

Competition and Competition Policy in Russia: *impact on industrial firms' performance and behavior*

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1

Motivation

Economic theory states that competition is an imperative for the efficient market economy

BUT:

- Does industrial structure actually determines competition?
 - Is the more competition – the better?
 - Should the natural market tendency of efficient firms “crowding out” inefficient be restricted?
 - How to find a right balance between effective scale of production and not letting a few firms to dominate the market?
 - Should approaches to competition regulation be different in different countries, namely transition economies?
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2

Outline

Introduction: *Should the initial market structure have an impact the competition policy?*

PART I. Does competition matter: the case of Russian industry?

How to measure competition: concentration ratio, price/costs indicators, "perception" indicators?

What do we know about competition environment in Russia?

Impact of competition on industrial firms

PART II. Does competition policy In Russia has anything to do with competition?

Evolution of competition policy in Russia

Dilemmas of Competition Policy: *preventing concentration vs. lowering entry-exit barriers*

Crisis of 2008 and possible consequences for Competition Policy

3

Start-up conditions for competition in Russia

- Due to the lack of competition concept in the planned economy the investment and production decisions were aimed at getting maximum gains from concentration and specialization.
- The inefficient enterprises were never liquidated. New, more modern enterprises co-existed with old ones with obsolete technologies. With prices fixed at some average level, there were a lot of so called "planned loss-making" inefficient enterprises.
- Industrial enterprises were created to be tightly inter-connected, i.e. they often were technologically depended from each other.
- Privatization and price liberalization *did not* create competition but a lot of "small monopolies"
- As a result vertical and horizontal concentration to increase the scale of production became the dominant trend in industrial structure evolution in Russia

4

Part I. What do we know about competition in Russian industry?

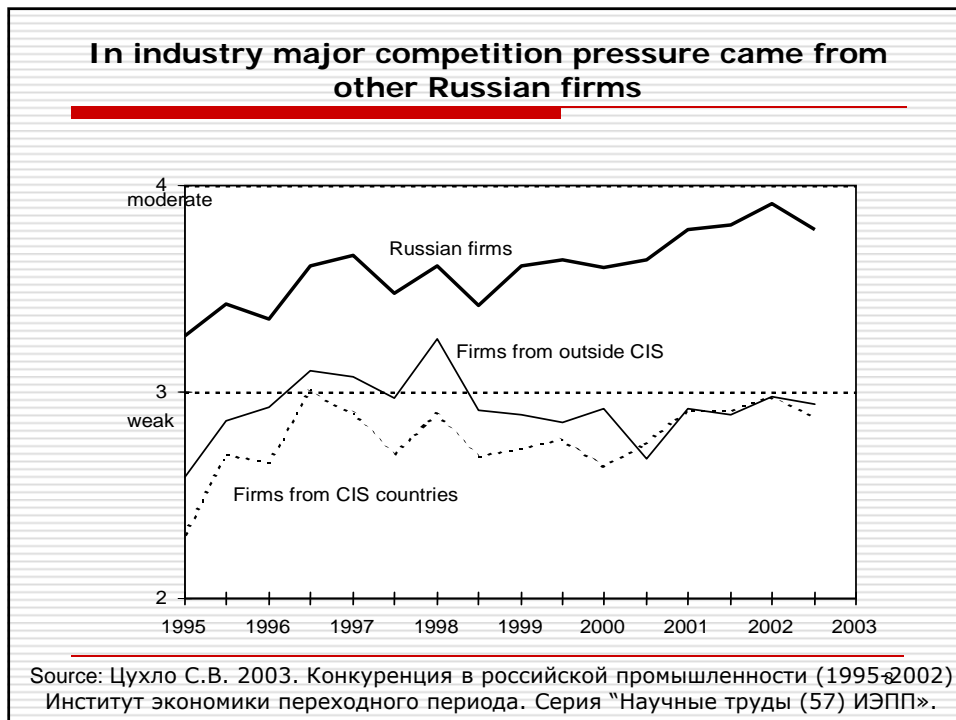
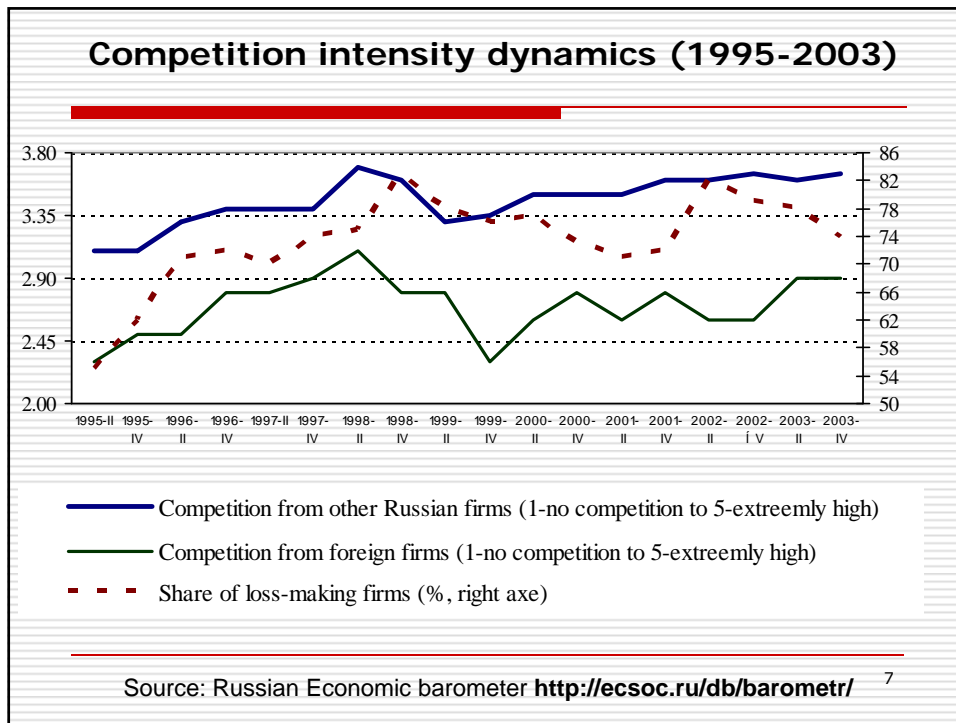
- How to measure: concentration ratio vs. “perception” indicators
- Dynamics of competitive pressure
- Where Russian industrial firms compete?
- With whom do they compete?
- How competition impact firms performance and behavior

5

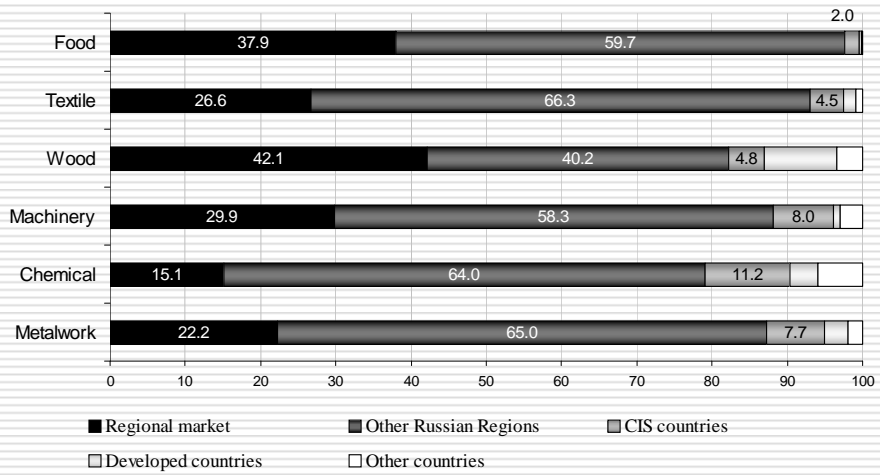
How we can measure Competition

- Harvard School concept - SCP (structure – conduct – performance):
Concentration leads to monopolistic pricing
- Chicago School concept:
“market behavior” indicators
- “Vulgar” empirical approach:
“perception” indicators of competitive pressure

6

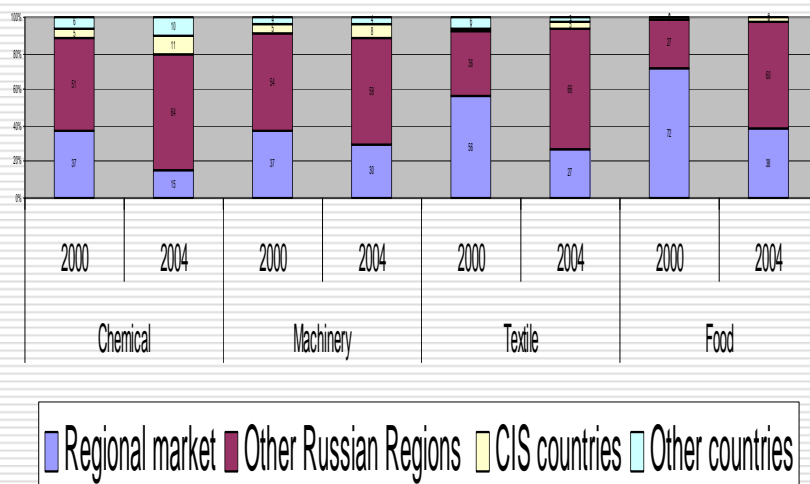


Where Compete Russian Firms?



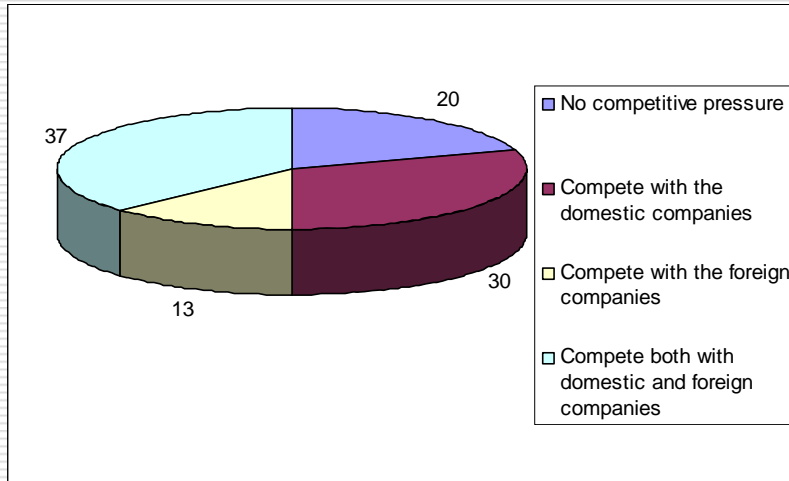
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Changes in the structure of markets



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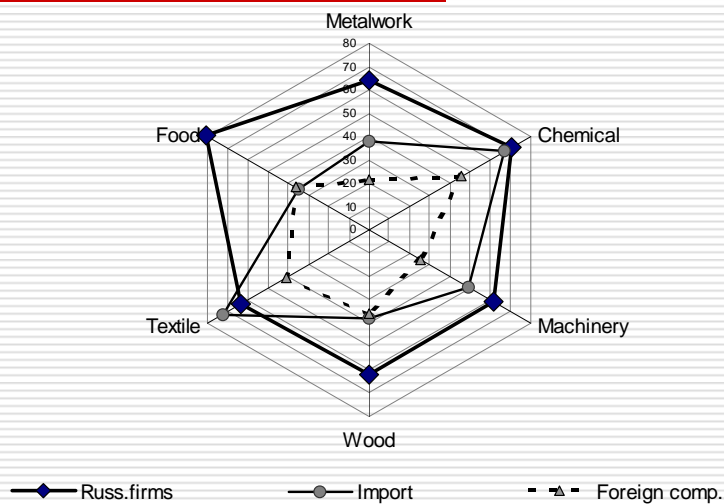
With whom compete Russian Firms? (1)



Source: HSE-WB Survey 2005

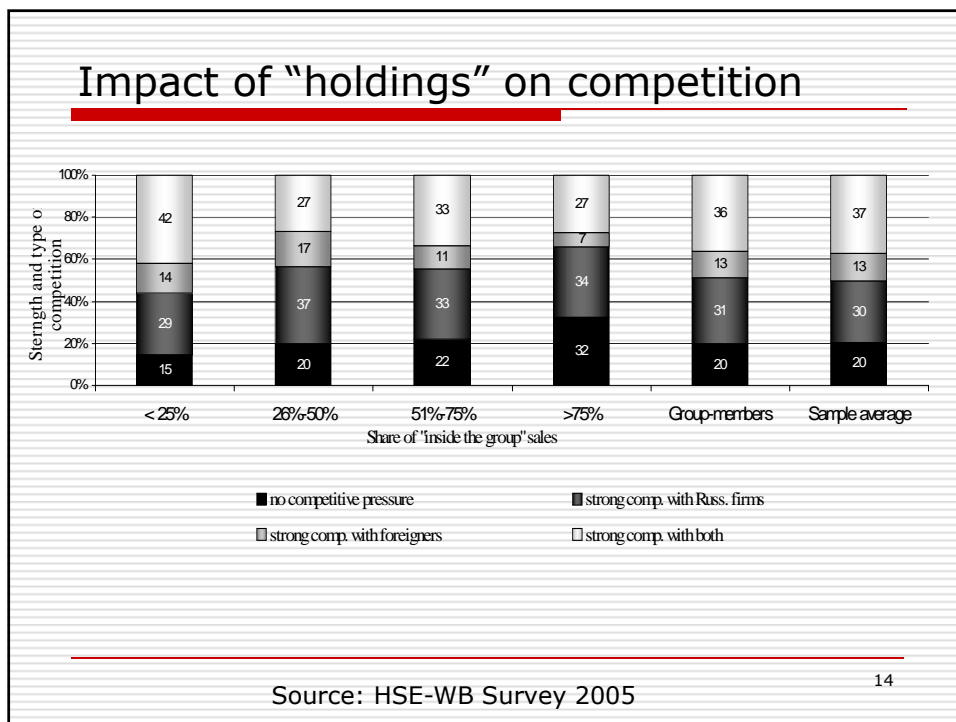
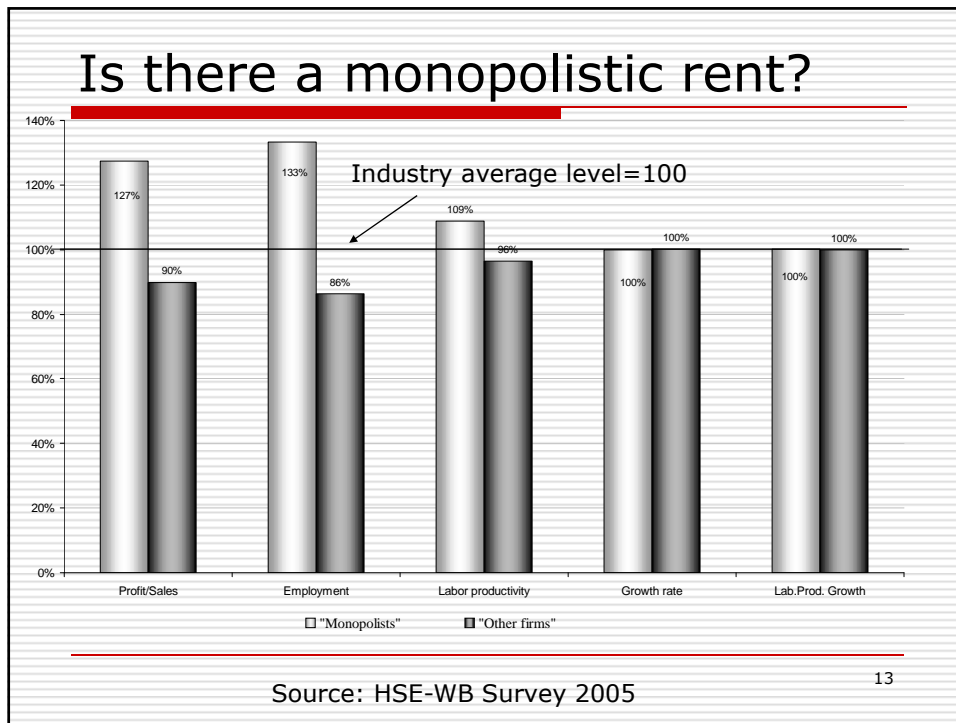
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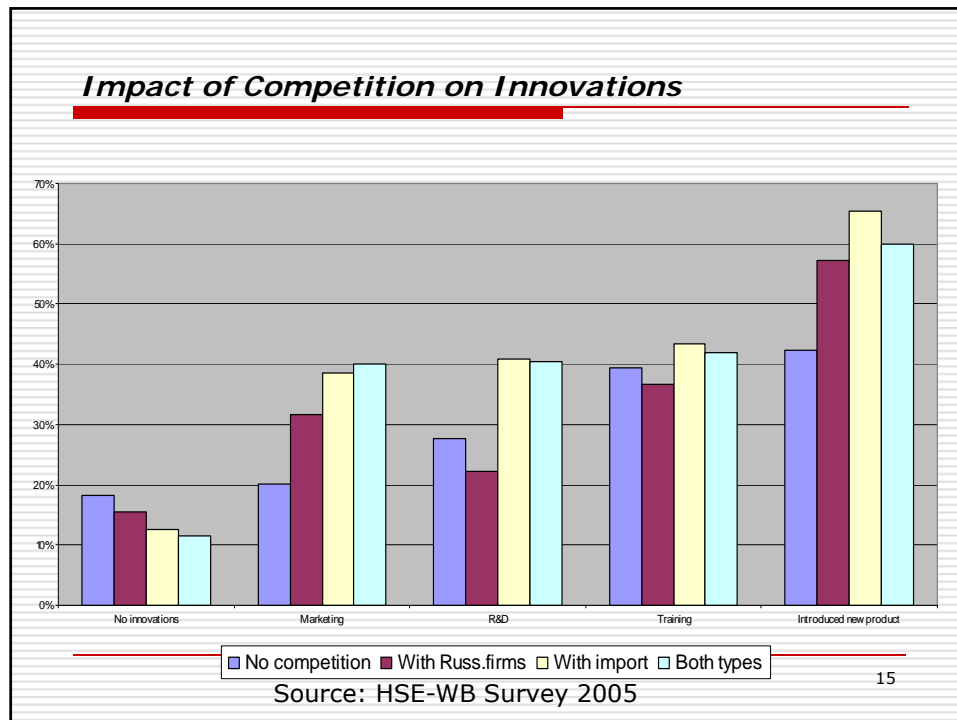
With whom compete Russian Firms? (2)



Source: HSE-WB Survey 2005

12





15

Results of a probit model of innovation activity (industry controlled)

Probability of a firm being innovative	Coef.	Std. Err.	Z	P>z
Strategy of integration into global market	0.37469	0.14047	2.67	0.008
Strategy of expansion to new markets	0.36656	0.12512	2.93	0.003
Serious competitive pressure	-0.3546	0.13888	2.55	0.011
Good financial situation	(dropped)			
Satisfactory financial situation	-0.6508	0.24796	-2.62	0.009
Bad financial situation	-1.2976	0.27832	-4.66	0
Size < 200 employees	-0.4478	0.20539	-2.18	0.029
200-500	-0.2935	0.1753	-1.67	0.094
500-1000	(dropped)			
> 1000	0.2818	0.16357	1.72	0.085
N of observation-	517	Pseudo R ² -	0.1703	

Source: IAC Innovation activity survey 2005

16

Conclusions for Part I

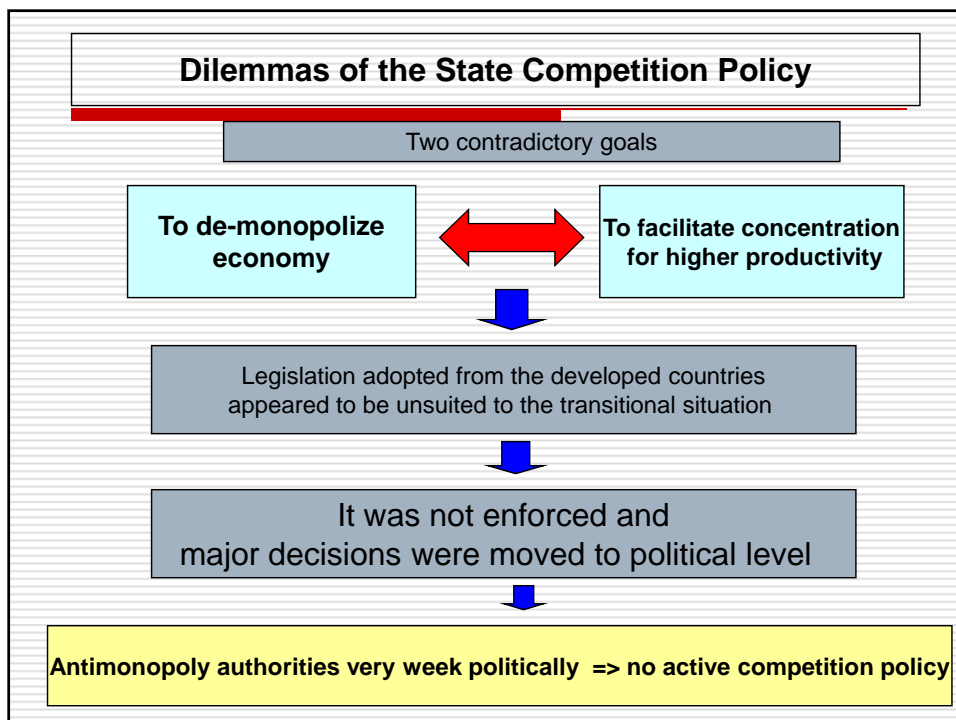
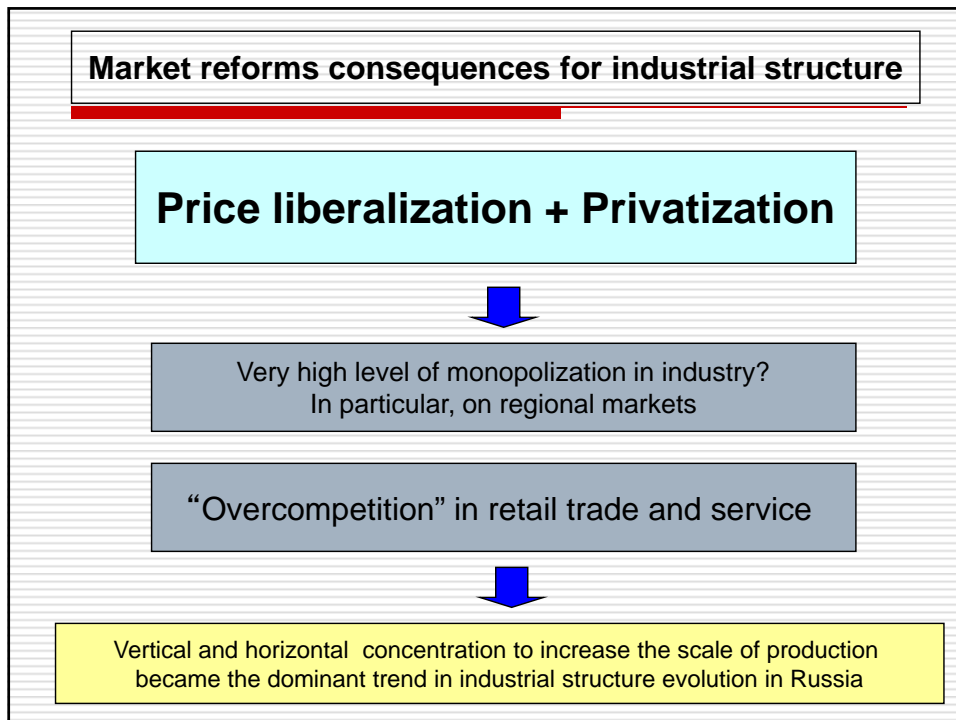
- The level of competition in Russian industry is growing over time, but about 20% of firms still are “excluded” from competition.
- Mostly Russian firms compete with each other, impact of import competition is significant only for several industries.
- For many firm’s the strategy is not to compete but to “withdraw from competition” by moving to specific market “niches”.
- While there are no empirical evidence of competition impact on performance of firms, there is strong evidence of competition influencing restructuring and innovation behavior of firms. BUT only in case of intense competition with foreign producers.
- The major problem for the competition policy seems to be not domineering position of big firms, but high barriers for entry due to lack of infrastructure and low profitability of some markets.

17

Part II. Competition policy

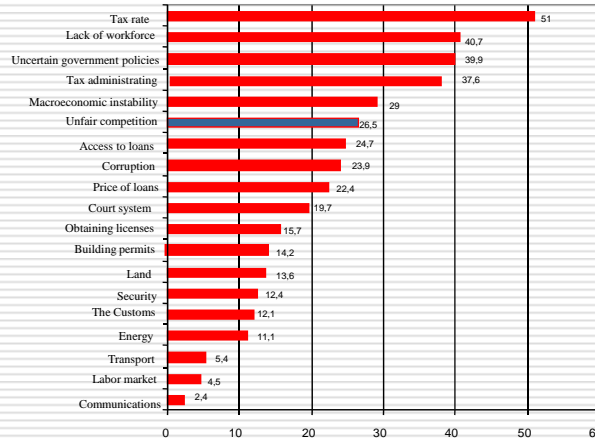
- Evolution of the competition policy in the 90-ies
- Changes in the legislation and policy focus in 2005-2008
- Proposed new changes and possible consequences for competition
- Financial crisis 2008 and its impact on the industrial structure and competition policy

18



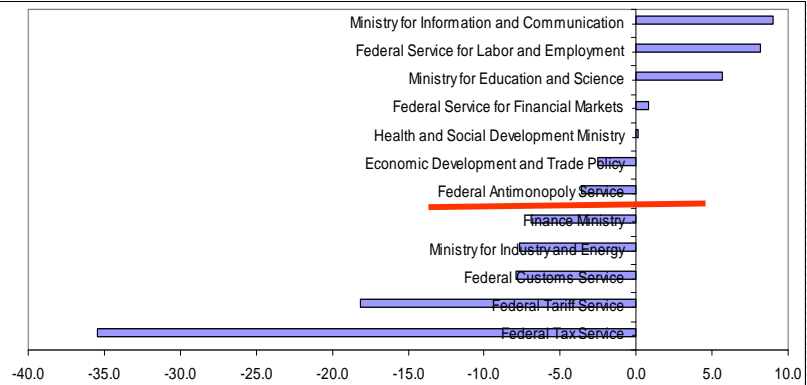
What investment climate constrains cause the greatest concern among manufacturing firms?

Company perceptions of business climate constrains (proportion of those who believe the obstacle to be serious or very serious, % of all respondents)



The “unfair competition” complaints rank relatively high in the list of barriers to business.

Evaluations of the effect of government agencies’ activities on the performance of enterprises



Federal antimonopoly agency is evaluated as having a slightly negative impact on the firms’ performance.
 BUT 80% of firms say there no impact from this agency’s activity at all...

Situation changes starting from 2005

- Up to 2005 the Competition Policy was unimportant. During the second term of Putin it became a useful political instrument to:
 - influence large Russian companies
 - to prevent foreign investors coming to strategic industries
 - to restrict activity of local and regional authorities
 - to “shadow” regulate the prices
- It became possible due to new “Competition law” introduced in October 2006 (instead of outdated law of 1991)
- The focus of Competition Policy is mostly anti-trust. No proactive policy to increase competition planned

23

The major legislative changes

- The level for “domineering” position is down from 65% до 50% and to 35% in some cases
- Introduced responsibility of state and municipal authorities for creating “preferences” for certain economic agents
- Introduced “turn-over” fines for abusing the competition
- Redefined (broaden up) the “affiliation” concept

24

The most “big” anti-trust cases

- “Rusal – Sual –Glencore” M&A
- “Siemens- Silovye machiny” case
- “Eurocement” case
- Russian Railroad Corporation Case
- S.-Petersburg “Milk” case
- TNK-BP – Lukoil case

25

Latest Changes

- New legislation (competition law) was introduced that provided antimonopoly authorities with powerful instruments to punish companies for unjust competition (sales based penalties) and led to several high-profile cases with dozens of millions USD in penalties.
- Now additional changes are being discussed. The new concept enhance concept of market domineering to the concept of “using market power”, that would allow authorities to control almost any deal in the economy.

26

New changes under discussion

- “Turnover” fines doubles. It may become an instrument to bankrupt any large company as efficient as tax claims
- Now additional changes are being discussed. The new concept enhance concept of market domineering to the concept of “using market power”, that would allow authorities to control almost any deal in the economy

27

Conclusions (1)

- Despite almost 20 years of transition Russia’s industrial organization is still quite monopolized. This monopolization is due not only to domineering position of large enterprises and financial groups but to high entry and exit barriers on many of the specific and local markets.
- State competitive policy during the recent years was focused mostly on controlling economic concentration in forms of M&A or informal cartel agreements between largest firms. Active competition policy directed on lowering entry barriers is not on the agenda of the Government.

28

Conclusions (2)

- The anti-trust policy more and more often tends to be shadow form of price-regulation as well as an instrument of state's pressure on large business.
- There exists a danger that current crisis will be used to increase direct and indirect state participation in all sectors of the economy and to renew protectionist foreign trade policy.
- Those risks together with state corporations expansion may lead to reverse changes in competition dynamics and to higher concentration ratio in most of the markets.