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Unfair Competition by Government Firms and Authorities in the Consulting Market

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Abstract

Government firms and authorities often sell services in the free market via affiliated consulting firms (CFs). In this study, I analyse whether these agents have an unfair competitive edge compared to private CFs. The theoretical analysis shows that private and state-owned CFs operate under different conditions. A private CF must choose between having permanent employees and pay full-time wages with the risk of over- and under-capacity or hiring professionals temporarily in the free market, which gives flexibility but may cause problems in hiring qualified professionals. In contrast, state-owned CFs can hire professionals from their parents and have the exclusive right to do so. With experiences from Sweden, I show that this exclusive dealing contract is a schoolbook example on unfair competition and gives several negative welfare effects and consequences. First, private CFs' profits are lowered. In some cases, private CFs are deterred from entering the market. Second, competition is limited, meaning that the buyers of consulting services are worse off. Third, a necessary reorganization of the Swedish consulting sector is prevented. Fourth, the unfair competition is the main reason why the re-flow to Sweden from multilateral development agencies has been so low during the recent 20 years. This last consequence is especially analysed.

1. Introduction

Government firms and authorities do not only focus on their main tasks but also sell consulting services in the free market in competition with private consulting firms (CFs). The government consulting projects are undertaken either by affiliated state-owned CFs with own responsibility for statement of account and profitability, which is the case for most government firms, or by unofficial consulting departments within government authorities.

A central question is how the competition conditions are affected by the presence of government agents in the consulting market. It has been claimed that state-owned CFs have a competitive advantage compared to private CFs, because the former have not the same costs as the latter (see e.g. EFCA, 1995). The most frequently used argument is that the state-owned CFs can hire professionals when necessary and thereby avoid overhead costs in the form of offices and costs when employees have no tasks (thus, the risk with overcapacity is avoided). This argument is, however, not valid, because many private CFs also use a strategy where professionals are hired on a project basis instead of having permanent employees.

In this study I will - based on the Industrial Organization theory - analyse in which way state-owned CFs and government authorities exert unfair competition in the consulting market. Interesting consequences to analyse of this unfair competition are welfare effects and which inefficiencies that arise. Examples are taken from Sweden, where the presence of government agents in the free consulting market is extensive. I will especially examine what has happened with Swedish consulting exports after many years of unfair competition from state-owned CFs and government authorities. It is here concluded that the involvement of government agents has caused a weak Swedish international competitiveness in the consulting sector and a low re-flow from multilateral development agencies (DAs)

The study is organized as follows. In section 2, I compare under which conditions state-owned and private CFs operate and investigate whether state-owned CFs have a competitive edge. Whether the competitive advantage is unfair or not is examined in section 3. In section 4, I analyse the consequences of the unfair competition. The connection between presence of government authorities in the market and the low re-flow to Sweden from multilateral DAs is examined in section 5, and the final section concludes.

2. Private versus state-owned consulting firms

Interesting issues to examine are whether the presence of state-owned CFs and government authorities in the market has deterred the establishment of private CFs and whether the state-owned agents enjoy a privileged position compared with the private CFs. To analyse these issues, one has to find out under which different conditions private and state-owned CFs operate. A frequently used argument is that the government financially guarantees the operations of the state-owned CFs with the taxpayer's money, implying that the financial risk is lower for state-owned CFs. This is an advantage, but not a decisive one in the consulting sector, because CFs do not invest in large risky projects but invoice on an hourly basis.[1]

There are more important differences in the conditions under which state-owned and private CFs operate. Essential problems to solve for a CF is: 1) to match resources (professionals) available with the demand for services. This is due to that CFs sell services on a project basis and offer the clients flexibility; and 2) to recruit, hire or have the exclusive right to qualified professionals. This is a crucial competitive factor for the CFs, because the only factor of production is the human capital that is controlled by the professionals who implement the services, and it is also likely that the long-term relationships with the clients are bound to these professionals (Svensson, 2001).

In Table 1, I show the different employment strategies that private and state-owned CFs can choose based on these two starting points. The private CFs must choose between the lower left corner, where they have the exclusive right to their permanent employees but pay full-time wages, have costs for offices and a low flexibility, and the upper right corner, where they temporarily hire professionals and have high flexibility, but must compete for the professionals with other firms and may experience problems in hiring qualified professionals. A third alternative for the private CFs is, of course, a combination of these two alternatives, where some professionals are temporarily hired and others are permanently employed. In contrast, the state-owned CFs, which have few permanent employees, can hire professionals from their parent operators (state-owned firms or government authorities) and have the exclusive right to do so, meaning that no private CF is allowed to hire professionals from these operators. The state-owned CFs are therefore placed in the upper left corner, where they have the exclusive right to the

[1] Another argument is based on that state-owned CFs can hire professionals from government authorities and state-owned firms to a price lower than the market price. This *may* be true, but a detailed empirical investigation is necessary to prove that state-owned CFs do utilize such an advantage in order to apply an under-pricing strategy.

professionals in their parent companies at the same time as they have full flexibility. The exclusive right for the state-owned CF does not mean that it can hire whoever of the professionals in the parent operator, but rather that only the state-owned CF and no private CF can hire these professionals. If the parent operator refuses to hire out a specific professional to the affiliated CF, there are many other similar professionals who can be hired out (though not all of them are highly qualified). If these rules apply and the state-owned CF does not pay an extra fee to the parent operator for the increased flexibility and the exclusive right to the pool of professionals, then there is no doubt that the state-owned CFs enjoy a competitive advantage compared with the private CFs. This analysis is valid for both state-owned CFs and consulting departments owned by government authorities.

The fact is that the state-owned parent operators of the state-owned CFs could be placed in the lower right corner of Table 1. The operators will take responsibility for their permanent employees when the affiliated CFs do not wish to hire them. This means that if one considers a state-owned CF and its parent company / government authority as *one* firm, this fictitious firm has no advantages in the hiring of, and exclusive right to, professionals compared with private firms. The fictitious firm would have the same problems as the private CFs in finding full-time tasks for its permanent employees. Thus, the losses to the parent operator in terms of flexibility and exclusive rights will exactly offset the gains to the affiliated CF. The problem is that the parent operator – which obviously sacrifices some resources for its affiliated CF – operates in another sector from that of the state-owned and the private CFs. The state-owned parents often operate in partly regulated markets, mostly have a market position that is close to a monopoly, and have no or few requirement for profit maximization.[2] They can therefore afford to lose some flexibility or resources. The flexibility and exclusive rights transferred to the state-owned CF could, however, be decisive in the consulting sector. The competition in the consulting sector is distorted, which is disadvantageous for the private CFs. In other words, the state-owned operators *cross-subsidize* their affiliated CFs. The point is that even if the state-owned CF has to pay the same fee to the state-owned operator for hiring professionals as a private CF does to pay for hiring professionals in the free market, the state-owned CF is subsidized anyway. The state-owned CF can always be sure to hire professionals, but a private CF with a hiring

[2] This is especially the case in Sweden.

strategy always faces the risk of not finding a professional who can execute the project. This means that the private CF will have higher search costs for professionals and larger restrictions on its production of services.

When Swedish state-owned CFs hire professionals from their parent companies, these professionals take leave and the state-owned CFs only pay salaries, subsistence levels and other project-specific costs for the temporarily hired professionals. The state-owned CFs pay nothing extra, however, for their privileged position.[3] When private CFs hire professionals in the free market, these professionals also take a leave.[4] Thus, the private CFs have similar costs as the state-owned CFs when hiring professionals temporarily, but have higher search costs and a higher probability that there will be restrictions on the production if they do not find any professionals to hire. Thus, the state-owned CFs have a competitive advantage compared with the private CFs.

3. Predation by putting rivals at a cost disadvantage

Now we turn to the question whether the privileged position of the state-owned CFs is unfair. The problem with the exclusive dealing contract between the state-owned CFs and their parents in the consulting sector is similar to an example of what is called "predation by putting rivals at a cost disadvantage" in the Industrial Organization literature (Ordover and Saloner, 1989).[5] As shown in Figure 1, a downstream firm (state-owned CF) signs an exclusive dealing contract with an upstream firm (state-owned infrastructure operator / government authority), which is the dominating supplier of intermediates (professionals) in the market. This operator agrees to supply professionals only to the state-owned CF and not to the rival firm (private CF). Alternatively, the operator hires out professionals to the private CF, but only on unfavourable terms; for example, the private CF is forced to hire professionals via the state-owned CF, thereby raising the hiring costs, or the private CF must offer the

[3] In Sweden, Swedavia seems to be the only exception among the state-owned CFs that pay hiring fees that are close to market fees. In addition to paying salaries and subsistence levels, they also pay for overhead costs and a small profit to the parent operator. It is not clear, however, whether these extra fees are based on market prices or not. Furthermore, SwedeRail pays some overhead costs to the parent operator when the professionals are hired on short-term contracts, but not for long-term contracts. Another state-owned CF, Swedesurvey, has the same conditions as SwedeRail when hiring professionals from its parent company.

[4] The professionals in "the free market" are mostly permanently employed in the government administration or in private firms, either in the domestic market or abroad. They usually take leave when hired by the private CFs.

[5] The term predation (from predatory) means here anticompetitive business strategies that have the effect of lowering a properly evaluated, measured social welfare.

professionals a permanent position but then loses flexibility (see Table 1). In addition, the state-owned CF can hire professionals in the free market in competition with the private CF, as can be seen in Figure 1.

Now, there are two aspects of this exclusive contract that must be analysed. Firstly, whether it is rational from a profit-maximizing business perspective with such a contract.[6] Secondly, which social welfare inefficiencies that arise and which agents win and lose due to the existence of this contract. According to Ordover and Saloner (1989), three conditions must be fulfilled to motivate – from a business perspective – the two parties in such an exclusive dealing contract: 1) The private CF must be hurt in terms of profit by the contract; 2) The private CF should not be able to respond to the state-owned CF's exclusive contract, for example, by making a similar deal with the other suppliers of professionals in the market; and 3) The state-owned operator's profit must be raised by the exclusive contract, compared with that seen if the operator chooses to hire out professionals to any CF.

Clearly, the private CF's profit is negatively affected by the exclusive dealing contract, because the costs of searching for professionals to hire are raised, and production restraints are imposed as the probability increases that the private CF will find no professionals to hire. Thus, the state-owned CF’s actions raise the costs at which the rival can hire professionals. The unfair competition can go so far that the private CF is forced out of business. [7] The alternative is that private CFs never can be established in the market. Furthermore, the private CF likely cannot respond to the exclusion by making a similar deal with other suppliers of professionals, because the other suppliers are small and scattered, and, as I discuss next, it is doubtful that the other suppliers will profit from such a deal. Moreover, the state-owned CF is not limited to hiring professionals from its parent operator, but can also hire professionals in the free market and compete with the private CF for the few remaining professionals who are still available for hire in the market. Thus, the first and second conditions are fulfilled.

Before I turn to the third condition, one could ask: What are the incentives for the government authority or state-owned firm to sign an exclusive dealing contract? One

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[6] It can be questioned whether one should analyse a government authority or state-owned firm from a business perspective. The government agents have authoritative tasks that cannot be analysed from a profit-maximizing business perspective, but the part that is connected with sales of consulting services in a competitive market has nothing to do with traditional government tasks. The purpose with the commercial sales for the government agents is to be profitable or at least fully financed. Thereby, it is possible to analyse the government agents’ sales of consulting services from a business perspective.
[7] In fact, this has already occurred for Swedish private CFs that compete in the export market.

explanation is connected with the external politico-economical control. A political goal for the government may be to keep the unemployment rate at a low level. The government may then refuse to allow a state-owned firm to lay-off personnel for whom they have no full-time tasks. Under these conditions, it can be an optimal strategy for the state-owned firm to keep professionals in-house by offering them permanent employment and letting them, for example, sell consulting services when they are not needed in the daily production. Another explanation is that government authorities and state-owned firms base their competence on human capital that is created in the organisation and controlled by the employees. The development of this human capital is connected with large investment costs, which a private CF is not willing to pay. If professionals in the government sector quit and join the private sector as soon as enough human capital has been accumulated, then the government authorities and state-owned firms would be less interested in making these investments. This would lead to less investment in human capital in the long run. The purpose with the exclusive dealing contract would then be that the state-owned firm removes the possibility for the employed professionals to search for jobs in the private sector. However, this strategy would only be effective if all alternative work places for the employed professionals are removed and a kind for "slavery contract" is established for the professionals.

However, the negative aspects of the exclusive dealing contract should dominate. The state-owned firm or government authority would get more choice alternatives and would be better paid if several CFs were allowed to compete on equal conditions for the professionals. The existence of the exclusive dealing contract is rather a token on government inefficiency and depends on that the state-owned firm does not maximize the profit. The owner of the state-owned firm, the government, does not have strong enough profit requirements or has other purposes (see unemployment goal above). In Sweden, for example, some of the state-owned firms have, or formerly had, a monopoly in the domestic market (e.g., Telia, Swedish Civil Aviation Administration, Swedish Railways) and have limited experience of maximizing profits on market conditions.[8]

It is improbable that the combination of an operator and a CF in one firm, or an exclusive dealing contract between them, would create any synergy effects or that it

[8] Other government authorities, like the Swedish Civil Aviation Administration and the National Land Survey of Sweden, still face a monopoly position and use affiliated CFs in domestic and overseas operations.

would be a superior way to organize production. *These arguments are strengthened by the fact that the private operators in the infrastructure sectors in Sweden and in other developed countries seldom have their own consulting affiliates or underused professionals in-house.*[9] If the combined operator-CF was a superior way to organize production, there should exist many such combined operator-CFs in the private sector. However, there are not. This indicates that there are no synergies.[10] One can expect that as state-owned firms in Sweden become more market oriented or privatised, their affiliates, that is, the state-owned CFs, will be sold off and organized in separate firms or closed down. This is what actually has occurred recently with the Swedish state-owned CFs Swedforest (Domänverket), SwedPlan (Boverket) and Swedtel (Telia).[11] The conclusions are that the cross-subsidy must be unfair because a private CF would never be able to gain such an advantage in a competitive market, and that, under profit-maximization, the third condition for putting rival firms at a disadvantage is not fulfilled. The preceding reasoning also explains why it is so difficult for the private CFs to make an exclusive deal with other profit-maximizing suppliers of professionals in the market.

The parent operator may have two purposes for hiring out its employees to CFs, which in turn implement projects for other operators abroad: 1) The parent operator will gain flexibility in its operation, because it does not need to pay salaries to employees who are hired out if the operator faces overcapacity; and 2) The competence and experience of the employees will be upgraded as these employees face new problems to solve in consulting projects. To obtain these goals, however, it is not necessary for the operator to own an affiliated CF. The first goal can be obtained if the affiliated state-owned CF is separated from the operator and this CF thereby offers some of the professionals employed by the operator a permanent position. The separated CF can then hire out its professionals on a project basis to the former parent operator and to operators abroad. The first goal can also be obtained if several CFs are allowed to temporarily hire professionals from the operator in a competitive way. It is then likely

[9] The few cases when private operators do have their own affiliated CFs occur when the private operators have recently become market oriented. After some years, the affiliated CFs are separated.

[10] In fact, the scientific burden of proof rests with the person or firm who claims that there are synergies, not with the person who believes that there are no synergies, or cannot find any.

[11] Swedec and SGAB were formerly state-owned CFs, but were acquired by Hifab in 1988 and 1992, respectively. SwedPlan was recently sold off to a private CF. In the mid-1990s, the state-owned forest administrator Domänverket was privatised at the same time as it merged the pulp and paper firm Assi and founded AssiDomän. Swedforest, an affiliated state-owned CF to Domänverket, was then separated and later acquired by SCC. In 2000, when Telia was privatised, the affiliated firm Swedtel was closed down.

that the operator can be better paid for the professionals it hires out than if there is only one affiliated CF that has the exclusive right to hire professionals. If the operator wishes to obtain the second goal and keep professionals with upgraded competence in-house, then it would also be an appropriate strategy to let several CFs hire professionals on a project basis from the operator. This strategy would be - for the operator - at least as good as own an affiliated CF.

4. Consequences of the exclusive dealing contract

Clearly, existing private CFs' profit is lowered and the establishment of new private CFs is deterred by the exclusive dealing contract between the state-owned operators and the affiliated state-owned CFs. The unfair competition by state-owned CFs explains why so few Swedish private CFs operate in sectors where state-owned CFs are present.[12] This is a very important observation. The existence of state-owned CFs decreases rather than increases competition in the market. In some cases, the state-owned CFs will be able to rape monopoly profits, for example, when The Swedish International Development and Cooperation Agency (Sida) finances projects and only Swedish firms are allowed to compete.[13]

The buyers of consulting services are hurt by the limited competition, because they have to pay higher prices, alternatively will get worse services for a specific price. In other words, an economic inefficiency (welfare loss) is created. In Sweden, Sida finances consulting projects for 3-4 billion SEK each year and is one of the largest buyers of consulting services in Sweden. Thereby, Sida makes a loss due to the limited competition caused by the exclusive dealing contracts. In recent years, Sida has had problems with motivating CFs to submit proposals when management services have been procured. Mostly, there are only three tenderers, or sometimes even two tenderers (although five or six are invited) that submit proposals (Sida, 1999). Sida says that the resource base of professionals is limited in Sweden. This is not true. It is the unfair competition that locks in the resource base.

A consequence of the limited competition and the fact that few CFs submit proposals when Sida procures consulting services is that Sida has started to invite foreign CFs to participate in the tenders. At the same time, Swedish CFs are not allowed to tender for projects financed by foreign bilateral DAs. This distorts competition in

[12] These sectors are, for example, aviation, land surveying, road security, railway and telecom services.
[13] Sida is the Swedish bilateral development agency.

disadvantage for Swedish CFs (Svensson, 2000b). I argue that the limited competition in Sweden is the main reason that Sida invites foreign CFs and not because Sida wishes to have a less protectionistic policy than its corresponding bilateral DAs in other developed countries.

Furthermore, the market for management professionals in Sweden is blocked and thereby a desired restructuring of the whole Swedish consulting sector is prevented. It has therefore been difficult particularly for the Swedish private engineering CFs to adapt themselves to the market trends towards more management content in the projects. The private engineering CFs in other European countries have not faced such a blockade to the same extent in their domestic markets and so have been able to restructure and upgrade their management skills through either employing management professionals permanently or hiring them temporarily.

5. Low re-flow from multilateral development agencies

During the last decade, there has been a trend towards that multilateral DAs finance more consulting projects in Eastern Europe and development countries rather than traditional infrastructure projects. The World Bank finances consulting projects for 3.5 billion USD each year and the EU finances development projects for 8 billion EURO each year, which almost exclusively are implemented by CFs, organizations and government authorities. The reason is that consulting projects are likely to be connected with a high knowledge transfer to the host country. There are three arguments why knowledge transfer should be intensive in consulting projects. First, CFs are the prototype for knowledge-based firms. Second, the services must be implemented in cooperation between the CF and the client (receiver). Third, consulting services can seldom be patented, meaning that the clients can later replicate the services in own projects.

Since some years ago, the low re-flow to Sweden from the EU development program and other multilateral DAs has been debated.[14] As can be seen in Table 2, the Swedish share of the supplies to the two most important EU-funds – EU-PHARE and EU-TACIS – is only about 1%, though the Swedish shares of the EU-budget and of GDP in the EU are 2.5-2.9% (Svensson, 2000a, 2000b). Apart from Belgium, which has a close distance to the EU bureaucracy in Brussels, the most successful countries are United Kingdom, Ireland, Denmark, Finland and the Netherlands. The re-flow to

[14] Other DAs include the World Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the United Nations, etc.

Sweden from the other multilateral DAs is low as well; for example, the share of the projects financed by the World Bank and the Asian Development Bank should be 1%, but is only 0.5% (Svensson, 2000a).

One reason to the low re-flow from EU could be that Sweden has only been member of the EU since 1995. However, countries like Austria and Finland that joined the EU at the same time as Sweden have larger shares of the supplies. Some have claimed that Sweden has a cost disadvantage compared to other countries, especially with respect to labour costs including high taxes. Neither this argument is valid, because some of the successful countries – like Denmark, Finland and the Netherlands – have high labour costs as well.

When Sweden was about to take the presidency of the EU, the Swedish Ministry for Foreign Affairs decided to order and finance a quick investigation about the low re-flow to Sweden from EU's development program. However, they neglected that the re-flow is low from other multilateral DAs as well. The ordered investigation claims that Swedish firms have no competitive disadvantage compared to firms originating in other EU-countries (Ramberg and Svingby, 2001). Instead, Swedish (private) firms are said to be uninterested of EU's development program, lack necessary competence and networks, do not know EU's procurement rules and are not aware of the market potential of the development program. It is especially emphasized that the ambitions of the Swedish private CFs must be improved in order to increase the re-flow, but there is no theoretical explanation why Swedish profit-maximizing CFs would be less ambitious than profit-maximizing CFs in other countries. The authors suggest that more government resources should be used to subsidize Swedish exports, for example, government authorities should assist the exporting firms with market analyses, project information and manuals how to win contracts and implement projects. Ramberg and Svingby (2001) neglect to analyse structural problems and have no suggestions on measures to solve such problems. In fact, the investigation is based on interviews and contains neither theoretical analysis nor statistics that can support their conclusions.

Instead, there are two structural problems in the Swedish consulting sector, which likely can explain the weak performance by Swedish CFs in the international market financed by multilateral DAs. The first is associated with many investment subsidies in Sweden. Since the 1960s, CFs in other European countries have had a more limited demand, and fewer government subsidies, in their domestic markets than that faced by the Swedish CFs (Svensson, 2000b). The foreign CFs have, therefore, been forced to seek business opportunities abroad at an early stage to survive, at the same time as the Swedish CFs have operated in a sheltered domestic market. Therefore, the foreign CFs obtained a strong advantage in reference assignments, long-term relationships with foreign clients, establishment of permanent offices abroad and ability to seek financing from different DAs, compared with the Swedish CFs. Moreover, the professionals employed by the foreign CFs thereby have curricula vitae with more merit. The Swedish CFs cannot regain the losses caused by these subsidies.

The second structural problem is associated with the existence of state-owned CFs and government authorities in Sweden. One interesting observation about the consulting projects in the development programs – especially EU's program – is that they more frequently contain management and restructuring services rather than engineering services.[15] Multidisciplinary projects including both management and engineering services have become common. The necessary skills to implement these projects can be found among professionals employed by government authorities and state-owned CFs as well as by private firms and CFs in developed countries. In other words, private and state-owned firms may compete for the same projects.[16]

In fact, the most successful countries – United Kingdom, Denmark and the Netherlands – are also among the most deregulated countries with respect state-owned firms. At the same time, Sweden is perhaps the country with the highest share of state-owned CFs and government authorities operating in the international market (Svensson, 2000). In 1996, the state-owned CFs accounted for as much as 47% of the total Swedish

[15] This has occurred by two reasons. Firstly, local CFs in the host country have during recent years learnt how to absorb engineering skills from CFs originating in developed countries. Therefore, engineering services are to a higher degree purchased from local CFs in the host country. Services purchased from CFs originating in developed countries aim more to facilitate knowledge transfer to the host country and to coordinate, support and train local CFs and professionals. Secondly, there have been trends toward privatisation of state-owned entities and deregulation of markets in the infrastructure sectors in emerging markets. The state-owned operators and authorities in these regions are often ineffective, corrupt and seldom ready to supply utilities in a competitive market. They need in other words, a great deal of reorganization to become more effective.

[16] Historically, the Swedish state-owned CFs have supplied management services to a much higher degree compared to private CFs that have supplied engineering services. Thereby, the two groups of CFs have competed in different segments of the infrastructure market. This is logical because the state-owned CFs are owned by large state-owned operators in the infrastructure sectors that have huge human capital resources and thereby know how to operate and reorganize a system or a plant. As a result of the trend toward management services in the market financed by DAs, the private engineering CFs have been forced to enter the market in which the state-owned CFs and government authorities operate. Furthermore, many Swedish government authorities have consulting departments that operate in the domestic and international markets. These consulting departments mainly supply management, operation, training and administration services in the government administration sectors abroad. These government sectors include the health, education, taxation, national statistics, fiscal policy, etc., sectors. *In the government administration sectors, there are hardly any Swedish private CFs operating abroad at all.*

consulting exports in the infrastructure sectors.[17] This is a unique Swedish phenomenon. Certainly, state-owned CFs exist also in other European countries, for example, in France, but the foreign state-owned CFs have only a few percent of the total consulting exports in their countries. Thus, there seems to be a positive correlation between the re-flow from the EU development program and other DAs and privatisations in the domestic market.

The unfair competition from state-owned CFs and government authorities, as discussed above, has not only deterred the development of private CFs in Sweden.[18] It has also caused that the two necessary skills – competent professionals and marketing towards the client – that firms must control to be successful in the international market are separated in Sweden. The state-owned CFs control many professionals but can nothing about marketing and the private CFs are skilled in marketing but are not allowed to hire professionals. Therefore, it is not surprising that Swedish firms win so few contracts financed by EU and other multilateral DAs.

The government blockade of professionals in Sweden has taken the attitude that it is almost impossible for a private CF to find management professionals to hire in the domestic market. Many of the Swedish private CFs have therefore been forced to hire foreign professionals. In fact, the most successful Swedish private CFs, which operate in the market financed by DAs, hire foreign professionals to a high degree.

Another interesting feature of the state-owned agents is that the consulting departments of the Swedish government authorities seldom compete for contracts financed by EU or multilateral DAs. These consulting departments have only directly purchased contracts by Sida. Thus, the consulting departments have not even learned how to win contracts in competition when mainly Swedish tenderers are allowed to compete. The Swedish government consulting departments will therefore have no chance to win contracts financed by EU and multilateral DAs. Since almost no private

[17] Here, the infrastructure sectors include the transport infrastructure, telecommunication, energy, environment, water supply & wastewater, natural resource and building sectors.

[18] The problem with cross-subsidized Swedish state-owned CFs also concerns foreign private CFs when they compete with the Swedish state-owned CFs for projects financed by EU, multilateral DAs or commercial projects. The foreign private CFs have a disadvantage compared with the cross-subsidized Swedish state-owned CFs, but are not as hurt as the Swedish private CFs, because their domestic market is not blocked and they can freely hire professionals in their domestic markets. Of course, Swedish private CFs can reduce the damage by hiring professionals in other countries, but they still have a disadvantage compared with the state-owned CFs because of the subsidies. Finally, the phenomenon with state-owned CFs is not limited to Sweden. Other countries have also state-owned or semi-state-owned CFs that possess unfair competitive advantages – but not to the same extent as in Sweden.

CFs exist in the Swedish government administration sectors, Sweden hardly participate at all when EU procure services in these sectors. Furthermore, participating in international tenders is risky. To submit a proposal costs between 5,000 and 15,000 USD. It is difficult to motivate that government-consulting departments participate in hard international competition and risk the taxpayers' money.

There is a solution to the problem with unfair competition by state-owned CFs and the inefficiencies that arise due to the exclusive dealing contracts (e.g. a low re-flow to Sweden from multilateral DAs). State-owned CFs should be privatised and government authorities should not be allowed to sell services in the free market. This would also be a necessary (but not a sufficient) condition in order to strengthen the Swedish consulting exports and increase the re-flow from multilateral DAs. The proposals should be submitted by private CFs, which are specialized in marketing and tender rules. The risk is the transmitted to the private sector. With no exclusive dealing contracts, more private CFs can be established in the market.

6. Conclusions

In this study, I have analysed in which way state-owned CFs and government authorities exert unfair competition in the consulting market. In principle, a private CF can choose between two employment strategies: 1) to have permanent employees, fixed wage costs and exclusive rights to these professionals; or 2) to hire professionals on a project basis when contracts are awarded. The CF will then have flexible wage costs but no exclusive rights to the hired professionals. A state-owned CF, on the other hand, can hire professionals from its parent company with exclusive right; that is, no private CF is allowed to hire these professionals. Thus, the state-owned CF has both exclusive right *and* full flexibility. Since the state-owned CFs do not pay extra for their privilege, they are cross-subsidized by their parent operators. At the same time, the state-owned CFs can also hire professionals in the free market. This kind of privileged position is called "predation by putting rivals at a cost disadvantage", and will cause the private CFs to have higher costs when searching for professionals to hire and larger restrictions on their production of services. The unfair competition will deter the establishment of private CFs.

With experiences from Sweden, I showed the consequences of the exclusive contracts between the state-owned CFs and the government parents (authorities or firms). First, private CFs' profits are lowered and the establishment of private CFs has been deterred in sectors where state-owned CFs are present. Second, the buyers of consulting services are hurt, because the competition level is lowered. Third, since the state-owned CFs in principle blockade the Swedish market for management professionals, a necessary restructuring of the Swedish consulting sector is prevented. Fourth, there is a low re-flow to Sweden from multilateral DAs. In this study, it has been argued that the low re-flow mainly depends on the unfair competition by state-owned CFs. The unfair competition is the reason why the two necessary skills – competent professionals and marketing – for firms to control in order to win international contracts are separated in Sweden. State-owned CFs control the professionals but do not master marketing and private CFs know marketing but are not allowed to hire professionals.

Privatising the state-owned CFs and allowing any CF to hire professionals from the government firms and authorities could solve the problems that the exclusive dealing contracts cause. Especially the re-flow to Sweden from multilateral DAs is likely to increase. This would mean that more private CFs are established and that the resources that are necessary to control to win contracts are combined.

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Table 1. Terms of employment and exclusive right to professionals in private and state-owned CFs.

	Exclusive right to professionals	No exclusive right to professionals
Hired professionals and variable wage costs (flexibility)	State-owned CFs	Private CFs
Permanent employees and fixed wage costs (no flexibility)	Private CFs	

Table 2. Consulting contracts in Eastern Europe financed by EU divided on supplying countries between 1995 and 1999 in MEUR and percent.

Country	Supplies (%)		Comparing figures (%)	
	EU-PHARE 1995-98	EU-TACIS 1995-99	Gross payment to EU's budget	GDP
Sweden	1.1	1.2	2.9	2.7
Finland	2.9	3.4	1.4	1.5
Denmark	8.2	4.2	2.0	2.1
Belgium	14.9	8.2	3.9	3.1
Netherlands	7.8	6.7	6.0	4.7
Luxembourg	0.2	0.4	0.2	0.2
Germany	13.3	20.5	26.4	26.1
Austria	2.8	1.6	2.7	2.6
United Kingdom	20.3	16.2	13.5	15.2
Ireland	5.2	2.6	1.0	0.8
France	9.4	18.6	17.2	17.6
Italy	7.3	9.9	13.0	13.9
Spain	2.3	3.5	6.9	6.7
Portugal	2.9	0.6	1.4	1.3
Greece	1.4	2.4	1.5	1.5
Total	100	100	100	100
Total budget (MEUR)	1,458	1,940	----	----

Source: Svensson (2000a).

Figure 1. The relationship between state-owned operators and CFs.