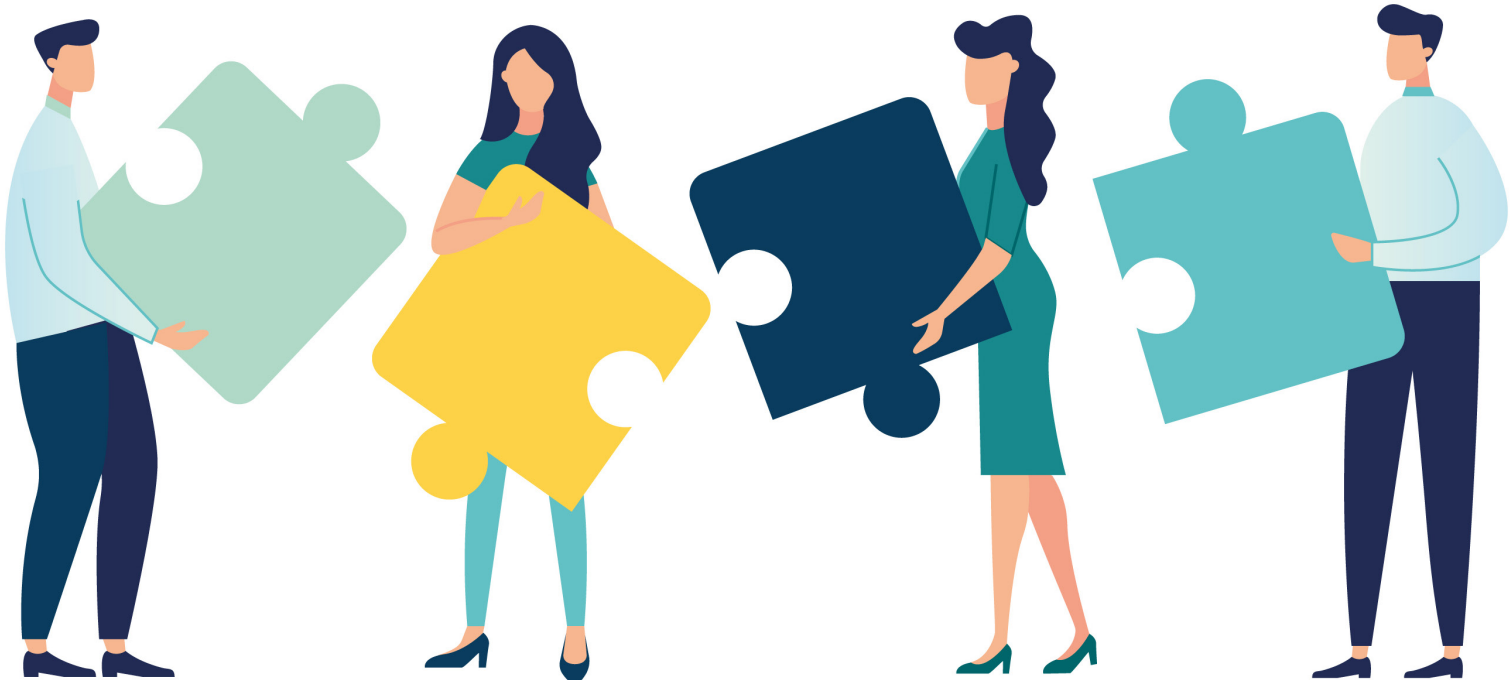




Fair Market Conditions for Competitiveness in the Adriatic Region **OECD Recommendation on Competitive Neutrality**



2021 OECD Recommendation on Competitive Neutrality

The importance of the OECD Recommendation on Competitive Neutrality:

- ✓ Ensures that the legal framework applicable to markets, in which enterprises currently or potentially compete, is neutral and competition is not unduly prevented, restricted or distorted;
- ✓ Helps governments adopt or maintain a competitively neutral competition law that addresses anti-competitive conduct and includes merger control;
- ✓ Encourages states to establish open, fair, non-discriminatory, and transparent conditions for competition in government procurement processes in order to ensure that no enterprise is granted any undue advantage;
- ✓ Supports stakeholders to identify and limit the special treatment for enterprises that are working to attain public policy objectives.

What is the issue?

“To enable the best to win, rules must be equal and fair.”

(OECD-GVH Regional Centre for Competition, 2021).

Competitive neutrality is a principle according to which all enterprises, public or private, domestic or foreign, face the same set of rules. Ensuring competitive neutrality is a key aspect of economic policy making, for OECD and non-OECD countries alike. In fact, over recent years, competitive neutrality has become a topic of growing concern across various policy areas, including trade, investment, tax and industry regulation (OECD, 2015).

Competitive neutrality is ensured when governments' ownership or involvement in the marketplace, in fact or law, does not confer an undue competitive advantage to any existing or potential market participant (OECD, 2015). It is essential for countries to ensure the effective use of their resources and to reap the benefits of competition. This includes the entry and expansion of more productive firms and the exit of inefficient firms, leading to lower prices (OECD, 2021).

While the principle of competitive neutrality is gaining wide support around the world, obtaining it in practice can be more difficult (OECD, 2022). Significant market distortions may arise when some enterprises benefit from undue competitive advantages conferred by state actions, for example on the basis of their ownership (public versus private) or nationality (foreign versus domestic) (OECD, 2022). Such distortions can limit competition and hence productivity and innovation and ultimately economic growth. In fact, a lack of effective

competitive neutrality can seriously affect investment and innovation, lower the quality of products and services, and lessen price reductions as well as business efficiency.

For governments to avoid such distortions and to ensure competitive neutrality, all competitors should be subject to the same rules and state actions should not give selected enterprises a competitive advantage over others.

Why Competitive Neutrality is key for the Adriatic Region?

For Bosnia and Herzegovina, Croatia and Serbia, competition policy plays a key role in fostering access to domestic markets by foreign and international firms, leading to increased allocative efficiency¹ (OECDd, 2021). Raised allocative efficiency among firms ensures that those who can provide goods and services do it best, which may involve market entry, expansion or exit.

In fact, due to the rather small market size, the number of companies operating in a specific sector is rather low across the Adriatic Region. This limited competition risks to magnify distortive effects in case of a lack of equal treatment. As a result, businesses benefitting from undue advantages are more likely to crowd out of the market competitors. Furthermore, dominant market actors, which benefit from those advantages, may have fewer incentives for achieving efficiency gains or innovations. In the mid and long term, this reduces their prospects to compete with foreign entrants into the Adriatic Region or to expand into foreign markets. In contrast, well-functioning markets and competitive neutrality between companies drive productivity, encourage innovation and support economic growth along consumer benefit (OECDd, 2021).

What is more, in the Adriatic Region, the role of SOEs is particularly strong, due to the historical role played by governments in the national economy. As an integral part of the region's economic architecture, SOEs often operate in systemically important sectors, such as electricity and gas, telecommunications, and public transportation, on which other businesses and the general public depend for their everyday operations. Accordingly, ensuring that SOEs operate efficiently, transparently and on a level playing field with private companies is key for the economic development and competitiveness of the region (OECDd, 2021)².

This being said, competitive neutrality is not an absolute principle (OECD, 2021). In some cases, private companies or even SOEs may be granted exemptions in the interest of public policy objectives. However, these must be limited to what is strictly necessary for achieving the aims. Furthermore, public policy goals should be balanced against the potential consumer welfare loss, especially if the same objectives can be achieved through less restrictive means,

¹ Allocative efficiency occurs when there is an optimal distribution of goods and services, taking into account consumer's preferences (<https://corporatefinanceinstitute.com/resources/knowledge/accounting/allocative-efficiency/>).

² For more details on the OECD guidelines on Anti-corruption and Integrity in State-owned Enterprises, please consult the [Anti-corruption SOE Policy Briefing Note](#)

such as competition enforcement and/or regulatory intervention (OECD-GVH Regional Centre for Competition, 2021).

The OECD Recommendation on Competitive Neutrality

Building upon the experience acquired among OECD member states and benefiting from consultations with different OECD bodies, the OECD Council adopted the OECD Recommendation on Competitive Neutrality (“the Recommendation”) on 31 May 2021. The Recommendation establishes a set of principles that promote a level-playing field among competitors. It also prevents situations where the state grants advantages to certain entities, thereby distorting competition within a market.

The objective of the Recommendation is to ensure a level-playing field both between state-owned and privately owned enterprises. Adherents should ensure that rules applied to enterprises within their markets are neutral. For example, they should maintain competitive neutrality in the enforcement of competition and bankruptcy laws. This means that competing enterprises are subject to equivalent rules, irrespective of their ownership, location or legal form. In addition, adherents should guarantee that competing activities are subject to the same regulatory environment and that enterprises are not responsible for regulating the markets in which they compete (OECDa, 2021).

The main elements which are addressed by the Recommendation include:

- I. [The adoption of a legal framework](#), which should ensure that all regulated markets in which enterprises compete are neutral and that competition is not unnecessarily restricted, distorted or prevented. To provide this, it is important to:
 1. **Adopt or maintain a competitively neutral competition law** that addresses anti-competitive conduct and includes merger control;
 2. **Maintain competitive neutrality in the enforcement of competition and bankruptcy law**, so that all competing enterprises are subject to the same competition and bankruptcy rules;
 3. **Maintain competitive neutrality in the regulatory environment.** The Recommendation states that no enterprise should be responsible for regulating the market in which they are competing. In particular, adherents should:
 - Subject competing activities to the same regulatory environment and enforce regulations with equal rigour, appropriate deadlines and equivalent transparency for all market participants;
 - Ensure that enterprises, regardless of their ownership, location or legal form, are not ultimately responsible for regulating the market(s) in which they compete (especially regarding entry or expansion of existing players);

4. Carry out competition assessments that identify and revise existing or proposed regulations that unduly restrict competition; and
 5. Establish open, fair, non-discriminatory, and transparent conditions of competition in government procurement processes so that no enterprise, regardless of its ownership, nationality, or legal form is granted undue advantage (OECDa, 2021).
- II. [The preservation of competitive neutrality](#) when governments design new measures that may enhance an enterprise's market performance and distort competition.

Competitive neutrality can be preserved by:

1. **Avoiding offering undue advantages that distort competition** and selectively benefit some enterprises over others. Such advantages could include loans, favourable tax treatment, grants and goods or services provided by governments at favourable prices. Where an overriding public policy objective requires an exception, this should be transparent to all, proportionate and such exceptions should be periodically reviewed (OECDa, 2021).
2. **Limiting compensation for any public service obligation** so that it is appropriate and proportionate to the value of the services. To this effect governments should:
 - Transparently and specifically identify any public service obligation placed upon an enterprise;
 - Impose high standards of transparency, account separation and disclosure on enterprises with public service obligations around their cost and revenue structures. This ensures that compensation provided to enterprises for fulfilling public service obligations is not used to cross-subsidise the offering of goods or services on another market; and
 - Establish or maintain independent oversight and monitoring to ensure that remuneration for public service obligations is calculated based on clear targets and objectives as well as on efficiently incurred costs. This entails adopting governance structures and rules for state-owned enterprises that do not provide them with undue advantages that distort competition. States are encouraged to align their policies with the Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises and the Recommendation of the Council concerning Structural Separation in Regulated Industries (OECDa, 2021).

III. [The establishment of suitable accountability mechanisms](#) to support and monitor the implementation of the principles set forth in the Recommendation.

To implement the Recommendation in an effective way, the OECD has identified the main areas where competition authorities are advised to be specifically aware of the unintended consequences of state intervention. To promote competitive neutrality, policy makers in Bosnia and Herzegovina, Croatia and Serbia should aim to tackle the following:

1. **Biased competition law framework and enforcement**, which may include exceptions that benefit certain companies and may be enforced in a discriminatory manner;
2. **Disrupted regulatory framework**, which may grant some actors preferential market access or special terms for competing;
3. **Disrupted public procurement legislation and processes**, which may favour SOEs, domestic bidders or incumbents (and, in some cases, SMEs);
4. **Biased public support measures**, which may give unfair financial advantages to selected companies; exclusive and special rights – usually granted for the provision of public services – which may create undue advantages in the way beneficiaries are selected,
5. **Granted rights and privileges that are attached to the public services** and the compensation paid;
6. **Influential state activism**, which favors “national champions” and that could influence how takeovers of national companies by foreign ones are constructed (OECDf, 2021).

In addition to the concrete examples of how these areas can create distortions in the Adriatic Region, this note depicts what type of tools competition authorities have at hand to address the concerns described previously and thus contribute to enhancing competitive neutrality in their jurisdictions. In essence, the paper outlines three different set of tools: (1) tools to stop anti-competitive legislative and administrative acts; (2) tools to support governments in the design of regulation and reform; and (3) tools to control public support measures (OECDf, 2021).

What can policy makers in the Adriatic Region do?

The Recommendation on Competitive Neutrality can help policy makers in the Adriatic Region enhance government policies prone to distorting competition. It hence can prevent regulatory and financial advantages granted to specific enterprises, be they private or state-owned, thereby ensuring competitive neutrality.

To successfully apply the Recommendation on Competitive Neutrality, competition authorities in Bosnia and Herzegovina, Croatia and Serbia can adopt a number of tools relating to the following potential areas of distortion.

1. Biased competition law framework and enforcement

To ensure competitive neutrality in the region, competition law must apply and be enforced in a non-discriminatory manner to all enterprises (e.g., irrespective of their ownership structure or nationality), unless overriding public policy objectives require otherwise. Governments and competition authorities from Bosnia and Herzegovina, Croatia and Serbia should ensure that there are no unjustifiable exemptions excluding certain companies from the application of competition law. Existing exemptions should be regularly re-assessed to determine whether they are still justified and proportionate.

Tools that can be used by competition authorities in the region if the scope of competition law is limited include 1) ensuring the independence of the competition authority as well as 2) providing greater general advocacy of jurisdictions (OECDf, 2021).

The following box illustrates good practices from Bosnia and Herzegovina where competition law enforcement is relatively advanced. These practices can serve as an example for the broader Adriatic Region.

- ✓ *In the Federation of Bosnia and Herzegovina, the Law on Public Enterprises establishes some basic principles aimed at ensuring a level playing field between SOEs and private competitors. It notably establishes that there must be sufficient supervision of state aid. In this sense, although a separate law applicable to SOEs may create different legal treatment, it does take steps towards minimising differences in the treatment between SOEs and private companies.*
- ✓ *In the Republika Srpska, the Law on Public Enterprises similarly establishes several principles related to avoiding distortions to fair competition in the marketplace. These include prohibiting abuses of dominant positions, liberalising services of general interest to prevent monopolies and prohibiting agreements by public enterprises that could prevent, distort or restrict competition in the marketplace.*

2. Disrupted regulatory framework

Some market players (including public, private, domestic, and foreign enterprises) may be subject to different regulatory frameworks or, when the same framework applies, they can be exempt from specific provisions. This may result in some actors having preferential market access or enjoying special terms for operating. To prevent competition distortions, governments in the Adriatic Region should subject all enterprises to the same requirements under sectoral laws and regulations as well as horizontal frameworks, irrespective of their ownership, location or legal form.

Non-neutral regulation can affect competitive neutrality by impacting negatively sectoral laws and regulations as well as licensing and other operational requirements. In this regard, competition authorities can put in place further competition assessments (e.g., impact assessments, discretionary assessments and market studies) (OECDf, 2021).

The following box provides an example of how the Romanian government advocates opposing restrictions to competition laws and regulations using the methodology of the OECD the Competition Assessment Toolkit³. The Toolkit can also help Bosnia and Herzegovina, Croatia and Serbia to eliminate competition barriers by identifying unnecessary restraints on market activities and developing alternative, less restrictive, measures that still achieve the defined government policy objectives.

✓ *In 2014, the Romanian government assessed regulatory constraints on competition in three key sectors: construction, freight transport and food processing. Together, these three sectors account for over 12% of GDP and almost 10% of employment. Making use of the methodology of the OECD Competition Assessment Toolkit, the project analysed legislation as well as assessed costs and benefits of regulations restricting competition in the designated sectors. In addition, specific recommendations on legal provisions that should be amended or repealed were proposed and discussed. These efforts build on the OECD Competition Assessment Toolkit.*

3. Disrupted public procurement legislation and processes

Public procurement legislation and tender terms may establish requirements or processes that favour specific types of companies, like SOEs or Multinational Enterprises (MNEs). Jurisdictions in the three economies should aim to avoid unjustified discriminations. Where measures are adopted to support certain companies (e.g. SMEs) on public-policy grounds, they should be carefully considered in terms of their effectiveness and their potential distortions to competition.

Non-neutral public procurement can disturb competitive neutrality by creating preconditions for discrimination by ownership (e.g. SOEs versus private companies), nationality (domestic bidders versus foreign ones) and preferential access to public land and facilities. To avoid such distortions, competition authorities in the region can put in place greater enforcement, competition assessments and strengthen general advocacy. This can include providing support in the design of legislation and procurement processes, building the capacity of procurement officials and signing memoranda of understanding with public purchasers (OECDf, 2021).

³ For more details on the OECD Competition Assessment Toolkit, please consult the [Competition Toolkit Policy Briefing Note](#).

The following box illustrates what type of measures the Croatian State Audit Office put in place to reassure natural public procurement.

- ✓ *In Croatia, some SOEs like the oil company Jadranski Naftovod and the Croatian Post, still enjoy certain exemptions when they act – beyond their role of a suppliers – as procurers, even though the same provisions of the Public Procurement Act cover them. To avoid such distortions, the country’s State Audit Office is aiming regular financial audits of SOEs, which have been considered an area of high risk.*

4. Biased public support measures

Public support measures are understood as financial advantages provided by the state to enterprises, on conditions that are not in line with market principles. Competition concerns should be integrated into the design and grant of public support measures to preserve competitive neutrality. Like for all measures that restrict competition transparency, proportionality and periodic reviews are key.

Distortive public support measures can affect state loans and guarantees and create preconditions for preferential tax treatment or preferential access to public land and facilities that can limit competitive neutrality. Given the substantial number of foreign entities operating the Adriatic Region and the particular risks for SOEs, competition authorities in Bosnia and Herzegovina, Croatia and Serbia could use the following tools: 1) enforcement, either through a specific state aid regime or general rules against anti-competitive practices; 2) specific advocacy powers, for example, to make non-binding requests that subsidies be abolished or modified or to issue reports on granted state aid; 3) general advocacy, for instance, by drafting guidelines and issuing opinions; 4) competition assessments to identify distortive measures (OECDf, 2021).

The following box provides two examples on how authorities monitor and advice on public service compensation in Central and Eastern Europe.

To ensure that compensation is proportionate and appropriate, policy makers in the region can implement market studies and competitive neutrality surveys as in some of the following country examples:

- ✓ *The Polish competition authority used surveys to determine whether compensation paid to companies is adequate (OECD, 2015);*
- ✓ *The Bulgarian competition authority issued an opinion about a legislative provision allowing compensation for a passenger transport provider for its obligation to provide discounts to certain categories of customers (OECD, 2015).*

5. Granted rights and privileges attached to public services

The rules dealing with special⁴ and exclusive rights⁵, specifically for the provision of public services, can create undue advantages and in turn distort competitive neutrality. Alteration could happen by allowing a selection of the public service operator, privileges and powers attached to the service as well as compensation for it. Therefore, competition authorities in the Adriatic Region, should first select public service operators through an open, fair and transparent bidding process. This ensures a competitive selection process. Second, jurisdictions should adopt fair and transparent public service compensation standards to ensure that compensation is appropriate and proportionate. Third, jurisdictions should define any exclusive right clearly, limit it to the public service obligation or reconsider the need for exclusive rights.

For Bosnia and Herzegovina and Serbia, it could be beneficial to follow the EU model for ensuring competitive neutrality and plan a provision like Article 106 EC, setting the rules for entities that perform services of general economic interest or are granted special or exclusive rights. The following box depicts an EU good practice that could be applied to Bosnia and Herzegovina and Serbia.

✓ *EU Member States, including Croatia, are obliged to notify the European Commission if they plan to grant a state aid to any company. The Commission then scrutinises the planned measure and decides whether to authorise it. In addition, the Transparency Directive requires public companies that have both commercial and non-commercial activities to separate their accounts to demonstrate how their budget is divided between commercial and non-commercial activities (OECD, 2011).*

6. Influential state activism

Governments sometimes also distort competition through state activism. This includes a wide range of sometimes subtle ways in which governments can participate in and influence markets: e.g., golden shares for governments, investments by sovereign wealth funds, political involvement in strategic deals, joint technological or industrial initiatives, public-private partnerships for infrastructure, administrative hardship or ease on certain industries (OECDf, 2021).

Distortive state activity, aiming to create or favour national champions through political involvement in strategic deals can interfere with competitive neutrality. To prevent this, Bosnia and Herzegovina, Croatia and Serbia could put in place general advocacy powers to promote pro-competitive public support measures.

⁴ In the EU, the generally accepted definition of a 'special right' involves limiting the performance of a certain activity to a restricted number of enterprises or providing selective advantages that affect the ability of other enterprises to perform an activity (OECDf, 2021).

⁵ An 'exclusive right' typically refers to a monopoly or sole right of an enterprise to produce certain goods or provide certain services (OECDf, 2021).

Political involvement in strategic deals can lead to counterproductive effects on prices as the following example from Serbia depicts:

- ✓ *In Serbia, some cases were revealed when the government signed public contracts that contained confidentiality clauses, which is not in line with the Serbian constitution (Article 51). Examples of such practice were related to the Belgrade Waterfront from 2015 and the Belgrade Airport from 2018. (Pavlovic, 2019).*
- ✓ *Similarly, an investigation revealed that there were some connections between the three lighting companies targeted to refurbish street lighting using LED lights and Serbian and Hungarian public officials. Researchers argue that these connections enabled the companies to win contracts in several towns and cities across Serbia (Barlett, 2021). The total value of the street-lighting contracts for 2020 was 66 million euros, of which 56 million euros went to these companies (<https://balkaninsight.com/2021/03/11/companies-linked-to-politicians-win-serbian-street-light-contracts-again/>) .*

A summary of the tools described above for the six types of competitive neutrality violations is provided in Table 1.

Table 1. Tools identified for different types of competitive-neutrality violations

Competitive-neutrality violation	Specific ways in which competitive neutrality can be affected	Examples of tools used by competition authorities
Non-neutral competition law	Scope of competition law Enforcement of competition law	- General advocacy, especially so jurisdictions (i) carefully consider whether an exemption is necessary before establishing it and, where it has already been established, whether, it is still justified and proportionate; and (ii) ensure the independence of the competition authority
Non-neutral regulation	Sectoral laws and regulations Licensing and other operational requirements Horizontal legal and regulatory framework	- Enforcement (for secondary legislation), either through the direct removal of anti-competitive rules or challenging them before courts - Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries - General advocacy
Non-neutral public procurement	Discrimination by ownership (SOEs) Discrimination by nationality (domestic bidders) Other discriminations (SMEs and new entrants)	- Enforcement, either through the direct removal of anti-competitive rules and acts or challenging them before courts - Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries - General advocacy, including providing support in the design of legislation and procurement processes, building the capacity of procurement officials and signing memoranda of understanding with public purchasers
Distortive public support measures	State loans and guarantees Preferential tax treatment Preferential access to public land and facilities	- Enforcement, either through a specific state aid regime or general rules against anti-competitive practices - Specific advocacy powers, for example, to make non-binding requests that subsidies be abolished or modified or to issue reports on granted state aid - General advocacy, for instance, by drafting guidelines and issuing opinions - Competition assessments to identify distortive measures
Distortive special and exclusive rights	Selection of the public service operator Privileges and powers attached to the public service Compensation for the public service	- Enforcement, by ensuring that the selection process is not anti-competitive and removing or challenging the grant of exclusive and special rights that result in competition infringements - Enforcement to take action against excessive compensation for public services - Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries - General advocacy
Other distortive state activity	State activism	- General advocacy. In the context of state activism, to support the competition authority's independence and to ensure that competition concerns are considered when the government intervenes through any mechanism. In the context of internal restrictions, to promote the elimination of such restrictions

Source: (OECDf, 2021) *The promotion of competitive neutrality by competition authorities*

Where do we go from here?

This policy-briefing note illustrates the importance of competitive neutrality to ensure fair competition in the Adriatic Region. It describes the OECD Recommendation on Competitive Neutrality as a key tool to level the competitive playing field. The Recommendation establishes a set of principles to ensure that government actions are neutral with regard to competition, irrespective of factors such as business ownership, location or legal form. This Recommendation is particularly relevant for the Adriatic Region in view of the important role of SOEs and the limited market size in specific sectors.

Furthermore, the document depicts six fields in which competition authorities in Bosnia and Herzegovina, Croatia and Serbia should be particularly attentive to avoid competitive distortions, including 1) biased competition law frameworks and enforcement; 2) disrupted regulatory frameworks; 3) disrupted public procurement legislation and processes; 4) biased public support measures; 5) granted rights and privileges attached to public services; and 6) influential state activism. In this context, the brief illustrates the tools governments have at hand to enhance competitive neutrality in these areas.

Rather than being exhaustive, this note has outlined the main areas where policy makers in the Adriatic Region can take action. However, there are a number of related fields and tools that would further benefit the governments of the Adriatic Region.

Taking into consideration the important role of SOEs, policy makers in the region should also consult the **OECD Guidelines on State-Owned Enterprises**, which give concrete advice to governments on how to manage more effectively their responsibilities as company owners. This can help SOEs to become more competitive, efficient and transparent.

Furthermore, the **OECD Competition Assessment Toolkit** would benefit Bosnia and Herzegovina, Croatia and Serbia. It provides a structured approach to assessing whether interventions have anti-competitive effects, whether any such effects are inevitable and how to assess the costs of such distortions. Thereby, the Toolkit enables governments to make informed policy choices on government interventions affecting the market place (OECD, 20215). The Toolkit can also serve as an instrument for sharing experience between policy makers in the Adriatic Region and OECD member countries (OECDa, 2021).

Do you want to find out more?

For further information, please consult:

<http://www.oecd.org/daf/competition/competitive-neutrality.htm>

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POLICY BRIEFING NOTES
**FAIR MARKET CONDITIONS FOR COMPETITIVENESS
IN THE ADRIATIC REGION PROJECT**

High levels of corruption and lack of transparency are key constraints to economic growth and competitiveness in many countries worldwide. The Policy Briefing Notes, designed for stakeholders from the Adriatic Region, aim to provide practical guidance to tackle corruption, foster integrity and level the playing field for all firms. They draw on OECD guidelines, legal instruments and good practices and are tailored to the region's circumstances.

The Policy Briefing Notes are one output of the three-year OECD project to promote fair market conditions for competitiveness in Bosnia and Herzegovina, Croatia, and Serbia, supported by the Siemens Integrity Initiative. Through Collective Action, government officials from the region along with business leaders, anti-corruption experts and practitioners, civil society representatives and academics have engaged to jointly identify country-specific challenges to integrity and foster fair market competition.

These efforts are part of the engagement of the OECD South East Europe Regional Programme, which collaborates with the region since 2000 to foster private sector development and competitiveness, improve the investment climate and raise living standards for an inclusive and sustainable future for the people of South East Europe.

**www.oecd.org/south-east-europe
oe.cd/fair-market-conditions**