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Institutions' Role in Promoting a Competitive Market

This paper aims to examine whether competition law and policies have greater effect on competition when sound institutions are in place. Reports by major global actors as well as governmental reforming, show that there is unanimity on the notion that political reforming is essential in order to reach a more competitive market. Later economic research shows that institutions such as governance effectiveness and trust among people are important in order to sustain and increase economic growth. This paper assumes that this impact is partly due to the fact that institutions increase the incentives to invest and that the effect of institutions is especially clear among the smaller entrepreneurs since they are more sensitive to unsecure markets. With a cross-country regression comparing 30 OECD-countries, this paper finds that from a first look competition law and policies appear to have no effect on competition. However, when analysing the same relationship with the modification that institutions are added as an explaining variable, the results indicate that competition law and policies have a positive effect on competition for those few countries that have sound institutions in place.

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1. Introduction

The huge transnational corporations have allegedly become the main determinants of the world market's new geography, concerning its structure, territories and populations. Hardt and Negri write about the nations' diminishing role in the world's economic and political arena. Nation-states have become instruments for the corporations' manoeuvring of commodities, monies, and populations across the continents.¹ This phenomenon, or "empire", is legitimated by itself, with its ability to exercise its force as an economic mechanism and to produce its own image of authority. Thus nothing from an external mechanism is needed in order to continue the development of its central role in the world arena.² The authors take non-governmental organizations as an example of self-legitimizing powerful global actors. Their images are often to act on the basis of ethical and moral imperatives. They are not run by governments and have therefore a different support by the world's citizens. These circumstances actually provide them with powers sometimes far greater than the ones held by nation-states.³

The social and economic impacts from the expansion of multinational companies and the subsequent costs from anti-competitive behaviour are indeed great. The negative impact from anti-competitive behaviour and the economies' potential gains from ensuring a competitive market are on the agendas of many important international bodies. Most of these bodies seem to be in consensus about the overall objectives on what kind of market they believe to be good in order to move towards social and economic welfare. Economies all over the world are taking major steps in order to control for more competitive markets. Competition law and policies are there to make sure that single operators do not take control of markets. Complementary strategies focus on the encouragement of small and new enterprises to engage themselves in the market.

¹ Hardt and Negri, 2000, pages 31-32 and 310-320

² Hardt and Negri, 2000, pages 33-34

³ Hardt and Negri, 2000, pages 35-36

Douglass North is one of the most prominent researchers in the field of institutional economics. He claims transaction costs to be a critical determinant of economic performance and through this statement emphasises the importance of institutions and effective enforcement mechanisms. He accordingly defines institutions as "the humanly devised constraints that structure political, economic, and social interaction".⁴ Olson argues that a low-income country may have just as big resources as a high-income country but that they lack the means to realize the large gains from specialization and trade. They lack the institutions that for example enforce contracts impartially or make property rights secure. These institutions are necessary in order to encourage investors to take risks connected to the economies' markets.⁵ Rothstein and Teorell have made another important finding; they show that "social capital, defined as norms about reciprocity and generalized trust in other people, seems to be determined by the quality of government and not the other way around".⁶ The more we know of how trust in the society is created the more we know of how to form a society with high incentives to invest and with low transaction costs from uncertainty in entering contracts and investing money.

In most reports that concern competition, institutions, in the wider definition including impartial governance and social trust, are if at all only mentioned as periphery contributors to well-functioning governance present in order to help policies to be properly implemented. However, it has many times been proved by economists that institutions have a far greater role in determining economic growth.

It should be pointed out that important actors, such as the World Bank and the UN, have taken steps in acknowledging institutional reforming as an important determinant of competition. The *Doing Business* report shows that economies are on a fairly high pace in introducing encouraging reforms to investment incentives, which is much of the essence in institutional theory. Yet, social capital for example has not been properly introduced by many important economic reports. The point of this paper is to show that there are more

⁴ North, 1995

⁵ Olson, in Knack, 2003

⁶ Rothstein and Teorell, 2005, page 1

gains to be seized from institutions; the world's politicians' engagement in improving competition law and policies and business facilitating reforming in for example property rights and the number of days it takes to start up a business is good, but not good enough in order to achieve a higher level of competitiveness.

In order to investigate the herein alleged relationship between level of competition, competition law and policies, and institutions a model will be presented with competition as the dependent variable and the other two as explaining independent variables. Diagrams plotting relationships between the variables will be presented in the argumentation of the relationship in order to make easier for the reader to follow the reasoning behind the hypothesis; competition law and policies have greater effect on competition when sound institutions are present.

The assumption that institutions are the critical factor deciding whether competition law and policies succeed in promoting competition should, when testing the model's strength, of course be adopted with precaution. The model will be tested for other variables possibly affecting competition law and policies' affect on competition. Two of these will be representing a certain type of institutions, by this paper assumed to be of extra significance to the affect on competition, while the third one is an index used in the *Global Competitiveness Report* that argues slightly differently on what the determinants of competition are.

The paper founds its argumentation on today's situation on competition, existing work towards a more competitive market, and economic research relevant to growth and competition. Information on these areas are gathered from reports made available and signed by the members of major global actors such as the World Bank and the UN, some prominent economists in the field of development economics, and course literature in the field of economic development. A more profound investigation of the specific countries concerning their views of competition as well as what is done in order to promote it, would probably have enriched the results and the reasoning behind the hypothesis of this paper. However, these kinds of investigations have not been done in this paper and it is instead solely based on the more general reports and research articles, discussing from a global perspective.

In chapter 2, competition is discussed with the aim to relate to its ability to promote economic growth and describe what is done today in order to promote a competitive market. Further, the, among economists and politicians, emerging realisation of institutions' role in economic growth is presented. Chapter 3 links competition law and policies with institutions and argues that institutions in various ways have the ability to serve as a complement or even a necessary precondition to reach a more competitive market. Chapter 4 gives a presentation of the data and what the empirical support to this theory seems to be. Chapter 5 presents the papers theory with a model and analyses its ability to explain the cause of competition.

2. Theories and Views of The Business Environment

2.1. Competition

From a micro-economic perspective, it is easy to see that imperfect competition is a necessary consequence of an industry that has internal but not external economies of scale. This is because the average production costs become lower when a company increases its production but no advantages come from a larger industry in itself, hence creating no opportunities for smaller companies to enter and benefit from external economies of scale.⁷

The ongoing expansion of market-dominating companies can both in theory and in reality be easily observed and understood. So what then are the impacts to the society from uncompetitive markets?

A clear effect is that the price becomes higher. When a market is dominated by a single or a few companies, the cost effective rules, such as price is equal to marginal cost and profit is zero, do no longer apply. If there is no producer that is willing or able to make the potential profit from lowering the price below the market-dominating producers' price, the few companies already in the market have no incentive to set the price to the marginal cost.

A higher price has obvious direct effects to the people that want to buy the products, since it negatively affects consuming possibilities. A much important consequence is also that investment in innovation in an industry dominated by a few companies may be significantly lowered due to the absence of competing companies with better products. Imperfect competition may also lead to dumping (exporting goods to a lower price) should the market be segmented and domestic buyers have no easy access to bye products that are being exported. This phenomenon is not only "market inefficient" but also considered as directly unfair to the buyers.⁸

⁷ Krugman and Obstfeld, 2003, pages 122 and 142

⁸ Szirmai, 2005, page 342

The 350 largest multilateral corporations now control more than 40% of the world trade and dominate the production, distribution, and sale of many goods from developing countries. Many multi national companies, MNCs, have annual sales volumes in excess of the GDP of the developing nations in which they operate. 97 of the top 100 MNCs are from North America, Western Europe, or Japan. MNCs often manipulate prices and make sure to be in control of certain areas by making it harder for new businesses to enter the market through using new technologies, special skills, and product differentiating.⁹ The MNCs may even take over the domestic firms in its attempt to dominate the market. The consequence of MNCs entering a foreign market in a developing country is not necessarily negative, where the domestic industry is bought and controlled by the MNC. Many countries that have strong institutional frameworks have managed to profit from the integration with the global economy.¹⁰

Many of the market dominating MNCs are inconceivably large in their capital resources and impose large effects with their choices of how they decide to invest their resources. With this economic importance they possess a certain kind of power in their interaction with governments and organizations. From a democratic point of view this may impose a threat to the way political decisions are taken and whom the decision takers are representing. Suppose an economy with democratic governance would consider it economically wise to let representatives from MNCs gain a lot of influence in a committee assigned to set up a plan for a city's development in becoming more sustainable and environmental friendly. The company would then be representing its shareholders and not an equally big proportion of the economy's citizens. Recalling the earlier mentioned authors Hardt and Negri, the global expansion of these gigantic companies is indeed happening and with an increased control over the market their level of power, both economic and political, can be expected to grow accordingly.

The multi-national companies do not automatically create a less competitive market. However there is still a clear tendency that can be stated; that it is these companies that have

⁹ Todaro and Smith, 2006, pages 708-710

¹⁰ Szirmai, 2005, page 342

the power to abuse a growing dominance over the particular market. It is also true that a market with a larger number of companies has less chance to suffer from anti-competitive behaviour.¹¹

The World Economic Forum and the OECD are both stating that competition is likely to have a significant positive impact on growth and the levels of income for their citizens.¹²

The United Nations Conference on Trade and Development, UNCTAD, reports that anti-competitive practices impair the process of trade expansion of developing countries more significantly than previously thought. They declare that developing countries should be given extra focus in the struggle towards eliminating anti-competitive behaviour. However, they further state that developing countries' conviction of the benefits from competition policy varies and that UNCTAD thus will serve as a credible organization that will provide policy advice and technical advice.¹³ Further the United Nations with its guidelines on competition law and policy takes a clear stand in that a competitive market is a common objective among the members of the UN. It recommends economies to take enforcing measures in order to ensure an economy with competitive prices that enables incorporation of businesses, in order to reach the overall objective to reach social and economic welfare.¹⁴

The Caribbean Community (CARICOM), The West African Economic and Monetary Union (UEMOA), and the Common Market for Eastern and Southern Africa (COMESA) have established or are considering regional competition frameworks.¹⁵

The ones not completely convinced of the urgency to take on policies in order to reach competition, point to the fact that it might harm the liberty to trade within and between economies. There are ongoing discussions within the members of the WTO of how to

¹¹ Krugman and Obstfeld, 2003, page 123

¹² World Economic Forum, 2008

¹³ UNCTAD, 2004

¹⁴ United Nations, 2008

¹⁵ Department for International Development, 2001

incorporate competition laws. 40 members of the WTO have bound themselves to the *Agreement on Government*, which promotes competition.¹⁶

All in all, it seems the world's economies are in consensus over the importance of ensuring a market free from uncompetitive behaviour, where huge companies do not dominate the market and gain extreme power, where new enterprises can emerge, and where incentives to innovate can create more efficient production of products and services.

Measures Taken to Actively Steer Towards a Competitive Market

The World Bank writes in its *Doing Business* report that it is principally the developed countries that continually reform and update their laws and policies, whereas developing countries tend to be working with old regulatory systems. Yet, they are now making reforms in the field of ease of doing business to a higher degree than developed countries. For example the low and lower middle-income economies stood for 64 percent of the reforms introduced in 2009.¹⁷

The report emphasizes the importance of a regulatory environment, where the implementation is transparent and efficient in order to seize opportunities in economic development, enable firms to reorient themselves and for new firms to enter the market. Further they emphasize that an economy should have efficient court and bankruptcy procedures as well as strong property rights and investor protections in order to make it easy to reallocate assets when needed and to increase the incentives to make new investments.¹⁸

From the looks of some positive statistics, it would be fair to say that the world to some extent have engaged itself in realizing the opportunities that are there to be seized through reforming towards a better regulatory environment. In 2008/2009 most of the reforms recorded aimed at improving the regulatory climate by introducing reforms that were intended to increase competitiveness and encourage the creation of firms and jobs.¹⁹

¹⁶ Anderson and Kovacic, 2009

¹⁷ The World Bank, 2009

¹⁸ The World Bank, 2009, page 1

¹⁹ The World Bank, 2009, page 1

The report measures ten different types of reforms that constitute the indicator measuring the "ease of doing business". The 10 reforms that constitute the "ease of doing business index" are showed in figure 1, copied from the *Doing Business* report, together with the top 10 reformers in the year 2008/2009.

Figure 1

The top 10 reformers in 2008/09

Economy	Starting a business	Dealing with construction permits	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
Rwanda	✓		✓	✓	✓	✓		✓		✓
Kyrgyz Republic	✓	✓	✓	✓	✓		✓	✓		
Macedonia, FYR	✓	✓	✓	✓	✓	✓	✓			
Belarus	✓	✓	✓	✓			✓	✓		
United Arab Emirates	✓	✓						✓		
Moldova	✓			✓			✓			
Colombia	✓	✓		✓	✓	✓	✓	✓		✓
Tajikistan	✓	✓			✓	✓				✓
Egypt, Arab Rep.	✓	✓			✓				✓	
Liberia	✓	✓						✓		

Note: Economies are ranked on the number and impact of reforms. First, Doing Business selects the economies that implemented reforms making it easier to do business in 3 or more of the Doing Business topics. Second, it ranks these economies on the increase in rank on the ease of doing business from the previous year. The larger the improvement, the higher the ranking as a reformer. Source: Doing Business database.

As the figure shows, it is the low- and lower-middle income economies that for the years 2008-2009 are mostly engaged in doing reforms to ease business engagements. The low- and lower-middle income economies that represent just under half of the world's economies realized no less than two-thirds of the recorded reforms in the ease of doing business for these years.²⁰

For the years 2004-2010, the three most common reforms within the areas of starting a business, getting credit, and registering property among the world economies are presented by the *Doing Business* report (figure 2, copied from the *Doing Business* report):

- The ease of starting a business may be a very profound ingredient in the struggle towards a more efficient market that is quick in seizing opportunities. Yet this is an area that can be significantly improved by many economies. It is a general conception

²⁰ The World Bank, 2009, page 2

among poor people in low and lower-middle income economies that starting a business is one of the most effective ways out of poverty. New businesses compose a major contribution to employment. Half the new jobs in the European Union, representing about 75 million people, are created by small and medium-size enterprises.²¹ It is the procedures of the notification of a company's existence and the tax registration that foremost are in need of becoming more effective. The comprehension of these economic and social gains that can be realised in this area seems to have reached many of the world's reformers. The indicator measuring the ease of business start-up has been the highest scorer of the reforms measured by the doing business report since 2003.

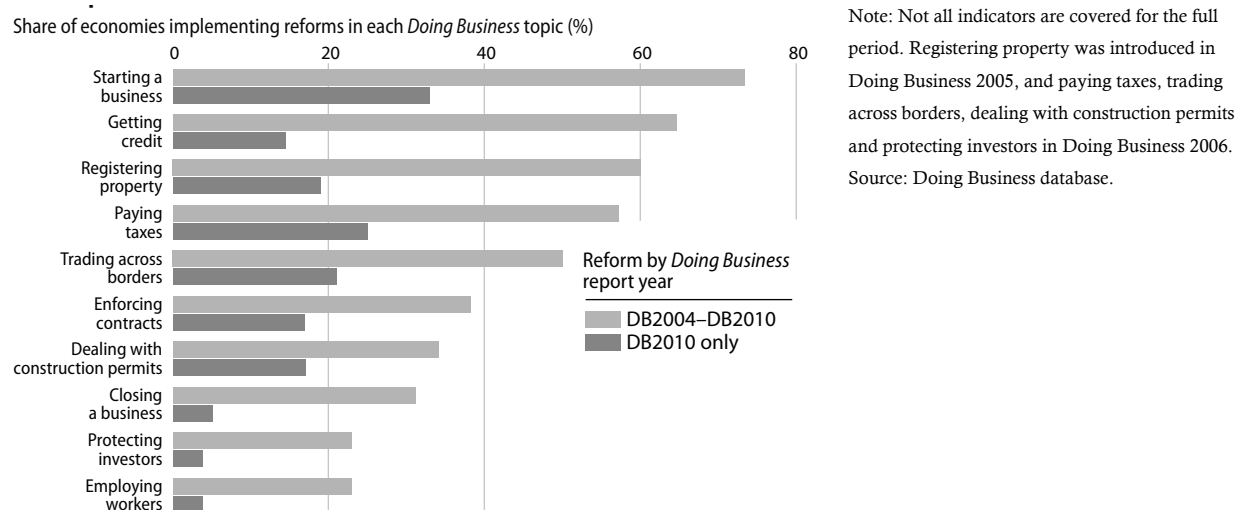
- In order to make investments, access to capital is needed. Capital holders that wish to lend their money to investors, that hopefully will increase the worth of the capital, will wish to have information on the creditworthiness of the borrower. Hence it is vital for an economy to provide mechanisms that can collect and spread necessary information. The existence of well functioning collateral laws and credit registries will make assessment of borrowers' creditworthiness through objective measures easier, which will give banks incentives to extend loans to a higher degree. Reforms in this field have been impressive over the 5 past years. 27 new credit bureaus have opened as well as 11 new collateral registries. Reforms strengthening the legal rights of borrowers and lenders, and reforms improving credit information have been recorded in 42 and 70 economies around the world, respectively.²²
- The incentive to invest in any production associated with land will be lowered if the ownership of the land is not cleared and secured. What is needed is a well-defined property system that can serve as a registry of land tenure. A study in Argentina tells us that the investment increase from providing property owners with a formal title may be as high as 47%. The societal benefit may be extra high from ameliorating women's access to land. Women's rates of return on investments tend to be higher than men's because they can make more productive use of capital since they normally start from a

²¹ The World Bank, 2009, page 10-16

²² The World Bank, 2009, pages 33-37

much lower investment base.²³ Women are discriminated against in many countries and have limited rights to own land. Hence empowering women in this area is important. Registration of property is the third most common reform among the world economies in the *Doing Business* report. They recorded 125 reforms (49 of these reduced taxes and fees) in 93 economies for the past 5 years.²⁴

Figure 2



Even though we can see high level of activity in reforming among the developing countries, they still have a long way to go. In the ranking list of how well economies' score on their current situation measured in ease of doing business the top ten scorers are all developed economies: Singapore, New Zealand, Hong Kong: China, United States, United Kingdom, Denmark, Ireland, Canada, Australia, and Norway. The OECD countries rank in average as number 30 whereas for example Latin American and Caribbean countries rank on average 95.²⁵

Results from Competition Law and Policies

Reforms aimed at ameliorating the investment climate are different from other macroeconomic reforms, which more often generate immediate benefits directly spread over

²³ Todaro and Smith, 2006, page 334

²⁴ The World Bank, 2009, pages 27-32

²⁵ The World Bank, 2009

the whole population albeit in a dispersed manner with only a smaller group actually benefiting. In the report *Reforming the Investment Climate*, the report lists obstacles connected to the *implementation* of these kinds of reforms. However even in this report that attempts to give some advice on how to reform investment climate, no substantive analysis of the results on the reforms implemented in this area is provided.²⁶

Results from *Doing Business* report show that “in relatively poor but well-governed economies, a 10-day reduction in start-up time was associated with an increase of 0.4 percentage points in the growth rate and 0.27 percentage points in the investment rate”.²⁷

There seems to be a lack of monitoring in the finale stage of the objectives of these reforms, namely the effect on competition. The *Reforming the Investment Climate* report presents an evaluation on the implementation of the reforms whereas the *Doing Business* report provides us with a report on how much reforming have been made in the area of ease of doing business. An interpretation could be that it is not reflected whether well implemented competition policies have the intended effects, rather it is assumed that they will have their intended effect should they only be implemented correctly.

2.2. Institutions

A New Perspective on Growth

North attempts to give an explanation to what determines an efficient, competitive market that economists many times only have mentioned as a given assumption. North argues that it cannot be seen as an automatic development that people more and more will interact in cooperate exchange and have the incentive to invest in innovation that can lead to a more efficient production and goods with better qualities. He refers to historic economic development and claims that without a development of ways of spreading risk, transforming uncertainty, creating large scale markets that lower costs of information, and enabling

²⁶ The International Bank for Reconstruction and Development / The World Bank, 2006

²⁷ The World Bank, 2009, page 3

negotiable government indebtedness, the growth of exchange and commerce as witnessed in the most affluent parts of Europe would not be today's reality.²⁸

He compares the economic evolution of England and Spain to show that Spain has developed under an institutional framework that has discouraged productivity-raising activities. Instead the creation of monopolies, restrictions of entry and factor mobility, and political organizations that establish property rights that redistribute rather than increase income have enhanced private profitability. However, for England's part, the institutional framework has permitted complex impersonal exchange, which, according to North, is necessary to attain political stability and to capture potential economic benefits".²⁹

The study of institutions and their effect on economic growth and other potentially affected variables has encountered difficulties in finding good indicators. The problems around claiming causality may also be a particularly difficult task for advocates of institutions. Rodrik has made an impressive empirical study of institutions. He uses mortality rates of colonial settlers as an instrument for measuring institutions³⁰ since this is viewed to be what determined whether the English colonizers settled and established functioning institutions. He then uses this instrument to show that institutions are what actually is the main determining factor to economic growth, both indirectly, through affecting the level of international trade, and directly through increased investment incentives in the domestic market. He even goes as far as saying, and not without foundation, that institutions trump everything else.³¹

If it were true that the world's economies are on the frontiers of neoclassical production functions, the low-income economies would have a marginal product of capital much higher than would the high-income economies. Olson divides possible explanations to growth into two groups. The first group includes any kind of resources belonging to an economy, such as capital, land, and labour. The second one includes institutions and public policies. He points

²⁸ North, 1995

²⁹ North, 1995

³⁰ Rodrik, 2004

³¹ Rodrik, 2004

to the fact that countries sharing borders can have big differences in per capita income and regions in the same countries have less of a difference in per capita income. He argues that these two circumstances show that it is the policies and institutions that must be the major explanatory factor to economic growth.³²

He claims that poorer countries are further from their potential per capita income and can therefore have a faster growth rate than a rich country. He supports this by the finding that the fastest-growing countries are never the countries with the highest per capita incomes but always a subset of the lower-income countries. He rejects the endogenous growth model from its disability to explain the poorer countries fast growth rates as well as the old growth theory since it incorrectly assumes general convergence. Olson's findings permit us to make the assumption that institutional growth theory has brought knowledge into our struggle to determine the reasons for why some countries have managed to develop fast where others have lagged behind.³³ Olson resumes his findings of the importance of institutions by saying that "... individual rationality is very far indeed from being sufficient for social rationality".³⁴

It has been and still is a major task for the institutionalists to find good indicators to measure institutions. Property rights have served as an indicator that has been used frequently and it has managed to explain economic growth to a large extent. Clague, Keefer, Knack and Olson have presented their instrument for property and contract rights: Contract-Intensive Money, CIM. With the CIM index they've showed a relationship between effective property and contract rights and growth, or, more specifically, a relationship between these institutions and (1) the share of GDP that should be generated by industries that are especially dependent on the third-party enforcement, (2) gains from economies of scale and specialization a country should reap and thus a higher capital stock, productivity, and per capita income, and (3) greater ability to firms to raise capital, higher rate of investment and faster rate of economic growth.³⁵

³² Olson, in Knack, 2003

³³ Olson, in Knack, 2003

³⁴ Olson, in Knack, 2003

³⁵ Clague, Keefer, Knack, and Olson, in Knack 2003

The indicator reflects the type of government that improves economic performance but does not attempt to *explain* it.³⁶ The underlying reasoning is that investment is needed for innovation and new technologies. Where third-party enforcement is absent, investment is hindered since no gains from capital-intensive and large-scale production can be made. Contract enforcement therefore affects the rate of growth.³⁷

Social Capital and the Importance of Trust

Rothstein and Teorell argue that quality of governance should be measured by the exercise of government power in the implementation of policies rather than by the detailed contents of the policies. They focus on the importance to the entrepreneur of knowing beforehand the risks implied in investing and the exact costs and requirements that the governments will enforce.

The authors admit that there is a trade-off between impartial governance and its effectiveness and efficiency. Impartial governance is however not much of worth if it is blindly focusing on doing everything as fairly as ever possible on the expense of getting almost nothing done. However, they still point out that the importance of impartiality is higher than effectiveness and efficiency and the latter should therefore only be seen as a desired condition in addition to impartial governance.³⁸

Also, in the respect of attaining the strong positive effect from property rights, Rothstein and Teorell claim that the impartial governance system is an important precondition. When citizens believe that laws (less important what kind of laws) are implemented in a fair way, they are assumed to act accordingly. Hence, existing property rights together with impartial governance will lead to higher incentives to investment since it is logical for the citizens to assume that people will not violate their properties.³⁹

³⁶ Clague, Keefer, Knack, and Olson, in Knack, 2003

³⁷ Clague, Keefer, Knack, and Olson, in Knack, 2003

³⁸ Rothstein and Teorell, 2005

³⁹ Rothstein and Teorell, 2005

A much recognized and serious issue is corruption. An act of an official, made in order to gain his own special interests to the cost of others, is violating the principles of impartiality. Studies show that growth is reduced by corruption's tendency to lower investment.⁴⁰ Social capital has by Knack and Keefer been claimed to be the main reason for this effect. Social capital, referring to individuals' trust to other inhabitants and the state, is viewed to have a positive effect on investment since people do not see the need to spend a lot of money to ensure that they are not being exploited in economic transactions. They state: "[trusting] societies not only have stronger incentives to innovation and to accumulate physical capital, but are also likely to have higher returns to accumulation of human capital".⁴¹

Trust can be considered as forming a part of a country's culture. It is basically representing expectations on whether the government succeed in fairly observing contracts. Without trust market transaction cannot be expected to take place. This is easy to see considering that a person who believes that its business partner will not fulfil his obligations, has, assuming he's acting as an economically rational individual, no incentive to fulfil his end of the contract. Consequently people only engage in these kinds of deals with people they know, which in turn will form a society built with clientelism, nepotism, and family ties. The reality also shows that an extreme absence of trust is one of the major characteristics of the culture of poverty.⁴²

⁴⁰ Rothstein and Teorell, 2005

⁴¹ Knack and Keefer, in Knack, 2003

⁴² Szirmai, 2005, page 501

3. The Need for Additional Mechanisms to Competition Law and Policies

3.1. Incentives to the Small Entrepreneur

Rodrik proves a positive relationship between institutions and GDP. What he further argues is that this relationship is due to institutions ability to stimulate entrepreneurship. In relation this statement, a much relevant question may therefore be what kind of entrepreneurship? This paper argues that it foremost benefits the kind of entrepreneurship that is smaller in its output quantity and constituting a smaller part of the market in which it is operating. In order to give an example one can imagine a small new entrepreneur who has little capital to invest, little power on the market, and who easily can be pushed away by bigger already well-established companies. This entrepreneur would have a greater incentive to make investments, enter contracts, and put his money at risk were there sound institutions in place that ensured property rights, enforced contracts and guaranteed no corruption.

Ten important factors that should exist in order to make competition reforms succeed are presented in the report, *Reforming the Investment Climate*. The ten listed factors concern the following:⁴³

Determining of policy reforms – Openness to international trade – Access to new information – Seizing the opportunity to make reforms when in crisis – Piloting – Education of the supporters to the reform – Management techniques into the public sector – Ensuring mechanisms that help make the reform permanent – Monitoring – Ensuring a good reform process

The report gives advice on how to implement the competition reforms. It discusses the importance of a presence of sound institutions. Yet, what is not mentioned as an obstacle is the existence of sound institutions that go *beyond* the actual implementation phase of the specific reform. Institutions *do* help competition policies to be implemented. What this paper

⁴³ The International Bank for Reconstruction and Development / The World Bank, 2006

emphasizes is that institutions help in another very important way; when the competition policies have succeeded in reducing the large companies' dominating role on the market, sound institutions will encourage entrepreneurs to enter the market and, by doing so, ensure a well-functioning competitive market.

3.2. Corruption

Corruption reduces the rates of return to capital for small firms more than for large firms. Large firms find it easier to circumvent regulations and to protect themselves from corrupt petty officials. Larger firms can use their political power to realise higher rates of return to capital. Their corruption is of a cost-reducing kind, allowing them to enjoy monopoly profits and scale economies. New start-ups and small firms are more vulnerable to corruption. For them, corruption acts as an additional cost-increasing tax on their activities. Thus, corruption will impede the entry of small-scale firms, which can make important contributions to innovation and employment growth.⁴⁴

3.3. Impartiality

It would be reasonable to assume that it is important to make sure that also the laws constraining trade and regulation, aiming at promoting competition and the ease of doing business, are correctly and impartially implemented. And further that the exact meanings of the laws and policies would be less relevant. As discussed in chapter 2, Rothstein argues for impartial governance. He analyses the different views on the popular concept of "rule of law". Here, there are different strands of which two are quite far away from each other. The first one implies that it is only the level of impartial implementation of the laws that should determine whether the rule of law is good or bad. The other strand argues that it is the laws themselves that also need to be "good", taking up the former Nazi Germany as an example of a well functioning legal system and therefore would, with the former strand's definition, score high on the rule of law. Rothstein supports the former strand.

Earlier in this paper, it is presented that Rothstein argues that property rights, together with an impartial government, encourage people's will to invest. In the same reasoning it should

⁴⁴ Szirmai, 2005, page 479

be logical to assume that the competition laws and policies as well as the doing-business reforms are better followed and more used if people consider the exercise of governance to be impartial.

The researchers introducing us to the CIM index provided evidence that "economic growth and investment significantly accelerate when governments impartially protect and precisely define the rights of all participants in the economy".⁴⁵

It would go in line with above statements to presume that an economy with more trust and a more impartial governance would also have a higher level of competition, taking into account the definition of competition with its actual objectives to increase production per input and investments in innovation. This paper argues that it is the smaller companies with less market power and less financial capital that are most benefiting from a system with fairer governance and encouragements in the ease of doing business. The smaller companies are the ones that in absence of these systems cannot afford to make investments since they are constrained from doing a proper calculation of its future revenues because of the uncertainties connected with doing business under these circumstances.

3.4. Different theory about institutions' role to competition

The *Global Competitiveness Report* defines competition in a much broader way and argues the existence of three stages of economic development structure, that will lead to a more competitive market. It divides competition into 12 pillars: institutions, infrastructure, macroeconomic stability, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market sophistication, technical readiness, market size, business sophistication, and innovation.⁴⁶ The *Global Competitiveness Report* has therefore emphasized the importance of other variables rather than just competition law and policies. Institutions are considered to represent one out of four indicators presumed to constitute the first stage in the development towards a competitive

⁴⁵ Clague, Keefer, Knack, and Olson, in Knack, 2003, page 104

⁴⁶ World Economic Forum, 2008

market. The other ones belonging to the factor-driven stage are infrastructure, macroeconomic stability, and health and primary education.

To assume that the road to a competitive market has three stages of economy structure, namely factor driven, efficiency-driven, and innovation driven economies, may seem like a logical and realistic image of development. However, this paper argues that institutions have a much higher degree of determinative significance to competition than as being one out of four factors constituting the fundamental precondition stage, as the *Global Competitiveness Report* suggests. This paper argues that institutions represent a major contributing factor to competition and would rather put institutions as the single factor constituting the basic first precondition to competition.

4. Cross Country Regression Analysis

This section presents the indicators that are used in order to analyse the relationship claimed between competition, competition law and policies, and institutions.

4.1. Choice of Indicators

Some of the indicators of institutions that by economists have been argued to have a positive effect on economic growth are impartial governance, property rights, rule of law, enforced contracts, absence of corruption, and trust. In order to test the hypothesis made in this paper, an index on institutions, presented by the *Global Competitiveness Report*, will be used. This index includes not only public institutions but also private institutions, incorporating accounting and reporting standards and transparency, which are assumed to be of great importance in order to maintain investor and consumer confidence.

In addition to the main regression that tests the hypothesis with the institutions index, three other indicators are used, replacing this index, in order to examine those that may be expected to have an extra strong impact on the effect of competition law and policies. Two of these are the earlier mentioned, important conditions: trust and corruption.⁴⁷ Trust can be viewed as measuring what people actually believe to be the status of many important institutions such as rule of law and impartial governance. Therefore it is assumed in this paper that it will serve as an important factor to create investment incentives and hence a high level of competition. As argued above it is reasonable to assume that new start-up firms and small firms are more vulnerable to corruption, why this indicator also is expected to increase competition law and policies' effect on competition and will be introduced as an explanatory variable.

The third indicator tested is the index also presented by the *Global Competitiveness Report*: basic requirements, consisting of the four sub-indicators: institutions, infrastructure, macroeconomic stability, and health and primary education. Since it is argued earlier in this

⁴⁷ Shleifer

paper that institutions alone should be better fitted to constitute this index, it is interesting to test whether this argument has any substance.⁴⁸

Measuring an economy's level of competition is a complex task and few reports make an attempt to make any quantitative measures at all. A higher level of competition should in theory stimulate innovation and productivity. The *Global Competitiveness Report* has presented an index measuring innovation that therefore will be used as an indicator of competition. Its two sub-indexes are innovation and sophistication, where sophistication is considered as a good measurement of efficiency in the production of goods and services.⁴⁹

Finally an indicator quantifying laws and policies that aims at promoting competition is used. The Competition Law and Policy Indicator, CPL, constituted by the sub-indicators antitrust framework and network sector regulation will serve as the corresponding indicator. This means that the policies incorporated in this index both covers the policies enhancing competition on a general level as well as on a decentralized level within deregulated network industries.⁵⁰

Limitations to the Analysis

The availability of the indicator CPL is limited, which constrains the data analysis to 30 OECD countries. Further, when measuring the effect of trust and corruption, the number of countries is reduced to 24 and 27 respectively. This means that there is limits to the paper's possibilities to draw general conclusions about its hypothesis outside these quite separated economies represented in the samples.

The CPL indicator measures the country scores of 2003. The institutions index and the competition indicators are values from 2007. This generates a time lag of four years. In this case this time lag may not be causing too much trouble since the CPL indicator serves as the determining variable and thus may take a few years to have its proper effect on competition.

⁴⁸ World Economic Forum, 2008

⁴⁹ World Economic Forum, 2008

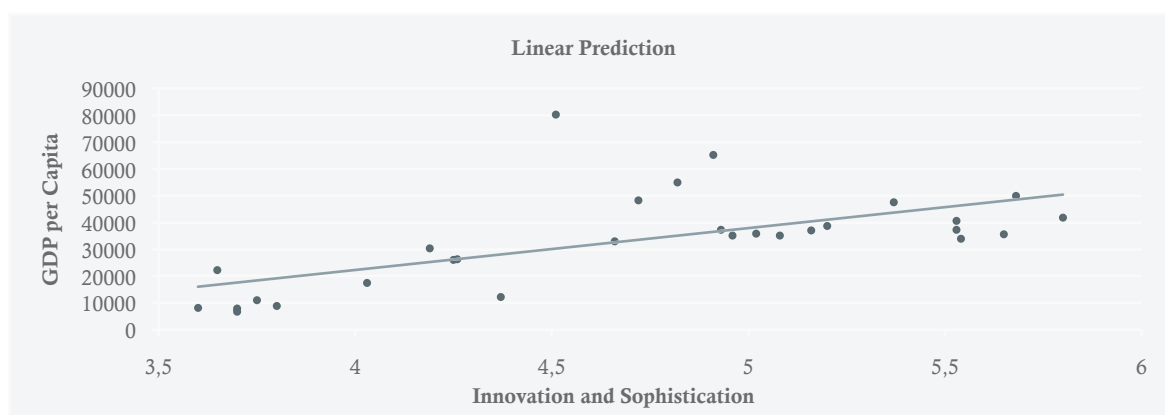
⁵⁰ OECD, 2007

In order to make the analysis coherent the other index variables are also measures from 2007.

4.2. Correlations relevant to competition and institutions

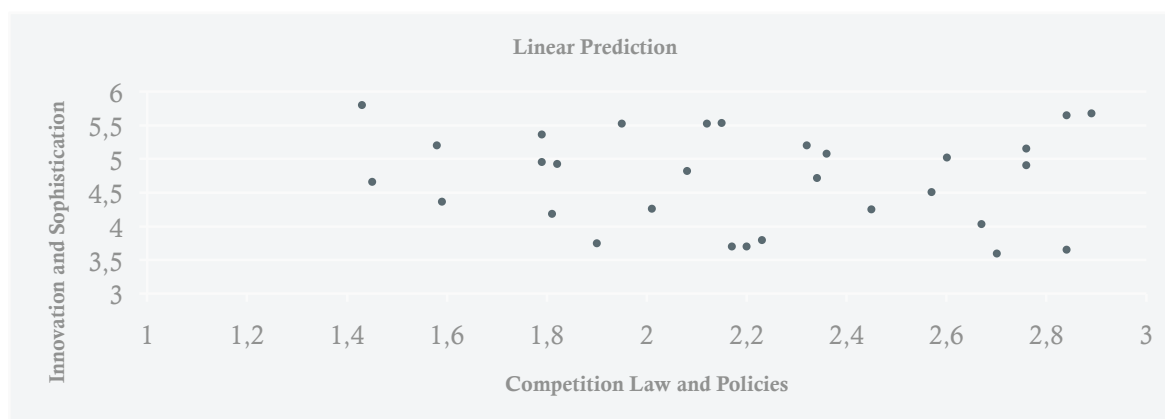
As earlier argued, various theories state that competition is important in order for an economy to seize its potentials in production. The regression in figure 3 shows that the claimed relationship has support from empirical data.

Figure 3



Competition law and policies appear to have no effect on competition from a simple regression between the two variables (Figure 4). This is interesting since the very objective of the introduction of these laws and policies is to attain a higher level of competition.

Figure 4



As earlier argued, institutions are expected to have a positive effect on competition. Assuming that the indicators chosen for institutions and competition are reliable, the

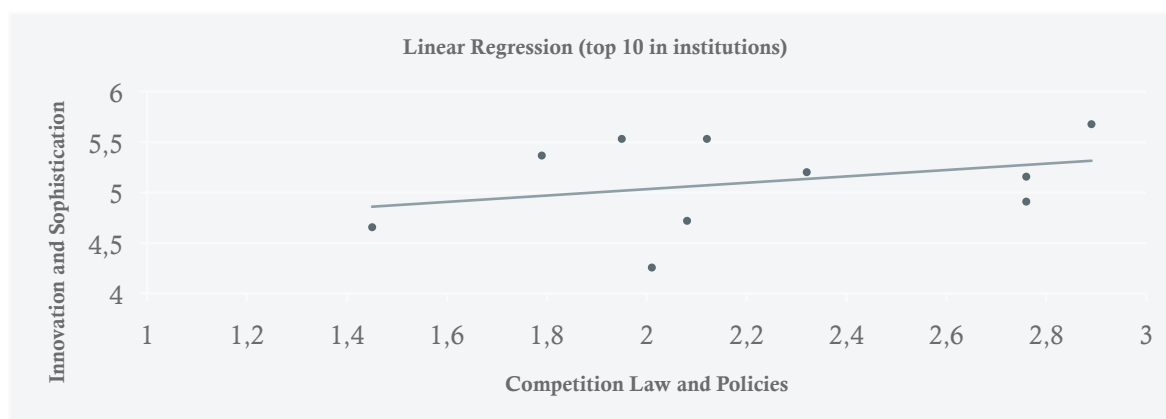
empirics, at least from the OECD economies herein analysed, indicate that the theory about institutions' effect on growth and competition has empirical support. (Figure 5)

Figure 5



The hypothesis of this paper, being that competition law and policies' effect on competition is stronger when sound institutions are in place, is reflected in figure 6. The ten countries that have the best scores on the institutions index have been separated from the initial sample of 30 and the regression made in figure 4 is here made with only these top-performing countries. The hypothesis would then suggest that these ten countries show a better relationship between the indicator of competition law and policies and the indicator of institutions. The plotted graph below shows a weak but positive relationship.

Figure 6



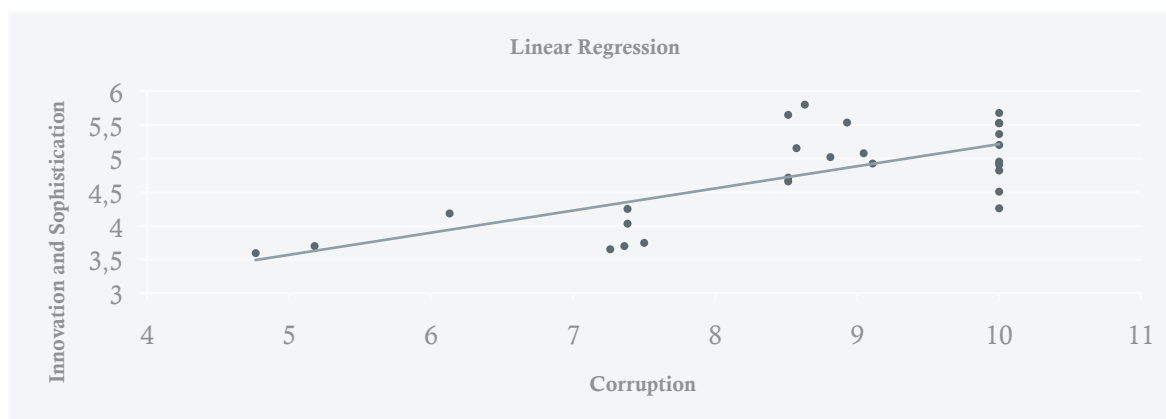
4.3. Testing for other measures of institutions

Trust, corruption, and the basic-requirements index (argued by the *Global Competitiveness Report*) are introduced in order to replace the institutions index. Since these variables, should they be put together in an explanatory model, probably would generate the problem of multicollinearity they are tested one by one. It has already been argued by economists, as presented in chapter 2, that trust and absence of corruption has a positive effect on growth and this paper expects that their contribution to competition also must be strong. This seems to be the case from the plotted regressions in figure 7 and 8, illustrating trust's and corruption's relations to competition respectively.

Figure 7



Figure 8



Should this paper's hypothesis be true, even for trust and corruption indicators on their own, the top performing economies for these indicators should therefore show a positive

correlation between competition law and policies and trust and corruption respectively. Yet, from the figures 9 and 10, no relationship seems to emerge.

Figure 9

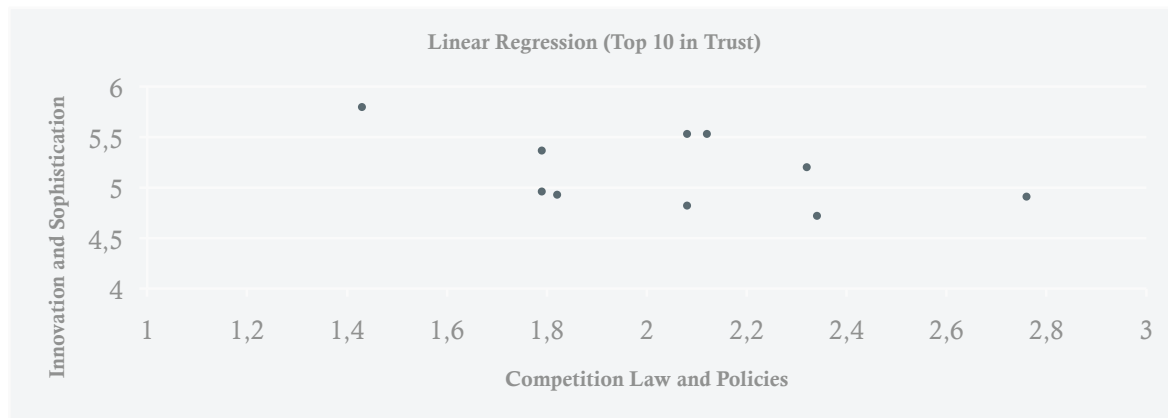
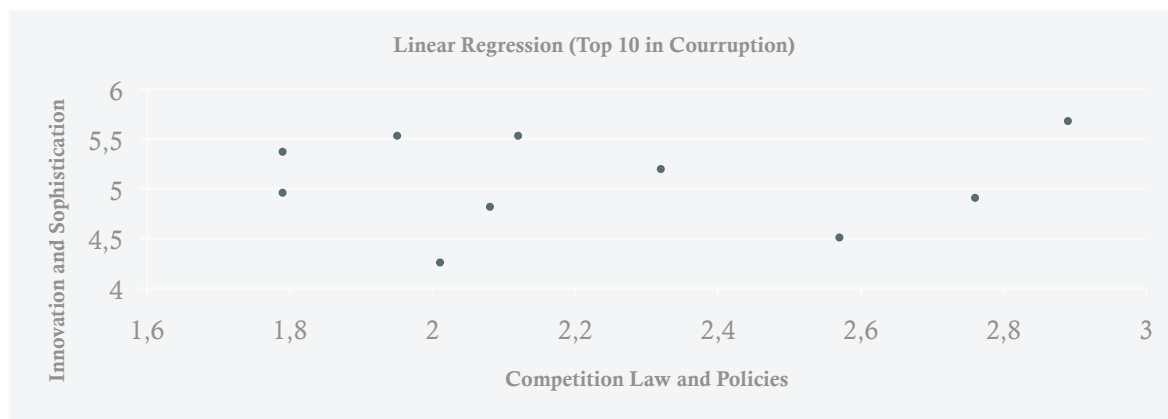
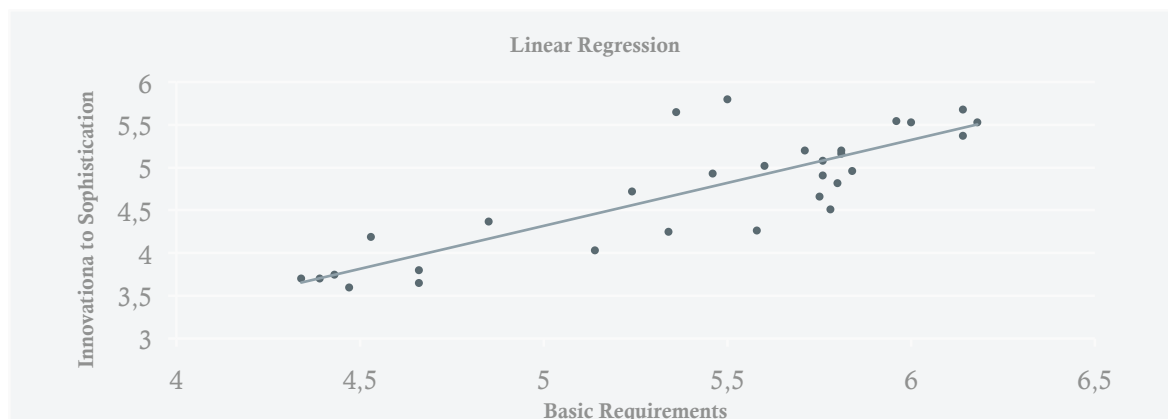


Figure 10



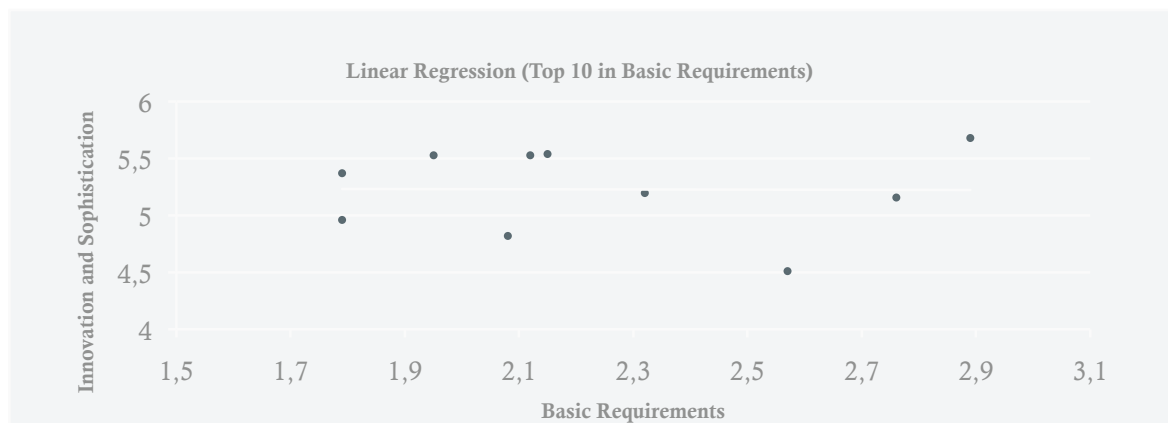
The basic requirements index is introduced, by the *Global Competitiveness Report*, as representing the basic requirements in order to be able to reach a more competitive market. A clear positive relationship is plotted in figure 11, supporting the report's assumption.

Figure 11



However, also this index seems fail in explaining the preconditions for competition law and policies' ability to affect an economy's competition level. (Figure 12)

Figure 12



In summary, all these three indicators that have made an attempt to replace the institutions index have failed (in these plotted diagrams) to show a tendency to contribute to CPL's ability to affect the level of competition. The institutions index seems however not to have failed the theory so far. These and other regressions will be further examined in the next chapter.

5. Econometric Analysis

5.1. Measuring the Strength of the Theory

The assumed model, describing the independent variables explaining competition can be written as a linear function:

$$Competition = \beta_2 + \beta_2 CPL + \beta_3 Institutions + \beta_4 CPL * Institutions + e_1$$

An economy's level of competition is thus assumed to be determined by the sum of a constant, the level of competition law and policies, the level of sound institutions, and the product of competition law and policies, and institutions. If the constant β_4 , determining the level of impact of the product of CPL and institutions on competition, is higher than 0, the indicators CPL and institutions not only on their own contribute to competition but are in addition causing a positive effect from complementing each other. If this is true, the change in competition, when increasing CPL and holding all other variables constant, will depend

on the level of institutions so that $\frac{\partial Competition}{\partial CPL} = \beta_2 + \beta_4 Institutions$.

5.2. Data

The summary statistics presented in figure 13 shows all the variables analyzed in this chapter.

Figure 13

Summary Statistics								
Dependent Variable: Innovation and Sophistication, 2007								
Variable	Abbreviation	Mean	St. Dev.	Min	Max	N	Year	Source
Competition Law and Policy	CPL	2.21	0.44	1.43	2.89	30	2003	OECD
Institutions Index	Inst	5.04	0.88	3.49	6.18	30	2007	World Economic Forum
CPL*Institutions Index	CPL*Inst	11.12	2.98	6.15	17.25	30	-	-
Trust in People	Trust	0.32	0.15	0.1	0.66	24	2007	Andreas Shleifer
CPL*Trust in People	CPL*Trust	.88	.36	.22	1.80	24	-	-
Corruption	Corr	8.58	1.52	4.76	10	27	2007	Andreas Shleifer
CPL*Corruption	CPL*Corr	19.23	4.82	11.10	28.90	27	-	-
Basic Requirements Index	BR	5.4	0.59	4.34	6.18	30	2007	World Economic Forum
CPL*Basic Requirements Index	CPL*BR	11.90	2.68	7.71	17.74	30	-	-
GDP/Capita	GDP/Cap	39703	21429	8874	103823	30	2007	The World Bank
GDP/Capita Growth	Growth	2.9	1.96	.82	10.46	30	2007	The World Bank
Public Sector Expense (% of GDP)	PublicExp	32.51	8.05	17.63	44.40	27	2007	The World Bank
Competition Law and Policies'	CPL'	2.22	.45	1.43	2.89	28	2003	OECD
Institutions'	Inst'	4.98	.88	3.49	6.18	28	2007	World Economic Forum
Competition Law and Policies*Institutions'	CPL*Inst'	11.04	3.07	6.15	17.25	28	-	-
'Outliers (New Zealand and Sweden) omitted								

5.3. Regressions Analysis

It would have been interesting to investigate the relationships with respect to change in time. This will not be done in this paper due to limits in access to data for both indicators on competition, and competition law and policies.

The variables that are serving as replacements for the institutions index are introduced one by one as presented in figure 14. This is in order to avoid an increase of degrees of freedom since the samples are small and risk to generate a low level of significance.

Figure 14

Regressions											
Dependent Variable: Innovation and Sophistication											
	1	2	3	4	5	6	7	8	9	10	11
Constant	5.10*** (.000)	1.70*** (.002)	6.36** (.030)	.76 (.751)	3.65 (.349)	4.56 (.243)	6.65* (.076)	6.80** (.024)	6.69** (.027)	8.30*** (.007)	5.91** (.039)
CPL	-.17 (.565)		-2.13* (.099)	1.21 (.262)	-.74 (.653)	-2.38 (.175)	-3.35* (.054)	-2.45* (.073)	-2.18* (.096)	-3.00** (.033)	
Inst		.60*** (.000)	-.24 (.665)					-.30 (.590)	-.29 (.609)	-.53 (.340)	
CPL*Inst			.382 (.128)					.45* (.093)	.39 (.123)	.52** (.049)	
Trust				9.22* (.094)							
CPL*Trust				-2.687 (.268)							
Corr					.14 (.746)						
CPL*Corr					.08 (.674)						
BR						.09 (.899)	-.23 (.724)				
CPL*BR						.41 (.196)	.56* (.071)				
GDP/Cap								-5.27E-6 (.414)			
Growth									-.03 (.495)		
PublicExp							-.002 (.831)			-.01 (.572)	
CPL'											-2.00 (.116)
Inst'											-.13 (.809)
CPL*Inst'											.35 (.158)
R ²	.01	.57	.63	.50	.52	.74	.81	.64	.63	.68	.81
N	30	30	30	24	27	30	27	30	30	30	30

'Outliers omitted
Significance level denoted by: ***(1% or less), **(5% or less), *(10% or less)
P-values in brackets

As the results from figure 14 shows, CPL*Inst enters the model with a positive sign, 0.523, and with a 95% significance for regression number 10 where public sector expenses are included. The p-value might have been lower if the sample had been bigger. The institutions index enters with a negative sign, however the p-value is not significant. Considering the sign and p-value of CPL's effect alone, it seems as though the indicator actually has a negative effect on competition.

The R²-value 0.63 in regression number 3, which serves as an indication of how well the model is describing its dependent variable, is not a spectacular one. In the regressions where

two outliers have been omitted, the R^2 -value increases to 0.81, which is quite high. Yet, this measure can be misleading if given too much focus.

With respect to the relatively small sample used in this analysis, it is of little use to look for autocorrelation, nonstationarity, heteroscedasticity or non-normally distributed residuals.

Replacing Institutions Index

A quite interesting difference between the trust indicator and the aggregated index of institutions is that trust on its own is significant on a 90% degree whereas the institutions index is strong in its ability to increase CPL's effect on competition. The p-values are very high for the regression with corruption as an explaining variable, however it should here be noted that the number of countries have been reduced from 30 to 27. Also the basic requirements index enters positively into the model with a significance of 90%. However, comparing with CPL*Inst, the CPL*BR coefficient scores lower for the level of significance (p-value: 0.071 compared to 0.049).

Correction for Omitted Variables

BNP/capita, BNP/capita growth, and public sector expenses in % of GDP have been introduced in order to correct for mistakenly omitted variables. The introduction of BNP/capita changes CPL*Inst to a higher coefficient as well as to a significance level of 90%. Public sector expenditure is one way of measuring the size of the public sector. It would be possible that the size of this sector impose an effect on the level of competition since a large government can be associated with less efficiency due to its ensured existence from the government. The results from the regressions in this paper show that it does have an effect. This introduced correction variable actually generates increases in the significance level for both CPL*BR and CPL*Inst, where the latter reaches a significance of 95%.

Outliers

New Zealand (2.01, 4.26) measures a very low value on innovation and sophistication and Sweden (1.95, 5.53) scores very high. Both are far away from the drawn regression line representing the thought relationship between competition law and policies and competition. Sweden has a slightly higher value on the institutions index than does New Zealand. A possible contributor to New Zealand's low level of competition may be its geographically

peripheral location, in that it might decrease its economy's exposure to the world market. Sweden, with a law system fairly open for interpretation, might have laws related to and maybe in a way covering anti-competitive behaviour resulting in the low score on CPL but still high level of competition. In figure 14, the regression in column 3 is remade in column 11 but with these two countries omitted. The results are however not improved by this adjustment of the sample.

Economic Significance

Some of the variables in the different correlations from figure 14 were significant and some were insignificant. This is of little importance to economic knowledge about what can and should be done in order to reach certain objectives if the effects discussed are trivially small.⁵¹ The economic significance of a few variables will therefore be discussed in this section in order to get a better understanding of the size of the effects that the claimed determinants can be expected to have on the level of competition.

To begin with, the coefficient for CPL*Inst for regression number 10, which is the one of extra relevance in this paper, will be examined. The coefficient takes the positive value of 0.523 in the regression. This suggests that a country such as Mexico, scoring among the lowest on the level of competition, 3.60, would have to increase CPL*Inst from 9.42 to 12.40 in order to get to the level of competition inherited by a country such as Austria, 5.16, being one of the top scorers of the index of competition (counting: $5.16 - 3.60 = 1.56$ and $0.523 * 2.98 = 1.56$). A value of 12.40 on the CPL*Inst index is, in relation to other countries' value, not very high considering that the highest scorer, Switzerland, reaches the value of 17.25. This would suggest that the economic significance of the coefficient for CPL*Inst is relatively high.

The basic requirements index generates pretty similar results as the institutions index in terms of statistical significance. The same comparison between Mexico and Switzerland is of use in order to see if an economic significance can be claimed. Using the regression where PublicExp is included, the calculations for the CPL*BR index with the slope set to 0.488

⁵¹ Ziliak and McCloskey, 2004

show that Mexico would have to raise its CPL*BR index from 12.07 to 14.84 in order to reach Austria's level of competition (counting: $5.16-3.60=1.56$ and $0.563*2.77=1.56$). It is true, also for the CPL*BR index, that the change, to move up to Austria's level of competition by reaching the CPL*BR score of 14.84, is far from impossible considering that the highest scorer of this index reaches 17.71 (Switzerland).

This paper claims the importance of institutions in order to get CPL to affect competition. The highest scorers on institutions are Denmark and Finland, both reaching 6.18. If Mexico can manage to attain their level of institutions and keep the level of CPL, 2.70, fixed it will, according to the model, elevate the level of competition from 3.60 to 5.79 (counting: $6.18*2.70-9.42=7.27$, $7.27*0.523=3.80$ and $3.80+3.60=7.40$), which means that Mexico would go from being the lowest scorer on competition among the 30 OECD countries included in this analysis to being the number one top scorer on competition (USA would reach 2nd with 5.80).

The regression of number 10 further suggests that an increase of CPL will result in a decrease of competition should the level of institutions be lower than 5.73 since CPL enters both negatively and positively in the model (counting: $0.523*5.73=2.998$). All but 6 of the 30 countries in this analysis fail to reach this level of sound institutions, namely: Denmark, Finland, Iceland, Norway, Sweden, and Switzerland.

Causality

It might be the case that institutions' effect on competition only is due to the fact that it affects the implementation of competition policies. Amin and Djankov argue that democracy leads to growth-enhancing reforms since the politicians in a democracy want to make the kind of reforms that will increase the possibility for them to be re-elected.⁵² Along these lines it could be reasonable to investigate whether sound institutions affect politicians in their choice of reforms. Institutions could in addition to their direct influence on people to invest also be expected to influence the will of politicians to make reforms in the area of competition law and policies since they with better institutions have better reasons to believe

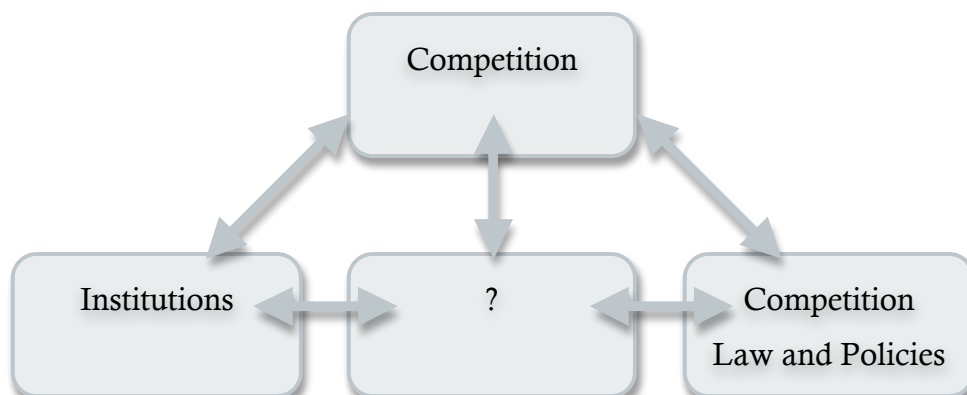
⁵² Amin and Djankov, 2009

that the introduced reform will have an effect on the competition level, which in turn would increase their chance to be re-elected. Yet, the regressions presented in figure 14 indicate that CPL rather will impose a negative effect on competition, so it may seem as rather unlikely that the positive effect from institutions is caused through its impact on CPL. Yet again, the institutions' relevance in the model cannot be stated just because CPL does not seem to be the real source. As illustrated in figure 15 this potential real source of positive effect is not known. The variable GDP/Capita could very well be such a variable. The inclusion of that variable resulted in an increase of the CPL*Inst variable however, just as did the PublicExp variable.

The possibility that the level of competition can affect the level of sound institutions should not be neglected. As argued above, a pressure, such as a higher level of competition from the foreign market, seems to result in more reforms made in the area of doing business, discussed in a World Bank report.⁵³ Thus a reverse causality than implied by the model should be considered as a possibility. However, the results from the regressions made in this chapter also show a tendency of a positive relationship between competition and the product of CPL and institutions. This causality might be more difficult to argue against; one would have to argue that a higher level of competition would lead to more competition law and policies to a higher extent when institutions are present than when they are absent. Or probably even harder to argue: that competition should lead to more sound institutions when competition law and policies are higher.

⁵³ The World Bank, 2009

Figure 15



Should the institutions' effect on competition only be due through their effect on the level of competition law and policies, a correlation would be to expect between the two variables. The correlation scheme in figure 16 indicates that there is little correlation between institutions and CPL.

Figure 16

Correlations					
		Innovation	CPL	Institutions	CPL*Institutions
Pearson Correlation	Innovation	1,000 (.)	-,109 (.283)	,758 (.000)	,430 (.009)
	CPL	-,109 (.283)	1,000 (.)	,019 (.460)	,755 (.000)
	Institutions	,758 (.000)	,019 (.460)	1,000 (.)	,660 (.000)
	CPL*Institutions	,430 (.009)	,755 (.000)	,660 (.000)	1,000 (.)
P-values in brackets. N: 30					

5.4. Implications of Results

The hypothesis that sound institutions are contributing to competition law and policies effect on competition seems to have support in the empirics. Both statistical and economic significance reach acceptable levels, which makes the hypothesis more robust.

The basic requirements index is a much general index as it encompasses institutions, infrastructure, macroeconomic stability, and health and primary education. However, it is not far behind the institutions index in its ability to serve as a contributor or prerequisite to competition law and policies. The index is not as statistically significant as the institutions

index and might therefore be considered as a less accurate variable in the attempt to explain the determinants of competition.

It is interesting that CPL appears to contribute negatively to competition when an economy does not have sound institutions in place. One possible explanation could be that many constraints to companies' ability in realizing the businesses they see as profit-generating, deter companies to enter the market at all, leading to less pressure on the companies that already are established on the market and hence contribute to a less competitive market.

The fact that there is a lagged time difference of four years in the regressions shouldn't be forgotten. However the analysed variables are quite slow moving over time and the errors creating risk of misinterpretation are probably not that major.

6. Discussion

WTO has pointed to the fact that companies become restricted in their possibilities to realize their strategic- and profit generating plans from the introduction of competition law and policies.⁵⁴ This is indeed a much relevant issue to take into account when determining what kinds of reforms that will be positive for an economy. Should the introduction of competition law and policies affect some major companies to choose to move parts of their business and production elsewhere, this particular action would most certainly harm the economy at least short term. Considering the fact that CPL seems to affect competition negatively for countries that do not have considerably sound institutions in place, the criticism brought up within the WTO is of great relevance.

As the introduction of this paper discusses, huge multi-national companies have gained a level of access to political and economic power that might undermine nation's influence of the world's developing path. A much frightening scenario would be a world order where democratically governed actors no longer were acknowledged by the large powerful companies and thus capital endowment together with other status-associated factors would be the sole determinants of the development of the world.

Findings from the World Bank's *Doing Business* report show that the kind of regulatory reforms that aim at making the business climate better tend to pick up when pressure rises. Such a pressure, they suggest, can result from higher competition from having entered a common market or trade agreement.⁵⁵ This can be considered as a positive effect since the pressure translates into business encouraging reforms. Maybe it can be reasonable to expect that governments will encounter similar pressures in the future and that the outcome, just as there have been increases in "doing-business reforms", also will be more reforms aiming towards ameliorating institutions of the kind that encourage impartial governance and trust in society?

⁵⁴ Anderson and Kovacic, 2009

⁵⁵ The World Bank, 2009, page 8

A major challenge to future research in the field of institutional economics is to transform the need of mechanisms that ensure sound institutions, such as the rule of law and the even more complex phenomenon impartial governance, into the adoption of reforms that can promote such sound institutions. Rodrik is emphasizing that only "identifying the deeper determinants of prosperity does not guarantee that we are left with clear-cut policy implications".⁵⁶ He basically admits that his results of the importance of institutions and that they are the main determinant to growth are of little meaning to the politician. The notion that institutions are important to growth merely tells us that what people expect from investments and governmental action has a high impact on economic growth.⁵⁷ Further, economies seem to profit differently from different kinds of institutional solutions. Striving towards finding universally applicable policies might therefore be a beforehand doomed attempt. Hence, even though sound institutions with well functioning laws and policies can be identified in one country, it is not likely that an attempt to copy the laws and policies from one country and introduce them in another would lead to the emergence of these sound institutions (such as trust and a low level of corruption). An explanation to this may be that laws and policies that do not correspond with existing norms and customs risk creating tensions and resulting in a situation where it is difficult to successfully implement and enforce these laws and policies.⁵⁸

It is important to be able to evaluate the effects from competition law and policies. Information on costs and benefits are necessary in order to enable a trade-off analysis of intervening policies contra liberty to the companies, which is necessary in order to seriously take into account the much legitimate critique brought up by the WTO. More information on the effects from competition law and policies are needed in future reports in order to enable further investigation of the determinants to the success of competition law and policies' effect on competition. Further, it cannot be considered sufficient only to use reports based on results from OECD countries when analyzing competition and its explaining

⁵⁶ Rodrik, 2004, page 136

⁵⁷ Rodrik, 2004

⁵⁸ Aoki, 2000 (Originally introduced by North, 1995)

components. The ability to hand out advice to developing countries is dependent on the monitoring of earlier work in these particular regions.

Other papers, such as *What is Quality of Governance*, where Rothstein argues that institutions might hold the key of understanding economic growth in developing countries, do of course provide important evidence to the assumption that institutions are important in economic growth. Therefore following the reasoning and the results from this paper, it is of great value to continue the research in this field among the world's poorer countries much in need of a creation of a business friendly and innovation-encouraging environment.

7. Conclusion

There is a general conception among the world's major global actors, such as the World Bank and the UN, that a competitive market is necessary in order for economies to seize their economic potentials. Competition keeps the prices low, encourages innovation, and results in more effective production. A simple plotted regression of competition and gross domestic product shows a clear relationship between the two factors. Today's primary recipe to attain a competitive market is competition law and policies. Other popular measures are business-encouraging reforms such as lowering the number of days it takes to start up a business. Prominent researchers in the field of development economics have in various ways provided the world's politicians with proof that institutions, such as rule of law, impartial governance, and trust among people are vital components of a well functioning economy with a high growth rate. The argumentation is straightforward; it is through the incentives to invest that these institutions have their important effect. This paper has investigated whether competition law and policies' effect on the level of competition is stronger when sound institutions are in place.

The indicators chosen to be representing the level of competition, competition law and policies, as well as institutions are all disputable and the number of countries used in the papers' data analysis amounts to no higher than 30. Despite these shortcomings the model does quite a good job in explaining the level of competition. The indicator measuring institutions enters the model with a positive sign and can be considered significant both in a statistical and economic respect. It can therefore be assumed that institutions contribute to competition law and policies' ability to positively affect competition. Further the results indicate that it is only the countries that have sound institutions in place that receive a positive effect on competition from increasing their competition law and policies. 24 of the 30 countries in the sample that is analysed in this paper do not reach this necessary level of sound institutions.

This paper is focusing on institutions' importance in promoting competition and argues that they can help competition law and policies to succeed in attaining this aim. Other major reports treat similar areas: the *Global Competitiveness Report* introduces ten different factors

that they claim all to be important components in reaching a competitive market but that the factors are components of three stages and the *Doing Business* report gives a thorough presentation of today's economies' attempts in promoting a more business-friendly environment through reforming. These reports indicate that the need of investigation of the determinants of competition as well as measuring entrepreneurial-encouraging reforms is gaining acceptance among the world's major actors that focus on economic development. However, important documents on competition-promoting measures still have an obvious main focus on competition law and policies and do foremost problematize their qualities as well as their implementation.

This paper encourages a widening and maybe a slight shift of focus in the discussions of competition-promoting reforms. This widening or shift should enable institutions, with their already much accepted and realised importance in economic growth, to take a more prominent role in the much important work to develop higher levels of competition within the world markets.

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