

Unclassified

ECO/WKP(2004)11



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

12-May-2004

English - Or. English

ECONOMICS DEPARTMENT

ECO/WKP(2004)11
Unclassified

PRODUCT MARKET COMPETITION AND ECONOMIC PERFORMANCE IN SWEDEN

ECONOMICS DEPARTMENT WORKING PAPERS No. 388

By
Deborah Roseveare, Martin Jørgensen and Lennart Goranson

All Economics Department Working Papers are now available through OECD's Internet Web site at
<http://www.oecd.org/eco>

JT00163972

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

ABSTRACT/RÉSUMÉ

Vigorous product market competition plays a central role in bolstering productivity growth. Sweden has strengthened competition legislation and deregulated a number of sectors, including electricity, telecommunications and parts of transport, over the past 10 to 15 years. This paper examines the current state of product market competition and proposes further measures. A stronger institutional framework would facilitate identification and elimination of anti-competitive behaviour, such as hard-core cartels. Efforts to inject effective competition into a range of network industries have been broadly successful, but specific measures could increase competition in several sectors, such as retail and construction. There is also room to boost competition in Sweden's large and decentralised public sector and in its interactions with the private sector, so that competitive neutrality applies to all public sector activities.

JEL classification: H4, K21, L1, L32, L33, L41, L43, L44, L8, L9, O52

Keywords: Sweden, competition, regulation, product markets, network industries, retail distribution, construction, public sector, competitive neutrality, public procurement.

* * *

La vigueur de la concurrence sur les marchés de produits joue un rôle central dans la stimulation des gains de productivité. La Suède a renforcé la législation concernant la concurrence et déréglementé un certain nombre de secteurs, dont l'électricité, les télécommunications et certains segments des transports. Cette étude examine l'état actuel de la concurrence en Suède et propose des mesures supplémentaires. Un cadre institutionnel renforcé faciliterait la détection et l'élimination des comportements anticoncurrentiels, dont les ententes injustifiables. Des efforts ont été accomplis pour introduire un peu plus de concurrence active dans un éventail d'industries de réseau et ils ont globalement été couronnés de succès, mais quelques mesures concrètes seront nécessaires pour améliorer la concurrence dans plusieurs autres secteurs, dont la distribution et la construction. Il y a lieu également d'intensifier les efforts pour stimuler la concurrence dans le vaste secteur public décentralisé de la Suède, et pour favoriser ses interactions avec le secteur privé, afin que des conditions de pleine concurrence s'appliquent à toutes les activités du secteur public.

Classification JEL : H4, K21, L1, L32, L33, L41, L43, L44, L8, L9, O52

Mots clés : La Suède, concurrence, réglementation, marchés de produits, industries de réseau, grande distribution, construction, neutralité de concurrence, marchés publics.

Copyright © OECD 2004. All rights reserved.

**Applications for permission to reproduce or translate all, or part of, this material should be made to:
Head of Publications Service, OECD, 2 rue André-Pascal, 75775 PARIS CEDEX 16, France**

TABLE OF CONTENTS

Product market competition and macroeconomic performance.....	6
Competition legislation and enforcement	9
Regulatory policy and competition issues in specific markets/sectors	13
Electricity generation and distribution.....	13
Telecommunications.....	15
Air transport.....	15
Rail transport	16
Construction.....	17
Rental housing	17
Food and groceries distribution	19
Pharmaceuticals	19
Alcohol retailing.....	21
Competition and the public sector	22
Public activities in competitive markets	25
Public procurement.....	26
Public enterprises and privatisations	28
Subsidies and state aid.....	28
Concluding remarks and priorities for policies.....	29
 Bibliography	 32
 <i>Annexes</i>	
1. Telecommunications competition in practice	35
2. Proposals by housing organisations	36
3. Alcohol retailing	37
4. Public Procurement.....	40
 Boxes	
1. The stance of competition in Sweden	7
2. Experiences with procurement at the municipal level	27
 Tables	
1. Consumption exposed to competition.....	6
2. Relative price levels.....	9
3. Output, employment and productivity	10
4. Major competition cases ruled upon by the Market Court.....	11
5. Fines claimed and imposed in major competition cases	12
6. Electricity prices	14
7. Total consumption of alcohol	21
8. State-owned enterprise sector	24

Figures

1.	Indicators on competition	8
2.	Market concentration in electricity	14
3.	Telephone charges	16
4.	Completed rental dwellings	18
5.	Relative pharmaceutical prices	20
6.	General government consumption and employment	22
7.	Public enterprise sector in EU countries	23
8.	Openly advertised public procurement	26
9.	State aid to enterprises in the EU	29

**PRODUCT MARKET COMPETITION AND ECONOMIC PERFORMANCE
IN SWEDEN**

by

Deborah Roseveare, Martin Jørgensen and Lennart Goranson¹

Sweden has seen strong GDP growth in the past decade, labour productivity has increased at rates well above the OECD average, and employment has improved markedly after the earlier labour shake-out. Developments in the telecommunication equipment sector have been especially impressive, whereas other sectors have lagged behind somewhat. To some extent, this slower rate of expansion in certain sectors is probably linked to insufficient pressure to compete and a resulting lack of dynamism.

The country has been engaged in a major effort to strengthen competition in the last 10-15 years. New competition legislation and monitoring institutions were introduced, and a number of sectors were deregulated, including previously largely state-owned network industries. Accession to the European Union in 1995 was a crucial step in this process. These measures have arguably increased the overall performance of the economy — the requirement to replace Sweden's liberalised agriculture policies with the Common Agricultural Policy (CAP) being one important exception.

Though the country was early in liberalising a number of important sectors, progress towards a more competitive economic structure seems to have lost momentum in recent years. This is especially evident for publicly provided services, where there is still too little recognition of the potential benefits to consumers from adopting pro-competition policies. These include higher cost effectiveness, better quality, more freedom of choice and greater responsiveness to clients.

This working paper identifies the main areas where impediments to competition are likely to keep the country from realising the highest output from available resources, and where a shift to pro-competition policies would help to boost growth potential. The first section briefly reviews the link between competition and growth and presents a number of general indicators on the stance of competition. The overall framework of competition legislation and its enforcement is then assessed before selected network industries and various other sectors are reviewed. Next, the stance of competition within the public sector is examined, and the final section presents conclusions and recommendations.

1. The authors are staff at the OECD. This paper draws on material originally produced for the *OECD Economic Survey of Sweden* published in March 2004 under the authority of the Economic and Development Review Committee. The authors are indebted to colleagues in the Economics Department of the OECD for comments and drafting suggestions, in particular Peter Jarrett, Mike Feiner, Jørgen Elmeskov, Val Koromzay, Andrew Dean, Maria Maher and Jens Høj. Special thanks go to Raoul Doquin de Saint Preux and Mee-Lan Frank for technical assistance.

Product market competition and macroeconomic performance

Competition is generally considered to contribute to stronger economic growth by generating static and dynamic gains in labour and multi-factor productivity. The link between competition and static gains is well established empirically for OECD countries, although the connection between competition and dynamic gains is not yet completely clear (OECD, 2002). In general, positive spill-over effects from product market competition to employment have been identified (Nicoletti *et al.*, 2001), although in Sweden, these benefits might not be fully realised, due to obstacles slowing adjustment in the labour market (OECD, 2004). Indeed, labour market characteristics can have a significant and complex impact on industrial structure and innovation, as stricter labour market regulations have been shown to generally inhibit the full realisation of gains from greater competition.

Sweden has been a leader in reforming and deregulating a range of sectors that had previously been shielded from competition. Examples are the financial market (mostly in the 1980s), rail transport (in successive steps; 1990, 1992 and 1996), taxis (1990), domestic air traffic (1992), the postal and telecom markets (1993) and electricity generation and distribution (1996). Alongside these changes, a new competition law was introduced (1993), and the Swedish legislation has since been harmonised with EU rules. The country has also been a steady advocate for freer international trade. Nevertheless, according to a recent study only 32 per cent of total household and public consumption was acquired on markets fully exposed to competition in 1999 — well below the European average of 45 per cent (Table 1).

Table 1. **Consumption exposed to competition¹**
1999

	Sweden		European Union		Sweden's relative position ²
	Per cent of:		Per cent of:		
	Total consumption	Category fully exposed to competition	Total consumption	Category fully exposed to competition	
Food and non-alcoholic beverages	8.1	20.0	9.6	50.0	<<
Alcohol and tobacco	2.7	0.0	3.2	80.0	<<
Clothing and footwear	3.5	100.0	5.0	100.0	=
Housing, water, electricity, gas and other fuels	19.7	33.3	15.7	50.0	<<
Furniture, appliances and household maintenance	3.1	100.0	5.2	100.0	=
Health care services	1.6	20.8	2.4	20.0	=
Transport	8.4	20.0	10.4	15.0	>
Communication	1.9	76.7	1.8	32.3	>>
Recreation and culture	7.1	50.5	6.9	50.0	=
Education	0.1	50.0	0.7	74.9	<<
Restaurants and hotels	3.3	96.1	6.2	80.1	>>
Other goods and services	4.8	100.0	7.2	100.0	=
Total private consumption	64.4	46.5	74.3	59.5	<<
Public consumption	35.6	5.1	25.7	5.0	=
Total consumption	100.0	31.8	100.0	45.5	<<

1. The assessment of exposure to competition is based on indicators of concentration and other impediments to competition in the various sectors. The focus is on domestic factors impeding competition, thus not taking into account the possible effects of, for instance, special import restrictions, which would lead to lower competition exposure in both Sweden and the EU.

2. >> (<<) indicates that Sweden is at least 10 percentage points more (less) exposed to competition than the European Union. > (<) indicates a difference of less than 10 percentage points.

Source: Braunerhjelm *et al.* (2002).

Notwithstanding these efforts in the 1990s, the picture of the overall stance of competition is mixed when looking at various individual indicators (Box 1). Although price level differences are normally linked to variations in GDP per capita in international comparisons, even when corrected for this effect, the overall price level — measured on the basis of purchasing power parities — does seem to be relatively high in Sweden (Figure 1). Comparatively high indirect taxes certainly explain part of the deviation, and quality differences possibly also contribute, but more sophisticated studies in Sweden have suggested that prices are indeed somewhat above what can be reasonably explained by such factors, despite the relative openness to international trade. So while significant efficiency gains have been realised and prices reduced on certain deregulated markets, with one study concluding that deregulation of the electricity, telecommunications and railway markets has resulted in efficiency improvements of around 5 to 10 per cent (Bergman, 2002), there are still indications of some effects from weak competition due to static inefficiency in general. Moreover there are major differences in prices of different categories of goods and services (Table 2).

Box 1. The stance of competition in Sweden

A number of indicators can be used to assess the state of competition in the economy, although they are subject to some measurement problems and should be interpreted with caution.

First, the price level is often used to gauge possible static inefficiency. The debate on competition in Sweden has focussed on this, with a number of research reports trying to explain the apparent higher prices when compared with other countries. The prevailing view is that only part of the comparatively high price level can be attributed to various special characteristics for Sweden. A number of studies commissioned by the Swedish Competition Authority have concluded (Konkurrensverket, 2003a):

- Prices are indeed higher in Sweden, and around half of the difference between Sweden and EU may be attributed to lack of competition pressure.
- Product markets with remarkably high price differences are characterised by high concentration, strong brand names, and/or little competition from imports. Also non-tariff barriers were fairly common.
- High food prices overall can partly be attributed to the planning process in municipalities, which impedes competition by favouring the three dominant actors on the retail food market.
- Substantial regional price differences in some sectors, notably food items and building materials, cannot be explained by differences in the economic and regulatory environment.

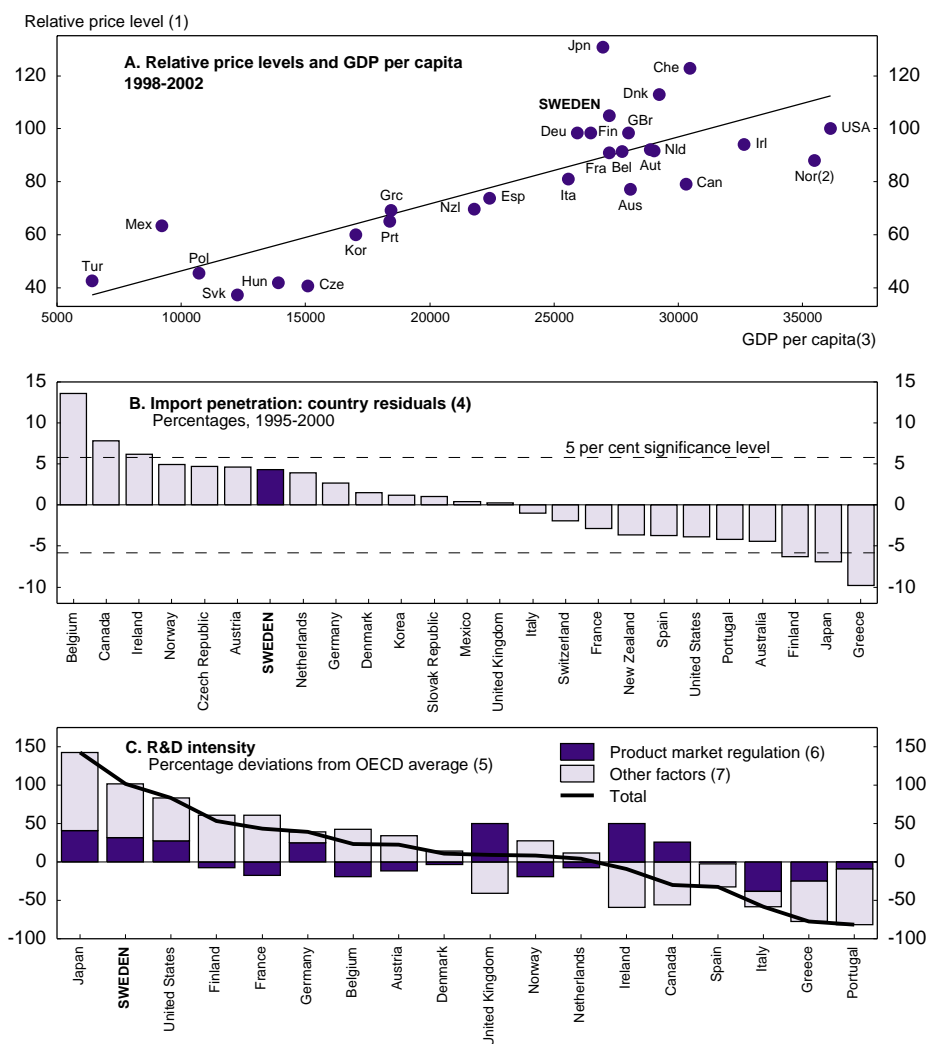
Second, profit mark-ups have not been high in Sweden, despite relatively high prices (Oliveira Martins *et al.*, 1997). Estimates show mark-ups well below average in a range of industries, indicating a relatively competitive environment, and average in other sectors. Also, wage *premia* have not been found to be especially high in Sweden, *i.e.* sharing of product market rents with workers does not seem to take place to an unusual extent (Jean and Nicoletti, 2002). This result may reflect wage bargaining arrangements and/or small rents to be shared between labour and capital.

Third, concentration indices for Sweden are found to be high in a number of industries including a range of chemical products, pharmaceuticals, food and beverages, pulp and paper, and construction materials (Konkurrensverket, 2002a). In non-manufacturing, relatively high concentration is also found in construction, retailing, water utilities and land transport. However as a small country, Sweden could be expected to have concentration indices generally above average, whereas its companies are more likely to be exposed to competition from abroad.

Fourth, Sweden has a relatively high import ratio, once corrected for structural factors such as country size (population), GDP per capita levels and natural barriers to trade associated with transportation costs. Large foreign direct investment flows relative to GDP are another indicator of openness. Johansson (2001) finds a positive effect from import competition on Swedish productivity growth in sectors where companies have very different technological levels. Sweden has been one of the most diligent in implementing EU directives that facilitate making the single European market a reality (European Commission, 2003). However, adoption of the EU Common Agricultural Policy has reduced the agricultural sector's exposure to competition from imports from third countries.

Fifth, entry and exit of businesses, which could be interpreted as indicators of dynamic competitive pressures, give a somewhat mixed picture. By international standards, Sweden has a relatively low number of entrepreneurs, which might to some extent reflect a higher degree of risk aversion.

Figure 1. Indicators on competition



1. Purchasing power parities divided by the exchange rate, USA = 100.
 2. 2001.
 3. In US\$, converted with the PPPs.
 4. Residuals after control for effects of country size, GDP per capita and transportation costs.
 5. The total deviation of R&D intensity from OECD average (adjusted for industry composition) is divided into estimated contributions from product market regulation and from other factors.
 6. Includes administrative and economic regulations.
 7. Includes EPL, other controls and country-specific effects.
- Source: OECD.

Although the comprehensive reforms in network industries in the 1990s have on the whole yielded positive results, the benefits of the earlier reforms cannot be clearly detected in the growth rate for GDP per capita, despite the relatively good growth performance since 1994. Labour productivity increases have indeed been higher than the OECD average, more than offsetting below-average increases in employment (Table 3). But a closer examination indicates that the evolution of labour productivity in different sectors is not obviously correlated with deregulation, especially for the sector comprising electricity, gas and water supply. On the other hand, product market deregulation seems to have contributed significantly to the high R&D intensity, which is generally believed to raise growth, although in Sweden's case this does not seem to have translated into substantially higher growth (OECD, 2004).

Table 2. **Relative price levels**
1999 EU-15 = 100

	Sweden	Denmark	Finland	Germany	United Kingdom	Italy	France	Netherlands
Food	118	127	113	101	101	97	109	94
Non-alcoholic beverages	126	143	123	105	120	92	88	90
Clothing and footwear	107	99	103	106	105	95	98	101
Rentals for housing	125	107	133	132	105	65	111	90
Construction	126	128	79	108	104	80	127	120
Electricity, gas and other fuels	86	158	90	106	86	103	102	125
Medical products and equipment	119	119	126	126	105	88	94	85
Purchases transport services	163	121	121	125	146	67	99	109

Source: Eurostat.

The apparent absence of links between pro-competition policies and the overall price level, and between innovation and growth, has recently been described as the Swedish growth and competition paradox (Braunerhjelm *et al.*, 2002; Andersson *et al.*, 2002). However, one difficulty in assessing the gains from pro-competition policies is the absence of a “counter-factual”, namely, what outcomes would have been in the absence of reforms. Another explanation could be that various aspects of the economic structure still prevent the country from realising some of the typical gains from pro-competition policies: the existence of some dominant sectors still shielded from competition (especially the public sector), regulations on the labour market, the tax structure and state subsidies.

Competition legislation and enforcement

An effective legal framework governing competition is a critical factor in shaping the way markets function and in boosting economic performance through product market competition. In 1993, Sweden adopted a modern Competition Act, modelled on the EU rules prohibiting restrictive agreements and abuse of a dominant position and including merger control. Legal reform has kept Swedish law in line with EU developments, and some changes have aimed at enhancing its effectiveness, such as strengthening the leniency rules, which provide for protection from prosecution for the first company that comes forward with information on undetected cartels. With the EU modernisation programme becoming effective in spring 2004, harmonisation and international co-operation in Swedish and Community competition law enforcement will be further enhanced. The Competition Act applies to the production and trade of all goods, services and other products and to all institutions engaged in such activity, except for two sectors; primary agricultural associations and certain types of co-operation between taxi companies enjoy a legal exemption from the prohibition of restrictive agreements. The Competition Authority (CA) has the competence to enforce the Competition Act in all economic sectors covered by the law although, under the new Electronic Communications Act, the CA will share its traditional role of sole expert on competition analysis with the telecommunications regulator. Co-ordination with sectoral regulators and other similar authorities has reportedly worked smoothly, and competition concerns have also been a high priority in regulated sectors.

In practice the Competition Act is difficult to apply on certain anti-competitive practices in the public sector, most notably abuse of a dominant position. While the competition rules, in principle, apply to all enterprises whether private or public, irrespective of legal or organisational status, and non-profit as well as profit-making, in practice they are based on concepts designed to apply to private profit-making enterprises, and have proven difficult to apply when bodies such as municipally-owned enterprises rely

Table 3. Output, employment and productivity
Average annual percentage change, 1994-2002

	Sweden	Denmark	Finland	United States	Germany	United Kingdom	European Union	OECD
Average GDP growth	3.1	2.8	3.8	3.3	1.6	2.9	2.4	2.7
<i>of which:</i>								
Productivity per worker	2.3	2.0	2.2	1.8	1.2	1.9	1.3	1.7
Employment	0.8	0.7	1.5	1.4	0.4	1.0	1.1	1.0
<i>of which:</i>								
Unemployment ¹	0.5	0.6	0.9	0.1	-0.1	0.6	0.3	0.1
Labour force	0.3	0.1	0.6	1.3	0.5	0.4	0.8	0.9
	1994-2001 ²							
Growth in labour productivity per worker in selected industries								
Manufacturing	6.5	4.2	5.4	4.0	2.8	1.7	..	..
Manufacturing of radio, television and communication equipment ³	42.9	8.5	17.5	11.7	10.8	4.8	..	..
Electricity, gas and water supply	0.5	2.6	5.7	1.3	6.2	10.8	..	..
Construction	0.8	0.5	-2.0	-0.0	0.3	1.8	..	..
Wholesale, retail trade, restaurants, hotels	3.7	1.7	3.0	4.3	-0.9	2.0	..	..
Transport, storage, communication	4.1	5.5	4.8	2.4	8.7	4.7	..	..
<i>Memorandum item:</i>								
MFP growth ⁴	1.6	1.0	2.9	1.0	1.0	1.2	..	..

1. A positive sign indicates that unemployment has declined and helped to boost output growth.

2. For Sweden and Germany: 1994-2000.

3. For United States: Manufacturing of machinery and equipment; for United Kingdom: Manufacturing of electrical and optical equipment.

4. Total economy: For Sweden and Finland: 1994-2000.

Source: OECD.

upon public finances to exclude competitors through pricing below costs. The CA is also empowered to apply the Law against Undue Behaviour in Public Procurement, but this Act has proven to be ineffective as a remedy against current problems related to public procurement.

The CA has the power to take certain enforcement decisions on its own, but more important decisions are subject to ruling by Stockholm City Court with scope for appeal to the specialised Market Court. Private actions in competition cases may be brought before all civil courts, but they are rare. The reasons often cited include: the costs involved; expectations of meagre damages; and prevailing cultural traditions. The process can be rather drawn out: for example, the CA initiated the Uponor hard-core cartel case in 1997 and the case finally concluded with the Market Court ruling in January 2003 (Table 4).

Table.4. **Major competition cases ruled upon by the Market Court**
1998 to January 2003

Case	Initiated at the CA	Petitioned to the Stockholm City Court by the CA	Stockholm City Court's first instance ruling	Market Court's last instance ruling
Optiroc (merger)	May 1997	Sep 1997	Mar 1998	Jul 1998
Nitro Nobel (fine, abuse of dominance)	Dec 1994	Mar 1997	Jun 1998	Sep 1999
Scandinavian Airlines Systems (fine, abuse of dominance)	Oct 1994	Oct 1996	Jun 1998	Nov 1999
State Railways (fine, abuse of dominance)	Dec 1993	Jan 1996	Dec 1998	Feb 2000
AGA Gas AB (fine, abuse of dominance)	Nov 1994	Apr 1999	Dec 2000	Sep 2002
Uponor Sverige and others (fines, cartel)	Jun 1997	Aug 1999	Dec 2001	Jan 2003

Source: Annual reports to the OECD on competition policy developments in Sweden.

So far, court proceedings in cartel cases have not resulted in clear signals deterring such behaviour. In such proceedings, defendants have engaged highly qualified legal experts, commensurate with the economic interests at stake. In some cases, very significant quantitative and qualitative resources have been put up by the defendants and the CA has consequently failed to prove its case. One example is the petrol cartel where leading companies had agreed on prices and reduced rebates. In court, the CA claimed that customers whose rebates were reduced suffered from an increased net price, but the Court found that price levels were not raised as a result of the concerted action and imposed fines less than 10 per cent of the level proposed by the CA (Table 5). Fines at this level provide little deterrent to other businesses from engaging in cartel activities. Furthermore, only one merger case has been brought to court since the CA lost the Optiroc case² in 1998, and in that instance, Svenska Girot, decided not to proceed with the acquisition. This development may partly be due to the fact that major mergers mostly fall under the competence of the European Commission, but the standards set by existing jurisprudence are also perceived to discourage the CA from bringing other merger cases to court.

2. The CA asserted that Optiroc's acquisition of Stråbruken would create a totally dominant position for product markets such as facing bricks, floor putty, mortar and dry concrete, with market shares of between 63 and 85 per cent. Optiroc and Stråbruken were also the only companies with anything approaching a full range of such products.

Table 5. **Fines claimed and imposed in major competition cases**

	Fine claimed by the CA	Fine decided by the Stockholm City Court	Fine decided by the Market Court
	(SEK 000s)		
Petrol companies (cartel)	651 000	52 000	Pending
State Railways (abuse of dominance)	30 000	8 000	8 000
Plastic pipe manufacturers (cartel)	17 500	10 600	10 600
Scandinavian Airlines Systems (abuse of dominance)	10 000	1 000	1 000
Nitro Nobel (abuse of dominance)	5 000	200	400
AGA Gas AB (abuse of dominance)	3 000	600	0

Source: Annual reports to the OECD on competition policy developments in Sweden and supplementary information from the Swedish Competition Authority.

Experience of the last 10 years indicates a number of areas where improvements could be sought. Public awareness of the detrimental effects of cartels has increased, but a competition culture is still not sufficiently strong in business circles, and the CA has so far unveiled conspiracies in such product markets as plastic pipes, petrol and asphalt. Some cartels even include state bodies, a prime example being the SNRA Construction and Maintenance subsidiary of the National Road Administration. Court rulings to date are unlikely to generate a strong deterrent effect given the potential economic rewards for companies participating in a cartel, and the sanctions actually imposed have not begun to approach the maximum of 10 per cent of annual turnover authorised by the law. Producing a clear demonstration effect through successful prosecution might be helped by providing the CA with the resources to employ more experts or to engage private counsel for litigating the most complex cases. Streamlining the process and shortening the time from initial investigation to final judgement might also help to reduce costs and make enforcement more effective. One option might be to replace the present two-tier court structure by establishing a Council within the CA for first-instance decisions, with appeal to one specialist court, following models applied in some other OECD countries.

The CA's capacity to act might also be helped by stronger incentives to 'whistle-blowers' and cartel participants who offer full co-operation with the enforcement authority. Since 2002, the Competition Act has allowed for total immunity from fines in cartel cases on conditions specified in the law, but at the discretion of the CA. Given OECD experience, the effectiveness of leniency programmes might be enhanced by increasing the risk of disclosure, increasing the gravity of sanctions, and improving the transparency and certainty of amnesty terms. Present sanctions do not include criminal or other sanctions applicable to natural persons. Although criminalisation has recently been rejected by a government commission, many OECD countries have found that more severe sanctions may be needed in order to deter cartel behaviour effectively, and a new commission is revisiting this issue. Reconsidering alternative ways to make sanctions applicable to individuals may be a way for the government to signal its firm rejection of anti-competitive attitudes where they may still prevail.

Merger control under national legislation does not at present have a demonstrable effect in preventing the development of anti-competitive structures in the economy, despite the resources spent, both in the enforcement agency and by the companies concerned. If present legislation does not provide sufficient support for such action, a reform of the merger provisions of the Competition Act may need to be considered.

Serious competition problems are found in the public sector — or at the private/public interface — where the enforcement of competition law often fails to be an effective remedy. These problems have been observed for a long time, but very little progress has been made in dealing with them. The Competition Act may need to be modified so that it applies to anti-competitive activities by municipalities or other public institutions in practice as well as in principle. The Government's Bill to Parliament (1999/2000:140) Competition Policy for Renewal and Manifoldness stated that “the share of the total economy where there is competition should increase”. But no major initiatives have been taken since the mid-1990s to expand the area exposed to competition and thus subject to competition law enforcement. An additional problem is that court rulings on anti-competitive practices have proved difficult to enforce, if the local government refuses to comply.

Regulatory policy and competition issues in specific markets/sectors

The Swedish case provides some useful lessons on liberalisation of certain markets, particularly network industries, where it took bold steps to inject competition, but where the results were not always quite those initially expected. The following section reviews some of these sectors where further changes have been necessary, but also where other countries at an earlier stage in the process might benefit from the Swedish experience. It then moves to discuss several sectors that are apparently resistant to efforts to strengthen competition and where the obstacles to competition are not always easy to pinpoint, let alone dismantle. The section concludes with a review of two state-owned retail monopolies, where the authorities are not seeking to increase competition.

Electricity generation and distribution

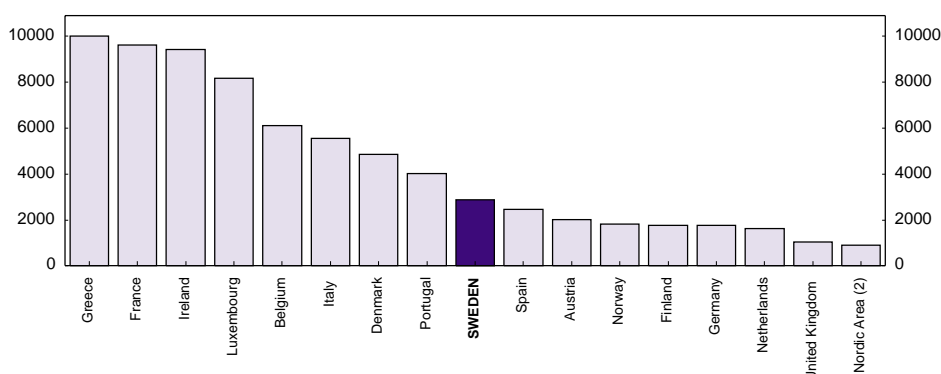
Sweden was an early mover in opening up its electricity markets to competition. Electricity generation was opened up to international trade, and prices are now entirely determined by supply and demand through Nordpool, the power trading exchange established in 1996. Analysis of price data for 2001 and 2002 indicates that prices were equalised over the whole Nordic region only one-third to one-half of the time (Nordic Competition Authorities, 2003). Bottlenecks in the grids and weather conditions mean that at other times, the relevant geographic market is a shifting combination of sub-regions, although it has been rare for the Swedish part of the market to be completely isolated from its neighbours.³ Simulations by the Nordic Competition Authorities indicate that there are several periods during the day when market power could be potentially exercised within the Nordpool area.⁴

Market concentration is a traditional measure of the degree of power that owners can conceivably exercise over a market. In Sweden, the state-owned company, Vattenfall AB, is the fifth largest electricity company in Europe and owns one-fifth of the generating capacity in the Nordic market and half of Sweden's. Nevertheless the Herfindahl-Hirschman Index (HHI) indicates that the Swedish market is less concentrated than many other European countries, and the Nordic market as a whole should be relatively free of market dominance (Figure 2). However, Vattenfall's management has already indicated its desire to buy hydroelectric generation in Norway as soon as that country eases ownership rules, which would enable the company to increase its market share in the Nordic region.

3. Over the past three years, this has only been the case for less than 0.1 per cent of the time. Usually Sweden and Finland or Sweden and East Denmark form the geographic market.

4. The extent to which market dominance can actually be exploited depends on the characteristics and nature of supply as spot electricity prices are relatively insensitive to changes in demand. The extent to which any supplier can respond to a potential excess of demand by increasing supply depends on whether the production technology is flexible, how close to capacity a plant is already operating and whether bottlenecks inhibit the distribution of any additional output (OECD, 2003a).

Figure 2. **Market concentration in electricity**
Herfindahl-Hirschman Index¹



1. This is defined as the sum of the squares of percentage market shares of all firms in the relevant market. The more concentrated a market is, the closer the index will come to its maximum of 10 000.
2. Denmark, Finland, Norway and Sweden.

Source: Nordic competition authorities.

Sweden's experience with electricity price movements after market liberalisation provides a salutary lesson on interpreting the benefits from reform. Prices fell dramatically on Nordpool between 1996 and 2000, although prices to consumers fell less sharply (Table 6). Given the co-incidence with the timing of market liberalisation, it would be tempting to attribute this to increased competition, as many Swedes apparently did. The large price movements since 2001 thus left many consumers feeling dismayed, especially those who had opted for electricity contracts which rapidly adjusted to the changes in wholesale prices. In fact, 1996 turned out to be a dry year, requiring greater recourse to more expensive forms of generation, while 1997 to 2000 were years of abundant precipitation, followed by another dry year in 2001. Thus, the very real benefits of competition were largely obscured by weather-related fluctuations in prices.

Table 6. **Electricity prices**
Excluding taxes, mean values, öre per kWh
As at 1 January

	1996 ¹	1997	1998	1999	2000	2001	2002	2003
Apartments	28.2	29.2	29.0	27.1	25.8	27.0	35.6	51.9
Single family dwelling								
Without electric heating	26.7	27.6	36.8	26.3	23.4	24.2	31.6	47.1
With electric heating	24.7	25.9	25.1	24.4	21.8	22.5	29.6	44.7
Agricultural and forestry	23.7	24.9	24.1	23.1	21.4	22.1	29.3	44.5
Commercial operations	n.a.	25.8	24.5	23.3	21.0	22.1	28.8	43.6
Industrial plant								
Small	24.0	25.6	24.1	22.8	20.4	22.0	28.5	44.3
Medium-sized	22.3	24.4	23.1	21.6	19.6	21.7	28.3	44.8
Electricity-intensive	22.0	23.7	22.7	22.5	19.7	22.6	28.3	48.0
Large electricity-intensive	n.a.	23.4	22.0	22.0	19.2	22.7	28.3	48.8
Average Nordpool system prices for full year	26.6	14.6	12.3	11.8	10.8	21.3	24.6	..

1. 1 July 1996.

Source: Swedish Energy Agency (2003).

It should also be noted that since the market was deregulated, installed capacity has fallen as uneconomic plants were decommissioned and replaced by imports. At the same time demand has risen. In the short term, with infrastructure limitations, this might lead to a lack of capacity on very cold days, with consequent rises in prices. But these increases would provide the necessary market signal to potential producers to expand capacity, while the reforms put in place should ensure that the new installations use the most efficient technology available within the Nordic region as a whole. Indeed, the full benefits of competition, *i.e.* the most efficient production of electricity possible in volumes that match consumer demand, will be realised through just such channels.

Sweden was also early in opening up retail distribution of electricity to competition, giving consumers the right to change electricity suppliers. Several remaining obstacles were eliminated in 1999, most notably the requirement for households to install expensive hourly metering equipment. In addition, the notification period was reduced from half a year to one month, and switching fees were no longer allowed. Around 45 per cent of Swedish electricity consumers have taken advantage of this opportunity to either switch supplier or to renegotiate their contract with their existing supplier, including virtually all industrial users. The legal requirement on distributors to publish their tariffs has helped consumers to compare rates and identify where gains might be possible.

Telecommunications

Sweden's experience as one of the first countries to liberalise its telecommunications market provides some insights into the practical issues that need to be addressed to generate effective competition (Annex 1). Some expected improvements did not materialise, and the 1993 Telecommunications Act was amended 15 times before being superseded by the Electronic Communications Act in July 2003. The new act strengthens the role of the National Post and Telecom Agency in several areas by giving it the powers to instruct the dominant operator to allow competitors access to their networks or limit their prices to the end-customer to what is reasonable. While the thrust of these provisions indicates a stronger *ex ante* regulatory approach than before, Sweden's experience suggests that it may not be sufficient to rely on the interested parties to negotiate contracts that provide effective competition. Nevertheless, Sweden already enjoys among the lowest prices for composite residential and business telephone charges in the OECD while mobile phone charges are around the middle of the range (Figure 3).

Air transport

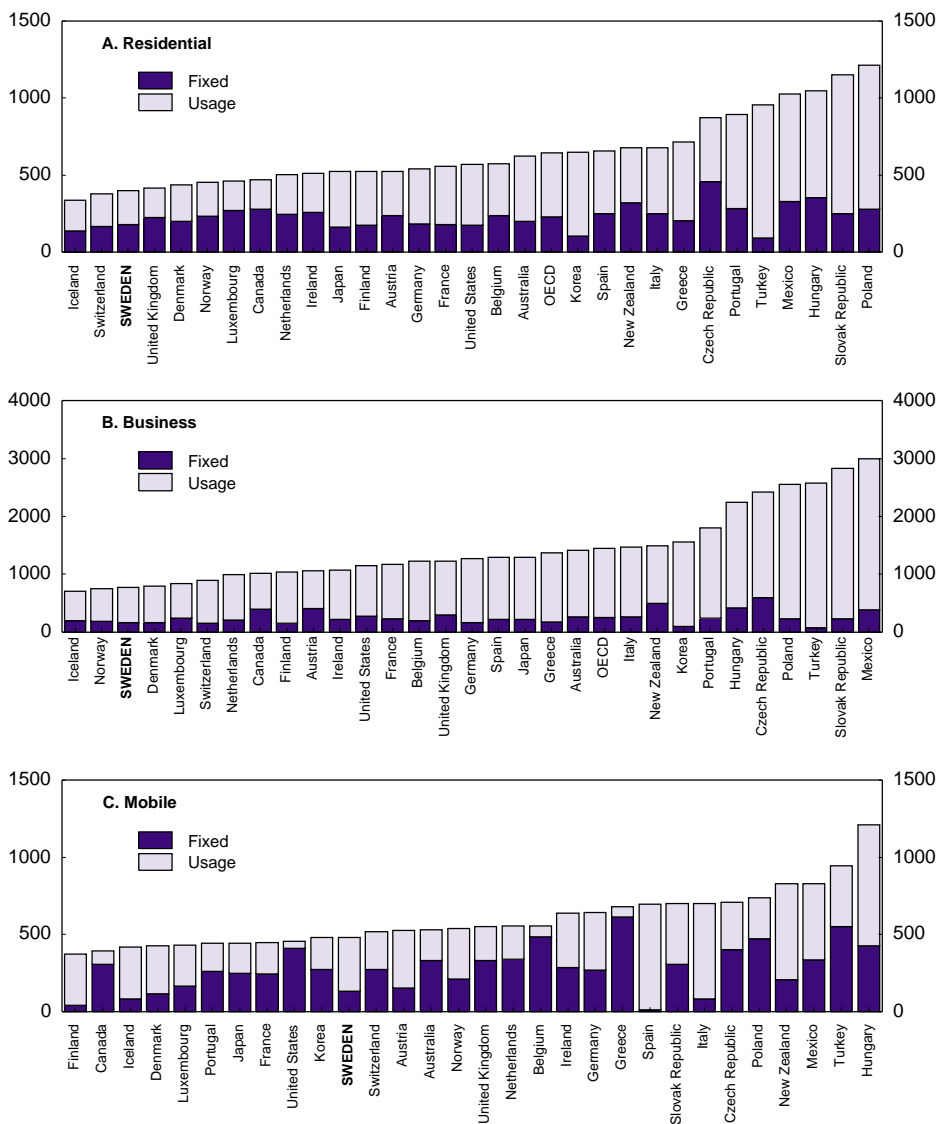
Various parts of the transport sector have been deregulated over the years, but getting vibrant competition to emerge has proved more difficult. Domestic air transport was liberalised in 1992, but SAS group still dominates the market, with 74 per cent market share, while Skyways, 25 per cent owned by SAS, has another 13 per cent of the market. Only seven routes provide any choice of airline, not counting the 10 routes that are provided on social grounds and for which tenders were called. The Nordic Competition Authorities rate SAS as a high-cost airline, partly because of its "business traveller profile", but also because it has a larger share of its income coming from its dominant position in its "domestic"⁵ market than other European airlines (Nordic Competition Authorities, 2002).

Two main obstacles have been repeatedly identified as hampering more effective competition in passenger airlines. *First*, SAS's evident dominant position makes the use of loyalty programmes (and fidelity discounts) an effective tool in inhibiting others entering the market. Indeed the Swedish market court ruled that, from October 2001, SAS could not award air-points on the seven routes currently subject to competition on grounds of abuse of dominant position. *Second*, in line with the EU Slots Regulation,

5. SAS's domestic market comprises Denmark, Norway and Sweden: SAS is half-owned by the governments of these three countries.

landing slots are “grandfathered” to incumbent airlines, as long as they have actually used it 80 per cent of the time in the previous year. This process could make it significantly harder for a new entrant to operate at a congested airport, although new entrants are entitled to be allocated half of any spare slots. Practically speaking, this only affects Stockholm-Arlanda airport, where serious congestion arises at both ends of the working day. Four-fifths of all domestic flights start or end there, and since 1997 almost half the available landing slots have been allocated to SAS, which gives them an advantage in offering flights at peak times.

Figure 3. Telephone charges¹
US dollars at current PPP, August 2002



1. Composite basket of services for residential and business charges and 'average user' basket for mobile charges.
Source: OECD (2003b).

Rail transport

Despite an early start on liberalising the rail market, effective competition is still patchy. The first steps towards liberalisation were taken in 1988, when the national railway was separated into a public

enterprise, Swedish State Railways (SJ), and a government agency, the National Rail Administration, which is responsible for the infrastructure. In addition, passenger services were deregulated for local services on the county lines. Further liberalisation took place in 1996, when county public transport authorities were given the right to operate passenger traffic on the main trunk network within the counties. However, SJ still retains a monopoly in long-distance passenger services. Where private providers were able to enter the market, either winning contracts for non-commercial services, or in providing inter-modal competition through bus services, the results have been beneficial for consumers. Prices have been reduced, especially for those in lower-income brackets such as students and pensioners (Nilsson, 2002).

Part of the original motivation for liberalising the rail sector in 1988 was to redress persistent operating deficits, despite state subsidies from the early 1960s onwards. But SJ found itself again in need of a capital injection and financial restructuring in 2002. The company had competed aggressively in tendering for non-commercial activities, beating other bidders by offering services at prices 20 to 30 per cent less than the costs for the same activities prior to competition (OECD, 1998*a*). Subsequent operating deficits would seem to confirm that these prices were set at unrealistically low levels. The CA investigated a complaint against the behaviour of SJ and found that it had used predatory pricing techniques, a conclusion subsequently confirmed by the courts. Such behaviour was possible because the government was willing to underwrite it, giving the company a “soft budget constraint”. Indeed, the government approved a new injection of capital in spring 2003 to stave off liquidation, while acknowledging that costs remain well above a level where it could compete with others (Regeringskansliet, 2003).

Construction

The construction sector is composed of several sub-markets with a high level of concentration, and significant vertical and horizontal integration. Sweden’s two largest construction companies, Skanska and NCC, offer a comprehensive range of construction and infrastructure services and rank among the 20 largest companies worldwide in this field. Other large construction companies also have significant international activities. Despite the sector’s evident competitiveness in international contracting, building costs in Sweden remain high, albeit with significant regional differences (Konkurrensverket, 2002*b*). Full implementation of the European single market has been hampered by slow progress in resolving the technical issues of the Construction Products Directive. However, with strong established networks, the industry as a whole tends to operate in a way that effectively excludes new suppliers, and several suspected cartels are under investigation or facing legal proceedings. Furthermore, the architecture and engineering consulting segments of the market have also become increasingly dominated by a few large companies. With their common practice of specifying Swedish materials and products, it will be difficult for imports to make inroads, even with the Construction Products Directive. Currently only 25 per cent of building materials are direct imports.

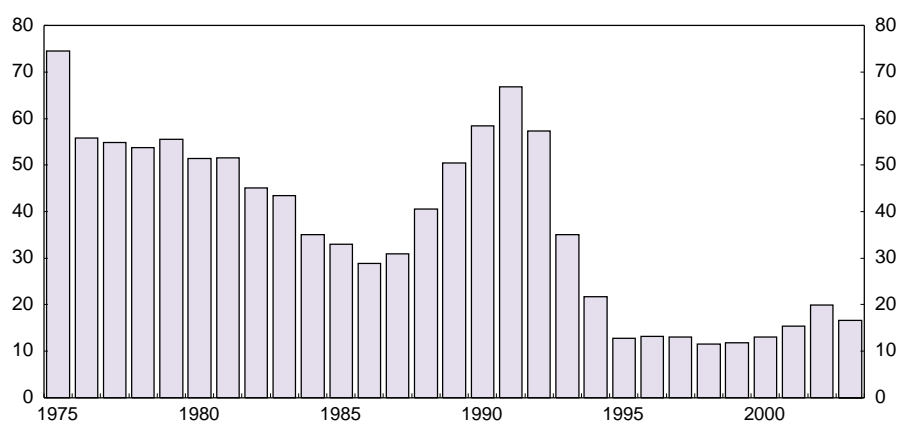
Rental housing

There are some unusual competition dimensions in the Swedish rental housing market. It is a market characterised by comprehensive rent regulation and extensive tenure rights (OECD, 2001). But this approach pre-empts the role of the price mechanism in helping the market to allocate efficiently the housing that is available, as well as to provide signals to expand the housing stock. The result is a very segregated market and limited turnover as tenants hold on apartments with low rent, even if they no longer suit their needs or preferences. In the Stockholm area, for example, older people often retain long-held central city apartments, while younger generations are left with high-priced apartments in new buildings and rental housing in the suburbs. The rationing system that has emerged for allocating apartments that do become available, along with widespread black-market activities, tends to particularly disadvantage low-income households (Andersson and Söderberg, 2002*a*). These outcomes raise the question whether the lottery-like characteristics of the rental housing market are compatible with the stated equity objectives of

the current rent-setting system. Such doubts are reinforced by the strong incentives for private landlords and existing tenants to circumvent the rules by accepting cash payments or sub-letting at a profit to those willing and able to pay the higher prices.

The rent negotiation system restricts the ability of rents to respond to changes in supply and demand, since in the collective rent negotiation system they are based on the so-called “use value” of the dwelling, which by and large corresponds to the cost-determined average rent (see previous *Survey*). With the rent structure effectively shielded from potential new tenants’ willingness to pay, investors face a low return on construction of new rental dwellings, especially in the growth regions where land prices and construction costs are relatively high. This impedes the supply response to demand changes, which is manifest in the very low level of construction over a number of years (Figure 4).

Figure 4. **Completed rental dwellings**
Thousand units



1. The number for the year 2003 is estimated, using the annual growth rate for total completed rental dwellings for the first three quarters as a proxy for the whole year.

Source: Statistics Sweden.

In 2003, the major actors on the rental market presented the government with joint proposals for changes to the Rent Act (see Annex 2). They would make the rental market work better by allowing more efficient ways of adjusting rent structures, including an adjustment of rents for new tenants to make investment in the housing sector more profitable. But they are defined within the current collective negotiation system, without opening the way to any individual negotiation over rents. Following these proposals, the government has initiated an inquiry on the possibilities for providing for special rental-setting rules for dwellings in newly constructed buildings and on possible improvements for tenants by allowing them to choose various sorts of extra services. The prerequisites for better adjusting the rents of existing dwellings, the so-called “use value”, are also to be reviewed. However, broader terms of reference might have been more appropriate. Two recent studies indicate that a total deregulation of the market would have positive overall welfare effects and that everybody could benefit from such a reform if suitable direct compensation were implemented (Anderson and Söderberg, 2002a and 2002b). This suggests that further empirical examination of the full equity implications of a wider range of different reform options could help to guide policy choices.

Meanwhile, in spring 2003 Parliament passed legislation introducing a subsidy to new construction and rebuilding of small and medium-sized rental and student dwellings in the period 2003-06. This was intended to help the government reach its stated goal of building 120 000 new dwellings in that period. It is designed as a tax expenditure (resembling a reduction of the VAT on construction from 25 to

6 per cent) and therefore technically avoids adding to pressure on the central government expenditure ceilings. The bill was partly motivated by recognition that construction costs are too high. But given the identified competition problems in the construction sector, subsidies of this kind may help contractors to maintain excessive profits, despite the subsidy being conditional on “acceptable” rent levels, and it would be more efficient to devote government efforts to lowering costs by encouraging more competition into the sector.

Food and groceries distribution

The food and groceries part of the distribution sector is widely recognised as lacking effective competition; three national chains between them control 90 per cent of sales and are vertically integrated with wholesale distribution (OECD, 2001). Surprisingly, although there are no constraints on opening hours, average opening hours in the whole retail sector (*i.e.* supermarkets and all other retail businesses) are very short — less than 10 per cent of all retail outlets are open for more than 65 hours per week, compared with around half in France, Belgium and Greece (OECD, 2003*c*). Swedish consumers thus face the double bind of higher prices and lack of convenience, both of which can be attributed to a lack of competition.

Currently, the municipal planning process often impedes competition by favouring the three dominant supermarket chains. Results of the CA’s examination of 16 000 planning decisions suggested that in areas with restrictive planning, shop space per inhabitant also tended to be smaller. That suggests that the decisions not only determine the location of shops, but also affect how many and how large they are. Municipalities often call in experts to assess the likely effects of providing land sites for food retailers and their inquiries almost always focus on the negative consequences and put too little emphasis on the positive implications of greater competition. Thus, it can be a challenging task for municipalities to take an informed decision based on these assessments.

Planning is also often slow and costly, including for the applicant, who often has to share the cost of consultancy studies. It also involves a high degree of uncertainty, as the process might lead to a rejection of a proposed new location for an outlet. Therefore the process favours the three established actors, as they have the experience and strong financial resources to carry them through a lengthy process and may even be well acquainted already with the planning staff. These factors impede entry by others and especially for smaller entrepreneurs (Konkurrensverket, 2003*a*). The CA has proposed: *i*) improving knowledge among city planners of the benefits from competition in terms of welfare; *ii*) better tools for assessing the positive effects of entry; and *iii*) clearer emphasis in the Planning and Building Act on competition.

Notwithstanding these difficulties, the German supermarket chain, Lidl, finally opened 11 stores in September 2003 and immediately provided one illustration of how the lack of competition had disadvantaged Swedish consumers. For example, the chain was able to sell fresh milk shipped from Germany at up to 20 ore per litre cheaper than the price of Swedish milk sold by the other chains. Swedish dairy suppliers complained about the competition, despite having declined to respond to Lidl’s invitation to tender to supply Lidl with “own brand” label milk. It could be noted that there are no rules that would prevent the established supermarkets from selling German milk as well.

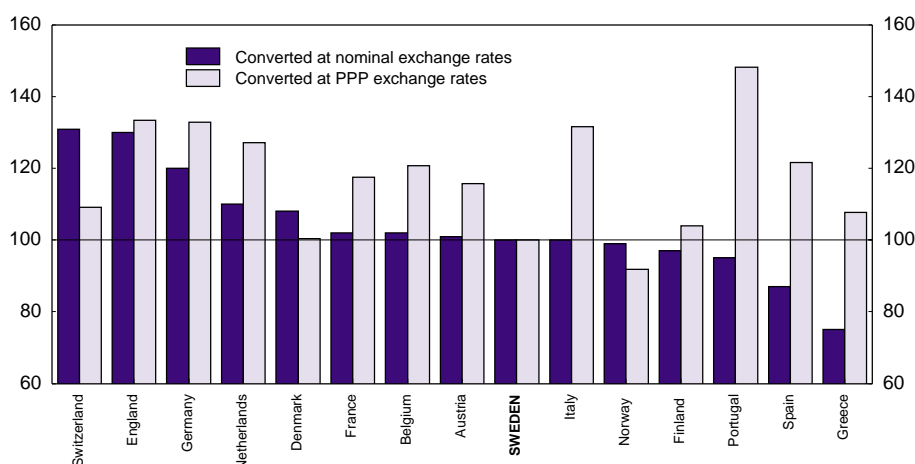
Pharmaceuticals

The retail distribution of pharmaceuticals (including those sold without a prescription) is in the hands of the state monopoly, Apoteket. The company’s overall objectives are to ensure a “rational use ... and a good provision of pharmaceutical products in Sweden ... supplied at the lowest possible cost” (Regeringskansliet, 2003). The Swedish government has opted to maintain this monopoly approach, in large part because it wishes to ensure uniform sales prices in all areas of the country. While this may

appear highly anti-competitive, pharmacies in other countries are generally highly regulated, and it has proved very difficult to establish effective competition as long as pharmaceutical purchases are almost fully reimbursed by the state⁶ (OECD, 2000). The key difficulty is establishing the appropriate retail mark-up in the face of asymmetric information about the individual pharmacy's costs. Applying the same reimbursement rate to all retail pharmacies means that the mark-up is generally set high enough to keep the marginal pharmacy in business (often found in rural areas). However, since this implies that some (possibly many) pharmacies will be over-compensated, countries generally impose further controls on entry or on profits.

The Swedish approach does indeed appear to have delivered pharmaceuticals at lower relative prices than in many other European countries (Figure 5), with part of these gains coming through being able to effectively implement a strategy favouring generics and parallel imports. Nevertheless, a state monopoly provider does carry risks that the absence of competition may over time result in costs higher than necessary. One alternative would be to introduce competition by tendering the right to operate a certain number of pharmacies across the country: this would reveal information about local cost conditions which could then be used to set appropriate reimbursement rates. All other pharmacies could set their own prices and freely enter and exit the market. However, while this approach is theoretically appealing from a competition and efficiency point of view, it has not been tested in practice.

Figure 5. **Relative pharmaceutical prices**
Sweden = 100



Source: Riksförsäkringsverket (2002) and OECD calculations.

Medicines that are available without a prescription are not reimbursed even when prescribed by a doctor. Since consumers pay the full retail price (although there is no VAT on pharmaceuticals if the patient has a prescription), the retail mark-up can be determined by what the consumer is willing to pay, and competition would put downward pressure on such prices. Restricting sales of these items to Apoteket inhibits this process. Allowing over-the-counter medicines to be sold through other retail outlets would expand competition and the case is even stronger for non-medical personal hygiene products that are also sold under the Apoteket monopoly.

6. Sweden operates a scale of user co-payments that gradually reduces to zero depending on the individual's consumption of pharmaceuticals in any given year (see previous *Survey*).

Alcohol retailing

Sweden also sells alcoholic beverages to the public through a state-owned monopoly, Systembolaget. It was allowed to retain this structure when it joined the European Union in 1995 because of concerns about public health, although monopolies in production and wholesaling were removed. However, concentration in wholesaling is still relatively high: the previous monopoly company, V&S group (still entirely state-owned), supplies more than a quarter of all beverages sold by Systembolaget (Konkurrensverket, 2003b). While there seems to be no discrimination against foreign suppliers, it has been argued that Systembolaget's system for selecting products to be offered in its outlets favours — and has been abused by — large incumbent suppliers (see Annex 3). Furthermore, Systembolaget is currently under police investigation for suspected bribery, and the company has already fired 10 managers on this account. Also, the European Commission has asked formally that the current prohibition of private imports *via* other companies than Systembolaget be lifted, as this ban is found to conflict with EU rules.

Since 1995, Sweden has successively increased the quantity of alcoholic beverages that individuals may import for private consumption, and from 1 January 2004 restrictions will be in line with the general rules in the EU. As taxes on alcohol remain the highest in the EU, the reduced import restrictions has led to higher imports for private consumption, and smuggling to avoid excise duties altogether has also increased (Table 7), while Systembolaget has experienced falling market shares especially in the regions closest to its southern neighbours. The incentives for Swedes to engage in cross-border trade were strengthened even further when Denmark reduced duties on alcoholic beverages from 1 October 2003. Indeed, Systembolaget's sales have plummeted in border regions, and similar initiatives in Finland in 2004 will add to the pressure.

Table 7. Total consumption of alcohol

	1996	1998	2000	2002
	Litres per person aged 15 and above, 100 per cent pure alcohol			
Spirits, wine and strong beer	6.7	7.1	7.4	9.1
Systembolaget	3.9	3.9	4.2	4.9
Restaurants	0.9	0.9	0.9	1.1
Import for private consumption	1.1	1.5	1.6	1.9
Smuggling	0.2	0.2	0.2	0.5
Home production	0.7	0.5	0.4	0.5
Light beer ¹	1.3	1.2	1.0	0.8
Total consumption	8.0	8.2	8.4	9.9
	Per cent			
Share of market for spirits, wine and strong beer				
Systembolaget	58	55	57	55
Restaurants	13	13	12	12
Import for private consumption	16	21	22	21
Smuggling	3	3	3	5
Home production	10	7	5	5

1. Almost exclusively purchased in food retail stores.

Source: Leifman and Gustafsson (2003).

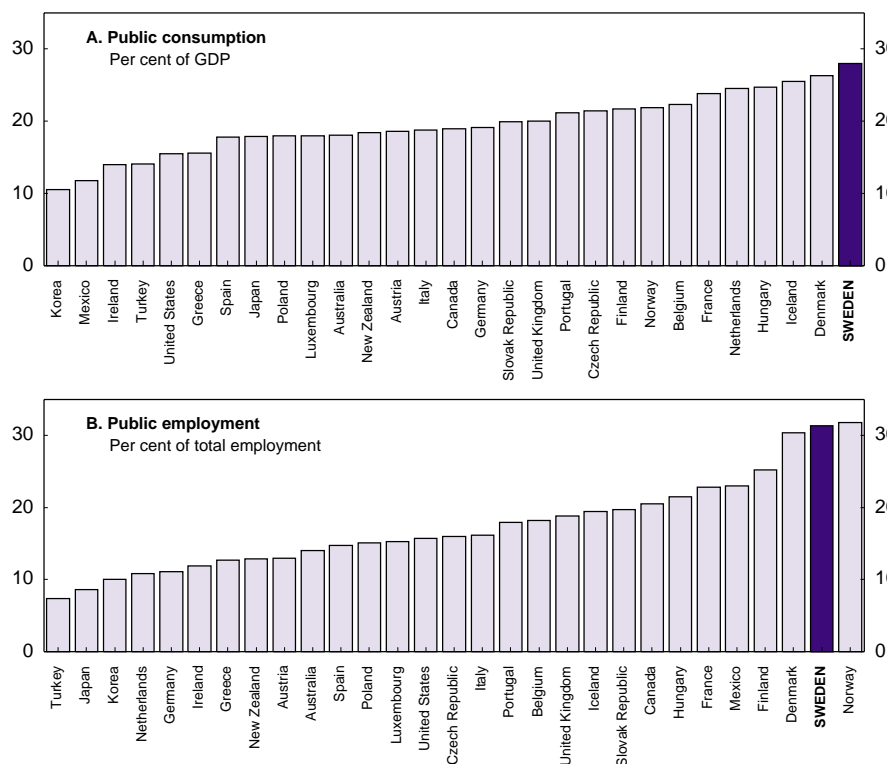
This calls into question whether retaining a state-owned retail monopoly will continue to be a viable way of controlling alcohol consumption. Furthermore, the main instruments through which Systembolaget ostensibly exercises control over the availability of alcohol, namely location of stores, opening hours, age limits and right of refusal to serve (Regeringskansliet, 2003) are embedded in

regulations that apply to competing retail outlets in many other OECD countries. Anyway, the apparently minor gap in consumption levels compared to, for instance, Denmark, where there is free entry to the market for retail of alcoholic beverages, suggests that retail competition and lower prices might not necessarily lead to an increase in quantities purchased; it might instead lead consumers to choose a wider range of products.

Competition and the public sector

The general government sector constitutes around 30 per cent of the Swedish economy, measured as a share of employment, while the public consumption-to-GDP ratio is the highest in the OECD area (Figure 6). In addition, fully or partly owned public enterprises produced almost 14 per cent of total

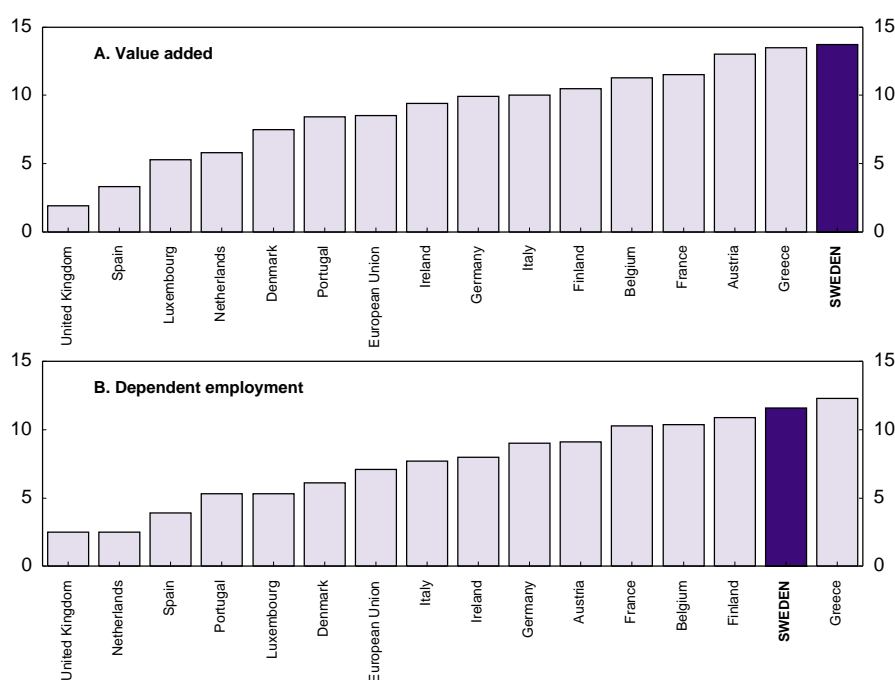
Figure 6. **General government consumption and employment**
Per cent, 2002



Source: OECD.

business-sector value added in 1998 (Figure 7), which was the highest in the EU. In 2002, seven government-owned companies each had a net turnover (roughly corresponding to value added) of more than SEK 10 billion and 16 more showed a turnover between SEK 1 billion and SEK 10 billion (Table 8) including in several cases significant earnings from activities abroad. Although the public sector has been pared back significantly since the early 1990s, it remains one of the largest in OECD countries and therefore of particular interest, as inefficiencies may have developed as a result of the usual absence of competition in the production of publicly funded services.

Figure 7. Public enterprise sector in EU countries¹
Per cent of total, 1998²



1. The figures are likely to underestimate the size of the public enterprise sector, since they include only enterprises with majority public participation. Thus, enterprises in which government had a controlling influence *via* large minority holdings or golden shares are not covered.
2. Total comprises the non-agricultural business sector.

Source: CEEP (2000).

Deregulation, privatisation and procurement of publicly provided services have been on the agenda in the last 10-15 years. The objectives and operations of state-owned enterprises have become much more transparent, and various user-choice arrangements as well as contracting out have been introduced. Sweden has also applied an enterprise structure to some government activities that remain within the general government sector in other countries. But major areas remain where competition is weak or non-existent. Although some local governments have taken a lead in opening their activities to competition, some parts of the public domain still appear unwilling to recognise the role that competition can play in ensuring more efficient production of public services, while in some circumstances also providing greater choice for consumers.

A number of studies on the effects of exposure to competition in local government show that the production and provision of public goods and services has become significantly more efficient, while quality has been maintained or improved (Konkurrensverket, 2002c). One particular effect identified is that the preparation of a call for tender has required a precise specification of the services required, which has allowed redundant functions to be identified and eliminated. However, smaller enterprises have sometimes found it difficult to get established in the public sector market, primarily because of lower ability to spread risks and relatively high fixed costs when engaging in public tenders. Some concentration of contractors has taken place, for instance in health and disability care, as minor enterprises have been bought out by bigger actors. However, this may partly reflect the scope for private contractors to benefit from economies of scale and scope.

Table 8. **State-owned enterprise sector**¹

	2000	2001	2002
Income statement			
Net turnover	247	294	337
<i>of which:</i>			
Vattenfall (electricity)	32	69	101
SAS (air)	48	51	65
TeliaSonera (telephony)	54	57	59
Apoteket (retail pharmacy)	28	30	32
Posten (postal services)	25	22	24
Systembolaget (alcohol retailing)	17	18	19
Svenska Spel (lotteries)	14	16	18
Operating profit	32	33	16
Net profit after tax	20	17	9
Dividends paid	9	9	10
Balance sheet			
Assets	860	963	977
Liabilities	698	787	782
Shareholders' equity	162	176	195
<i>Memorandum items:</i>			
Net capital investment	69	95	24
Government grants	22	23	24
Return on equity (per cent)	12.9	10.3	4.6
Employees (thousands)	197	201	199

1. Includes only state enterprises included in the government's annual report on State-owned companies. It does not include companies set up as subsidiaries of state agencies or those owned by counties and municipalities.

Source: Regeringskansliet (2003).

Some Swedes have expressed concern about whether exposure to competition through external procurement would reduce democratic control and management of activities. One examination of experience in the city of Stockholm revealed that objectives were better targeted, but some politicians observed that it was more difficult to change objectives and reorganise activities once the contract was established (Konkurrensverket, 2002c). A central issue is the design of processes and agreement terms, *i.e.* whether the services in question and level of quality had been clearly identified in discussions involving the main interested parties. In those cases where an adequate design had been worked out, politicians — as well as relevant consumer representatives — would have substantial influence on outcomes. Another concern has been continuity in the supply of services, especially health and disability care. Frequent changes of supplier could reduce the perceived quality of the services and make it more difficult to find firms willing to invest in developing expertise or making associated capital investments. Stockholm City has introduced consumer choice among certified suppliers in elderly care, in order to reduce uncertainties for both consumers and employees once activities have been procured and to improve the incentives for suppliers to develop their services.

The effective opening up of publicly funded services to competition can be hampered by the tax system. A special grant providing compensation for VAT on inputs for private producers of tax-exempt services has helped to alleviate the cost disadvantage faced by private providers competing with municipal producers, thereby ensuring a more level playing field. However, the effectiveness of this system has been called into question, and the Competition Authority has found it insufficient to remedy the cost disadvantage for private providers of dental care. Furthermore, both the level and the structure of taxes

affect competition more generally, especially through their impact on business creation and small, closely held companies (OECD, 2004).

Public activities in competitive markets

It has become increasingly common for various levels of government to operate in areas where private companies already exist (Konkurrensskommissionen, 2002; Statskontoret, 2000). To some extent, this might reflect state ownership of companies that were previously monopolies on now deregulated markets, for instance in the telecommunications and postal sectors. On the local government level, it might also be a result of policies to deal with regional differences, for example in rural areas ostensibly lacking potential private providers. Examples can be found of municipalities operating bakeries, gymnasiums, garden centres, sun-bed centres and privately financed health care, either as part of the municipal administration or provided through a company owned by the municipality.

While there may be legitimate reasons for publicly operated activities on competitive markets, the extent to which it is happening in Sweden has been challenged. The Swedish Agency for Public Management has concluded that in a number of cases there are no valid motives for the state to engage in activities on competitive markets, and that distortions to competition from such activities in general have a negative effect on the ability of these markets to function effectively (Statskontoret, 2000). Meanwhile, the National Commission for Competition on Equal Terms⁷ has registered what it considers an unnecessarily large number of conflicts between private and public providers, while the Competition Authority has received complaints that the public provider cross-subsidises the competition-exposed activity, thereby distorting competition. Other examples of recorded problems are:

- Some non-profit public entities have a statutory right, although no obligation, to carry out competitive operations. For example, this is the case with commissioned courses provided by universities and upper secondary schools and municipalities running hotels, holiday villages, camping sites and ski slopes.
- Public agencies pursue competitive operations on the premises of the agency's primary activities, for example hospitals providing restaurant facilities and public swimming pools providing gymnasium or solarium facilities.
- Services developed for internal purposes, for instance in transport, cleaning, laboratory or carwash services, are sold to others to make use of spare capacity.
- Official authority in activities protected by monopoly is used to gain advantages in a related competitive market. An example is the municipal rescue service, which also sells fire-control equipment in competition with private retailers.
- Public companies have engaged in unlawful behaviour, for instance by participating in cartels, as already noted above.

Several Acts regulate competition between private and public producers. The Competition Act includes restrictions on predatory pricing, but those provisions apply only to companies with a dominant position. The practical application of that law has not prevented public agencies operating in competitive markets and non-profit entities from trying to exclude others. Local government legislation imposes some

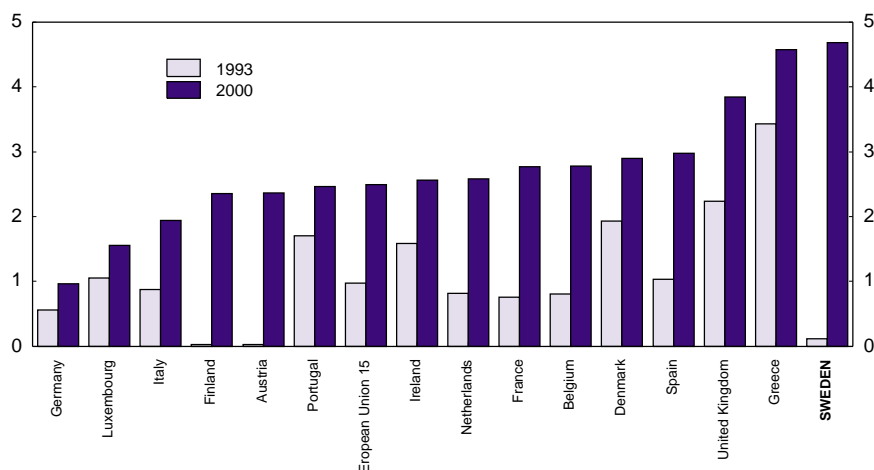
7. This Commission was established in 1998 to resolve disputes concerning competition between public and private actors, as the competition law was considered an inadequate tool for dealing with such problems. The Commission has no judicial powers and can only express opinions. Its mandate ended on 31 December 2003, and the government has instead instructed the Competition Authority to pay attention to conflicts between public and private actors.

restrictions, but not, for instance, on activities in competitive markets that do not fully cover costs. Also, central government authorities are subject to certain restrictions, but there are large grey areas here as well as in the local government domain. In a few sectors, special legislation does clarify competition issues, but the general picture is that legislation on public activities on competitive markets is non-transparent, lacks coverage and provides little room for private actors to address competition problems through the legal system. Even though any citizen can take the municipality in which s/he resides to court for an alleged infringement of the Local Government Act, there are no effective sanctions to ensure enforcement of any subsequent court rulings. Furthermore, the legality of local government companies cannot be tested in court.

Public procurement

Outsourcing *via* public procurement is one way of introducing greater competition for the supply of goods and services in the public sector. Sweden has adopted the EC Directive on public procurement, but it has proved difficult to ensure full compliance with its requirements. Nearly 5 per cent of GDP was openly advertised public procurement in 2001, which is higher than the EU average (Figure 8). However, public consumption is also higher in Sweden, and the scope for further public procurement (or other forms of exposure to competition) has been estimated at 11-12 per cent of GDP (Konkurrensverket, 2002*c*). Thus, even though experience to date has been generally positive (Box 2), it seems that Sweden is still a long way from using all the possibilities in this area. This could be for a number of reasons, including weaknesses in the legislative and institutional framework, as well as reluctance by some municipalities and state institutions to put activities out to tender.

Figure 8. **Openly advertised public procurement**
Per cent of GDP



Source: Eurostat.

Almost all public procurement in Sweden is regulated by the Public Procurement Act (LOU), which was implemented in 1992. The rules vary for procurement of services according to the amount involved (see Annex 4) while the regulations applying to tenders larger than the threshold value reflect EC directives. The National Board for Public Procurement, an independent public authority under the Ministry of Finance, is responsible for observance of the Act. The government's National Commission for Competition on Equal Terms performs regular monitoring of the Act as does the Competition Commission (a private initiative).

Box 2. Experiences with procurement at the municipal level

Most of the surveys conducted on the experience of exposure of public activities to competition have focused on municipalities, as state activities have primarily been exposed to competition through deregulation of various markets. The Competition Authority draws the following general conclusions from the existing studies in Sweden (Konkurrensverket, 2002c):

- In most cases exposure to competition has initially resulted in cost reductions and/or quality improvements for the local government and individual consumers — even if an activity continued to be produced by the local government itself after exposure to competition.
- The procurement process has led to lower costs on goods and services and more focus on quality issues, one reason being increased incentives (through the Public Procurement Act) for municipalities to provide a detailed description of the service to be produced in the invitation to tender. However, careful preparation is required when introducing competition in order to reduce the risk of default, which could leave clients stranded.
- Municipal production can become as cost-effective as that of private sector suppliers. There are some cases where exposure to competition has raised the efficiency of in-house production units competing alongside others.
- Sentiment in consumer polls is neutral in most case on whether a service is produced by municipal or private actors. However, frequent changes of providers can undermine the continuity of a service, which is a highly valued quality for consumers, especially in service areas such as elderly and child care. Employee morale has often been lifted by exposure to competition, although offset by a perceived heavier workload.
- It is important for municipalities to separate the role as purchasing and financing authority from that of producer in order to minimise the risk of inconsistency or conflict, although some interaction between these various roles will sometimes be almost unavoidable in order to improve the service.

These institutions have identified several impediments to effective procurement, including: unlawful direct procurement; distortion through vague design of the tender documents or specifications aimed at a particular company; awarding contracts based on factors other than those stated in the contract documents; and local governments purchasing goods and services directly from their own companies (total or part ownership), even though they are obliged to undertake a public procurement process. Examples of the last are, for instance, found in the areas of cleaning, management of housing buildings, street maintenance and laundry services. In many cases, contracts are prolonged automatically, and the municipal companies are often at the same time competing with private companies by supplying surplus production to the private sector. While it might be natural to allow government-owned production units to compete with private firms for procurement contracts in a transition period following the opening up of a market, there are examples of these companies being favoured by discontinued procurement procedures⁸ as well as better conditions in terms of specific requirements in the contract documents and the lack of a required return to capital in general (Konkurrensverket, 2002c).

Unlawful direct procurement seems to be significant (Konkurrenskommissionen, 2002). To some extent, this might be explained by insufficient knowledge about the legislation as well as lack of internal management and control of procurement in the public institutions, which at least partly reflects insufficient guidelines in the present legislation. However, the absence of effective sanctions against such behaviour might also play a role. Although this has been pointed out by a number of organisations and government committees for several years, no proposal on sanctions has yet been introduced to Parliament. Nevertheless, the government is making efforts to improve the public procurement process and is considering introducing special sanctions where the rules are breached by signing a contract directly with a supplier, although corresponding legislative amendments have not yet appeared.

8. In some instances, public entities have cancelled a procurement process, once it was clear that external companies had submitted lower offers than in-house production units could match. Discontinuation of the procurement process would imply that internal production would continue.

Until recently, it was almost impossible for private suppliers to bring an alleged infringement of the Public Procurement Act to court. But in 2002, the Act was amended to make it easier for tendering firms to request a legal review of the tendering institution's decision. Now, the tender decision must be made subject to review for at least ten calendar days, and the secrecy requirement on submitted tenders now expires on the decision date instead of when the contract is signed. While this is obviously an improvement, the ten days minimum reviewing period is still very short. In addition, court practice has implicitly required that a supplier must have submitted a tender or an application to tender in order to be able to bring the matter before the courts. Thus, any company wanting a court ruling on an alleged unlawful procurement process must be able to document a financial loss. Along with the short minimum reviewing period, this constitutes a significant impediment to an effective application of the legal framework to the procuring institutions.

In certain cases, public authorities have deliberately ignored court rulings. This is made possible by a legislative framework that lacks mechanisms or sanctions to ensure that court rulings are actually observed by public institutions, although new rules implemented in 2002 gave further scope to municipal auditors to investigate and report on observance of court rulings. Unlawful decisions in procurement processes are typically not considered to be the exercise of authority under the penal code, thereby preventing prosecutions for misconduct in office, and members of municipal executive committees are not subject to disciplinary responsibility regulated by either law or collective agreements (Konkurrenskommissionen, 2002). Thus, it seems that Sweden does not currently fulfil EC directives on public procurement that require national legislation to guarantee observance of court rulings. Also, some municipal and state companies and a few other public organisations apparently believe that they are not subject to the Public Procurement Act. This suggests that the coverage of the Act also needs to be clarified.

Public enterprises and privatisations

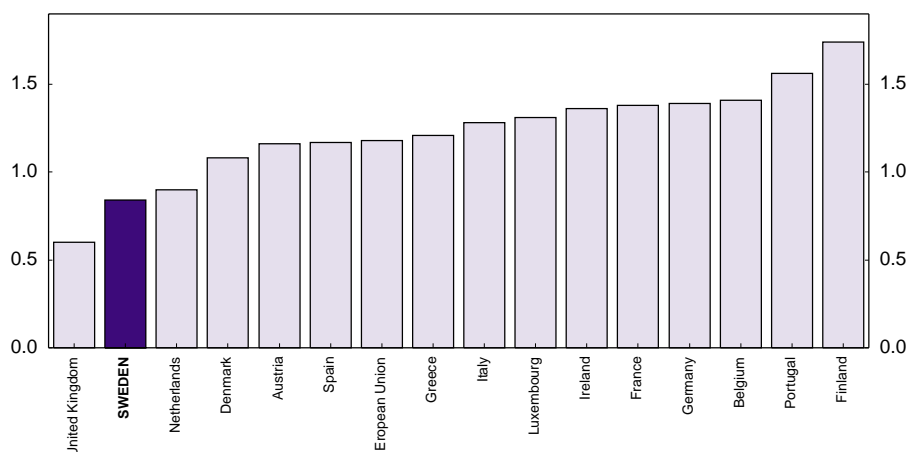
The Swedish state is the corporate sector's largest shareholder, and the government has made strenuous efforts over a number of years to provide a sound governance structure for these activities. One key element is the distinct treatment of companies deemed to be operating under market conditions versus those with special societal interests. State ownership is clearly a choice made on political criteria (and any sale of shares in a company more than half owned by the state must be approved by the Swedish Parliament). But as already indicated above, some state-owned enterprises have very strong positions in their markets, and the capacity of the government to underwrite any eventual losses could add to their market dominance or increase their capacity to see off competitors (OECD, 1998b). At the same time, international empirical evidence indicates that privatised firms almost always become more efficient, more profitable, increase capital investment spending and become financially healthier, although the impact on employment is unclear (Megginson and Netter, 2001). These benefits could be interpreted as unexploited dynamic gains from competition that are stifled by continued public ownership.

Subsidies and state aid

State aid paid by the Swedish state amounts to a small share of GDP compared with most other EU countries (Figure 9). Around one third is directed to the manufacturing sector and one third to the transport sector, almost all of which is provided to the railroad track company (Näringsdepartementet, 2002). It is difficult to assess the extent to which this might distort inter-modal competition, especially with road transport, given the public provision of the road network. More generally, the numbers reported according to the European Commission criteria may not reflect the full extent of economic subsidies. In some cases, these are made indirectly or are disguised, for example, as lower VAT rates. Also, local governments provide significant amounts of aid in the form of cheap loans and guarantees (Konkurrenskommissionen, 2003). Other aid to Swedish producers is delivered by the EU,

in particular through the Common Agricultural Policy, which provided Swedish farmers with half their gross receipts in the form of direct payments and market price support in 1999 (OECD, 2003*d*).

Figure 9. State aid to enterprises in the EU
Per cent of GDP, average 1997-1999



Source: European Commission (2001).

Subsidies have often been used to maintain employment in the short term, especially in specific sectors experiencing severe downturns, but the effect is to impede structural adjustments. Some local government subsidies might also conflict with the prohibition in the Local Government Act against subsidies to individual companies. Currently, residents in the municipality may take the local authorities' decisions on subsidies to the courts. However, it is very difficult, and sometimes impossible, for a company to contest the subsidies given to a competitor. The company claiming an economic loss can only make a case if it is registered in the municipality. Even if an appeal can be filed, the court can go no further than finding the municipality guilty of subsidising in an unlawful manner, as no sanctions are provided. In the situation where a municipal company decides to provide a subsidy, a court appeal cannot even be filed. Also, it is often difficult for a company to detect that the municipality has decided to make a subsidy, and an appeal might then be refused on formal grounds, for instance, because the time limit has expired.

Concluding remarks and priorities for policies

There are many areas where competition is already working well, or steadily improving, but the analysis in this Chapter indicates a number of areas where adjustments to policy settings could facilitate the emergence of greater competition and lead to a more dynamic and thriving economy. The authorities themselves have pinpointed a number of areas where competition is still weak and have set in train a range of measures designed to make markets work more effectively (Ministry of Finance, 2003). But it should be admitted that in some areas it is no easy matter to generate effective competition; in several sectors, the government has removed all apparent obstacles and has still seen disappointingly little improvement in results. This perhaps indicates the importance of also shifting the expectations of both businesses and consumers so that they value and more actively seek out the benefits of competition. It could also be helped by more widespread recognition of the need for more flexible labour markets, so that the economy can adjust more rapidly and easily to the greater changes at the firm level that more intense competition implies.

The first area where competition could be enhanced is through strengthening enforcement. While the competition legislation contains the right framework for underpinning competition, it is handicapped by several gaps that need to be addressed:

- The Competition Authority and the courts need to demonstrate their capacity to break down hard-core cartels through successful prosecutions, and fines that correspond to the economic damage inflicted. Despite efforts made by these institutions, success to date falls short of providing an effective deterrent to such anti-competitive behaviour, in part because of the asymmetry between the specialist resources available to the authority compared with those at the disposal of the defendants.
- The time taken for cases to reach a final ruling through the courts could be shortened by streamlining the legal process; reconsidering the need for two separate judicial reviews of the rulings of the CA might be one worthwhile option.
- Providing scope to penalise the individuals within companies for their anti-competitive actions, without resorting to criminal sanctions, could send a clearer signal that such behaviour is unacceptable, strengthen the recently introduced leniency provisions and help change the business culture in sectors where collusion remains common.

There are several sectors where further action is needed to ensure that effective competition occurs, even though considerable progress towards liberalisation has already taken place in some instances:

- *Electricity* is fully exposed to competition through Nordpool, but large generators are still able to exercise some market power in Sweden at certain times when grid bottlenecks occur. This could for example be dealt with by extending the grid infrastructure to reduce the scope and possibility for the companies to manipulate prices.
- Given the present EU regulation that “grandfathers” landing slots at Stockholm-Arlanda *airport*, the only option available to the Swedish authorities to reduce congestion at peak times and boost competition is to expand airport capacity so as to create more slots.
- The financial injection provided to the state-owned *railway* company, SJ, gives it an advantage against competitors. This playing field will only be levelled if SJ faces a hard budget constraint, in other words, if it is allowed to go out of business if it cannot compete. Other passenger transport companies would still compete to provide rail or alternative modes of transport, while market signals would be better able to establish the most appropriate services.
- Injecting greater competition into *construction* activities would be facilitated by implementation of the EC Construction Products Directive. The demonstration effect of successfully tackling cartels within this sector would help to reduce the pervasive co-operation within the market that shuts others out, despite their potential to supply at lower cost.
- While the *rental housing* market is oriented towards meeting equity objectives, a careful examination of the equity and efficiency implications of a less tightly regulated market might identify alternative ways to meet key social goals more effectively, while securing the economic benefits of a better functioning market.
- Increasing competition in the *food and groceries* sector would be helped by easier access to suitable building sites for new supermarkets. Although planning approvals are a local government responsibility, the Planning and Building Act could be modified to include a clear requirement to take the benefits of competition into account in making decisions.

- The present state-owned monopoly approach to *alcohol retailing* is designed to place limits on the consumption of alcohol, but such controls could instead be imposed through regulation of competing private-sector outlets as occurs in most other OECD countries.

The public sector is very large in Sweden and thus has a significant impact on competition in several different ways that need to be addressed:

- Where public companies compete in markets in which other suppliers also operate, greater efforts are needed to ensure that they are not benefiting from explicit or implicit subsidies. The legal framework governing such activities could be strengthened to reduce the likelihood of unfair competition emerging; these activities could be brought within the scope of the Competition Authority; and the opportunity to seek redress through the courts could be expanded.
- Despite Sweden's adoption of the EC Public Procurement Directive, and the government's efforts to expand public procurement, there is still significant scope to raise the degree of competition through such channels. Given that most of it takes place at the sub-national level, this would benefit from a multi-pronged approach:
 - Devoting more resources to education, information and supervision in the area of public procurement.
 - Rationalising the present supervisory structure into one agency and granting it the authority to impose fines in cases involving serious infringements of the law on public procurement, such as illegal direct procurement.
 - Modifying the legislation governing public procurement to give identical status to tenders from internal units and external producers, while requiring the call for tender to specify whether internal offers will also be considered.
- Delegation and decentralisation of the activities of the 300-odd state agencies has made it possible for some agencies to diversify into commercial activities in ways that are unhelpful to competition. This suggests that government's mandates to agencies need to specify more clearly the core activities of agencies and place limits on possible expansion in other directions. More effective monitoring of these agencies' behaviour and their compliance with public procurement rules would also demonstrate the government's commitment to promoting competition through its own activities.

BIBLIOGRAPHY

- Andersson, R. and B. Söderberg (2002a),
“Välfärdsvinster vid avveckling av hyresregleringen”, *Ekonomisk Debatt* 2002:7.
- Andersson, R. and B. Söderberg (2002b),
“Hur kan en avveckling av hyresregleringen genomföras?”, *Ekonomisk Debatt* 2002:7.
- Andersson, T., O. Asplund and M. Henrekson (2002),
Betydelsen av innovations system – Utmaningar för samhället och för politiken, Vinnova Forum, VFI 2002:1.
- Bergman, M. (2002),
Lärobok för regelnissar – en ESO-rapport om regelhantering vid avreglering, ESO (Ds 2002:21).
- Braunerhjelm, P. (ed.), M. Ganslandt, S. Nyberg, J. Stennek and N. Wahl (2002),
“Gränslös konkurrens, Sverige i ett integrerat Europa”, *Ekonomirådets Rapport 2002*, SNS Förlag, Stockholm.
- CEEP (2000),
The Development of Enterprises of Public Participation and of General Economic Interest in Europe Since 1996, <http://www.ceep.org>.
- European Commission (2001),
Ninth Survey on State Aid in the European Union, Brussels.
- European Commission (2003),
“International Market Scoreboard”, <http://europe.eu.int/>.
- Jean, S. and G. Nicoletti (2002),
“Product Market Regulation and Wage Premia in Europe and North America: An Empirical Investigation”, OECD Economics Department Working Papers No. 318.
- Johansson, H. (2001),
“Import Competition, Technology Dispersion and Productivity”, Paper presented at the 2001 SNEE Mölle Conference, <http://www.snee.org>.
- Konkurrenskommissionen (2002),
Verksamhetsberättelse – åttonde verksamhetsåret (2001/2002), <http://www.dnv.se>.
- Konkurrenskommissionen (2003),
Written assessments provided at OECD mission, June.
- Konkurrensverket (2002a),
Competition in Sweden 2002, Executive Summary of the report 2002:4.

- Konkurrensverket (2002b),
Varför är byggvaror dyra i Skåne och maten billig i Västsverige?, Konkurrensverkets rapportserie, 2002:1.
- Konkurrensverket (2002c),
Vårda och skapa konkurrens, Konkurrensverkets rapportserie 2002:2.
- Konkurrensverket (2003a),
High Prices in Sweden – A Result of Poor Competition?, July.
- Konkurrensverket (2003b),
Övervakning av det svenska detaljhandelsmonopolet för alkoholdrycker – Rapport til Europeiska kommissionen, June.
- Leifman, H. and N. Gustafsson (2003),
“En skäl för det nya millenniet – En studie av svenska folkets alkoholkonsumtion i början av 2000-talet”, Forskningsrapport nr. 11, SoRAD.
- Megginson, W.L. and J.M. Netter (2001),
“From State to Market: A Survey of Empirical Studies on Privatization”, *Journal of Economic Literature*, June.
- Ministry of Finance (2003),
National Report on Economic Reform of the Product and Capital Markets, Sweden, November.
- Näringsdepartementet (2002),
Benchmarking av näringspolitiken, Ds 2002:20.
- National Post and Telecom Agency (2003),
Reflections: Ten years of experience with the Swedish Telecommunications Act, Stockholm, March.
- Nicoletti, G., A. Bassanini, E. Ernst, S. Jean, P. Santiago and P. Swaim (2001),
“Product and Labour Markets Interactions in OECD countries”, Economics Department Working Papers No. 312.
- Nilsson, Jan-Eric (2002),
“Restructuring Sweden’s Railways: The Unintentional Deregulation”, *Swedish Economic Policy Review* 9.
- Nordic Competition Authorities (2002),
Competitive Airlines, Copenhagen, Helsinki, Oslo, Stockholm.
- Nordic Competition Authorities (2003),
A Powerful Competition Policy, Copenhagen, Helsinki, Oslo, Stockholm.
- NOU (2003),
A Brief Description of the Public Procurement Act in Sweden and the National Board for Public Procurement, <http://www.nou.se>.
- OECD (1998a),
Railways: Structure, Regulation and Competition Policy, DAFFE/CLP(98)1, Paris.
- OECD (1998b),
Corporate Governance, State-owned Enterprises and Privatization, Paris.

ECO/WKP(2004)11

OECD (2000),
Competition and Regulation Issues in the Pharmaceutical Industry, DAFFE/CLP/WP2(2000)4, Paris.

OECD (2001),
Economic Survey of Sweden, Paris.

OECD (2002),
Product Market Competition and Economic Performance: A Framework for EDRC Reviews, ECO/CPE/WP1(2002)11, Paris.

OECD (2003a),
Round Table on Electricity, DAFFE/COMP(2003)14, Paris.

OECD (2003b),
OECD Communications Outlook 2003, Paris

OECD (2003c),
Economic Survey of Austria, Paris.

OECD (2003d),
Farm Household Income, Issues and Policy Responses, Paris.

OECD (2004),
Economic Survey of Sweden, Paris.

Oliveira Martins, J., S. Scarpetta and D. Pilat (1997),
“Mark-up Pricing, Market Structure and the Business Cycle”, *OECD Economic Studies No. 27, 1996/II*, Paris.

Regeringskansliet (2003),
Annual Report State-owned Companies 2002.

Riksförsäkringsverket (2002),
“Internationell prisjämförelse av storsäljande läkemedel i Sverige 2001”, *Analysrar 2002:7*, Stockholm.

SABO, Hyresgästföreningen and Fastighetsägarna (2003),
Reformerad bostadshyressättning, <http://www.sabo.se>.

Statskontoret (2000),
“Staten som kommersiell aktör”, *Report 2000:16*, <http://www.statskontoret.se>.

Swedish Energy Agency (2003),
The Electricity Market 2003, Eskiltuna.

Systembolaget (2003),
About Systembolaget, <http://www.systembolaget.se>.

V&S Group (2003),
Korta fakta 1917-2003, <http://www.vinsprit.se>.

ANNEX 1

TELECOMMUNICATIONS COMPETITION IN PRACTICE

A recent review by the National Post and Telecommunications Agency identified the following areas where lessons emerged from the experiences of the last decade with deregulation (National Post and Telecom Agency, 2003):

- *Interconnection* charges were originally left to be negotiated between the relevant operators, with the National Post and Telecommunications Agency (PTS) empowered to act as mediator in disputes. This proved ineffective, and in 1997 the PTS was given the authority to make a decision if any of the parties requested it to do so. This amendment significantly rebalanced the powers between the larger and smaller operators and produced a major reduction in interconnection charges. However, the resolution of disputes can still take a long time, in part because of the appeals process.
- “*Pre-selection*” (enabling the consumer to automatically place calls with alternative operators) was implemented at the end of 1998, and approximately one-third of private telephone subscribers have opted to use this facility. In addition, consumers can now choose between around 30 operators. This reform has facilitated greater competition than the earlier “dial-a-prefix” arrangements were able to deliver.
- *Number portability* introduced for mobile phones from September 2001 was expected to make it significantly less costly for consumers to switch operators and increase competitive pressures. But to date it has not lived up to expectations, in part because of lack of public awareness. Operators have weak incentives to promote number portability because the switching costs are relatively high.
- *Provision of mobile network capacity* may require that operators be obliged to lease network capacity to those who do not have their own infrastructure. Several new service providers have entered the market, but their market shares remain tiny. Incumbents have very limited incentive to open up their networks, while the PTS can only mediate in disputes, and it faces significant informational asymmetries *vis-à-vis* the established operators.
- *National roaming* was introduced in 1999 to make it easier for new mobile operators (subsequently including UMTS licence holders) to enter the market without having to establish complete geographical coverage from the outset. In practice, it has proved difficult to conclude contracts to cover roaming, and the mediation efforts of the PTS have not yielded significant results.
- *Access to the local loop* is covered by EU regulation and requires operators to grant reasonable requests for access to the network for a cost-based fee. Telia has published a reference offer that complies with the regulation, but few access leases are in place. Access for ADSL connections are not covered by the regulation, and Telia has already established a strong advantage in the market.

ANNEX 2

PROPOSALS BY HOUSING ORGANISATIONS

Acknowledging that imbalances had been building up in the rental housing market, the main actors on the rental market initiated a discussion in 2001 on how to improve the system. In 2003, SABO (Swedish Association of Municipal Housing Companies), the Swedish Union of Tenants and the Swedish Property Federation presented a joint proposal (SABO *et al.*, 2003). Under the presumption that the collective negotiation of rental terms be retained, the organisations suggested various changes to the Rent Act:

- Special attention to construction costs should be allowed in the collective agreements negotiated on rents for newly constructed dwellings. Currently, a tenant can apply for a “fairness test” of the rent by a rental committee, based on a “use value” comparison with other rental dwellings after six months of rental. In many localities there is a big risk that it will lead to a reduction of the rent to a level below that required to cover production costs. If the organisations on the rental market could agree on rents that would cover construction costs, only very special circumstances should make the rental committee decide in favour of the tenant.
- Collective agreements on different rent levels for dwellings with the same “use value” should be allowed. Rents in some locations do not adequately reflect the use value of dwellings, leading to differences in rents that do not reflect variation in characteristics. One way of rearranging the rent structure would be to fully adjust rents for vacant dwellings, while rents for existing tenants could be raised gradually, but this is currently prohibited by the Rent Act. A relaxation of the rules, combined with transition regulations that protect existing tenants from excessive rent hikes, should make it possible to gradually adjust rents — and rent differences — to better reflect the real assessments of various dwellings. To prevent abuse, the transition regulation should not apply for dwelling-swapping or subletting.
- Multi-annual agreements on certain individual rental arrangements, such as special installations and services supplied to the tenant, should be allowed. If these arrangements involve additional constructions or rebuilding, costs could be higher than the rent based on “use value”, and uncertainty about the outcome of a subsequent “fairness test” of the total rent — especially because a basis for comparison of a certain investment might be hard to find — has made owners reluctant to make such investments. In some instances, tenants have then chosen to bear the full costs themselves, even though the asset produced by the investment ultimately belongs to the owner of the dwelling. Multi-annual agreements could pave the way for a fairer division of benefits and costs as well as a wider range of services offered to tenants.
- The Act should include a clear requirement that rent committees provide a detailed description of the basis for decisions in cases where a comparison of rents is not possible. While the “use value” system in general presumes that rent disputes are settled on the basis of a comparison with rents for similar dwellings, there has been a trend for rent committees to base their rulings on a “fairness assessment” rather than on comparisons, allegedly because there has been no basis for comparison. The motivation for the ruling in such cases has been found unclear and inadequate by the parties on the housing market, leaving no guidance for future negotiations.

ANNEX 3

ALCOHOL RETAILING

Prior to Sweden's accession to the EU in 1995, retail and wholesale trade as well as production of alcoholic beverages was confined to state monopolies. The system has its roots back in the middle of the 19th century, when the first local distribution outlet, "Systembolaget", was formed by mine owners as a reaction to alcohol abuse among the mine workers. Similar outlets spread around the country (they were later merged in 1955), and various restrictions on production, trade and consumption followed (home-distilling was prohibited already in 1860). Throughout, the concern for public health has been the dominant motivation for developing the state monopoly (Systembolaget, 2003).

Health concern was also the argument put forward by the Swedish government, when negotiating the terms for Sweden's accession to the EU. While Systembolaget's monopoly in alcohol retailing was accepted by the EU (based on a balance of concerns between health and competition), the monopolies in wholesale trade (to restaurants and others with a license to serve alcohol) and production had to be given up. To monitor the risk that the monopoly might be abusing its dominant position, the Swedish Competition Authority prepares semi-annual surveillance reports to the EU, focusing on consumer choice of products and the possibilities of entry for new products.

Systembolaget is obliged to offer a wide range of various alcoholic beverages. After a strong increase in the number of products in the second half of the 1990s, there has been a decline in recent years. While the company itself emphasises changes in demand patterns and exhaustion of stocks as possible explanations, some have suggested that Systembolaget's new selection policy restricts product diversity. One of the main objectives of Systembolaget is to offer the products with the highest demand based on market surveys and various other contacts with consumers and suppliers, while at the same time ensuring that new products are introduced continuously to replace the less popular brands within different market segments.

Systembolaget's purchase procedures are as follows (Konkurrensverket, 2003b): *i*) when preparing the selection strategy for the following year, an introduction plan for purchases of new products is drawn up, which is then sent to all suppliers; *ii*) each month, tender inquiries are sent to all companies holding a right to wholesale trade of alcoholic beverages in Sweden; *iii*) the offers submitted by the companies are registered and investigated by Systembolaget and samples are requested for selected products; *iv*) the samples are blind-tested by Systembolaget and ranked; *v*) the products with the highest ranking in each category are purchased.

In general, no discrimination against foreign suppliers seems to be taking place in the selection of products offered. However, a number of concerns have been raised regarding entry of suppliers/products to Systembolaget's selection of products:

- Products that — based on Systembolaget's evaluation of the product — have not been admitted to the basic or supplementary range of Systembolaget's ordinary list of products can be signed up to an evaluation by a consumer test panel, which then might recommend that the product is included on the ordinary list. However, there is currently a long queue of products waiting to be tested amounting to several years. Since wholesalers often have to place an order with a producer

within a few months and are required to supply a certain quantity of the product, if and when, the product is admitted, they face a risk and significant costs when trying to introduce the product through this channel. While the queue is partly due to some companies signing up products but failing to deliver samples for the test, the capacity of the test panel is also an explaining factor. The CA has received complaints that a number of well-established wholesale traders/importers have blocked the testing of products from new companies by signing up numerous products for testing. Systembolaget has introduced a number of restrictions on suppliers to reduce abuse of the system.

- The ordering list — from which consumers can order products that have not qualified to Systembolaget's ordinary list of products — is not considered an attractive way for entry to the market for wholesale traders. By signing up a product to the order list, the wholesaler undertakes to deliver as little as a single bottle at the request of a customer of a Systembolaget outlet, and the distribution cost then often exceeds the wholesaler's margin. Also, since the delivery time could be up to a week, consumers will often tend to choose other products that are available straight away from Systembolaget's stocks.
- In general, suppliers indicate that Systembolaget's supply contracts place a large part of the delivery costs on them. For instance, a subsidiary company of Systembolaget, Lagena, that was set up to ensure distribution access for smaller wholesale traders and producers is charging basic fees for its services at a level that is regarded to be prohibitive by smaller companies.
- A wholesale trader/producer that has offered a product to Systembolaget but has been rejected can file a complaint at the Alcohol Selection Council (ASC). However, the ASC will not deal with the complaint until the product has been tried out for the test list. Given the waiting period in the test list system, this process is not a viable way of getting a product introduced to consumers, and wholesale traders/producers have, thus, to a large extent ignored this option.
- Smaller wholesale traders/producers find it difficult to meet Systembolaget's thresholds for minimum quantities to be supplied.
- There have been reports of purchase interventions by wholesale traders/producers in support of their own products to have them transferred from the order list to Systembolaget's ordinary selection or displayed in a larger number of outlets. Systembolaget claims to have developed statistical systems to reveal such behaviour.

Overall, these problems point to some discrimination against minor wholesale traders and producers. That might — at least partly — be reflected in the supply structure. Today, Systembolaget has around 200 suppliers, but the concentration among them is very high. The five biggest suppliers alone accounted for 50 per cent of Systembolaget's wine sales in 2002, the largest supplier being the government-owned V&S Group with 23 per cent (Konkurrensverket, 2003*b*). The supply of strong beer is dominated by Carlsberg Sverige AB with 39 per cent and Spendrups with 21 per cent, whereas V&S Group dominates the supply of other beverages with a supply share of 54 per cent.

In total, V&S Group account for a quarter of the beverages supplied to Systembolaget. The company is owned entirely by the Swedish state and was, prior to the accession to the EU, a monopolist in import, export, production and wholesale trade in Sweden and thus sole supplier to Systembolaget. In 2000, it was the world's eighth largest alcohol beverage company in terms of sales volumes, producing, for instance, the brand Absolut vodka and owning a vineyard in France. Since 1995, when the Swedish state gave up the domestic monopoly, the company has expanded worldwide, buying up several companies,

especially in Denmark and Finland. At the same time, the company's production plants in Sweden have undergone some rationalisation (V&S Group, 2003).

Swedes aged 15 and above consume on average 9.9 litres of pure alcohol per year, of which 1.1 litres is provided through smuggling and home brewing (Leifman and Gustafsson, 2003). That is only 12 per cent below Danish consumption, where there is a free market for alcoholic beverages. Around 25 per cent of the total consumption in Sweden is provided through legal and illegal private imports, mostly from Germany and Denmark.

ANNEX 4

PUBLIC PROCUREMENT¹

In Sweden the EU Council directives on public procurement have been implemented by means of the Public Procurement Act (Lagen om offentlig upphandling, LOU). Contracting entities must procure goods, works and services in a businesslike, competitive and non-discriminatory (objective) way. LOU consists of seven sections: *i*) general provisions; *ii*) supply contracts over the threshold values; *iii*) works contracts over the threshold values; *iv*) contracts within the areas of water supply, energy, transport and telecommunications over the threshold values; *v*) service contracts over the threshold values; *vi*) procurement under the threshold values and “B-services” regardless of value, etc.; and *vii*) review and damages, etc.

Contracting entities are government agencies, local government agencies and other agencies, county councils and certain publicly-owned companies, foundations, societies and associations. In addition, certain private companies that conduct operations with special permission from the authorities can be contracting entities in the utilities sectors. The above-described organisations must decide whether they are covered by LOU. However, if a procurement is appealed, the courts will ultimately determine whether the organisation is within the jurisdiction of LOU.

The contracting entities shall calculate the value of each procurement in order to determine whether the procurement is over or under the so-called threshold values. The threshold values for supplies and services are around SEK 1.8 million (in the utilities sectors there are other higher values and for central government a lower value, around SEK 1.3 million) and for works just under SEK 46 million (the threshold values in Swedish currency are determined in a regulation and apply for a period of two years). The value of the contract is normally calculated for the entire duration of the contract, and options and prolongation clauses must also be included as if they were utilised. Extension of a contract can only take place if the contract includes a prolongation clause, and a new procurement must take place when the contract period has ended, after the invocation of a possible prolongation clause. Procurements may not be divided into smaller parts with the aim of avoiding values above the threshold. Procurements under the threshold values must follow the same basic principles as procurements over these values, but the tender procedure is not regulated in as much detail.

Various sorts of procurement processes exist, depending on whether the procurement contract is of a value above or below the thresholds. Three procedures for procurements either above or below the threshold values are stipulated in the Act:

Above the thresholds:

- Open procedure: All suppliers may submit tenders. After advertising the call for tender, the supplier requests the contract documents and these are dispatched as requests are received. Negotiations with suppliers are not allowed.

1. The following is largely taken from www.sweden.se and NOU (2003).

- **Restricted procedure:** The contracting entity publishes an advertisement inviting suppliers to submit tenders. The contract notice must specify the conditions to be fulfilled by suppliers, and these have to verify their ability to meet these requirements by submitting adequate certificates and apply to participate in the tendering (pre-qualification phase). Among the qualified suppliers the contracting entity selects between five and twenty (the exact number is to be stated in the contract notice), to whom the contract documents are sent simultaneously. Only tenders submitted by invited suppliers will be evaluated and negotiations with suppliers are not allowed.
- **Negotiation procedure:** The contracting entity invites certain suppliers to submit tenders and then negotiates with one or several of them. There is a pre-qualification phase similar to that in the restricted procedure, after which suppliers are invited to submit tenders or participate in negotiations. This procedure may only be used in a few situations stated in the Act, except in the utility sector.

Below the thresholds:

- **Simplified procedure:** This is somewhat similar to the open procedure, however, negotiations may take place with one or more suppliers, and under certain circumstances the contracting entity may send a written request for a tender to a supplier without publishing a contract notice.
- **Selective procedure:** All suppliers have the right to apply to tender, and the contracting entity invites some of the applicants to submit tenders. There are no rules on how the qualification of suppliers should be conducted, although the fundamental EC principles must be followed, but the invitation to apply to tender should be made in a publicly accessible electronic database.
- **Direct procurement:** Procurement without formal requirements may be used if the value of the procurement is very low or if there are other particular reasons. If possible, a comparison of prices should be made. Contracting entities with the intention of making direct procurements should stipulate ceiling amounts for these and indicate when direct procurement may take place.

The Public Procurement Act includes specific remedies that can lead to rectification of a procurement procedure, and it also regulates the award of damages to persons harmed by an infringement. During an ongoing procedure (until the conclusion of a contract), a supplier who believes he is harmed or risks being harmed may appeal to a County Administrative Court. Contracting entities are required to leave a period of at least ten days between awarding a contract — and announcing this to all applicants and tenderers — and final signing of the contract. The County Administrative Court may order recommencement of the award procedure or rule that it may not be concluded until the infringement has been remedied. The court can also make an interim decision pending a final decision. An appeal of the court's ruling can be lodged at the Administrative Court of Appeal. After the conclusion of an award procedure, a supplier can claim damages for alleged infringement against the contracting entity at a District Court. Appeal of the District Court's ruling can be filed at a Court of Appeal.

NOU is an independent public authority under the Ministry of Finance, charged with governing observance of the Act. It consists of a secretariat and a board. The secretariat is responsible for day-to-day operations and for contacts with contracting entities, other organisations and individuals. The tasks of NOU includes: *i*) to supervise observation of the Public Procurement Act (LOU) and the Government Procurement Agreement (GPA) under the WTO; *ii*) to work for efficiency in public procurement; *iii*) to spread information by telephone, newsletters, publications, seminars, etc.; *iv*) to give general comments on how the procurement regulations shall be interpreted; *v*) to follow developments in the area of procurement in the European Union and the WTO. The NOU reviews only cases of principle or general interest and is unable to execute legal sanctions against a contracting entity.

WORKING PAPERS

The full series of Economics Department Working Papers can be consulted at www.oecd.org/eco/Working_Papers/

387. *Product Market Competition and Economic Performance in Japan*
(May 2004) Jens Høj and Michael Wise
386. *Migration and Integration of Immigrants in Denmark*
(May 2004) Deborah Roseveare and Martin Jørgensen
385. *Factors Driving Risk Premia*
(April 2004) Torsten Sløk and Mike Kennedy
384. *Rationalising Public Expenditure in the Slovak Republic*
(March 2004) Rauf Gönenç and Peter Walkenhorst
383. *Product Market Competition and Economic Performance in Switzerland*
(March 2004) Claude Giorno, Miguel Jimenez and Philippe Gugler
383. *Concurrence sur les Marchés de Produits et Performance Économique en Suisse*
(Mars 2004) Claude Giorno, Miguel Jimenez and Philippe Gugler
382. *Differences in Resilience between the Euro-Area and US Economies*
(March 2004) Aaron Drew, Mike Kennedy and Torsten Sløk
381. *Product Market Competition and Economic Performance in Hungary*
(March 2004) Carl Gjersem, Philip Hemmings and Andreas Reindl
380. *Enhancing the Effectiveness of Public Spending: Experience in OECD Countries*
(February 2004) Isabelle Joumard, Per Mathis Kongsrud, Young-Sook Nam and Robert Price
379. *Is there a Change in the Trade-Off between Output and Inflation at Low or Stable Inflation Rates? Some Evidence in the Case of Japan*
(February 2004) Annabelle Mourougane and Hideyuki Ibaragi
378. *Policies bearing on product market competition and growth in Europe*
(January 2004) Carl Gjersem
377. *Reforming the Public Expenditure System in Korea*
(December 2003) Young-Sook Nam and Randall Jones
376. *Female Labour Force Participation: Past Trends and Main Determinants in OECD Countries*
(December 2003) Florence Jaumotte
375. *Fiscal Relations Across Government Levels*
(December 2003) Isabelle Joumard and Per Mathis Kongsrud
374. *Health-Care Systems: Lessons from the Reform Experience*
(December 2003) Elizabeth Docteur and Howard Oxley
373. *Non-Tariff Measures Affecting EU Exports: Evidence from a Complaints-Inventory*
(December 2003) Peter Walkenhorst and Barbara Fliess
372. *The OECD Medium-Term Reference Scenario: Economic Outlook No. 74*
(November 2003) Peter Downes, Aaron Drew and Patrice Ollivaud

371. *Coping with Ageing: A Dynamic Approach to Quantify the Impact of Alternative Policy Options on Future Labour Supply in OECD Countries*
(November 2003) Jean-Marc Burniaux, Romain Duval and Florence Jaumotte
370. *The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries*
(November 2003) Romain Duval
369. *Policies for an Ageing Society: Recent Measures and Areas for Further Reform*
(November 2003) Bernard Casey, Howard Oxley, Edward Whitehouse, Pablo Antolin, Romain Duval, Willi Leibfritz
368. *Financial Market Integration in the Euro Area*
(October 2003) Carl Gjersem
367. *Recent and Prospective Trends in Real Long-Term Interest Rates: Fiscal Policy and Other Drivers*
(September 2003) Anne-Marie Brook
366. *Consolidating Germany's finances: Issues in public sector spending reform*
(September 2003) Eckhard Wurzel
365. *Corporate Taxation of Foreign Direct Investment Income 1991-2001*
(August 2003) Kwang-Yeol Yoo
364. *Indicator Models of Real GDP Growth in Selected OECD Countries*
(July 2003) Franck Sédillot and Nigel Pain
363. *Post-Crisis Change in Banking and Corporate Landscapes – the Case of Thailand*
(July 2003) Margit Molnar
362. *Post-Crisis Changes in Banking and Corporate Landscapes in Dynamic Asia*
(June 2003) Margit Molnar
361. *After The Telecommunications Bubble*
(June 2003) by Patrick Lenain and Sam Paltridge
360. *Controlling Public Spending in Iceland*
(June 2003) Hannes Suppanz
359. *Policies and International Integration: Influences on Trade and Foreign Direct Investment*
(June 2003) Giuseppe Nicoletti, Steve Golub, Dana Hajkova, Daniel Mirza, Kwang-Yeol Yoo
358. *Enhancing the Effectiveness of Public Spending in Finland*
(June 2003) Philip Hemmings, David Turner and Seija Parviainen
357. *Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries*
(May 2003) Stephen S. Golub
356. *Tax Incentives and House Price Volatility in the Euro Area: Theory and Evidence*
(May 2003) Paul van den Noord
355. *Structural Policies and Growth: A Non-technical Overview*
(May 2003) Alain de Serres
354. *Tax Reform in Belgium*
(May 2003) David Carey
353. *Macroeconomic Policy and Economic Performance*
(April 2003) Pedro de Lima, Alain de Serres and Mike Kennedy