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Competition

BOOSTING PRODUCTIVITY THROUGH GREATER COMPETITION

- Although Iceland has recovered from the economic and financial crisis, it has since experienced low labour productivity growth.
- Replacing public policies and laws that unduly restrict competition with more pro-competitive alternatives would help the government boost productivity.
- In particular, reducing barriers to entry for foreign firms would increase productivity growth and spur innovation.
- Iceland would benefit from a comprehensive programme that reviews regulations across key sectors and provides the government with a list of reforms needed to enhance competition.
- OECD experts could work with experts from the government to conduct such a review, using the OECD's Competition Assessment Toolkit.

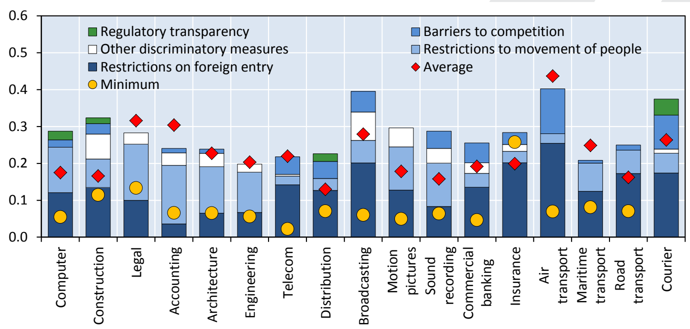
What's the issue?

Many sectors of the Icelandic economy - such as electricity and transportation - have weak competitive pressures. According to the OECD's Product Market Regulation index, competition is hampered by complex regulatory procedures, including those for starting up new companies, and strong protection of incumbent operators. Greater competition could be achieved by abolishing unnecessary barriers in existing or proposed laws and regulations, with the aim of achieving whatever regulatory goal is served by such constraints in a more competition-friendly manner.

Fostering competition can be a challenge given the small size of the Icelandic economy. In a number of important sectors, such as financial services, food and telecoms, only a few firms operate. This makes abuses of dominance and cartels more likely. Effective implementation of competition law by the competition authority with the support of the government is therefore especially important. Where a natural monopoly element is important in a market, separating the competitive segment and setting access rules for the monopoly element can encourage competition.

Iceland restricts trade and foreign participation in services

OECD Services Trade Restrictiveness Index (STRI)



Note: The STRI indices take values between 0 and 1, from least to most restrictive. The STRI database records measures applying on a most-favoured-nation basis; preferential trade agreements are not taken into account. The average and minimum scores take into account all countries included in the STRI database.
Source: OECD (2014), STRI Database.

In addition, in a small economy, competition from imports and from foreign-owned firms is crucial. Yet Iceland scores badly on both the Service Trade Restrictiveness index (STRI) and FDI Regulatory Restrictiveness index. Iceland's STRI score is relatively high and above the cross-country average in 11 out of 17 sectors covered by the index (see Figure). This is partly attributed to horizontal regulation introduced as a result of the banking and balance of payment crisis in 2008. Iceland requires that half of the board members and the manager of corporations must be resident in Iceland or a European Economic Area member country. Foreign direct investment can be subject to screening and is approved when investment is considered in the national interest. Additional authorisation procedures apply to foreign state owned enterprises. Moreover, Iceland has in place labour market tests for temporary services suppliers who may stay in the country for up to 12 months on their first entry permit. Iceland has thus ample room to lift barriers to sharpen competition through trade. The introduction in 2014 of a bilateral trade agreement with China is a step in this direction.

Why is this important for Iceland?

Income per capita in Iceland is lower than in other Nordic countries and around the OECD average, reflecting a lower level of labour productivity. During 2009 to 2013, GDP per hour worked averaged 72 percent of the US level in Iceland, compared with around 80 percent in Denmark and Sweden and around 110 percent in Norway. In addition, labour productivity growth has slumped since the crisis, partly held back by the drop in investment.

The government has recently expressed a willingness to create a more business-friendly environment in Iceland to raise productivity and GDP per capita growth. Boosting competition should be an important element of any strategy to achieve this objective, as numerous economic studies have found that firms facing more competition experience faster productivity growth. Indeed, productivity in sectors more exposed to competition, such as energy-intensive metal production, is high in Iceland compared with similar sectors in other Nordic countries. However, weaker productivity in more sheltered sectors drags the economy-wide average down. In addition to benefitting the economy through greater efficiency, stronger competition would help to lower prices and increase the quality and variety of products and services through innovation.

What should policy makers do?

- Support the Icelandic Competition Authority in a systematic review programme covering existing regulation in key sectors, to suggest more pro-competitive alternatives.
- Review all new public policies, laws and regulation before their introduction to identify and remove unnecessary restrictions to competition.
- Liberalise FDI, for example by easing equity holding restrictions, to increase competition and productivity.
- Establish a Productivity Commission to generate information relevant to pro-productivity policies and independently advocate reform.
- Toughen competition policy to ensure that abuse of dominant position or cartel/tacit collusion does not stifle competition.
- Further ease restrictions that affect trade, for instance by liberalizing postal and insurance services and phasing-out screening of investment.

Further reading

OECD (2014), *Factsheet on How Competition Policy Affects Macroeconomic Outcomes*, OECD Publishing. *http://www.oecd.org/daf/competition/2014-competition-factsheet-for-print-en.pdf*

OECD (2013), *OECD Competition Assessment Reviews: Greece*, OECD Publishing. *http://www.oecd.org/daf/competition/Greece-Competition-Assessment-2013.pdf*

OECD (2011), *OECD Competition Assessment Toolkit, Volume 1: Principles*, OECD Publishing. *http://www.oecd.org/daf/competition/46193173.pdf*

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