartel enforcement, competition authorities can heighten *the risk* of detection and can raise the cost of detection through more stringent penalties. This reduces the anticipated benefit of cartelization and deters firms from engaging in cartels.

Enforcement and compliance tools directly affect the incidence of cartels. For example, enhanced investigative tools – including IT forensics and other advanced solutions – can raise the likelihood of detection and punishment. More severe penalties can offset the anticipated profits from collusion. Leniency programs increase incentives for cartel members to defect from the cartel (to receive more lenient treatment/fines from authorities) and make cartels less stable. On the other hand, if firms expect that their anticompetitive agreement will not be prosecuted, they will have greater incentives to collude.

Governments must take steps to put in place the building blocks of an anticartel enforcement regime to act as a deterrent. The key tools used in a cartel investigation are included in Figure 35 from tools to detect cartels to tools to gather and analyze evidence. In addition to anticartel enforcement, public bodies can review their interventions to ensure they are not intentionally or unintentionally facilitating cartelistic agreements.

FIGURE 35: KEY ELEMENTS OF CARTEL INVESTIGATIONS



Source: Licetti et al 2021

Strengthening anticartel enforcement and deterring cartel formation

1. *Adopt an adequate legal framework*

A legal framework for competition that can be adequately enforced is a necessary first step toward effective anticartel enforcement. Governments should establish cartelization as a per se violation of the law and prohibit the granting of legal exemptions. Other concerted practices can be treated on a rule-of-reason basis.

2. *Build institutional capacity to conduct investigations into cartel agreements and launch proactive investigations*

To prosecute cartels, competition authorities must usually uncover direct evidence of an agreement via emails, physical files, or recordings. When competition authorities rely solely on indirect evidence to support a hypothesis or decision, their actions are more likely to be annulled by the judiciary. Table 15 summarizes different types of evidence and their role in supporting cases against cartel members. Surprise inspections at the premises of the alleged cartel member, so-called 'dawn raids', can help competition authorities gather sufficient evidence to successfully prosecute and fine cartel members. In these unannounced visits, investigative teams often find crucial pieces of "hard" evidence of cartelization (such as physical documents, emails). Around the world, competition authorities are also increasingly investing in information technologies (IT) forensics, applying screening tools to digital platforms and public procurement data, and using advanced technologies to identify new forms of collusion (such as algorithmic collusion). For example, Brazil's competition authority has developed a tool to gather digital evidence on cartels and an algorithm to identify similar features in digital documents, reducing the amount of data analyzed with forensic software.

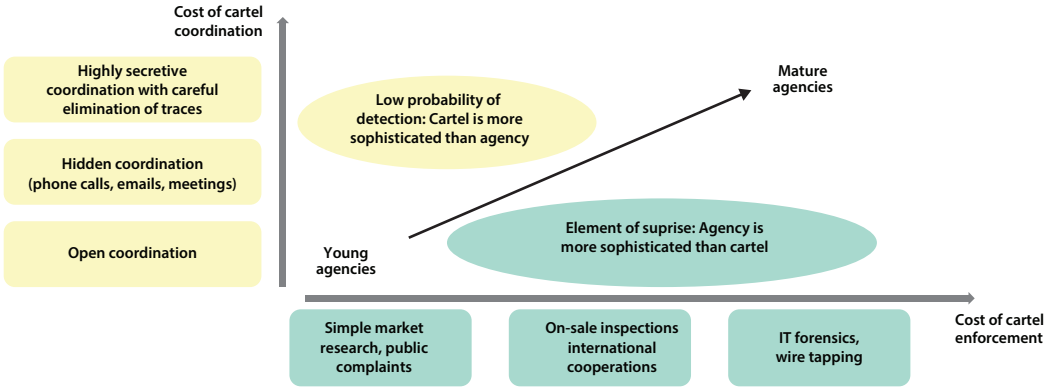
TABLE 15: TYPES OF EVIDENCE IN CARTEL CASES

Type of evidence	Examples	Relation to the evidentiary threshold of proving a violation of anti-cartel laws
Direct evidence	Copies of email correspondence that reflects an agreement	Usually sufficient to prove the existence of a cartel infringement (especially under 'per se' rule)
Indirect/ circumstantial evidence (communications)	Indirect/ circumstantial evidence (communications)	Can support direct evidence Requires ruling out any alternative and reasonable explanations
Indirect/ circumstantial evidence (economic	Structural indicators (concentration, homogeneity) Behavioral indicators (parallel pricing)	Can support direct evidence Is usually not considered sufficient to prove the existence of a cartel (even if alternative explanations are ruled out) Typically requires at least a 'plus-factor' (circumstantial evidence of communication)

Source: Authors' own elaboration

However, the development of investigative tools should be proportionate to the competition authority's resources and capabilities and the relative sophistication of cartel activity in the country. Figure 36 shows how the relationship between the sophistication of cartels in a country and the sophistication of anticartel enforcement should be proportional. Developing and deploying investigative tools is costly and applying new tools without adequate procedural fairness and confidentiality standards can weaken the business and investment climate. Future investigations may be placed at risk when a dawn raid causes undue harm to companies or individual employees. Procedural guidelines and checklists can help ensure the consistent, professional, and effective implementation of dawn raids. Screening tools can be useful to test a hypothesis on whether, when, and amongst whom a cartel may have occurred. However, the success of screens (especially structural screens) is mixed (Abrantes-Metz and Sokol 2012). Well-targeted behavioral and price-variance screens have been relatively more successful, particularly for auctions and public procurements. Even so, such (indirect) economic evidence is still almost always insufficient to prove an unlawful conspiracy.

FIGURE 36: RELATIONSHIP BETWEEN THE SOPHISTICATION OF CARTELS AND CARTEL ENFORCEMENT



Source: Authors' own elaboration

3. Create programs that destabilize cartels

Leniency agreements or whistleblower protections encourage cartel members or third parties to cooperate with the authorities. Leniency programs reinforce the ability of the competition authorities to deter and detect cartels by: (i) weakening incentives to form or remain within cartels, (ii) increasing the likelihood of cartel detection while making enforcement more cost-effective, (iii) allowing the prosecuting body to collect hard evidence on multiple cartel participants, and (iv) providing essential information on cartel activity and enhancing the competition authority's ability to detect cartels.

In countries with nascent competition enforcement, compliance programs for business associations can be a first step to stopping unlawful behavior while raising awareness. These programs can target sectors with concerns about potential anticompetitive agreements among competitors and give associations and their members the chance to update their rules and practices to comply with the competition framework. For these forbearance programs to be successful, there should be a credible threat that if the association and its members do not comply with the law, an investigation will follow. This approach has been successfully implemented in Kenya in the financial and agriculture sectors.[5]

For mature institutions with the capacity to implement leniency programs, success will depend on cartels facing a credible threat of detection and consistent prosecution. In developing economies, the risk of detection is often small, the costs of being detected are limited to modest since fines are relatively low, and the credibility of leniency programs is threatened by the unpredictable use of official discretion. In these cases, competition authorities need to increase both the risk of detection and the cost of prosecution while ensuring that leniency applicants are protected to the greatest extent possible. This could be done by extending the leniency benefit to subsequent cooperators on a diminishing basis and setting evidence thresholds comparatively low for first applicants. Leniency programs should also allow verbal applications,

with special measures to ensure confidentiality. Competition authorities should coordinate with prosecutors in cases where cartel members may be subject to criminal sanctions while working to steadily increase the predictability of both criminal and administrative penalties.

4. *Set appropriate fines.*

Administrative fines tend to be too small to deter cartels. A back-of-the-envelope simulation based on the WBG's Anticartel Enforcement Database[6] suggests that fines represented only 3 percent of the expected benefits that cartel members gained by colluding. Considering the low probability of a cartel being detected, firms face little risk that cartel activity will result in a financial loss. Fines should also be fixed as a percentage of turnover rather than fixed as nominal amounts since this makes them a closer proxy for the harm caused by collusion.

Underlying these steps, establishing strong, independent, and effective institutions is key. Increasing the independence of the agencies that initiate cartel investigations (the prosecutorial units) and those that decide the cases (the adjudicatory units) could improve their effectiveness while reinforcing public confidence in the legitimacy of their decisions. Scope for political interference or officials' unfettered discretion can give politically connected or economically important firms disproportionate incentives to collude. At the same time, setting up efficient procedures and team structures can help make the best use of limited resources. The institutional setup of competition authorities is further explored in Chapter 8.

In addition, authorities should strengthen merger control as a complementary tool to anticartel enforcement. In some cases, firms that cannot form or sustain a cartel agreement decide to merge and, as a consolidated entity, can coordinate their actions in a manner that would be prohibited for multiple separate firms. For example, in 2016, the Peruvian Competition Authority fined five pharmacy chains involved in a price-fixing agreement, and in 2018, one of the former cartel members acquired two of the members. At the time, Peru's merger-control regime was applied only to the electricity sector, and thus, the acquisition was not evaluated or cleared by the authorities. In addition, adopting efficient merger review procedures can help authorities ensure they focus sufficient resources on the most harmful types of anticompetitive behavior, including cartels.

TOOLKIT ITEM 22 Anticartel enforcement can become more effective if legal frameworks and institutions are reformed to enhance the likelihood of uncovering a cartel and the costs of being detected. Table 16 presents examples of opportunities for reform for core anti-cartel enforcement tools.

TABLE 16: PRIORITY POLICY STEPS FOR EFFECTIVE ANTICARTEL ENFORCEMENT

Core anti-cartel enforcement tools	Examples of (first and second best) opportunities for reform
Legal framework	• Limit exemptions from pro-competition laws. • Establish hard-core cartelization as a per se violation of the law.
Investigative tools	• Develop the legal and institutional capability to conduct surprise inspections. • Adopt guidelines and checklists to ensure prosecutorial predictability, due process, and confidentiality. • Develop capacities to process digital evidence (IT forensics) and employ alternative screening tools to detect novel forms of collusion using digital platforms.
Leniency programs	• Grant greater leniency benefits to the first applicant and lesser benefits to subsequent applicants. • Allow for oral applications and ensure confidentiality. • Establishing effective cooperation with public prosecutors if cartel members are subject to criminal sanctions. • Increase predictability and legal certainty through regulatory development of leniency provisions.
Adequate fines	• Set fine limits as a percentage of turnover rather than an absolute limit. • Ensure fines are set in proportion to the damages caused and at a level that acts as a disincentive from collusion.

TABLE 16: PRIORITY POLICY STEPS FOR EFFECTIVE ANTICARTEL ENFORCEMENT *(Contd.)*

Core anti-cartel enforcement tools	Examples of (first and second best) opportunities for reform
Institutional foundations	• Strengthen the political independence of competition authorities by (i) appointing adjudicating officials through a merit-based appointment process; (ii) adopting two-stage appointment processes with independent bodies, (iii) creating fixed mandates, (iv) appointing a collegiate body, and (v) establishing conflict-of-interest rules and mandatory cooling-off periods. • Strengthen the financial independence of competition authorities by allowing them to request budget allocations directly from the legislature or to self-finance by levying fees on merger notifications. The latter is the second-best option, given concerns of distorting incentives towards charging higher fees for merger applications. The recommendation assumes agencies will balance addressing financial needs and properly fulfilling their mandate. • Strengthen the procedural independence of competition authorities by ensuring that the adjudicating unit does not determine the prosecutorial unit's budget or team composition, separating the two units' technical teams, and limiting the influence of executive officials outside the authority.
Other antitrust tools (such as merger control) to ensure that authorities can dedicate sufficient resources to anti-cartel enforcement	• Establish appropriate and clear definition of which transactions are subject to review; for mandatory notification regimes: establish proper notification thresholds. • Adopt efficient M&A review procedures and provide guidelines for firms. • Ensure that available human resources are adequate to manage the expected volume of M&A notifications and focus M&A review capacity on sectors susceptible to anticompetitive behavior.

Source: Authors' own elaboration.

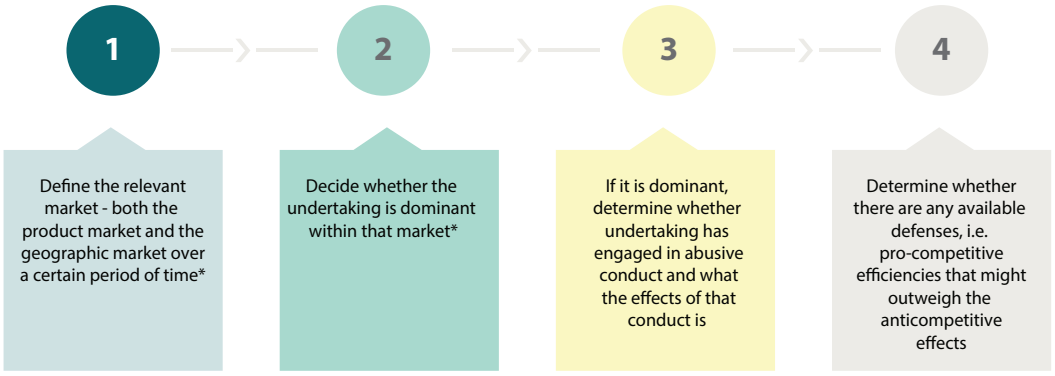
The optimal combination of enforcement/compliance measures with market reforms to address facilitating factors and risks of cartelization will depend on the market involved and the country's context. Developing countries vary widely in terms of their market institutions and relative degree of government participation in the economy. In some countries, establishing a competition law and functioning competition authority will be necessary for an effective anticartel policy. Countries with more sophisticated institutional capabilities may adopt advanced investigative techniques (such as IT forensics). Anticartel enforcement may be less effective than policy reforms designed to foster more competitive markets in economies that exhibit many facilitating factors for cartelization, such as price controls, low levels of trade openness, small domestic markets, and high regulatory entry barriers. Given these country-level differences, a taxonomy of country characteristics can identify priority areas for pro-competition policy (see Licetti et al 2021). For example:

- Countries with mature anticartel tools (Type I and Type III) can scale up successful enforcement activities and expand pro-competition advocacy. These countries can further consolidate the institutional independence of their competition authorities and increase their resources to protect the gains achieved to date and scale up future investigations.
- Because many countries with strong anticartel institutions still feature restrictive regulations in specific markets (Type I), in Type I countries, sophisticated pro-competition legal and institutional frameworks need to be complemented by stronger advocacy work and pro-competitive regulatory reform. For example, prices and service standards for regulated professions in Honduras are often determined by trade associations rather than by the market. Even without regulating prices directly, these associations can create barriers to entry that facilitate cartelization. The Honduran government has responded by embracing a comprehensive outreach strategy to inform associations of what constitutes an anticompetitive agreement.
- Type II countries with less developed antitrust institutions and numerous facilitating factors would benefit from starting by leveraging pro-competition regulation to attract private investment and increasing market dynamism to weaken the stability and coordination that cartels require.
- Type IV countries with few facilitating factors but lacking an antitrust framework are in a good position to focus on building anticartel enforcement capacity.

7.2. Enforcement against abuse of dominance

Disciplining incumbents with significant market power means effectively enforcing abuse of dominance provisions. Abuse of dominance requires (i) proving the existence of dominance and (ii) that the firm engaged in abusive behavior. Unlike cartels, abuse of dominance cases follow an effects-based approach. This requires a detailed assessment of each case focused on outlining a theory of harm. All authorities should generally use an analytical framework based on economic principles. The steps in an abuse of dominance case are outlined in Figure 37.

FIGURE 37: STEPS IN THE ANALYSIS OF ABUSE OF DOMINANCE



Source: Authors' own elaboration
*Note: * In the case of digital markets, market definition and analysis of dominance presents certain variations, see Annex A.2.*

Dominance should not be defined according to any single market share formula – instead, an assessment of dominance should thoroughly consider constraints from actual competitors, potential competitors, barriers to entry, and countervailing buyer power. Proving dominance is typically done by defining a relevant product and geographic market and proving the existence of power over price or rivals through traditional criteria, such as market share, entry barriers, demand elasticity, strength of rivals, market dynamism, and so forth. Most jurisdictions similarly define dominance in functional economic terms concerning these sorts of criteria. In some jurisdictions, the dominance definition also applies to several companies that jointly possess market power, which is known as "collective dominance." Although authorities should not use only market shares to make a finding of dominance, it may be useful – to both authorities and firms – to use market share-based thresholds as a safe harbor (i.e., to determine a level under which an authority will generally not find dominance). Authorities should also try to make their dominance assessments transparent and subject to the protection of confidential information.

Complementary resources:
- Relevant product and geographic market (Box 1)
- Antitrust and digital platforms: an analysis of global patterns and approaches by competition authorities (Available here)

The next step is understanding whether the firm has engaged in abusive conduct. Two broad types of conduct have traditionally been seen as abusive by competition laws:

1. **Exploitative conduct:** practices that result in a *direct loss* of consumer welfare where the dominant firm takes advantage of its market power to extract rents from customers that could not have been obtained by a non-dominant firm. Examples include excessively high prices to consumers, paying low prices to suppliers, excessive data collection on consumers or suppliers, and discrimination between different consumers or suppliers.

   The challenge with such cases is that it is very difficult for an authority to determine the right market price. Efforts to do so can amount to de facto price regulation which may exacerbate market issues and dampen incentives for firms to invest in expansion if they fear regulation of their prices if they become too big. Therefore, typically, it is considered a good approach for authorities to focus on exclusionary conduct by dominant firms rather than exploitative conduct.

2. **Exclusionary conduct:** Practices directed against rivals that *indirectly* cause a loss to consumer welfare by limiting the ability of the dominant firm's (actual or potential) rivals to compete (such as predatory pricing). This adverse effect on rivals is termed "foreclosure" or "anticompetitive foreclosure." Examples of this include:
   - **Exclusive dealing** where a dominant firm imposes restrictions on another firm's freedom to do business with others.
   - **Refusal to deal** where a dominant firm refuses to do business with a specific customer or supplier that it competes with in downstream or upstream markets.
   - **Predatory pricing** when the dominant firm prices a product below the cost of producing it to put rivals out of business or deter potential rivals from entering the market.
   - **Rebates** where a dominant firm offers loyalty or fidelity price rebates to customers (based on quantities) instead of rebates due to cost savings. Due to differences in scale, it would not be possible for smaller rivals to replicate these prices.
   - **Tying and bundling** where the sale of one product is conditional on a buyer purchasing another product.
   - **Margin squeeze** when a vertically integrated dominant firm sells an upstream input to firms that compete in a downstream market alongside the dominant firm in providing a downstream product. Here, the dominant firm lowers retail prices and/or increases the upstream wholesale prices it charges to its downstream rivals so that retail margins are 'squeezed' downstream.

It is important to remember a few key points when assessing these behaviors:

- These behaviors are only considered anticompetitive when the firm implementing them is dominant because the market does not offer enough alternatives for consumers.
- Since some of these behaviors can enhance market efficiency and benefit consumers, a thorough economic analysis of the anticompetitive effects and any efficiencies is required. Thus, proving abuse in these cases should be based on effects and not simply on the existence of a certain behavior (i.e., the assessment should be effects-based rather than based on the form of behavior).
- Intent should not be necessary to prove the existence of an abuse. In other words, a dominant firm need not have intended to exclude its rivals for its behavior to be found to be exclusionary under the law.

Digital platforms have a greater tendency to tip towards dominance due to market characteristics. The prevalence of network effects, along with strong economies of scale and scope arising from high fixed costs/low variable cost structures, as well as the reliance on data and data-intensive technologies, to gain a competitive advantage. Box 18 provides examples of commonly observed cases, as per the World Banks's Global Digital Antitrust Database.

BOX 18: EXAMPLES OF ABUSE OF DOMINANCE IN DIGITAL MARKETS

- Dominance in the search markets can manifest in abuse in the shopping market.
- A platform refuses to provide access to information that would allow a third party to interoperate with it.
- A platform may rank its own products higher than others when returning a response to a consumer's search.
- A supplier of operating systems (OS) obliges device manufacturers to install the supplier's suite of apps as a condition for licensing the OS.
- Ride-hailing apps are accused of predatory pricing to drive taxis out of the market.

Source: Nyman and Barajas 2021

Setting appropriate remedies and fines

Remedies aim to restore competition or prevent anticompetitive conduct, whereas fines punish it to deter the behavior in the future. In some jurisdictions, fines are also used to force firms that have abused their dominance to compensate victims. Both fines and remedies can be important actions following a finding of abuse of dominance – as long as they are well-designed. The level of fine imposed should consider the gravity of the abuse, the length of time the abuse was taking place, the effect of the infringement, the size and profitability of the dominant firm, profits earned from unlawful conduct, cooperation by the dominant firm, whether the abuse was a repeat infringement.

Designing appropriate and effective remedies in abuse of dominance cases is not an easy task. First, it requires determining which objectives the authority wishes to pursue (restoring competition, preventing the behavior, deterring future behavior, compensating victims). Second, it can be difficult to design measures to meet the objectives once this is determined. For example, it can be difficult to determine ex-ante the effect of behavioral remedies, and it may be impractical or impossible to monitor compliance with them. There is also a lack of evidence on the effectiveness of remedies, even in high-income economies. This is partly because abuse of dominance cases are relatively rare compared to mergers and cartel cases.

There are two main types of remedies: structural remedies and behavioral remedies.

- **Structural remedies** require firms to cut links to assets they hold (such as through functional separations or divestitures). Their advantage is that they may be able to rapidly address market power rapidly while potentially creating new competitors. Because they involve one-off actions, they may also require less monitoring by courts and authorities than behavioral remedies. On the other hand, some structural remedies can be very disruptive and may create inefficiencies. Determining how assets and businesses should be divided can also be difficult when some assets are very intertwined.
- **Behavioral remedies** obligate a company to do something or stop doing something. At the most basic level, authorities typically issue a "cease" order to prohibit the conduct from continuing. Authorities might also ask the firm to take certain actions to boost competition. The duration of these actions may be time-bound due to market dynamism and/or informed by constant review of the market conditions. Behavioral remedies often do not address concentration and market power directly, so their efficacy is unclear. They also tend to require ongoing monitoring by authorities to ensure compliance.

Typically, behavioral remedies are preferred over structural ones as they are considered less interventionist and lower risk. Some jurisdictions allow structural remedies only when there is no equally effective behavioral remedy or when such a remedy would be more burdensome to comply with than the structural remedy. However, based on economic analysis and evidence, every remedy must be designed case-by-case. Competition authorities should, therefore, ensure they have sufficient resources and capacity for this.

7.3. Merger control

Merger control is a policy tool that aims to prevent mergers with a high probability of generating a significant harmful impact on the level of market competition – or to mitigate the harm from them if they are allowed. It identifies situations in which a change in market structure will likely affect market outcomes and harm consumers. It should be based on a clear and evidenced analysis of the merger's likely effects – both procompetitive and anticompetitive. It should not be implemented intrusively by defining firm sizes or market structures that would be prohibited (for example, the number of firms in the market) without considering the effects. Entry, growth, and exit of business are natural in a competitive business environment and could be motivated by industry changes, business strategy, achievement of synergies and reduction of redundancy, achievement of scale economies, rapid expansion to new markets, vertical integrations, or even tax and accounting reasons. Therefore, merger regulations should not obstruct these natural processes unless they are likely to have harmful effects. It should allow for beneficial changes in market structure to occur.

When an investigation reveals that a merger will likely result in substantial harm to competition, the authority can either prohibit it or allow it to proceed with certain conditions. Imposing conditions allows for efficiencies and benefits from the merger while taking measures to maintain or restore competition that is otherwise lost due to the merger. These remedies can either be behavioral (such as the firm guaranteeing rivals access to key technology or infrastructure that it controls) or structural (such as requiring the sale of certain assets or rights). Authorities have traditionally preferred structural remedies given their immediate market impact and the fact that they require continuous monitoring. In any case, competition authorities must ensure that remedies are necessary, clear, enforceable, effective, sufficient in scope, and capable of being effectively implemented quickly.

In general, to allow the most efficient firms to thrive, it is best practice not to use merger control to pursue other public policy objectives. Some countries' legal framework includes the possibility of pondering public interest concerns beyond competition in merger review procedures. For instance, employment objectives, national security, or support for domestic champions (see Example 20).

EXAMPLE 20: MOROCCO – GENERAL INTEREST CONCERNS IN MERGER REVIEW PROCEDURES

In the Kingdom of Morocco, Law No. 104-12 on freedom of prices and competition establishes that the Department of General Affairs and Governance of the Ministry of Economy, Finance and Administrative Reform (the Ministry) may raise the matter of "general interest" and decide on a merger that has been notified to the Competition Council under Article 18 of Law 104-12.

"General interest" means actions directed to protecting and benefiting the Moroccan population, which relate to the following three areas: industrial development, international competitiveness of the firms in question, and the creation or maintenance of employment.

Once a review is commenced, the Ministry will conduct a two-step assessment. In the first review stage, the Ministry will apply an initial screening to eliminate consideration of mergers that are not likely to raise substantial and merger-specific general interest concerns. Only if there are likely substantial merger-specific general interest concerns will the Ministry proceed to the second stage of review. In the second review stage, the Ministry will conduct a full evaluation of the general interest concerns, including assessing the appropriateness of intervention, balancing likely positive and negative effects of the merger, requesting additional information from the parties, and, if warranted, determining an appropriate intervention.

Source: Authors' own elaboration based on Law No. 104-12 on freedom of prices and competition

Every country needs to get the merger control policy right, as it has important implications for the evolution of competition, firm investment, and the cost of doing business. While merger control is necessary for protecting the competitive process, it does add to the cost of doing business for firms. They may need to notify their merger transaction authorities for a review that may ultimately prohibit their transaction or impose conditions on that transaction. Overly burdensome information requirements, a lengthy review process, and an unclear and broad scope of merger review would increase administrative costs, economic costs of delaying the completion of the transaction, and business risks. Merger control also has a cost on the authority. It will need to review a wide range of mergers and respond within a specific timeframe, which requires significant resources. Thus, if not appropriately designed, merger reviews can displace investigations on actual anticompetitive behavior reducing the effectiveness of the whole competition framework. Merger review should, therefore, be designed so that the costs for government and businesses are proportionate to the risks.

The key elements of a sound merger control framework are outlined in Table 17. Defining which transactions will be evaluated is one of the primary elements that can help ensure that the framework will enable the review of mergers with a risk of anticompetitive outcomes while avoiding unnecessary costs for firms and managing the authority's resources. The parameters for determining which mergers firms should notify authorities will be discussed below. Other important elements include establishing procedures such as time limits for review and creating different review phases to reflect the complexity of different mergers (simple mergers can follow simpler procedures), laying out a clear economic framework for analyzing the effects of a merger, and determining remedies (if any) and addressing other institutional issues, such as ensuring sufficient budget and human resource for merger review.

TOOLKIT ITEM 23 Merger control can become more effective and less burdensome to the private sector if it targets transactions more likely to affect competition. Table 17 presents the elements for a sound merger control framework.

TABLE 17: ELEMENTS FOR A SOUND MERGER CONTROL FRAMEWORK

Components	Components
1. Defining transactions that will be evaluated	• Voluntary or mandatory, ex-ante or ex-post notification. • Definition of economic concentration: definition of control, change in control, types of transactions. • Thresholds for merger notification: variables, values, and calculation method.
2. Establishing formal procedures for merger review	• Timeframe: time limits, staggered process (different phases for less and more complex cases). • Required documentation and confidential treatment of information. • Required payments: calculation of merger filing fees. • Due process: transparency, consistency, accountability.
3. Setting the economic framework for analysis	• Criteria for evaluating potential anticompetitive effects: unilateral and coordinated effects. • Treatment of efficiencies, pass through to consumers, and compensation of anticompetitive effects. • Criteria to set remedies or conditions that can remove anticompetitive concerns.
4. Addressing other institutional constraints	• Availability and management of resources to conduct merger review. • Allowing for settlements to determine merger conditions to restore/preserve competition. • Optimization of the organization set up for effective and independent enforcement (See Institutional design of competition enforcement institutions for further details).

Source: Authors' own elaboration.

Defining which mergers will be notified and reviewed

Most countries adopt a mandatory pre-merger notification regime – where mergers that meet certain criteria *must* be notified before the merger is consummated. Regimes where merger notification is voluntary are less common globally, and where they are utilized, a sophisticated intelligence system is vital. Globally, only 8 out of 134 jurisdictions employ voluntary regimes (World Bank Group 2019). Although some regimes, such as the UK, Australia, and Chile, do have voluntary notification systems, these agencies typically have sophisticated market intelligence tools to detect and thereafter "call in" mergers where they are concerned such transactions may raise competition issues.

Voluntary merger regimes provide less legal certainty for businesses and agencies compared to mandatory pre-merger notification. From the perspective of businesses, a voluntary regime provides less legal certainty since there is always a risk that the competition authority may call the transaction even if the parties have undertaken a reasonable self-assessment. For the authority, the benefit of a voluntary regime is that it can focus on those cases that are likely to be harmful to competition rather than rubber stamping every merger that hits a prescribed notification threshold. However, the downside is the significant risk that potentially harmful mergers are missed.

Thresholds are used to determine which mergers should be notified to and reviewed by the authority. Setting appropriate thresholds for merger notification is an efficient way of focusing on transactions that may significantly impede competition. It ensures that resources expended by companies and the competition agency in the notification and review of transactions are limited to those mergers that would have a material anticompetitive effect on the market. The thresholds should be clear, accessible, and based on objectively quantifiable criteria to let firms easily determine whether a transaction is notifiable. Regulations should also provide for the regular review of the size or value of thresholds considering changing market conditions

or the reviewing authorities' capacities or priorities. Typically, thresholds would be based on the turnover or assets of the merging firms (although this raises some issues in digital markets, which are discussed further in Box 20). It is not considered good practice to base thresholds on market share since this would require a complex (and potentially subjective) assessment of the relevant market by the firm. Globally, only 7 percent of jurisdictions have thresholds based solely on market shares. Around 25 percent of jurisdictions have thresholds that include market shares alongside other criteria. Box 19 provides a review of merger thresholds in Africa as an example.

Regarding geographical scope, the thresholds should have a nexus with activities within the jurisdiction of the reviewing competition agency. Moreover, authorities should only review those mergers where the activities of the firms involved in the transaction have an appropriate nexus with their jurisdiction. Therefore, the focus should be only on transactions likely to have a significant direct and immediate economic connection within the reviewing jurisdiction, i.e., if each firm has significant activities (sales or assets) within the jurisdiction.

Identifying anticompetitive mergers in digital markets is more challenging than in traditional markets. These mergers are less likely to meet the turnover or asset thresholds typically established in competition legal frameworks that signify when a merger must be notified to a competition authority. This is because digital firms, by their nature, are less likely to hold tangible assets and may not generate significant revenues, especially in their startup phases. Box 20 delves deeper into this issue. As per the Global Digital Antitrust Database, captured digital mergers were prohibited in seven percent of cases and approved with conditions in 30 percent of cases. The remainder were approved unconditionally. This is similar to cases reviewed by a group of authorities globally in 2017/18 for mergers across all sectors (including beyond digital), although the proportion of mergers blocked is slightly lower across all sectors (Nyman and Barajas 2021).

BOX 19: MERGER REVIEW THRESHOLDS IN AFRICA

A recent survey of competition authorities in Africa found that they could improve efficiency with more appropriate objective notification thresholds (World Bank Group and Africa Competition Forum 2022). All reporting authorities conducted merger control; per best practice, 85 percent operate a mandatory pre-merger notification regime. However, only 50 percent of the authorities set objective notification criteria (based on assets or turnover), while 17 percent do not set a threshold at all.

From the surveyed authorities:

50% SUBJECTIVE THRESHOLD CRITERIA

33% USE MARKET SHARE THRESHOLDS

17% DO NOT SELL THRESHOLDS

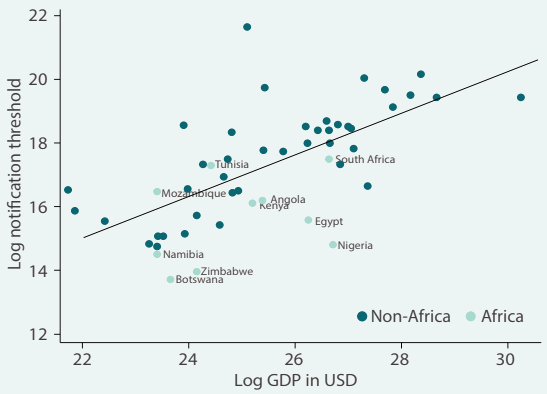
18 JURISDICTIONS (CONGO, MOROCCO, TUNISIA NOT AVAILABLE)

In Africa, combined local merger thresholds (controlling for GDP) are six times lower than global comparators (Figure 38). In this context, the lack of appropriate notification rules can undermine the authorities' capacity to balance their resources among different functions, such as fighting cartels or promoting advocacy.

Indeed, for 11 out of the 15 authorities that provided case numbers, their workloads are skewed towards mergers relative to anticompetitive practices (even after controlling for the average time of analysis). For seven out of these authorities, the merger workload was over 20 times higher than for practices. Moreover, there are indications that the ratio of conditional merger approvals in Africa is higher than in other regions, like the EU, which makes it even more important to dedicate enough resources to each merger.

Source: World Bank and Africa Competition Forum 2022

FIGURE 38: COMBINED LOCAL THRESHOLDS IN AFRICA (CONTROLLING FOR GDP)



Source: World Bank Merger Control Database 2019 and World Bank World Development Indicators

BOX 20: MERGERS IN DIGITAL MARKETS

Data and data-related assets are important intangible assets that digital firms hold, thus making them relevant to the analysis of mergers in the sector. At the same time, network effects often concentrate the structure of digital markets, making competition for the market particularly important to discipline incumbents. This, in turn, makes potential competitors particularly valuable for competition compared to traditional markets, which may justify a different approach to digital markets. These characteristics give rise to some additional risks:

- "Small" mergers or vertical mergers, which are typically not considered to pose a risk to competition, may, in fact, be damaging to the competitive dynamics of digital markets where the target firm holds data or intellectual property that may provide a competitive advantage to the acquirer. An example would be a social media site that acquires a messaging service and other social media sites and then merges datasets to acquire a broader set of data.
- The emergence of killer or zombie acquisitions is a potential theory of harm, whereby (typically cash-rich) digital platforms acquire smaller firms and put their innovations on hold before they become a competitive threat. One example would be a platform with a map service that acquires a smaller maps app partially to eliminate an independent source of mapping software.

While there is still some debate on the best approach to take to control mergers in digital markets and evidence is still being built, these features have given rise to several suggestions on how merger control in digital markets can be improved:

- Introduce thresholds based on value of the transaction for digital markets (rather than turnover or assets) may help the authorities screen for mergers that warrant a more in-depth analysis, since it represents the magnitude of the effects (both beneficial and detrimental) associated to the transaction.
- Authorities could maintain the right to claw back small mergers that will not otherwise meet notification thresholds if they subsequently raise competition issues post consummation.
- For firms designated as dominant (or that hold a significant market position), shifting the burden of proof to show that a proposed merger will not cause anticompetitive harm to the firm.
- Adjust how the counterfactual and theory of harm are defined, such as to allow for a longer period to assess the potential for entry (given the time it can take for a technology-focused firm to develop), account for monetization strategies (including through data use), account for two-sided markets, and allow for more uncertainty in the counterfactual.

Source: Authors' own elaboration.

NOTES

1 Voigt, S. 2009. "The Effects of Competition Policy on Development: Cross-Country Evidence Using Four New Indicators." Journal of Development Studies 45 (8): 1225–48; Buccirossi et. al (2013); Dutz and Hayri 1999; Dutz and Vagliasindi 2000; Petersen 2013; Symeonidis 2008.

2 See Article 3 Resolution 26/2007 of the Secretaría de Comercio Interior.

3 For an overview, see Harrington (2006). For specific examples see Bajari and Ye (2003) for seal coating auctions), Baldwin Marshall, and Richard (1997) for timber auctions), Banerji and Meenakshi (2004) for wheat auctions, Porter and Zona (1999) for milk auctions, and Porter and Zona (1993) for highway construction.

4 Settlement programs can be complementary to leniency programs and can efficiently bring investigations and sanctioning procedures to a close.

5 See Competition Authority of Kenya (2016), Special Compliance Process, Final report, available at https://cak.go.ke/sites/default/files/2019-06/Special%20Compliace%20Report.pdf

6 As at 2022, this includes a review of cartels in 32 countries in the Latin American and Caribbean region.

7 Thus, for example, the Competition Commission of Singapore explained dominance in the following economic terms: "An undertaking will not be deemed dominant unless it has substantial market power. Market power arises where an undertaking does not face sufficiently strong competitive pressure and can be thought of as the ability to profitably sustain prices above competitive levels or to restrict output or quality below competitive levels. An undertaking with market power might also have the ability and incentive to harm the process of competition in other ways, for example by weakening existing competition, raising entry barriers or slowing innovation. Both buyers and sellers can have market power." Singapore Competition Commission Guidelines on the Section 47 Prohibition (2007) at Section 3.3, available at http://www.ccs.gov.sg/content/dam/ccs/PDFs/CCSGuidelines/s47_Jul07FINAL.pdf

8 The Global Digital Antitrust Database (the MCT DAD) aims to be a comprehensive source of information on antitrust cases involving digital platforms, which have been finalized by competition authorities worldwide. The database has been generated by collecting publicly available information on all finalized antitrust cases (regardless of the ultimate findings of the case) in all countries globally as of January 2020. The information included has been taken from decisions published by competition authorities, or else alternative sources with the most comprehensive information when a decision was not available.

9 In the EU, five percent of all mergers assessed were approved with remedies (2018, GCR) against eight percent in the ACF jurisdictions surveyed (2016–2018 average).

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8. IMPLEMENTING COMPETITION REFORMS

After conducting a proper market diagnostic, identifying government interventions that distort market dynamics, and designing the least restrictive alternatives, the following step informs the strategy for successfully advocating for and ultimately implementing competition reforms.

Chapter 8. What's in this chapter…

8.1. Prioritizing potential reforms

The key step before reform implementation is to prioritize which reforms to pursue, which typically requires a balance between impact and feasibility. In some cases, it may be necessary to start with small, achievable reforms (such as in certain rules, products, or regions) to show proof of concept and use this as a basis for scaling up reforms. Moreover, if the first-best solution to a market restriction is not feasible, looking for second or third-best options will be necessary. At the same time, this pragmatic approach should be balanced against the risk of overfocusing on reforms that may be feasible but are ultimately toothless or ineffective. For example, there is often criticism of reforms establishing new institutions to regulate markets but failing to provide the institutions with the resources, capacity, and independence to implement their mandate. Where the strategy is to start small and scale up, there should be a planned path and timeline to build on previous reforms and move towards fuller reforms with deeper structural impacts. Fostering interinstitutional cooperation could strengthen the reform agenda, for which it is important to identify potential allies or synergies with other government institutions.

The guiding questions below can help understand a particular reform's feasibility. This information especially when combined with a mapping of the key players that influence a sector and their interests and connections (including the executive branch, legislative branch, local government, private sector, industry associations, consumer associations, as well as the media, think tanks, and academia for their role in information transmission) is critical to assess stumbling blocks.

BOX 21: GUIDING QUESTIONS TO ASSESS FEASIBILITY OF REFORM

1. What is the legal status of the restrictive government intervention? Or, if the issue is the lack of specific intervention, what would be the required legal status of the new rule?
   - Does a law need to be passed or just an amendment to implementing regulations?
   - Could the implementation of a certain rule be sufficiently changed with a revised guideline on its application, or rules/systems that increase transparency/accountability?
2. What are the authorities and procedures required to pass and implement a reform?
   - What is the capacity of the required authorities? Is this reform aligned with their current objectives?
3. To what extent is there political will to introduce the reforms and, most importantly, to effectively enforce the proposed changes?
   - Is there a government champion for reform? Is there a private sector group that can champion reform?
   - Has the government already identified this as an area for reform? Is there an existing reform process underway? Are different branches of government in agreement about this reform?
4. Who are the potential beneficiaries and individuals, groups, or regions affected by the reform, and what is its impact on each of them? Are they able to advocate for reform?
5. If political economy issues are likely to arise, are there compensation mechanisms that could help to overcome these issues?

Source: Authors' own elaboration.

Notwithstanding the above questions, the feasibility of reform can also be built or enhanced by conducting advocacy on reform impact and identifying local champions. Understanding market outcomes, estimating the impact of alleviating constraints to competition or the cost of not acting, and using this evidence to engage with media, citizens, and other stakeholders is key to building support for reform and overcoming political economy constraints. In parallel, identify individuals or bodies who can act as competition champions to elevate the competition agenda in national policy more broadly and build the institutional capacity of authorities and regulators to embed competition principles in their work.

8.2. Understanding the institutional ecosystem of market institutions

The successful implementation of any pro-competition microeconomic reform depends on the effective functioning of its market institutions. Competition agencies can lead the process of applying the MCPAT in countries where they are operational. Otherwise, this can be done by different agencies as long as the principles are clear (informed by the competition policy) and a public entity takes the lead – which, for instance, could be the ministry of finance or the prime minister's office. Overall, it is important to remember that competition principles can (and should) be embedded across economic policies that are designed and implemented by various government agencies. National competition policies are a useful tool for this. The well-known example of Australia's National Competition Policy, as well as more recent examples in the United States of America (White House 2021) and the Philippines (Philippine Competition Commission 2022) can serve as references for other countries.

An ecosystem of market institutions is needed to achieve well-functioning markets, and any of these institutions may lead or contribute to needed reforms. Competition authorities are only one element that is necessary but not sufficient. Other authorities – from sector regulators to public procurement agencies and state control agencies – must also integrate market/competition principles. Table 19 provides an overview of the government's different roles and how various government institutions contribute to market efficiency – through free entry, prices reflecting market signals, and a level playing field – given the different types of sectors and their characteristics. Competition agencies can inform many of these roles from the market efficiency perspective by supporting interventions that address market failures, through antitrust investigations or advocacy.

In competitive sectors, competition authorities play a larger role as enforcers and advocates to eliminate restrictions to competition. In these sectors with more limited market failures, various government institutions can help ensuring that prices are set by market forces, rules do not unnecessarily restrict entry, or barriers for imports and foreign investment are removed. Regulatory simplification programs and regulatory impact assessment initiatives can also support competition. Ensuring that price controls are only used where necessary and designed to minimize harm (see section 6.1) is an important area for competition advocacy. Competition authorities can also work with public procurement authorities to support the design of open and competitive public procurement processes.

In contestable sectors, where regulation is needed to enable competition, competition authorities and sector regulators need to collaborate. Where sector regulators lack independence or prioritize other policy goals, competition authorities have been a good ally in using antitrust instruments to remedy gaps in ex-ante regulation and boost competition. Antitrust decisions in telecommunications (such as in Brazil, Mexico, Russia, and South Africa) and payment systems (in Brazil, Kenya and Zimbabwe) are examples of antitrust decisions aiding regulatory intervention in middle and low-income economies. Stronger collaboration can be enabled to support the synergies between competition law and pro-competition sector regulation. Various instruments, including informal collaboration, memoranda of understanding, formal networks of regulators, or a national competition policy, can be applied. Protocols to refer cases, conduct joint market studies, request technical opinions, and exchange information are useful to enable synergies. When the government operates as a supplier or financier, competition authorities can also help advocate for competitive neutrality and support the design of privatization and PPP processes and business support measures to minimize distortions to competition.

Competition authorities, where operational, are the natural candidates to champion pro-competition reforms. They play an essential role in bringing competition principles into government interventions, and in countries where competition frameworks are in place, they can enforce tools to discipline market players. In some countries, certain sectors are excluded from the general antitrust framework; therefore, coordination between the competition authority and the sector regulator becomes more important. As competition agencies strengthen their institutional capacity, competition policy has the potential to gain more visibility in the public agenda, enabling inter-institutional cooperation that can help initiate reform processes.

TABLE 18: A FRAMEWORK FOR MARKET INSTITUTIONS TAILORED TO DIFFERENT TYPES OF SECTORS

Factors affecting market efficiency	Areas for government intervention	Natural monopolies	Partially contestable	Competitive
Entry	Sector regulation: Entry (access)/ quantity	Independent sectoral regulator	Independent sectoral regulator	Various economy-wide agencies (including competition authorities, RIA agencies) and ministries
	International rule-maker: trade of goods, investment, persons	Investment Authority, Ministry of Trade	Investment Authority, Ministry of Trade, Competition Authority	Investment Authority, Ministry of Trade, Competition Authority
	Gov as buyer: Public procurement	Ministry, state control agency (competition authority)	Public procurement authority, competition authority	Public procurement authority, competition authority
Price and other product/ service characteristics	Sector regulation: Prices	Independent sectoral regulator	Independent sectoral regulator for network industries and finance to regulate prices of essential facilities, Authorities that regulate natural resources (water, mining rights)	Various economy-wide agencies (such as competition authority, consumer protection authority) and ministries to ensure prices are set by market forces
	Sector regulation: Quality/service conditions	Independent sectoral regulator	Independent sectoral regulator for network industries and finance, Commission within ministry for natural resources or regulator	Consumer protection authority, Standards, quality and metrology agency, Competition Authority
	Market Referee: Anti-competitive practices	Competition authority in collaboration with independent sectoral regulator	Competition authority in collaboration with sector regulator/other agencies	Competition authority in collaboration with independent sectoral regulator
Level playing field	Gov as supplier: Public ownership	SOE oversight agency/system	Privatization authority, PPP agency, SOE/BOS oversight agency/ system, competition authority	Privatization authority, PPP agency, state aid control agency, SOE/BOS oversight agency
	Gov as financier: Public programs to support markets	State control agency (competition authority), sectoral ministry	State control agency (competition authority), national treasury/ ministry of finance	State control agency (competition authority), national treasury/ ministry of finance, agencies/ministries that design and administer measures (such for science and innovation, investment, SME development, agriculture)

The competition authority's role is essential

The competition authority's role is important in integrating competition principles

Source: Adapted from Begazo, Licetti and Gramegna (forthcoming)

TOOLKIT ITEM 24

Agency effectiveness depends on several factors: the legal and policy framework, organizational structure and resources, enforcement capacity, and integration of competition principles across government.

It is also important to remember that competition authorities do not operate in a vacuum. They are part of an ecosystem of institutions that can either support pro-competitive reforms or pose reform challenges.

Competition authorities

Competition authorities need appropriate institutional designs, adequate competition laws and resources to maximize their impact potential. Without well-designed and sufficiently resourced institutions, even adequate competition laws would have limited impact. A suboptimal institutional setup can mean that authorities become overwhelmed with merger review, struggle to build robust cases to sanction cartels or abuses of dominance, and fail to use their advocacy powers. Many countries around the world now have the necessary suite of competition rules, but in many countries, their implementation is still limited. For example, in Africa, at least 42 African countries have a national competition law or are members of a regional agreement establishing antitrust regulations, accounting for more than 93 percent of the GDP. Yet only a handful of these jurisdictions have finalized a cartel or abuse of dominance case.

FIGURE 39: ELEMENTS OF EFFECTIVE IMPLEMENTATION OF COMPETITION LAW AND POLICY

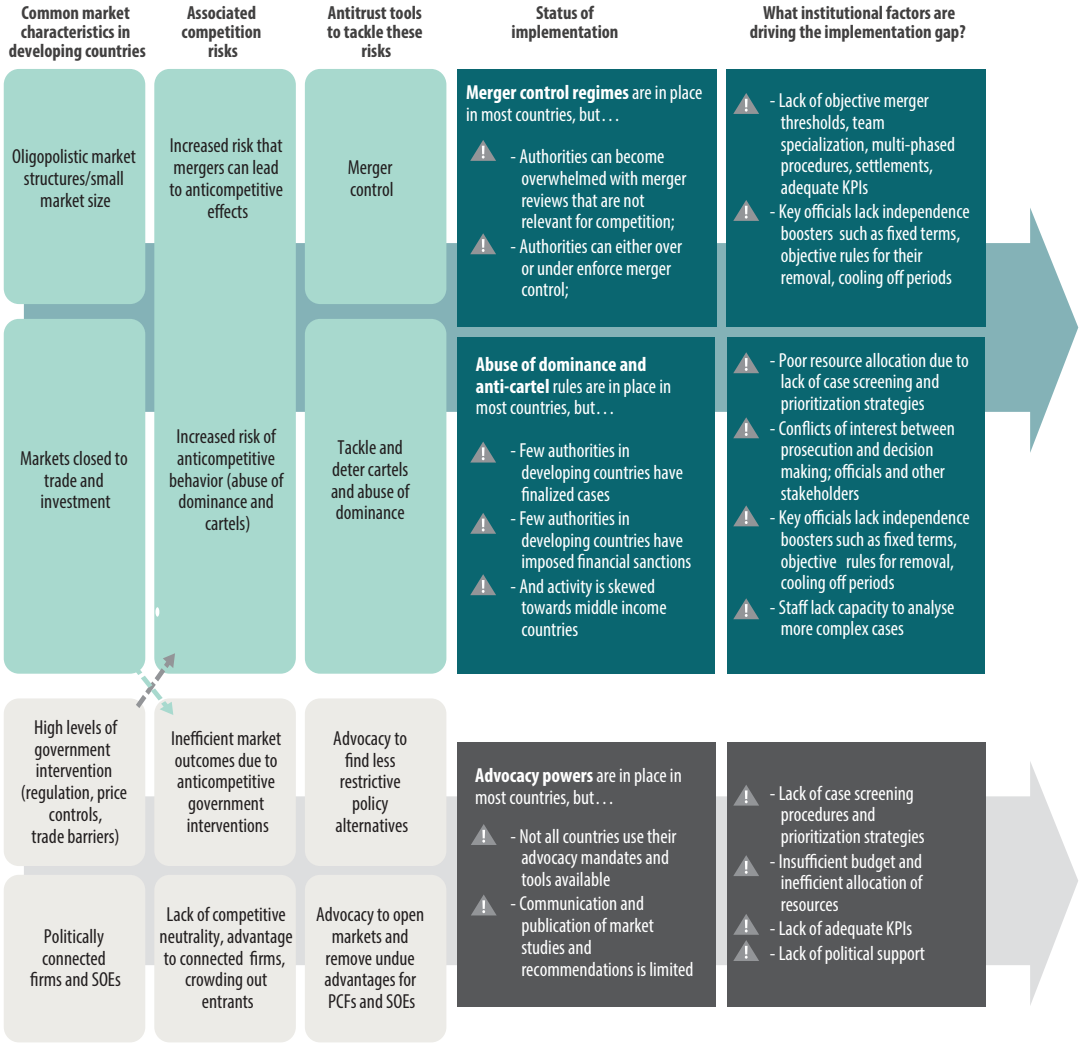
A. Legal and policy framework	B. Operational framework	C. Competition law enforcement	D. Integration of competition principles
Competition policy	Structure of the authority	Regulatory framework: competition regulations and guidelines	Collaboration with regulators and ministries within the government
Competition law	Staffing and financial resources for the authority	Case handling: analysis of anticompetitive practices and merger review	Opinions on relevant laws/ regulations that are likely to harm competition
Laws that create the competition agency	Selection of board members and/or head of the agency	Implementation of the authority's powers	Market studies in sectors with competition concerns
Other relevant laws with competition mandates (such as sectoral framework and public procurement)	Strategic planning	Administrative efficiency, procedural fairness, and due process in case handling	Awareness raising/capacity building for private sector, child society, journalists, academia, public sector

Source: World Bank and Africa Competition Forum 2016

An important driver for poor implementation is the lack of an institutional design that is conducive to independent and efficient outcomes. Independence is key since authorities with the capacity to investigate, prosecute, and impose sanctions for anticompetitive violations require the highest degree of independence, mirroring the judicial system. Neither public nor private stakeholders should be able to decide who and what should be investigated or prosecuted or steer the final decision-making. Efficiency is important since one of the main challenges for institutional design is to help competition authorities to best allocate limited resources across competing priorities. A functional review of a competition authority can help identify these constraints.

Certain implementation gaps of the competition frameworks in low and middle-income countries are more relevant given market characteristics. Common gaps in developing countries relate to lacking elements for more efficient use of their resources: objective merger thresholds, multi-phased (risks-based) procedures, prioritization strategies, use of screening procedures, and effective use of settlements to finalize cases. Other institutional design features that are commonly missed include: having a strategic plan and a monitoring framework with sound performance indicators, rules against conflict-of-interest, and structures that limit the undue influence of external stakeholders (Figure 40).

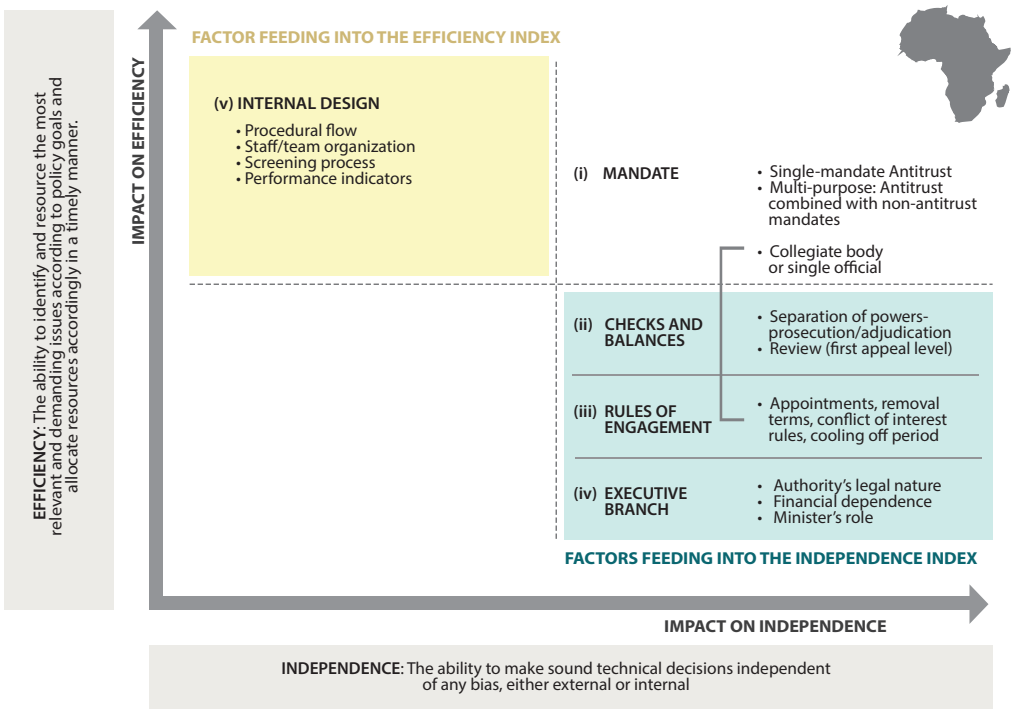
FIGURE 40: INSTITUTIONAL DRIVERS OF IMPLEMENTATION GAPS IN COMPETITION LAW IN AFRICA



Source: World Bank and Africa Competition Forum 2022.
Note: Dotted arrows indicate examples of secondary relationships between some market characteristics and different competition risks. The figure includes the antitrust tools most likely to be relevant to tackle different competition risks, although others could be used depending on characteristics of specific cases.

Although there is no ideal set of institutional features that fits all competition authorities, their policy goals and country contexts, there are key principles that inform successful models. Five key institutional features are relevant for independence and efficiency: (1) mandate, (2) checks and balances, (3) relationship with the executive branch, (4) rules of engagement, and (5) internal design. Figure 41 presents these institutional features according to their potential positive impacts on promoting efficiency and independence in antitrust policy implementation.[3]

FIGURE 41: FRAMEWORK OF INDEPENDENCE AND EFFICIENCY INSTITUTIONAL FEATURES



Source: World Bank and Africa Competition Forum 2022.

Some key elements to consider when assessing the institutional design of competition authorities

Key elements of institutional design that are key to understanding and optimizing when assessing competition authorities are discussed below.

Mandate: the overall objectives and purpose of the authority.

- **Single or multi-mandate authority:** Some authorities are focused on a single "antitrust mandate", including merger control, anticompetitive practices, and competition advocacy. Other competition authorities are also responsible for non-antitrust matters, such as consumer protection, state aid control, unfair commercial practices, or sector regulation. Each setup presents different tradeoffs as well as strengths and weaknesses. For example, combining antitrust with consumer protection is common and may be fruitful for policy alignment and awareness raising. However, authorities must manage internal competition for human and financial resources, which can affect overall efficiency. Moreover, multi-mandate authorities will also need to be very cautious in prioritizing and balancing their mandates to remain effective.

Checks and balances: the checks and balances mechanisms in prosecution and adjudication.

- **Collegiate body or single official:** An authority can have a multi-person decision-making organ/board or a single individual who is the decision maker. Collegiate bodies foster debate and reduce the scope for individual bias in decision-making, thereby supporting more independent outcomes. However, they may also increase bureaucracy and transaction costs compared to a single decision-maker (Jenny 2016). If a collegiate body is used, it would be important to give more attention to other pro-efficiency features to mitigate the transaction costs, while if a single decision maker is used, other pro-independence features can be used to provide checks and balances.
- **Separation of powers:** It is important to understand whether a competition authority combines prosecution (and investigation) with adjudication (decision-making) functions. The greater the separation between the functions, the lower the risks of confirmation biases and the greater the effectiveness of

internal checks and balances. For those authorities that carry out both functions, a collegiate body can design rules to emulate an internal separation of powers, for example, by preventing the overlapping of staff performing the different functions, limiting the reporting and hierarchy between divisions, and ensuring that budgets of key functions do not depend on the allocations made by the officials in charge of the other functions (i.e. staff, reporting, hierarchical, and financial separations).

- **Right to appeal:** Once the adjudicator makes a first-instance decision, parties should have the right to appeal their cases before an authority independent of the first-instance adjudicator (for example, a specialized or common judicial court). An external review complements the internal separation of powers, thus boosting the likelihood of an independent and procedurally fair outcome.

Rules of engagement: rules governing the employment and functions of key officials.

The rules governing the engagement of key officials can determine how well insulated an authority is from external influence that might undermine its independence. Key officials would include those responsible for (1) the final decisions on prosecution and (2) first-instance adjudication:

- **Appointments:** Appointments that follow a two-stage process, with the nomination of candidates by an entity independent of the appointing authority, may provide some insulation from political interests.
- **Term of appointment:** Assigning fixed terms to key officials may increase stability and reduce the risks of external influence. In authorities with collegiate bodies, adopting staggered terms may also further isolate them from political influence.
- **Rules for removal:** Establishing objective criteria for removal for key officials rather than leaving it to the sole discretion of the heads of state can also increase transparency.
- **Conflict-of-interest:** Rules that prevent officials from working on cases where they might have competing interests in specific cases or imposing mandatory cooling-off periods for key officials after they leave the authority can help insulate the authority from the influence of market players and other private stakeholders.

Relationship with the executive branch: the relationship between antitrust authorities and the executive branch.

The relationship between the competition authority and the executive branch affects the extent to which political interests may shape the day-to-day business of the institution. Ideally, decisions of the competition authority should be based solely on their technical capacity and the ruling body of law.

- **Financial independence:** Ideally an authority should have the final word on requesting and allocating its own resources. Authorities with financial independence will receive their budget directly from the Parliament, based on a request prepared and proposed by the authority. A lower degree of independence is achieved if the authority receives its budget from the Parliament but relies on a Ministry to submit its budget request. An even lower degree of independence is present if the Ministry allocates the authority resources from its own budget. Financial independence is boosted when an authority can diversify its funding by charging fees for merger review. However, an authority should not be financed through fines since this can lead to competing interests in handling cases.
- **Technical independence:** Ideally, the authority should be an independent entity (not part of a ministry) that does not report to a ministry at the technical level.
- **Ability of the executive branch (i.e., a Minister) to intervene in cases:** It is important to assess whether the authority can make final and ultimate decisions on its mandate by law, without depending on representatives of the executive branch. For example, the executive branch or Minister should not be able to initiate investigations, provide recommendations, or make, veto or appeal final decisions.

Internal design: internal procedures and managerial decisions to boost efficiency.

- **Procedural flow:** Setting up differentiated procedures for cases of different sizes or complexity can help better channel scarce resources. For example, authorities can use multi-phase procedures for merger review, where an initial phase of review helps determine if the assessment of the merger's effects on competition requires additional time to conduct an in-depth investigation, which would then be performed in a second phase. This allows the procedure for non-complex cases to be fast-tracked.

- **Staff/team organization:** Depending on the size of the authority and resources available, having dedicated teams to work on different mandates can improve efficiency. This is especially important for authorities combining multiple mandates, such as antitrust and consumer protection. This is particularly important because non-antitrust cases make up most of the cases for many authorities. The lack of dedicated resources can reduce the capacity of authorities to prioritize their responsibilities to those activities that can be most harmful to the economy – and potentially compromise the quality of their analyses and decision-making. It is worth noting, however, that a model with dedicated teams may not be feasible for smaller authorities, where greater fungibility of staff would be required. Authorities should consider the importance of specialization as they grow.
- **Screening process for prioritization:** Agency-wide and mandate-specific screening devices to prioritize cases, as well as potential approaches to cases (such as an advocacy initiative, an investigation of an anticompetitive practice, or a market inquiry) to promote resource prioritization. Authorities can screen for information like the quality of information available and the likely complexity of the case.
- **Performance indicators:** Applying agency-wide and mandate-specific performance indicators to both monitor performance and push for better results can increase productivity. However, these indicators should be carefully designed to avoid competing interests.
- **Considering that various mandates falling under the same institution may generate resource disputes,** it is important to consider the specific needs of its various functions and mandates to inform budget requests, budget allocations, prioritization, and staff organization.
- **Internal procedures and managerial decisions can also help build and boost agencies' credibility:** through publishing decisions, having very clear procedures and guidelines, appropriately handling confidential information, and adopting very well-thought-out settlement and fines policies.

Prioritizing institutional measures based on development levels

As competition authorities identify institutional gaps and plan for future improvements, they can prioritize measures depending on their stage of development and policy objectives. Figure 42 illustrates how authorities can focus their limited resources on building the fundamentals that will enable a full implementation of their mandates over time. First, it is important to guarantee a stable and independent stream of resources that can be properly managed to fulfill policy prioritizations. Secondly, authorities should ensure they are not overwhelmed by lower-priority cases (such as mergers that are unlikely to have significant impacts on competition) since these can drain resources and prevent authorities from engaging in more strategic cases and reaching policy goals. Thirdly, authorities can explore the power of advocacy to boost compliance and improve other government policies, such as consumer protection. An advocacy approach can be an important first step to build staff capacity, enhance market intelligence, and gain legitimacy before engaging in enforcement cases involving litigation based on newly established legal frameworks. If legal frameworks are not properly employed, this type of litigation can drain significant portions of scarce resources in the short term with limited results, while undermining the business environment's predictability for firms. Once authorities have secured resources, properly screened case flow, and have made progress on strategic advocacy initiatives, they can focus on ensuring they have a full suite of sound internal procedures conducive to staff productivity in an environment that enables independent technical decisions. Finally, authorities would then be ready to dive into full-fledged adversarial cases, investigating and sanctioning market players while putting to test their practices and decisions before the judicial system.

FIGURE 42: INSTITUTIONAL MATURITY PROGRESSION: REFORM PRIORITIZATION AS AUTHORITIES INCREASE IN MATURITY

Secure budget. Assure that the authority will have resources to deliver on its mandates on an independent and sustainable fashion.

- Diversify sources, preferably finding options that are independent from executive branch
- Guarantee minimum flow of resources every year to deliver on core mandates
- Gather and allocate budget according to the needs of mandate (e.g., merger control, anticompetitive practices, advocacy)

Streamline merger control. Assure resources are not inefficiently drained towards merger reviews, which could prevent the authority to promote *ex-officio* mandates such as advocacy and investigation and sanction of anticompetitive practices.

- Implement efficiency enhancing mechanisms to (a) reduce the number of benign mergers affected by mandatory notification (e.g., adequate merger notification triggers), (b) allocate public and private resources according to the case's complexities (e.g., simplified/multi-phased procedures; screening)

Boost advocacy specialization. Develop efficiency mechanisms to increase the capacity to promote transformative advocacy initiatives.

- Set clear sectors and topics of priority, establish advocacy specific screenings to identify opportunities, define advocacy teams/responsible staff, establish workflow of activities.

Establish performance indicators. Develop indicators to measure both the overall authority goals as well as of its key functions (e.g., merger review, anticompetitive practices, and advocacy);

Increase credibility by mitigating risks of internal conflicts of interest. Developing internal independence between different functions conducted by the authority, separating specially investigation and prosecution from adjudication.

- Reduce reporting relationship between prosecutorial and adjudication functions
- Prevent that heads of prosecution/merger analysis are appointed by heads of adjudication

Increase credibility by mitigating risks of external undue influence. Establish mechanisms that insulate key officials and decision makers from undue external influence from both public and private entities.

- Limit the capacity of the executive branch to directly participate in decision making
- Strengthen rules of engagements of key officials, prosecutors and adjudicators, for example by improving rules of appointment, removal, and cooling off periods.

Boost capacity to investigate, prosecute and sanction anticompetitive practices

- Implement efficient mechanisms to gather evidence and induce cooperation with the Authority, define specialized teams by conduct, define workflow procedures, set screening focused on enforcement against anticompetitive practices, develop settlement capabilities

Source: World Bank and Africa Competition Forum 2022.

8.3. Mapping interested and affected parties

Besides understanding the institutional setup, it is critical to identify parties who may have an interest in or be affected by a competition reform either at the national or subnational level. This would usually be done at the market or sector level, where reforms are being considered in a particular market and can initially be based on literature and internet research. These should include competitors in the market of interest, paying attention to private firms and SOEs, firms of different sizes, politically connected firms and non-politically connected firms, firms of different ages, as well as potential entrants (those who would like to enter the market but have not been able to). The mapping should also include key downstream and upstream firms (customers of and suppliers to the market of interest), financial sector partners, industry associations, consumers and consumer groups, politicians, civil servants, regulators, judiciary, military, academia and think tanks, and journalists and media. Getting insights about the political economy of the country or sector implies understanding how major political parties, ethnic groups, or family groups link to business activities, including through looking at (recent) economic and political history such as elections, tensions between groups of society, and overall political stability.

Understanding the identified actors' interests, incentives for or against reform, and the impact the reform would have on them is essential. Much of this information would be best collected through interviews. It can also be gathered from desk research (media articles, reports, public statements) and analysis of reform effects, taking into account impacts on different parts of society and aggregate impact.

Finally, the interdependencies between political power (through political connections) and economic power would be important to consider as part of this analysis. This would include (Table 20) :

- Whether there are signs of a revolving door between key government positions and business, where high-level state officials sit on company boards and business executives take strategic positions in the administration or as advisors.
- Regional/subnational dynamics. For example, appointing regional representatives in parliament in exchange for business protection in regions.
- Campaign support by firms to politicians (such as presidential candidates and members of political parties). For example, in some countries, data on campaign financing by firms or individuals could be useful to understand how economic power supports politicians.
- The mechanisms through which the state provides market advantages for some economic groups. This is further discussed below.

TABLE 19: GUIDING QUESTIONS TO UNDERSTAND THE INTERDEPENDENCIES BETWEEN POLITICAL POWER AND ECONOMIC POWER

Questions
• What are the key government bodies relevant for firms working in the sector and what aspects of operations are they relevant for?
• Are any politicians involved in regulating the sector?
• How do key actors in these government bodies obtain and retain authority/power?
• Do political parties or individual politicians have control or interests in the sector of interest? Are many examples of specific politicians linked with certain businesses?
• Aside from political parties, are there other relevant actors that influence firm behavior (unions, etc.) in the sector?
• How would you describe government expertise within the sector and has it changed over time?
• Are there any fiscal/non-fiscal benefits the government provides in the sector (such as subsidies)?
• Has corruption been a particular challenge in the sectors of interest? Is the problem related to (i) particular political leaders, (ii) the political connectedness of particular firms, or (iii) a systemic problem (i.e., does not necessarily put certain actors at an advantage over others)?

Source: Authors' own elaboration based on Country Private Sector Diagnostics Methodology Guidance Note on Political Economy
Note: The term politician refers to a person actively engaged in party politics as a profession.

Mapping the presence and influence of politically connected firms (PCFs)

One starting point for mapping PCFs is identifying politically exposed persons (PEPs) and linked firms.[4] While there is no comprehensive dataset on all PEPs in a given country, a variety of sources can help identify relevant persons. Box 22 provides an overview of potential avenues for research. In addition, researchers have used PEP information and firm-level data to identify linkages between firms and the government across the economy[5] and in specific sectors.[6] Interviews with (non-connected) firms and sector experts can also be useful.

Mapping where the government holds stakes in firms (either controlling or minority) or partners with the private sector is also useful. Box 22 provides information on the BOS database which can help with this exercise. Even where the government does not have a controlling interest in a firm, minority shareholdings in firms managed by private players can create concerns regarding competing interests. The government might have an interest as a shareholder/investor and regulator/policy maker even if it does not control the firm. In other cases, SOE can reach commercial arrangements with private firms to carry out joint ventures with private entities for specific projects. In this case, these joint ventures can be used either to favor specific

private entities or to create or reinforce political connections between the private player and the SOE. Given these two considerations, it is important to map minority state shareholding and joint ventures with private firms across sectors. Table 20 outlines guidance questions for mapping PCFs to be answered with desk research.

TABLE 20: GUIDING QUESTIONS FOR THE MAPPING OF PCF

	Questions
Identification of PEPs and PCFs (economy-wide)	• Who are PEPs and which sectors do they operate in? Are there firms affiliated with a PEP operating in key segments of the economy? • Are there links between the CEO/CFO/COO, shareholders or board members of the main firms with government officials in high level positions? Are linked persons high level officers at the regulator or policy maker for this sector? • Do high-level government officials, politicians or political parties have ownership of firms in the sector? • Are there prominent business persons (from a relevant sector) who have entered politics or have been in politics in the past? • SOE (majority state-owned) operating in key segments, products (goods or services) they offer and relative importance (market share, control of essential segment for the sector) • In which other firms does the government hold shareholdings? How much? • Joint ventures between private firms and SOE in key segments, products (goods or services) they offer and relative importance (market share, control of essential segment for the sector)

Source: Authors' own elaboration based on Country Private Sector Diagnostics Methodology Guidance Note on Political Economy.

BOX 22: OVERVIEW OF SOURCES FOR IDENTIFYING PEP, PCF AND SOE

External sources

- Internet research, for example on Google, Wikipedia, Factiva and other prominent news websites (also in the local language).
- Information on businesses and businessmen/-women:
  - Capital IQ provides information on public and private companies as well as biographies of individuals. The WBG library provides access to the portal.
  - Forbes publishes articles on prominent businessmen and -women that also contain information on political connections and/or recent allegations of fraud or corruption. www.forbes.com
  - OpenCorporates is a website offering a free search tool of companies and officers, see www.opencorporates.com
- Asset disclosures and income declaration filing lists. Some countries (c. 114 jurisdictions) publish the income declarations of public officials or even a list of the names of filers. The list may not include the names of some filers, for example if national security or law enforcement concerns outweigh the benefit of publication of names.[7]
- The Investigative Dashboard Browse provides a global index of public registries for companies, land registries and courts, which can be used to attain information on companies and individuals. Available at https://investigativedashboard.org/databases/
- Panama Papers
  - Information on prominent politicians is provided by the International Consortium of Investigative Journalists (ICIJ) in their mapping of "Power Players": See https://www.icij.org/investigations/panama-papers/the-power-players/
  - Also published in the context of the Panama Papers investigations[8], the Offshore Leaks Database provides information on who is behind more than 785,000 offshore companies, foundations and trusts: https://offshoreleaks.icij.org

Commercial databases

A range of commercial providers offer databases on PEPs. The most important sources are listed below. Note that commercial databases also draw from publicly available information and might, therefore, not always be as comprehensive or reliable. In addition, the definition of PEPs used by those providers may not always align with the definition used in this note, which entails that certain categories of PEPs might be included or excluded.

- The biggest database on PEPs with over 1.6 million counterparts is provided by Accuity and available at https://accuity.com/what-we-do/sanctions-screening-pep-data/.
- "World Compliance" by Lexisnexis, available at https://risk.lexisnexis.com/global/en/products/worldcompliance-online-search-tool-global
- RDC compiles data on senior officeholders and their relatives and close associates, available at https://rdc.com/insights/pep-connect-screening-methodology/
- Dow Jones Watchlist (Olenick 2019) is one of the most comprehensive lists of PEPs https://www.fis.dowjones.com/marketing/products/watchlist.html
- Comply Advantage PEP data: https://complyadvantage.com/politically-exposed-persons/

World Bank internal databases

The WB Business of the State (BOS) database contains comprehensive data on enterprises in which the state holds at least a 10 percent stake in more than 90 countries across all regions. The enterprises contained in the database satisfy the following definition. All entities where national or subnational governments have ownership stake of at least 10 percent, either directly or indirectly. In the BOS database, corporations are business entities that are (a) capable of generating a profit or other financial gain for their owners, (b) recognized by law as legal entities separate from their owners and with limited liability, and (c) set up for purposes of engaging in market production. The database was built using data from ORBIS and complemented with data from government sources, such as business registries, central depositories, central oversight bodies, and Ministry of Finance. It tracks several variables such as company names, 4-digit NACE code, financial variables such as revenue, employment, and profit and loss as of 2019, percent of state ownership stake, and different layers of the ownership chain. For further information on the database, please refer to the paper (Dall'Olio et al. 2022).

Source: Authors' own elaboration.

Complementary resources:

- Questionnaires to understand how politically connected firms shape market dynamics (Annex A.18).

Understanding the source of advantages received by politically connected firms

Politically connected firms often receive preferential treatment by government actors and are granted advantages that are not available to all firms. This impacts competition and, ultimately, the ability to attract new investment and to innovate. Government interventions can help protect PCFs from competition formally (*de jure*) and informally (*de facto*) (Figure 43). Informal mechanisms are particularly important in contexts of strong political parties, ethnic groups or families that control economic assets.

It is important to identify the source of advantages for PCFs to (i) design reforms that will address those advantages; (ii) understand where resistance to reform might stem from. Figure 43 provides a framework to identify where the advantages received by PCFs stem from. An assessment of these factors must be carried out at the market/sector level since the impact of PCFs on market outcomes is influenced by the characteristics and dynamics of individual markets, the firms on those markets, and specific market regulation and policies. The types of government intervention that shape the position of PCFs can be summarized as follows:

- **Identify government interventions that reinforce dominance or limit entry.** In the presence of PCFs, government interventions may be designed to protect the markets of incumbent PCFs from new entry and competition. De jure restrictions include absolute and relative bans on entry, such as exclusive access to crucial inputs or a lack of access regulation for essential facilities (particularly those run by PCFs). Demanding entry requirements, license restrictions, and criteria for government procurement

contracts that favor incumbent firms can also create barriers to entry. De facto restrictions hinder new firm entry through the behavior of agencies and government officials. For example, PCFs might profit from excessive discretion or lack of enforcement in licensing or entry requirements. Further, while public procurement contracts might theoretically be accessible to new entrants, the actual decisions of state actors might favor PCFs.

- **Identify government interventions that create an unlevel playing field or limit competitive neutrality.** PCFs often receive subsidies and direct transfers of public funds (such as grants, tax benefits, direct transfers, concessional loans, and debt guarantees, and access to inputs, such as water and spectrum) more easily or on advantageous terms, creating an unlevel playing field. *De jure* restrictions exist when eligibility criteria are set so that it is easier for PCFs to receive subsidies and transfers of public funds. Public procurement rules that make it difficult for non-connected firms to access public contracts are another example of *de jure* restrictions. PCFs might also face less stringent operating rules. *De facto* restrictions are present when subsidies and other support measures are awarded in favor of PCFs even though the rules allow for equal access by all firms. Similarly, PCFs might find it easier to conduct daily operations in the sector when operating regulations are less stringently applied. PCFs may also enjoy greater security of their assets and property due to how law enforcement is implemented. If SOEs are active in the sector, it is key to assess whether there are regulatory frameworks that ensure competitive neutrality between SOEs and other private firms.

FIGURE 43: FRAMEWORK FOR GOVERNMENT INTERVENTIONS THAT SHAPE THE POSITION OF PCF IN MARKETS

Reinforce dominance / limit entry	Level playing field/Competitive neutrality

De jure:
- Restrictions on the number of licenses that protect the position of incumbent PCFs (e.g. quotas on the number of firms, quotas on import licenses, limited geographic areas, lack of licensing of scarce resources, minimum distance requirements)
- Entry requirements (firm characteristics, minimum operating requirements or standards) set in a way that favors PCFs (including caps on foreign investment)
- Lack of access regulation for essential facilities (particularly those run by PCFs)
- Involvement of incumbents in entry decisions
  - Incumbents responsible for setting official entry requirements
  - Incumbents are involved in official decisions on entry of specific operators
- Eligibility criteria for tax benefits, grants, concessional loans or other financial advantages favor incumbent PCFs over entrants
- Public procurement: Exclusive contracts to supply to government awarded to PCFs
- Exclusive access for PCFs to crucial inputs provided by the state/SOEs (e.g. energy, water, land, spectrum, other natural resources)
	De jure:
	- Eligibility criteria for financial advantages from the state (including to avoid insolvency) favor PCFs
	  - Tax benefits (exemptions, rebates, refunds, deferrals of tax payments for certain firms)
	  - Direct transfers, grants or subsidies
	  - Concessional loans
	  - Debt guarantees.
	- Lack of de jure regulatory neutrality: Operating regulations are defined less stringently for PCFs
	- Defined terms of access to crucial inputs provided by the state/SOEs favor PCFs
	  - In terms of cost, quality, and timeliness of access
	  - For energy, water, land, spectrum, etc.
	- Public procurement:
	  - Lack of competitively awarded tenders or participation in government schemes by untransparent negotiation
	  - Tender rules designed to favor PCFs
	- Rules regarding trade administration and customs are defined in a way that favors PCFs

De facto:
- Excessive discretion or lack of enforcement in licensing favoring PCFs in terms of:
  - Time (delays)
  - Cost (fees or unofficial payments)
- Excessive discretion or lack of enforcement in enforcing entry requirements in a way that favors PCFs
- PCFs play a significant role in influencing entry regulation in practice (including through business associations):
  - Influence in setting entry requirements
  - Influence in allowing entry of specific operators
- Decisions to grant tax benefits, grants, concessional loans or other financial advantages favor incumbent over entrants
- Crucial inputs from the state/SOEs are provided to PCFs but not to PCFs in practice (e.g. energy, water, and other natural resources)
- Public procurement: PCFs favored in decisions to award contracts
	De facto:
	- Decisions to grant tax benefits, grants, concessional loans, guarantees or other financial advantages favor PCFs
	- Lack of de facto regulatory neutrality: Operating regulations are applied less stringently for PCFs in practice
	- Access to crucial inputs provided by the state/SOEs is provided in a way that favors PCFs in practice
	  - In terms of cost, quality, and timeliness of access
	  - E.g. for energy, water, land, spectrum, etc.
	- Application of trade administration & customs procedures favor PCFs in terms of
	  - Time (delays in processing)
	  - Costs (including practices such as undervaluation or misclassification, fees, and unofficial payments)
	- PCFs benefit from greater security (e.g. against kidnap, other criminal activity)
	- Reporting requirements applied more stringently to non-PCFs (e.g. non-PCFs more frequently subjected to tax audits)
	- PCFs benefit disproportionately from business association's influence on sector regulation and self-regulation

Source: Authors' own elaboration.

8.4. Understanding the winners and losers of reform

Most competition reforms will generate both winners and losers in the short-medium term, even when societal welfare improves overall. Considering these differential effects when analyzing the potential impact of proposed reforms is important. This can help in several ways.

a. **Winners:** Identifying winners upfront (whether these are households, workers, or businesses) can help build backing for reform. Once winners have been identified, practitioners/policymakers can target communication with these groups to inform them of their potential gains and increase their appetite and demands for reform.

b. **Vulnerable losers:** In some cases, those who might lose from reforms in the short term make up vulnerable parts of society – such as low-income households, low-skilled workers, or small firms with low capabilities. In these cases, the differential effects may have implications for development outcomes, at least in the short term, even when the aggregate effects are positive. It is important to identify vulnerable losers in advance to complement pro-competition reforms with support for vulnerable populations. This could include income support for households, retraining workers, or raising firms' capabilities and access to resources.

c. **Empowered losers:** In cases where losers are individuals or businesses with economic or political power, these losers may attempt to block or hinder reforms (and this could be especially successful where they are politicians or PCFs, or where weak governance allows firms to bribe or influence politicians or regulators). It is important to identify empowered losers upfront to identify potential sources of resistance to reforms. This allows the practitioner or policymakers to identify the feasibility of reforms and/or to implement measures to address the sources of resistance and increase reform feasibility. This could include developing compensation mechanisms and offering redistributive transfers from those who win to those who lose out from reforms. While this may reduce the payoff from the reform for winners, it may be desirable if it significantly increases the likelihood of reform.

d. **Vulnerable but empowered losers:** Of course, there will be some cases where vulnerable losers are also empowered politically and have significant influence over politicians – for example, this may be the case with powerful unions or parts of the population that are especially important as an electorate. In these cases, support packages that address inequalities and provide more opportunity must be part of the compensation/redistributive package used to increase reform likelihood.

8.5. Insights on implementing SOE-related reforms

Addressing the distortions caused by the presence of SOEs requires understanding their precise sources and may require sequencing the reform of those sources. Box 23 outlines key steps to address the distortions caused by the presence of SOEs. These include understanding where the SOE sits in the value chain (and which markets will be affected); understanding the SOEs' incentives and possible sources of distortions (i.e., policies, preferences, or protections); identifying less distortive policies and regulations; identifying the political angle of reforms by understanding the rationale for the preferences and protections received; and finally considering greater moves to private participation where necessary.

One important message from this process is that the sequencing of reforms will be important. In particular, if the protections and preferences received by an SOE are due to its policy role, it will be important to *address the policy role first before reforming the preferences and protections.* If not – and if the policy role requires subsidies – those reforms to the preferences and protections received will be unfeasible or unsustainable. Annex A.14 provides some examples of where policy mandates, preferences and protections have led to distortions in markets with SOEs – and suggests some recommendations for addressing those distortions.

BOX 23: STEPS TO ADDRESS THE DISTORTIONS CAUSED BY THE PRESENCE OF SOE

Step 1. Identify the position of the SOE in the value chain

Which market(s) is it in? Who does it sell to? Who uses its products? What are the main markets/ players it sells to?

Step 2. Understand the SOE's incentives and possible sources of distortions. To do this:

A. Identify whether the SOE implements policy

- If so, what are the mechanisms it uses, and in which markets? Such as through prices, quantities, selection of location for operation, selection of which players it contracts with (such as for inputs or for distribution), selection of which players it supplies, and the number of people it employs (such as overemployment).

B. If yes (the SOE implements policy), identify whether policies distort markets per se, and which markets are affected

- Do prices, quantities, choice of contracted firms, choice of off-takers, employment choices, etc, significantly differ from (what would likely be) the market outcome? For example, does the choice appear to lead the SOE to make a non-commercial rate of return? Do they appear to significantly misallocate resources from the allocation that appears to be most efficient? Through Interviews, comparisons of costs with prices, comparison of parameters of private vs state players, and comparison in similar sectors across countries where SOEs do not operate. This may require some subjective judgement – although if the SOE needs to receive preferences and protections to maintain operations, this would be a clear sign that policy implementation is distortive.
- Can the magnitude of distortion be quantified?

C. Identify other issues that may cause similar distortions, such as

- Political patronage – Are there reports of the SOE being used to provide populist measures or to support political campaigns or elections? Are there reports of the SOEs being used for cronyism? Are there reports of politicians' connections to board members or management of the SOE?
- Existence of SBC: Has this SOE or other SOEs been supported during periods of poor performance in the past? Has the government announced that it will support the SOEs during periods of poor performance?

D. Identify whether the SOE receives preferences and protections and if so which ones

- Apply red flag checklist.
- Assess which preferences and protections appear most harmful to market outcomes.

Step 3. Rectify distortions: Identify less distortive policies and regulations

A. If the answer to 2.B. was yes (i.e., policies distort markets), reform the SOE's policy mandate

- Identify and implement less distortive alternatives to implement the SOE's policy mandate (see examples in Table 8 and Guiding Principles in Designing less distortive alternatives and identifying pro-competition reforms) so that SOE can take on a more commercial-oriented and less complex strategy.

B. If the answer to 2.D was yes (i.e., the SOE receives preferences or protections), engage in regulatory reform to address preferences and protections:

- Identify regulatory reforms and engage in regulatory reform with regulators and policymakers based on identified red flags, using the Guiding Principles and Checklist for Industrial Policy[9] (See Table 12).
- For preferences, apply competitive neutrality principles, such as putting mechanisms in place to avoid preferential credits, establishing rate-of-return targets, establishing dividend guidelines or targets, reviewing rules on SOE participation in public procurement, etc.

Step 4. Identify the political angle of reforms: Understand the rationale for the preferences and protections received

A. Are the preferences and protections necessary due to policies implemented?
   - If yes, address the policy role of the SOE before engaging in regulatory reform on preferences and protection since otherwise reforms will be unfeasible or unsustainable.

B. Are they due to political patronage?
   - If yes, engaging in regulatory reform may support the process of addressing political patronage by reducing channels for patronage – although political economy issues should be acknowledged, and further complementary governance reforms may also be needed.

C. Are they purely because of soft budget constraints?
   - If yes, engaging in regulatory reform may support the process of addressing soft budget constraints if this is feasible from a political economy perspective.

Step 5. Decide on whether greater private participation is a solution

A. If moving to greater private participation, see the next section for guidance.
   - Note, if the issue of preferences and protections, the soft budget constraints, and high agency costs persist and continue to dampen incentives despite dealing with the SOE policy role, it may be worth moving towards greater private participation.

In particular, the success of crowding in private investment relies – to a significant extent – on (i) removing or addressing the policy objective of the SOE and (ii) removing preferences and protections before introducing greater private participation in the SOE. The effectiveness of the privatization mechanism for delivering greater technical efficiency relies largely on the removal of SOE's noncommercial objectives and the incentives provided by the threat of bankruptcy and takeover. Therefore, these distortions should be addressed before moving to greater private participation.

Private participation may help to reduce the prevalence of protections and preferences – but not always. It may be argued that greater private participation per se (i.e., without addressing policy issues directly) may reduce the risk of protections and preferences being granted by removing the ease with which the SOE can be used for political patronage, reducing competing interests, or potentially reducing the soft budget constraints.[10] While this *may* be the case, it is not necessarily true. For example:

- **Privatization will not necessarily deal with the soft budget constraint and harden the enterprises' budget constraints if they continue undertaking the government's policy objective.** Lin and Li (2008) find that when SOEs continue to undertake policy burdens after privatization, privatization will not eradicate SBC problems. It will exacerbate them because it increases the cost of state subsidization. They find that the massive privatization of SOEs in the Eastern European economies did not eradicate the SBC. On the contrary, the state provided even more subsidies to those privatized enterprises (Röller and Zhang 2005).
- **Another scenario where privatization would not reduce the risk of protections and preferences is where the privatized firm could be considered a politically connected firm and, therefore, may have access to preferences and protections.** This is more likely to happen when the process of privatization is not run in a fully competitive manner and where the process is instead used to reward connected individuals or firms.

Thus, for greater private participation in SOEs to have the desired effect on incentives for technical efficiency and to reduce distortions to market outcomes, the policy role of the SOE should be addressed, and preferences/protections should be removed. While privatization may help reduce the scope for preferences and protections, it is important to ensure that the process is conducted in a competitive manner to prevent the involvement of connected firms that may continue to receive such preferences and protections.

Ensuring pro-competitive procedures and outcomes of SOE reforms

Governments should craft public tendering processes for contracts or divestitures via open, competitive auctions to guarantee transparency and reduce allegations of favoritism. This can help build legitimacy of the process and avoid public complaints of abuse of privilege by private firms in the future. Suppose there is a sufficiently large number of private participants. In that case, auctions will also increase the revenues governments will obtain from the sale of SOEs or from payments that private firms make for the right to operate public concessions.

External and civil organization actors could oversee the sales process to increase transparency and accountability. For example, improvements could be made in the general laws and regulations to approve the sale of SOEs (in the case of divestiture) or to specify mechanisms to outsource activities to private firms (in the case of privatization by contracts). Audit offices can advise on legal procedures developed for the process and supervise the selection of participating firms. Monitoring committees, including representatives of stakeholder groups from society, can also be created who receive detailed information about the auctions, the participating firms, and the criteria adopted to select winners.

An important source of concern – especially for privatization by divestiture – is who will acquire the SOE. Market incumbents may use privatizations to gain greater market control over their markets. Restricting output or quality and charging excessive prices will harm inclusion and welfare, as well as undermine competition and productivity.

While it is likely not possible to exclude incumbents from the privatization process, antitrust remedies that review potential transactions to assess potential anticompetitive effects are one potential solution. Where privatization triggers a change in control of an SOE, antitrust authorities might condition the approval of divestitures on their assessment of post-privatization competition by exercising their merger control powers. They might also enforce conditions on the transactions, such as requiring large acquirers to sell part of their existing operations to avoid anticompetitive effects post-privatization.

In the case of SOEs holding a dominant position before privatization, it is important to avoid replacing a dominant SOE with a private dominant firm. Often, the privatization process will involve SOEs that, before their privatization, held a monopoly or a dominant position. In many cases, market dominance usually results from exclusive or special rights granted to the entity to be privatized rather than from internal growth in competitive conditions. This position may continue to be entrenched after privatization, and if the acquirer is a competitor, a supplier, or a customer of the SOE, there is a risk that the transaction will further reinforce the SOE's dominance.

Factors an antitrust authority should consider in assessing the risk that a dominant position held by a privatized enterprise would be strengthened would include:

- *Horizontal effects where the acquirer competes on the same market as the privatized firm:* the risk that the acquisition would lead to an increase in a dominant firm's market shares or market power, the risk that a non-dominant acquirer that is a significant actual or potential competitor would disappear from the market, or that the dominant firm would obtain access to competitively significant know-how in possession of another party to the transaction
- *Vertical or conglomerate effects where the acquiror does not compete on the market of the dominant undertaking:* The ability of the new entity to offer a fuller product range as a result of the combination of complementary product ranges, thereby limiting actual or potential competition, particularly if the market of the dominant firm is characterized by high entry barriers; the ability of firms with strong positions in upstream product markets to make access to their goods or services more difficult for non-integrated competitors, strengthening the combined entity's position in the downstream market; and the ability of a dominant firm operating in an upstream market to acquire a substantial competitive advantage by combining its activities with those of another party to the concentration, which operates in a downstream market, thereby strengthening the combined entity's position in the downstream market; the risk that the market position of the dominant undertaking to be privatized will be strengthened by the know-how, manufacturing, financial capacity or marketing capacity of the acquiring company or group, or its financial power.

Given these concerns, where possible, it may be best to resolve the possible anticompetitive concerns by eliminating the SOE's dominant position before starting the privatization process. This can be done by opening the relevant market to competition and restructuring (including breaking up when necessary) the dominant enterprise before privatization. Antitrust authorities should also continue to monitor post-privatization markets for signs of anticompetitive behavior and to ensure that regulatory arrangements are sufficiently pro-competition. Box 24 provides an example of how the competition authority in Australia monitored privatization processes and post-privatization markets in the ports sector to ensure that competition concerns were being addressed.

BOX 24: THE ROLE OF THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION IN ADDRESSING COMPETITION CONCERNS IN THE PRIVATIZATION OF AUSTRALIAN PORTS

In the wave of numerous privatizations of Australian ports by governments, the Australian Competition and Consumer Commission (ACCC) was concerned that some subnational governments were focused too much on achieving high one-off sale proceeds at the expense of appropriately addressing competition and economic efficiency concerns. Over the longer-term, this would worsen or entrench significant market power, and inadequate regulatory arrangements through the privatization process would lead to higher prices for port users and consumers.

While the ACCC did not have a formal role in the privatization processes, it used a variety of approaches to advocate for subnational governments to put in place pro-competition arrangements that would deliver better outcomes for the long-term interests of Australians.

For example, in Victoria, the Victorian Government initially proposed price caps and price monitoring for some ports charges for the first 15 years. However, the covered charges excluded land rents even though this was an area of port operations over which the private operator would have significant market power. The Victorian Government also proposed to pay compensation to the private operator if a second port operating in competition with the Port of Melbourne was developed by the government sometime over an unspecified period of up to 50 years.

While the ACCC had some engagement with the Victorian Government early in the privatization process, the ACCC ultimately made a submission and appeared at the hearings of a committee inquiring into the privatization. The ACCC also provided commentary of some concerns with the proposed arrangements in media interviews and speeches. This resulted in a constructive dialogue with the Victorian Government about how it could improve the proposed arrangements.

The ACCC's advocacy work resulted in there being more regular reviews by the regulator of the private operator's compliance against strengthened pricing principles, and the ability for more direct forms of price regulation to be imposed. Reviews of land rents and the ability for access seekers to seek independent dispute resolution of these charges were also included. Further, the compensation clause was limited to only 15 years with increased transparency of the arrangements.

Overall, the ACCC's advocacy efforts led to strengthened pricing regimes, improved oversight, and independent dispute resolution for the privatizations of a number of ports. These changes reduce the potential for monopoly pricing and increase the likelihood that users will be able to access those monopoly port services on reasonable terms and conditions post-privatization. More broadly, these advocacy efforts influenced a shift towards more competitive and efficiency-focused outcomes in those privatization processes.

Source: ACCC submission to the ICN-WBG Competition Advocacy Contest

Privatizing SOEs can often involve substantial injections of capital prior to privatization to attract private investors, potentially providing an unfair competitive advantage to the recipient. This advantage may prevent competition from developing and defeat the original purpose of privatization. In most cases, SOEs are privatized because they have become a political or financial burden. In these cases, the SOE may not be attractive to buyers without some form of financial assistance, such as writing off debts or converting debt into capital.

Targeted support to the to-be-privatized firm may be justifiable if it is aimed specifically at restructuring the failing firm – which would be considered a first step towards privatization. Historically, in the EU, the European Commission has conditioned its consent to privatization state aid on establishing a detailed restructuring plan that enables the firm to become viable in a short period, with commitments on closing excess capacity, reducing market share, or closing certain business lines. Support/state aid that maintains the firm's status quo should be avoided. One conclusion of this scrutiny of subsidies or state support to SOEs may be that countries should consider the winding up of a failing public undertaking as a serious alternative to privatization, where this would be a cheaper and less distortive alternative.

Post-privatization, private operators that are regulated or under contract (such as in a PPP) may request changes in their contracts, regulated tariffs, or government payments to adjust their rate of return. This may be done considering unexpected events (say, economic crises or sudden increases in input costs). However, frequent renegotiations may open channels of inappropriate influence and corruption. Well-connected operators, for example, could try to lobby regulators to boost their profits beyond what was expected at the bidding stage. As discussed in the procurement section, this can sometimes be used ex-post to affect competition ex-ante by allowing some bidders to make unviable bids. Regulators and contract administrators should define and follow transparent rules post-privatization, including rules on how to adjust prices (for example, a study of the power sector by Foster and Rana (2020) of the power sector found that post-privatization most countries adopted automatic tariff mechanisms based on external variables that substantially affect service costs (such as oil prices or exchange rates)).

A mechanism to address any remaining discretionary interference by the government will be important to maintain firm incentives and avoid distortions. Even in privatizations by divesture, governments may decide to retain ownership stakes in the privatized SOEs or use their political clout to guide the appointment of executives and board members. This may allow the government to push its political agenda through the privatized firm. For instance, they may ask managers to keep prices low or invest in unprofitable areas to please their political constituencies. With contracts and PPPs, exercising this influence may be even easier.

Various complementary mechanisms should be used to avoid such government discretionary interventions. First, ensuring that privatization procedures do not favor politically connected firms will reduce the risk of government discretion post-privatization. Independent regulatory agencies should be created or strengthened to enforce rules applicable to all players, regardless of their remaining government ties. Legislation protecting the interests of private shareholders can also require that firm strategies are discussed and approved by boards comprised of independent and qualified members.

Complementary resources:
- A Policy Toolkit for practitioners: Business of the State (BOS) and Private sector development (available here)
- WBG's The Business of the State. Chapter 6: A practitioner's guide on when (not) to use BOSs (available here)

8.6. The potential of competition advocacy

Competition advocacy encompasses activities that promote a competitive environment through non-enforcement mechanisms. Competition advocacy aims to enhance the understanding of the competitive process and provide a framework for thinking about business and public policy issues from a competition perspective. It cultivates a competition-oriented society by educating business operators, policymakers, and the general public.[11] This includes building relationships with government entities, increasing public awareness of competition benefits, and identifying and removing anticompetitive policies and regulations. The means of promoting competition are multi-faceted, depending on the specific objectives of the advocacy initiative, the various areas of analysis on which advocacy initiatives are based; the tools employed to implement advocacy; the sets of mandates that competition authorities hold; and the advocacy strategy employed (Goodwin and Licetti 2014)[11]

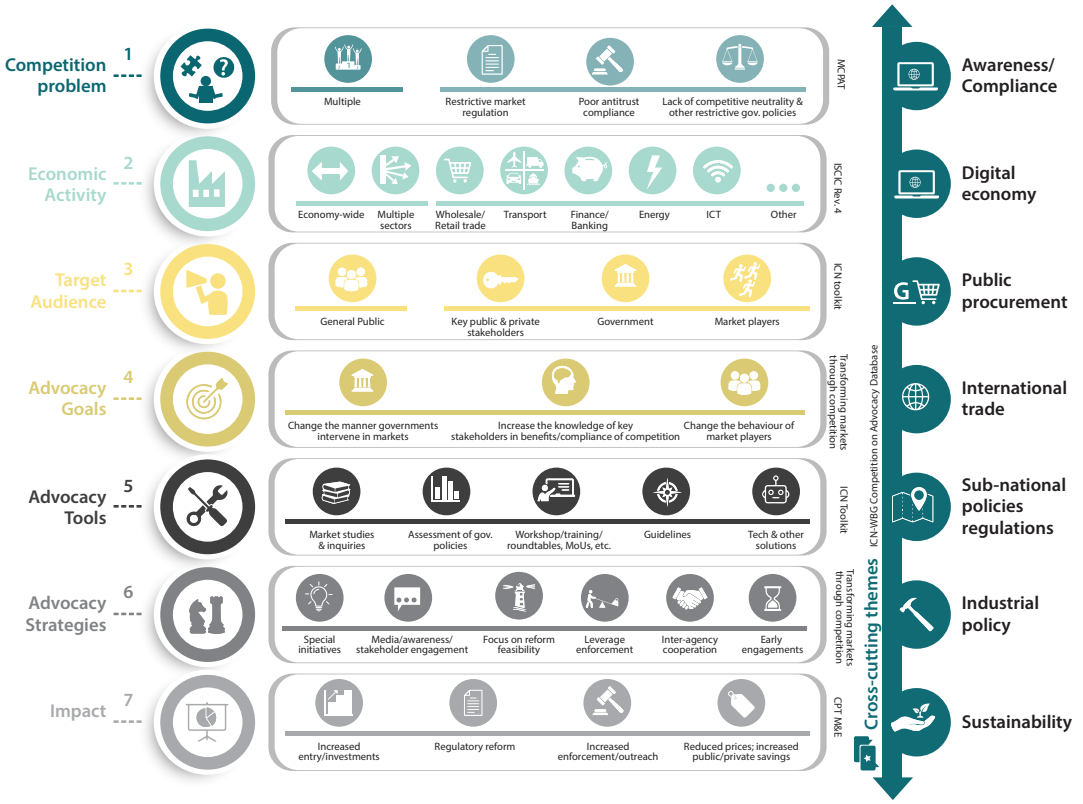
Competition advocacy goes beyond traditional enforcement activities, making a broader impact on the competitive market environment. Studies on specific sectors, markets, or policy areas, regulatory assessments on past or proposed laws and regulations, and formal market inquiries can help better understand complex topics or market dynamics, facilitating enforcement tasks. Advocacy initiatives can take a comprehensive approach, spanning various behaviors, multiple related markets, or entire sectors.

This flexibility enables competition authorities to address the core issues of competition distortions rather than only dealing with anticompetitive practices. Further, competition advocates can be innovative in their approach, whether through stakeholder engagements, apps, behavioral tools, or other creative strategies to achieve their objectives. Advocacy initiatives allow for a more flexible and innovative approach than enforcement.

Advocacy can help build an effective ecosystem of market institutions by promoting competition principles and disseminating the benefits of competitive markets among public authorities. Embedding competition principles in legislative and public policy design may not involve intense resource use but can contribute to better market outcomes. If policymakers are unaware of the benefits of competition and how it can be affected, they may unintentionally harm the competitive process. Competition advocacy is key to raising awareness of the costs of uncompetitive markets.

Since its inception in 2013, the World Bank – International Competition Network Competition Advocacy Contest has rewarded authorities' efforts to transform markets, benefitting firms, consumers, and the economy. The contest recognizes and celebrates exceptional initiatives undertaken by competition agencies and their partners. Each year, competition authorities and other public bodies submit competition advocacy initiatives under a changing set of themes. Awarded initiatives are selected based on relevance, innovation, success, and impact. Over the years, the contest has evolved significantly, reflecting the changing landscape of competition policy globally. Notably, since 2013, the number of submissions and participating agencies has significantly increased (299 entries between 2013 and 2023), showcasing the growing relevance of competition advocacy to embed competition principles in key markets and address various economic and societal challenges. Moreover, the contest has been key for capturing the evolution in advocacy techniques as competition authorities adapted to the digital age, embracing new technologies and communication strategies to disseminate pro-competitive policies and practices. Figure 44 summarizes the competition advocacy stories in seven key dimensions.

FIGURE 44: KEY DIMENSIONS OF COMPETITION ADVOCACY SUBMISSIONS TO THE ICN-WBG CONTEST 2013-2023



Source: World Bank 2023.

TOOLKIT ITEM 25 Competition advocacy provides an opportunity to implement microeconomic structural reforms and achieve impact, even while operating in suboptimal institutional setups.

8.7. A final thought on competition reforms

Competition reforms are not easy, but they are vital for economic productivity, growth, and population welfare. Implementing holistic policies to boost competition and improve dynamics can help drive the structural shifts needed for economic recovery in coming years, especially in tight fiscal environments. Success is possible, and competition reforms have already reaped rewards in several developing countries, including in markets crucial for development, such as food, agriculture, and health. For example:

- **In Kenya:** Eliminating restrictive requirements for new processing firms to enter the tea sector (such as seeking consent from incumbents for a new license and minimum hectarage requirements), led to new entry and the development of new products. This potentially increased incomes for farmers producing purple tea by 70 percent, as well as export earnings by up to US$60 million.
- **In Honduras**: After the reform of discretionary registration procedures for new varieties of pesticides, the number of additional products registered per year increased by 340 percent, leading to a 9 percent decrease in pesticide prices.
- **In South Africa:** Enforcement action to tackle cartels in four cartels in wheat, maize, poultry, and pharmaceuticals (a small proportion of the 76 cartels tackled by the authority in the period from 2005 to 2015) led to income gains for the poorest 40 percent that were 3.4 times higher than those for the richest 40 percent (World Bank 2016). Overall poverty stood to fall by 0.4 percentage points.[12] Comparing this poverty impact per U.S. dollar spent on the Competition Commission's budget to the poverty impact per South African rand spent on cash transfers revealed that the potential poverty impact from anticartel enforcement per dollar spent was about 38 times higher in this case.
- **In Pakistan:** In 2009, the competition authority determined that a 1972 bilateral agreement between Pakistan and Saudi Arabia had created an unduly severe barrier to competition and recommended opening up the routes to other airlines. After the modification of the bilateral service agreement, the market now includes four competitors offering more choices for passengers in flights and fares. Consumer savings in the year 2013 alone were US$60 million.
- **In Mexico:** Regulations that restricted shop opening hours in the Municipality of Oaxaca de Juárez had prevented some firms with innovative business models from entering the market. Reform of these regulations allowed for investment in the municipality and was associated with a 6.8 percent increase in annual retail sales growth (Dauda, Goodwin and Licetti forthcoming).

Competition authorities can play an impactful role in advocating for competition reforms. Over 70 percent of all the ICN-WBG Competition Advocacy Contest entries showed tangible impact. In their submissions, advocacy champions consistently demonstrated the links between their activities and at least one of four types of measurable results (i) Increased entry or investments, (ii) Increased enforcement or outreach, (iii) Reduced prices or increased public or private savings, (iv) Regulatory change (such as laws, regulations, policies). Tangible impact is often achieved through sectoral engagements, with targeted diagnostics and actionable solutions, as well as targeted audiences (such as public authorities and business associations).

The largest impact is associated with competition advocacy shaping government policies. Following a formal investigation in Malawi, the *Competition Commission* successfully advocated for amendments to the Credit Reference Bureau Act that obliged lenders to share information with credit bureaus.[13] In **Mexico**, the COFECE contributed to adopting the Financial Technologies Institutions Law, creating the country's legal foundations for open banking.[14] By 2022, 650 Mexican Fintech were operating in the country, an increase of 26% compared to the 521 in 2021. In the **European Union**, *the Directorate-General for Competition* was critical in adopting EU Regulation 2018/302 prohibiting geographically based restrictions on online shopping.[15] While competition advocacy was primarily focused on specific changes in sectoral regulations,

competition authorities have also been instrumental in building platforms for systemic policy change. In **Peru**, for instance, the competition authority was responsible for supervising a process through which over 950 bureaucratic barriers in infrastructure and retail sectors were repealed.

A focus on markets and products allowed competition advocates to formulate actionable recommendations. Sectoral competition advocacy initiatives are distinct from economy-wide initiatives because they do not cover horizontal issues affecting suppliers and purchasers. However, sectoral initiatives are not homogeneous – they differ in the breadth and depth of issues addressed. In general, sectoral initiatives that focused on specific markets and specific products instead of sector-wide issues made up the bulk of submissions to the ICN-WBG Competition Advocacy Contest. In **South Africa**, the Competition *Commission conducted* an inquiry into the banking sector that covered services as varied as interchange fees and cash withdrawal.[16] In **Brazil**, the *Administrative Council for Economic Defense (CADE)* analyzed the entire value chain for petroleum products in response to complaints about elevated prices at the pump.[17] In Ukraine, the Antimonopoly Committee simultaneously reviewed barriers to competition in the electricity and thermal coal markets.[18]

Sectoral initiatives often have spillover effects and generate wider economic benefits. Although they are often considered limited in their capacity to influence broader economic development objectives, in practice, the changes associated with sectoral initiatives can spill over to other sectors and generate wider economic benefits. In **Israel**, the ICA played a critical role in reducing interchange fees by more than 50 percent for debit payments, thus lowering transaction costs for the entire economy.[19] In **Argentina**, the CNDC convinced the Foreign Trade Commission that anti-dumping measures in upstream manufacturing may exacerbate bottlenecks in downstream sectors and result in worse outcomes overall.[20] *The Federal Antimonopoly Service of the* ***Russian Federation*** promoted national roaming legislation in mobile services that improved connectivity throughout the country.[21] In **Kenya**, the *Competition Authority* convinced a provider of mobile money transfer services to terminate exclusionary practices, reducing the cost of sending, receiving, and storing money.

Nevertheless, economy-wide initiatives have also delivered important results. Economywide initiatives focused on competition laws and their enforcement, public procurement, SOEs, and the regulatory process in general. Information campaigns related to leniency and bid-rigging in public procurement were particularly common among initiatives focused on antitrust. In **Sweden**, the SCA published interactive guidance to help public authorities and firms identify anti-competitive conduct in public procurement.[22] In **Hungary**, the Competition Authority established an anonymous chat line to encourage firms engaged in cartels to file for leniency.[23] In **Peru**, the competition authority led efforts to change public procurement regulations to make reserve prices confidential and implement other changes that reduced the risk of collusion among bidders.[24]

Competition advocacy in public procurement is a powerful means to save public funds. In **Panama** and **Mexico**, the competition authorities targeted public entities responsible for the largest procurement contracts, such as the Social Security Fund in Panama or the National Housing Institute in Mexico. The latter generated savings of 287 million dollars (5 billion pesos) and used competitive bidding in 38% of its purchases. **Spain's** efforts to maintain competitive procurement during COVID-19 helped at a time of increasing public spending.

Inter-institutional cooperation is a central tool for effective advocacy, especially when dealing with new topics such as digital markets. The **United Kingdom's** regulatory authorities highlighted the need for a more coherent and coordinated action between digital-related regulators and, in 2020, launched the Digital Regulation Cooperation Forum to promote a more cohesive action by regulators in digital markets. The Forum brings together the CMA, Ofcom, the communications regulator, the *Information Commissioner's Office* (ICO), and the *Financial Conduct Authority* (FCA). The authorities have coordinated action plans for 2022-2023, setting priorities that include promoting competition and privacy in online advertising and supporting improvements in algorithmic transparency. In August 2023 the ICO and the CMA published a joint analysis on harmful design in digital markets, including a consensus on how companies can promote positive online architecture practices, facilitating compliance by online enterprises

(Digital Regulation Cooperation Forum, 2023). In 2018, the Portuguese Competition Authority published the study on *Technological Innovation and Competition in the Financial Sector*, prepared with the support of key stakeholders from sector regulators to banking and FinTech associations.

In sum, competition reforms are possible if pursued by a champion supported by an ecosystem of institutions, based on technically sound analysis that shows benefits from reforms, and considering the political economy for a feasible strategy. Overall, advocating for competition reforms has unequivocally proven itself as a high-value investment for competition authorities, as confirmed by a WBG survey addressed to competition authorities that submitted competition advocacy initiatives to the ICN-WBG contests that took place between 2013 and 2023. (Miralles et al 2023, unpublished)

NOTES

1 See Australia National Competition Council – National Competition Policy http://ncp.ncc.gov.au/

2 See for example the functional review conducted for Romania. World Bank. 2010. Romania - Functional Review: Romania Competition Council. http://hdl.handle.net/10986/12281

3 While here we focus on institutional aspects of antitrust enforcement, procedural elements of the antitrust law are another aspect that is key for independence in implementation. This includes a robust due process to provide for transparency and accountability, safeguarding not only the rights of the parties regarding fair and technical enforcement, but also allowing other interested stakeholders to scrutinize the work of a competition enforcer, particularly regarding the investigation, prosecution, and adjudication of anticompetitive practices and merger control. Such rules have the potential to dissuade deviations from the legal framework, therefore promoting predictability and higher-quality decisions.

4 PEPs are "individuals who are or have been entrusted with prominent public functions in a country" like (current and former) senior government, judicial, or military officials, senior executives of SOEs, & important political party officials. Middle or junior-ranked people do usually not count as PEPs, while family members and close associates of known PEPs do. See IFC IDD guidelines 2017.

5 See for example Commander and Poupakis (2017), "Political connections and firms: network dimensions" and Balabushko et al (2018), "Crony capitalism in Ukraine: impact on economic outcomes".

6 For instance, in the telecommunications sector, Faccio and Zingales (2017) measure data for 148 countries and estimate the proportion of top employees of each country's mobile phone operator that has served in top government positions (head of state, minister, member of parliament, and those working for anyone in these positions). They use data from the International Telecommunication Union (ITU) and the Groupe Speciale Mobiles Association (GSMA) for information related to the telecommunications operators, and data from Capital IQ for the biographies of the individuals.

7 The range of public officials depends on the legislation. Some agencies like ombudsmen, supreme courts, tax authorities, anticorruption commissions, etc. collect and monitor this information. Rossi, I, Pop, L, Clementucci, F, and Sawaqed, L. World Bank (2012). Using Asset Disclosure for Identifying Politically Exposed Persons, p.6 available at http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Using_AD_for_PEP_identification.pdf

8 As well as the Offshore Leaks, Bahama Leaks and Paradise Papers investigations.

9 Since SOE-supporting subsidies are a form of industrial policy.

10 Shleifer, Andrei & Boycko, Maxim & Vishny, Robert. (1996). A Theory of Privatisation. Economic Journal. 106. 309-19. 10.2307/2235248. "Privatization of public enterprises can raise the cost to politicians of influencing them, since subsidies to private firms necessary to force them to remain inefficient are politically harder to sustain than wasted profits of the state firms".

11 For guidance regarding competition advocacy strategies and tools for competition authorities, visit: https://www.internationalcompetitionnetwork.org/working-groups/advocacy/

11 For a framework on competition advocacy and successful examples see Goodwin & Licetti (2014).

12 Under the conservative assumption that this led to a 10 percent decrease in prices across products.

13 Submission of the Competition and Fair Trading Commission to the 2015-2016 WBG-ICN Competition Advocacy Contest.

14 Submission of the Federal Competition Commission to the 2018-2019 WBG-ICN Competition Advocacy Contest.

15 Submission of the European Commission to the 2017-2018 WBG-ICN Competition Advocacy Contest.

16 Submission of the Competition Commission to the 2014-2015 WBG-ICN Competition Advocacy Contest.

17 Submission of the Council for Economic Defense to the 2018-2019 WBG-ICN Competition Advocacy Contest.

18 Submission of the Antimonopoly Committee to the 2016-2017 WBG-ICN Competition Advocacy Contest.

19 Submission of the Competition Authority to the 2014-2015 WBG-ICN Competition Advocacy Contest.

20 Submission of the National Commission for the Defense of Competition to the 2017-2018 WBG-ICN Competition Advocacy Contest.

[21] Submission of the Federal Antimonopoly Service to the 2018-2019 WBG-ICN Competition Advocacy Contest.

[22] Submission of the Competition Authority to the 2015-2016 WBG-ICN Competition Advocacy Contest.

[23] Submission of the Competition Authority to the 2015-2016 WBG-ICN Competition Advocacy Contest.

[24] Submission of the Institute for Defense of Competition and Intellectual Property Rights to the 2018-2019 WBG-ICN Competition Advocacy Contest.

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