



An empirical assessment of the relationship between competition policy and investment

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ABSTRACT

The relationship between competition policy and investment is empirically examined. Empirical findings suggest that increasing market competition has a positive and robust impact on the share of total investment in GDP per capita. Developing countries enjoy benefits from competition legislation efficiency improvement, whereas the reduction of government anti-competitive price control intervention enhances the good investment environment in developed countries. In relation to the potential impacts of ASEAN competition policies, if ASEAN-4 countries (Indonesia, Malaysia, Philippines, and Thailand) become as competitive as Singapore, the investment shares are expected to increase to approximately 2–4%. Further, foreign direct investment inflows from the 30 OECD countries are expected to increase roughly 0.6–1.2%.

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1. Introduction

The world has experienced a tremendous rise in unprecedented economic integration, as noted by a large number of bilateral Free Trade Agreements (FTAs), as well as other forms of economic cooperation (such as regional cooperation in investments and industrial linkages) over the last two decades. In the context of Southeast Asian regional economic integration, the Association of Southeast Asian Nations (ASEAN) member countries agreed in October 2003 to establish an ASEAN Economic Community (AEC) by 2020. This timeline has recently been changed to 2015. In order to advance the AEC, ASEAN member countries have agreed to implement the AEC Blueprint, in which one of key elements specified is a highly competitive economic region policy.¹

Although competition policy is a crucial element in economic development, there have not been many studies on this subject. Whether increasing market competition promotes economic development and creates a good investment environment is still an open question. High competition, together with good enforcement, is believed to stimulate economic and technological efficiency, which in turn attracts new investment in an economy (Evenett, 2005). In contrast, high competition may reduce the tendency of dominant firms to innovate and invest more if monopoly profits are used to finance innovative activities (Blundell, Griffith, & Reenen, 1995). Despite this ambiguous theoretical relationship, existing empirical studies on the effects of cross-country competition policy are scarce and quite restricted. As suggested by Dutz and Hayri (2000), empirical studies have failed to capture economy-wide effects. Although they investigated the partial correlation of an economy-wide competition variable, specifically in growth models, there are plenty of areas in need of further examination.

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¹ See ASEAN Secretariat (2008).

The objectives of this study are to investigate empirically whether high competition is robustly correlated with high investment and to assess the potential impact of ASEAN competition policy on investment. The methodology employed is straightforward. An investment model is drawn from the work of [Levine and Renelt \(1992\)](#) and [Sudsawasd and Moore \(2006\)](#), where the model is extended to include a set of competition policy measures. Seven measures related to competition policy are selected according to a broad definition of competition policy. Since a relationship between competition policy and investment in developed and developing economies can be significantly different, this study estimates the impact of completion policy on investment and performs a robustness test in order to identify relevant robust competition policy in the context of both developed and developing countries.

After the areas of competition policy that should be emphasized are identified, the potential impacts of ASEAN competition regional policies on the share of total investment in GDP per capita are calculated by considering the case in which all ASEAN countries are becoming as competitive as Singapore, the most competitive country in the region. In addition, a gravity model of bilateral foreign direct investment (FDI) flows is applied to evaluate the effects on the FDI inflows from the 30 OECD countries. The findings will provide useful information for policymakers and other stakeholders in terms of choosing appropriate policies for each individual ASEAN member country.

2. Methodology

A variant of the [Levine and Renelt \(1992\)](#) and [Sudsawasd and Moore \(2006\)](#) frameworks is employed in this study. [Levine and Renelt \(1992\)](#) used cross-sectional data to investigate the empirical links between various macroeconomic indicators and investment. They employed [Leamer's \(1983\)](#) Extreme-Bound Analysis (EBA) approach to perform a robustness test, in which a robust relationship between investment and international trade was found. In a subsequent study by [Sudsawasd and Moore \(2006\)](#), the [Levine and Renelt \(1992\)](#) dataset was expanded to a panel dataset. They found a robust correlation between investment and trade policy volatility. For this study, the focus is on the relationship between investment and competition policy. The model is in the following general form:

$$Y = \beta_X X + \beta_M M + \beta_Z Z + \varepsilon,$$

where Y is the dependent variable, X is the set of variables always included, M is a set of policy variables of interest, Z is a set of optional variables that have been identified previously as potential important explanatory variables, β is the estimated coefficient, and ε is the error term.

The Y -variable is the share of total investment, including both domestic and foreign investment, in GDP per capita (INV). Further, the M -variables are the competition policy measures (COM). For the X -variables, as suggested by [Levine and Renelt \(1992\)](#), the share of total trade in GDP per capita (X) is identified as one of the X -variables. However, since the level of development of a country may influence the level of investment through increases in domestic savings and capital inflows, GDP per capita (GDPPC) is additionally included.

The Z -variables are similar to those employed by [Sudsawasd and Moore \(2006\)](#), including the share of government expenditures in GDP per capita (GOV), inflation rate (INFL), growth rate of domestic credit (GDC), standard deviation of inflation (STINFL), and standard deviation of domestic credit growth (STGDC). Since the set of included Z -variables is generally unknown, EBA analysis will provide the extreme upper and lower bounds for the estimated parameters of interest (β_M).

Applying the EBA approach, the model is first estimated without the Z -variables. This regression is referred to as the base equation. Next, regressions estimate all possible combinations of the Z -variables in order to identify the upper and lower bounds.² The extreme upper (lower) bound is identified by the highest (lowest) estimated coefficient of the variables of interest, β_M , plus (minus) two standard deviations. If the estimated parameters remain significant and have the same sign within both bounds, the EBA results suggest a “robust” relationship; otherwise, the relationship is considered to be “fragile.”

3. Competition policy measures

There is no consensus on a definition for competition policy. Developing countries may view competition policy differently from those of developed countries, as competition policy has often met more resistance in developing countries. [Evenett \(2005\)](#) provides basic arguments of such resistance. For instance, a larger firm size may be necessary to compete in a global market, market power may enhance innovation, and too much rivalry may lead to inefficiencies in natural monopolies and some network industries.

In general, competition policy is regarded as a government policy used to constrain “anti-competitive acts,” such as abuse of a dominant position and merger practices to foster economic efficiency. However, there has been some work completed on the scope of “anti-competitive acts.” [Hoekman and Mavroidis \(2002\)](#) define competition policy as “the set of rules and disciplines maintained by governments aiming to counteract attempts to monopolize the market, either through agreements between firms that restrict competition or through unilateral behavior.” Their definition places emphasis on firm behavior.

² Using the set of five Z -variables, 31 alternative combinations can be identified for each M variable.

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