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Session I: Competition and Poverty

- Contribution from Spain -

28-29 September 2023

The attached document from Spain is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 28–29 September 2023 in Quito, Ecuador.

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Session I: Competition and poverty

– Contribution from Spain –

1. Introduction[1]

1. Government action to combat poverty does not normally prioritise promoting competitive markets. Nevertheless, it can have a decisive effect on poverty reduction. Competition leads to lower prices, the availability of more and better products, and higher levels of innovation, growth and employment.

2. Although generating competitive and efficient markets benefits all types of consumers, the effects may be stronger for lower-income households. In other words, competition can have a distributional impact on consumers. Competition policy can help combat income inequality. It should be considered in this respect in developing countries in particular, where public resources are scarce and tackling poverty is a priority.

3. Competition policy should not replace policies specifically designed to combat poverty, but it can complement them as an additional tool to address inequality.

2. Competition as a means to improve the consumption of disadvantaged households

4. The primary reason why lower-income households in particular benefit from markets for goods and services with more affordable prices is that they allocate proportionately more of their (relatively lower) income to consumer staples and have little opportunity to divert their spending from goods in those markets, where there is little competition, to other substitute goods or to savings.

5. Many studies have found a significant negative correlation between the income elasticity of different goods and services and the market concentration of the corresponding industries. Given that low-income households generally spend a substantial part of their budget on income-inelastic goods, their spending will tend to be relatively more exposed to the more concentrated industries (Davies and Mariuzzo, 2022[2]).

6. The consumption expenditure of lower-income households tends to be concentrated on essentials. For example, data from Spain (INE, 2021) show that lower-income households spend an above-average proportion of their income on essentials such as food and drinks, communications, and fuel and energy. Demand for these goods tends to be rather inelastic or rigid relative to price. This implies potentially higher corporate profits if supply in these sectors deviates from perfect competitive behaviour, due for example to anti-competitive cartels or mergers. Interestingly, there tends to be greater regulation of

[1] This contribution has been prepared by staff at the Comisión Nacional de los Mercados y la Competencia (CNMC) (Spanish National Markets and Competition Commission staff). It should not be considered an official CNMC position, except for the official documents mentioned throughout the text.

[2] Mariuzzo, F. and S.W. Davies (2022), *Inequality and Concentration: Are the Poor More Exposed to Concentrated Markets?*, Centre for Competition Policy and School of Economics, University of East Anglia, UK. Available at SSRN 4013575.

these essential sectors, often justified on equity grounds. However its actual effects may ultimately differ from those expected. There is therefore a compelling argument for efficient economic regulation that achieves the intended objectives of combating poverty while minimising competitive distortions.

7. Researchers have carried out empirical studies on how the lack of competition can disproportionately reduce the welfare of lower-income consumers across the consumer channel. For example, Creedy and Dixon (1998), analysing Australian household data, found that the relative welfare losses from monopoly were more severe for low-income consumers than for high-income consumers.[3] Regarding the role of regulation, Chambers, Collins and Krause (2019) show that regulations tend to increase consumer prices, which in turn has a disproportionately negative effect on lower-income households.[4] In addition, some research has focused on specific sectors to identify the distributional effect of lower prices driven by increased competition. These sectors include retail (Hausman and Leibtag, 2007), telecommunications (Hausman and Sidak, 2004;[5] Urzúa, 2013[6]) and electricity (Romero-Jordán, Del Río and Peñasco, 2016[7]).

8. Lower-income households are therefore more vulnerable to uncompetitive markets because income level determines the composition of the consumption basket, but also because their income tends to come from wages (and lower-skilled jobs) rather than from capital. As wealthy households are more likely to be shareholders or investors in firms, or skilled workers, their incomes suffer less from the effects of lack of competition in some sectors. This compensating effect does not occur in the same way in the wages of less skilled jobs, which usually evolve countercyclically with market power (Eeckhout, 2021[8]).

9. As competition policy follows a consumer welfare standard, it tends to prevent conduct that would benefit shareholders at the expense of consumers (Baker and Salop, 2015[9]). Lower-income households can also benefit from more competition in the financial sector, even if they do not have significant savings. They may require some basic financial services necessary for operating a bank account, such as payments and transfers, which are essential for the proper functioning of a market economy.

[3] Creedy, J. and R. Dixon (1998), "The relative burden of monopoly on households with different incomes", *Economica*, Vol. 65/285, pp. 285–293.

[4] Chambers, D., C. Collins and A. Krause (2019), "How do federal regulations affect consumer prices? An analysis of the regressive effects of regulation", *Public Choice,* pp. 57-90. ISSN 0048-5829

[5] Hausman, J. A. and J. G. Sidak (2004), "Why do the poor and the less-educated pay more for long-distance calls?", *Contributions in Economic and Policy Research*, Vol. 3/1, pp. 1–26.

[6] Urzúa, C. M. (2013), "Distributive and regional effects of monopoly power", *Economía Mexicana. Nueva Época*, Vol. 22/2, pp. 279–295.

[7] Romero-Jordán, D., P. Del Río and C. Peñasco (2016), "An analysis of the welfare and distributive implications of factors influencing household electricity consumption", *Energy Policy,* Vol. 88, pp. 361-370.

[8] Eeckhout, J. (2022), *The Profit Paradox. How Thriving Firms Threaten the Future of Work,* Princeton University Press.

[9] Baker, J. B. and S. C. Salop (2015). "Antitrust, competition policy, and inequality", *Georgetown Law Journal Online*, Vol. 104, pp. 1–28.

3. Competition as a means to increase the income of disadvantaged households

10. Aside from improving the consumption conditions of lower-income households, competition can also help them in other ways. They are not just consumers of essential goods and services, they are also part of the workforce – almost all of their income comes from wages – and small-business owners. As a result, competition can not only improve the spending conditions of impoverished households, it can also allow them to increase their resources.

11. Competition can potentially help raise wages and levels of employment. In theory, increasing competition in markets for goods and services – either by eliminating anti-competitive practices or by removing undue regulatory barriers to competition – should increase the production of those goods and services. This is another advantage of the pro-competitive price reductions noted above. Higher levels of production will require higher levels of employment. This may benefit lower-income households in particular, since most of their income tends to come from their wages. Moreover, if labour markets are sufficiently competitive, wages should rise as market power in goods and services markets declines. This is because the competitive wage tends to equal the marginal revenue from the marginal product of labour, and this marginal revenue is always lower when the firm has market power over the products it offers.

12. However, this may not be the case; firms may also have "labour-market power" when hiring employees, which enables them to set wages below the level of marginal revenue product. Such a reduction in wages would lead to income inequality between workers in concentrated labour markets and those in competitive labour markets. Moreover, in these situations, low-income workers generally suffer most, as they tend to lack bargaining power (Naidu, Posner and Weyl, 2018[10]). The proliferation of non-compete clauses in many low-wage sectors in certain countries has particularly disadvantaged low-income households.

13. Empirical evidence suggests that reduced inter-firm competition in hiring has a greater negative impact on wages for low-skill jobs. In addition, lack of competition may suppress the labour force participation rate. These findings suggest that concentration of companies has a negative impact on equality levels (De Loecker, Eeckhout and Unger, 2020[11]).

14. Members of lower-income households may also be small-business owners or self-employed. They are particularly likely to choose these alternatives if the labour market does not offer the possibility of earning a living wage. However, both anti-competitive practices by established firms and regulations that unduly hinder new firms' entry into the market prevent these smaller firms from accessing the market and thriving, thereby curbing the income levels of the impoverished households that start these businesses. Tackling these obstacles can therefore be a key element in the battle against income inequality. Moreover, this inequality of opportunities in market access makes business performance less responsive to effort, ability and inventiveness. Consequently, those companies protected by unjustified entry barriers receive extraordinary benefits that do not correspond to their own merits. Such situations, which perpetuate arbitrariness or privilege based on favouritism or clientelism networks, are blocking routes out of poverty.

[10] Naidu, S., E. A. Posner and G. Weyl (2018), "Antitrust remedies for labor market power", *Harvard Law Review*, Vol. 132/537.

[11] De Loecker, J., J. Eeckhout and G. Unger (2020), "The rise of market power and the macroeconomic implications", *The Quarterly Journal of Economics*, Vol. 135/2, pp. 561–644.

15. Finally, it is worth noting again that increased competition, which could be achieved through a successful competition policy, is not a solution to poverty but a potentially powerful tool to combat it. Redistributive public policies, with their multiple instruments, should be the primary solution in the fight against poverty. These policies are designed to support lower-income and more vulnerable groups, who also tend to rely more heavily on public services, such as education, health or social assistance (Anghel et al.; 2018 Verbist, Förster and Vaalavuo, 2012[12][13]). However, competition can help boost the work of the public sector in different ways. First, competition and efficient economic regulation, by boosting growth, help increase government revenues and thereby the resources available for these policies. Second, yardstick competition between different public administrations and agencies in charge of public services can create good incentives for public administrators to quickly adopt best practices and innovations, leading to an optimisation of public resources. And last, competition is essential for efficient public procurement, achieved through open, transparent and non-discriminatory public bidding procedures.

[12] Anghel, B. et al. (2018), "La desigualdad de la renta, el consumo y la riqueza" [Inequality of income, consumption and wealth], *Banco de España, Documentos Ocasionales,* No. 1806.

[13] Verbist, G., M. Förster and M. Vaalavuo (2012), "The impact of publicly provided services on the distribution of resources: Review of new results and methods", *OECD Social, Employment and Migration Working Papers,* No. 130.