Implementing Competition Policy in Developing Countries: The Role of Donors

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# List of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Summary</td>
<td>3</td>
</tr>
<tr>
<td>Introduction</td>
<td>5</td>
</tr>
<tr>
<td>Why is the topic important for pro-poor growth?</td>
<td>7</td>
</tr>
<tr>
<td>What do we know so far and/or still need to know?</td>
<td>9</td>
</tr>
<tr>
<td>What are the big controversies?</td>
<td>11</td>
</tr>
<tr>
<td>What sort of policy implications and suggestions can we give for donors?</td>
<td>12</td>
</tr>
<tr>
<td>Recommended best practices</td>
<td>15</td>
</tr>
<tr>
<td>Further Reading</td>
<td>17</td>
</tr>
<tr>
<td>References</td>
<td>17</td>
</tr>
</tbody>
</table>
Executive Summary

For the past several years, DFID has worked to encourage the wider use of competition policy and law in developing countries, because of the contribution this can make to economic development and poverty reduction. This paper summarises DFID’s experiences on the promotion of competition policy and law, reinforced by the views of some other donor agencies.

The power of competitive markets to promote economic growth is now widely recognised. Effective competition results in the most effective use of a nation’s resources, it provides continuing incentives for innovation, and it allows consumers to benefit from lower prices, better quality and a greater variety of goods and services.

Issues related to the process of competition can be highly significant for small and medium enterprises. Globalisation leads to a wider spread of sources of competition than in the past, and this means that suppliers face greater competition, both in their home markets and in export markets. This raises both opportunities and challenges for all enterprises.

Exporting is not just for industrial giants and TNCs. Many small enterprises from a range of countries have found they are able to develop worthwhile niche export markets. While ‘competition’ is not synonymous with ‘competitiveness’, studies have shown that firms are far more likely to succeed in export markets if they operate within competitive domestic markets.

While the benefits possible from the existence of competitive markets are large, it is neither sustainable nor socially equitable that there should be no limits to the powers of large suppliers, whether domestic or international. A national competition policy, including competition law, can help remedy many situations where markets fail to work well. Competition policy provides a framework that can guide the design of relevant areas of public policy, while competition law, when effectively administered, provides a mechanism for identifying and investigating specific impediments to
competition that result from anti-competitive conduct, and for taking remedial action where appropriate.

The design of a national competition law must reflect national priorities. While competition law is a general law of general application, many countries also include in their laws measures directed at some of the competition concerns of small and medium enterprises.

The paper discusses why the topic of competition policy and law is important for pro-poor growth, it notes topics of controversy, it records areas where more research is needed, and it outlines policy implications for donors who would like to support the wider use of competition policy and law in developing countries.
Introduction

Over the past five or six years, the UK Department for International Development (DFID) has worked to encourage the wider use of competition policy and law in developing countries because of the role this can play in economic development. DFID’s focus is poverty reduction, but many issues affecting the interests of the poor apply equally to the operation of small enterprises.

As the World Bank has noted, “a poor business environment often hits smaller and informal firms the hardest” and “smaller and informal firms may stand to benefit more from broad-based investment climate reforms than many large firms”\textsuperscript{i}. The policy solutions suggested by the Bank to alleviate these problems of small enterprises were:

- to reduce administrative and regulatory barriers
- to adopt innovative ways to reduce the costs of regulation
- to introduce ways to increase regulatory predictability, and
- to develop competition policy.

The power of competitive markets to promote economic growth is now widely recognised. There are strong links between the existence of competitive markets and economic growth, and between growth and poverty reduction.

Effective competition strongly encourages use of the most efficient methods of production, and the channelling of an economy’s resources to production of the goods and services that society values most highly. There will be continuing incentives for innovation that increase productivity, and consumers will benefit from lower prices, better quality and a greater variety of goods and services.

Globalisation means that suppliers face greater competition, both in their home markets, and in export markets. This raises both opportunities and challenges for all firms, and certainly for small and medium enterprises. Exporting is not just for industrial giants and TNCs. Many small enterprises from a range of countries have found they have been able to develop worthwhile niche export markets. While
'competition’ is not synonymous with ‘competitiveness’, studies have shown that firms are far more likely to succeed in export markets if they operate within competitive domestic markets.

The benefits possible from the existence of competitive markets are large. However, it is not sustainable, or socially equitable, that there should be no limits to the powers of large suppliers, whether domestic or international. A national competition policy will influence the ways in which the forces of competition work, by providing a coherent framework to guide the design of relevant areas of public policy. Competition law, an important element of competition policy, seeks to promote efficiency and fairness in markets, and to increase consumer welfare. Where it exists, and is properly administered, competition law provides a mechanism for identifying and investigating specific impediments to effective competition that result from anti-competitive conduct, and for taking remedial action where appropriate.

As the Nobel Prize winning economist Joseph Stiglitz said, “a strong competition policy is not just a luxury to be enjoyed by rich countries”. However, the design of individual competition laws must reflect national priorities.

Competition law and policy can be of particular relevance to small enterprise development. The core of most competition laws is a general law of general application. However, many countries include additional protection for small and medium enterprises in their competition laws.

For example, some laws provide for the authorisation of “certain cooperation agreements between small and medium size enterprises, where such arrangements are designed to promote the efficiency and competitiveness of such enterprises vis a vis large enterprises”.

In relation to Article 81 (1) of the Treaty, the European Commission has codified its decisions on conduct that would have no appreciable effect on competition, in the form of the Notice on agreements of minor importance. This Notice, which has been revised regularly, includes thresholds that provide guidance to small and medium enterprises on the applicability of EC competition law.
Provisions in competition laws on mergers and acquisitions would rarely affect such arrangements between small and medium enterprises, because they would normally fall below notification thresholds, and would, by their nature, be unlikely to result to a substantial lessening of competition in the markets concerned.

Small and medium enterprises may encounter two broad categories of competition-related problems.

One is the nature of the regulatory environment. People who wish to operate small businesses may encounter unnecessarily expensive or time-consuming procedures, imposed by national, provincial or municipal governments, that must be undertaken before the approvals needed to commence business can be obtained. Similarly, inappropriate regulatory barriers can make it difficult for firms operating in the informal sector to move into the formal sector.

The second category of problems includes those that are the result of anti-competitive actions by existing firms operating in collusion, or by dominant firms. Such firms sometimes seek to block the entry of new competitors, or their expansion, by preventing them from obtaining access to supplies of inputs on fair terms, or by obstructing the access of new firms to the necessary distribution channels. In the absence of effective protection from competition law, such actions could preclude the entry of new small firms into markets, or could prevent existing small firms from growing.

This ‘hot topic’ paper reflects DFID’s experiences with encouraging the wider use of competition policy and law in developing countries, with valued contributions from other donor agencies in the POVNET group.

Why is the topic important for pro-poor growth?

Achieving the Millennium Development Goals requires rapid and sustained growth in developing countries. It is now widely accepted that the private sector must be the engine of growth, and that governments must create environments that allow the private sector to flourish.
Competition is essential if markets are to work well for the poor. When firms have to compete vigorously, they must find better ways to produce and distribute goods and services. Competition benefits consumers both directly, through lower prices, better quality and an improved choice of products, and indirectly, through its impact on economic growth. As women constitute a larger share of very poor people, women especially will benefit from the impetus given to growth by the existence of competitive markets.

The provision of services by central and local governments contributes significantly to the welfare of the poor. Competition is important for the effectiveness of government procurement, as anti-competitive practices by suppliers will reduce what governments can achieve with the inevitably limited funds available.

Jobs are an important route to poverty reduction. Competitive markets are more likely to provide the poor with opportunities to be employed or to start their own small business. These opportunities include export-oriented industries.

Competitive domestic markets can benefit farmers. They will be in a more favourable position if the markets in which they buy their inputs, arrange transport of their crops to market and sell their outputs are competitive.

The Task Team’s analytical framework *Accelerating Pro-Poor Growth through Support for Private Sector Development* reflects the importance of competition policy to the poor. It discusses the effects of entry and exit barriers on entrepreneurship, and the contribution made by competition to innovation and productivity.

Such views are complemented by a growing body of evidence on the link between growth and poverty reduction. The World Bank’s *World Development Report 2005* emphasised the importance of competition for investment, and noted how competitive pressure leads to innovation, new products and new technology. When it released *Asian Development Outlook 2005* in April 2005, the Asian Development Bank Headlined its view that effective competition policies are needed “if Asian countries are to maintain their high rates of growth and employment”.
The existence of competition policy reduces uncertainty for business, and is an important element of a good regulatory package for private sector development. There are also indications that, by reducing the scope for arbitrary decisions by officials, competition law reduces the scope for corruption. Corruption hurts the poor.

Competition policy, including competition law, is needed because markets do not always work well. As noted above, anticompetitive actions by firms are one cause, but inappropriate regulations by governments at all levels are also frequent causes of market failure.

What do we know so far and/or still need to know?

A favourable view of competition policy’s contribution to economic growth is widely held. An OECD paper based on a survey of members and invited non-members who participated in the 2002 Global Forum on Competition concluded that:

“There are strong links between competition policy and numerous basic pillars of economic development…There is persuasive evidence from all over the world confirming that rising levels of competition have been unambiguously associated with increased economic growth, productivity, investment and increased average living standards.”

Competitive markets allow new firms to enter, efficient firms to thrive, and sub-standard firms to fail and exit. A study of 53 countries found a strong correlation between the effectiveness of competition policy and law and growth. The Australian Productivity Commission found its National Competition Policy reforms mean “national output will be... 2.5% higher than otherwise – an amount equivalent to almost one year of economic growth”. This estimate did not include the dynamic efficiency gains also expected to flow from the competition reforms.

There is increasing information on the harm anti-competitive practices in both national and international markets can do to developing countries. Some examples of domestic anti-competitive practices that especially affect the poor include:
a) ring tendering for polythene pipe supplied to the Nepal Drinking Water Corporation\textsuperscript{xii}, and for school construction in China\textsuperscript{xii};

b) flower exports from Morocco being made uncompetitive by the combined effects of a trucking cartel, a freight forwarding cartel and compulsory use of the national airline\textsuperscript{xiii};

c) cartels by companies buying tea, sugar and tobacco forcing down returns to farmers in Malawi\textsuperscript{xiv}, and cartels for retail sales of flour, bread and poultry affecting retail prices in Peru\textsuperscript{xv};

d) ‘bundling’\textsuperscript{xvi} by dominant firms, such as the action of a gas company in southwestern India forcing new customers to buy hot plates when they were connected to the gas supply\textsuperscript{xvii}.

Studies of international cartels investigated by E.C. and USA competition authorities illustrate their large impact on poor countries. The World Bank’s \textit{Global Economic Prospects 2003} noted six international cartels overcharged developing countries between $3$ billion and $7$ billion in the 1990s. A 2001 paper\textsuperscript{xviii} estimated that 16 international cartels overcharged developing countries between $16$ billion and $32$ billion in 1997, and found that prices fell 20 to 40\% following the break up of the cartels. A study of cartels for aluminium, steel and heavy electrical equipment estimated that they had overcharged Kenya $111$ million, Zimbabwe $141$ million and Southern African Customs Union members $1,114$ million in 1999\textsuperscript{xix}. Research on one major cartel (vitamins) found that suppliers had overcharged developing countries that lacked a competition law more than countries that had such a law\textsuperscript{xx}.

Much has been written by economists on the harmful effects of monopoly on prices, output and consumer welfare. However, there has been little empirical research on the impact of competition policy on national economies, and very little on the impacts on developing countries.

There are several possible reasons for this, including limits on the availability of data. Most developing countries have a relatively short history of competition law.
Countries that have adopted competition law since about 1990, often accompanied it with other significant policy changes, including privatisation, deregulation and trade liberalisation. Separating the effects of these policies presents a challenge.

In the case of transitional economies, the appropriate sequencing of policy changes, including the introduction of competition, is of great importance. The experiences of Russia and of Syria, for example, highlight the need for better understanding of how to introduce competition to transitional economies.

More empirical research on the harm caused to developing countries by inadequate competition, and on the effects of increasing the intensity of competition through the adoption of competition policy and law, would be of value.

Developing countries are short of finance and skilled people, and must choose carefully how to use them to best advantage. For small countries that are members of regional economic groups, a regional competition law could enhance the impact of the domestic law. Cooperation arrangements with developed countries could provide help with staff training through exchange programmes, and through information exchanges.

**What are the big controversies?**

Competition policy and law is still new in much of the world and there are a few areas of controversy. The main ones seem to be:

*Does every country need a competition law?*

Some people argue that if a country is open to trade and investment, it does not need a competition law. Openness to trade and investment can have large and beneficial impacts on competition. However, foreign investment can bring heightened concern in developing countries about competition, and, in any case, some goods and services cannot be traded internationally. Competition policy and law can benefit all countries, whatever their size and level of development, but the law must be appropriate to their needs.
What is the right relationship between competition law and sector regulators?

Sector regulators are required where competition cannot work effectively, such as with natural monopolies xxii. Regulated sectors generally include major public utilities that are important for consumer welfare. Decisions made by sector regulators include technical issues and pricing or profit ceilings. However, some decisions by regulators are on matters that affect competition. In these cases their decisions should reflect competition principles. If not, there can be distortions in the use of national resources that can harm consumers, including the poor.

Does having a competition law mean developing countries cannot have an industrial policy?

Every national competition law includes some allowances for national priorities, and there is no necessary conflict between competition and industrial policy. Well-designed policies can be complementary. The ‘Development Box’ approach in WTO arrangements is relevant not only for industry, but also for agriculture.

How should the introduction of competition policy, including its enforcement structure, be sequenced?

There are specific constraints that are characteristic of the degree of development of an economy, and of its society as a whole. There is a need to investigate the extent to which a blueprint approach can be used to address the question of sequencing.

What sort of policy implications and suggestions can we give for donors?

The overall policy implication for donors is the need to recognise the contribution that effective competition can make to the welfare of the poor. As the 2001 Nobel Prize winner Joseph Stiglitz said: “Strong competition policy is not just a luxury to be enjoyed by rich countries, but a real necessity for those striving to create democratic market economies”xxiii.

Increasingly, developing countries want to adopt appropriate competition regimes, but need help. Specific national issues must be identified clearly, and the analysis of what help is appropriate requires close attention. In providing the help needed it is desirable that donors should, where possible, harmonise their activities to avoid the possibility
of duplication, or of leaving gaps. There is significant scope for additional support from donors, in four major areas:

**Policy research to build and disseminate the evidence base**

More empirical research on the impact of competition policy and law in developing countries, as well as on best practice, would be of considerable value. Worthwhile areas for research include those noted in the ‘controversies’ section above.

**Culture of competition**

A ‘culture of competition’, is the desirable situation that exists within a country when the rules and benefits of competition are widely known and supported, and where serious consideration of the likely impact of actions and regulations on competition forms a natural part of the background for decisions by firms and governments. Building a culture of competition and an effective competition regime is a long-term endeavour, and not just a matter for one-off events. Competition must be ‘mainstreamed’ in all sectors.

Advocacy is needed for a new competition regime to succeed. Politicians and officials need to understand why competition is good for the economy, and how to apply its principles to government decisions. There is a need to overcome opposition from the business sector, by emphasising the benefits competition law can provide, such as cheaper inputs, and the contribution competition law and policy can make to create a good pro-investment climate.

Some NGOs, especially consumer groups, can be strong allies for competition policy and law, because they know how it can benefit consumers. Donors could find it effective to fund relevant work by reform-minded NGOs, especially those based in developing countries. For example, DFID has funded research and advocacy programmes (such as the CUTS 7-Up projects [xiii]) that include participation by local consumer groups, and has funded the preparation of materials by Consumers International for use by consumer organisations.
Bilateral Technical assistance and capacity building

Developing countries need help in formulating competition policy and law, and in developing and strengthening the institutions that will enforce the competition law, including the training of specialist staff. Assistance can be provided by funding training programmes organised by the competition authority in the donor’s country, including staff exchanges, and by funding studies of barriers to competition in important sectors of the economy.

There is scope for donors to support proposals for roundtable forums on competition policy and law for senior policy makers from developing countries.

Programme funding

Donors can fund the technical assistance and capacity building programmes of international organisations (including UNCTAD, the ICN, the World Bank, the WTO and OECD), and regional organisations.

UNCTAD has a well-established programme of technical assistance and capacity building activities. It also organises annual meetings of the Intergovernmental Group of Experts on Competition Law and Policy (IGE), a useful forum for competition officials in developing countries.

Membership of The International Competition Network (ICN) is open to competition authorities of all countries. A ‘virtual’ organisation, the ICN addresses both practical enforcement issues, and policy issues, and it seeks convergence of best practice. The ICN’s Competition Policy Implementation Working Group seeks to identify the key elements needed for successful capacity building and competition policy implementation in developing and transition economies.

The World Bank is active in policy research and capacity building on competition policy issues.

While competition policy has been removed from the scope of the DOHA Round, the WTO has continued to provide some technical assistance on competition.
‘Peer reviews’ can be a valuable way to objectively review the operation of national competition laws. Some have been undertaken by the OECD, with donor support\textsuperscript{xxvi}, and UNCTAD included peer reviews of Jamaica and Kenya in its recent conference in Turkey.

Donors can assist organisations working to create a regional competition policy and law as part of a regional economic structure, such as CARICOM, COMESA, UEMOA and MERCOSUR. Assistance may be needed by ACP countries in identifying their objectives and negotiating on them in the EPA negotiations.

**Recommended best practices**

Modern regulatory regimes for private sector development should include competition policy regimes. Some of the practices to be encouraged in the design and operation of a competition law are outlined below.

1. The design of the law should reflect the level of economic development of the country concerned, the structure of its economy and its constitution and culture. A competition law should not simply be transplanted from a developed country, or even from another developing country. A competition law should not stand alone, but should be part of a well-designed package of measures to create the right environment to allow competitive markets to benefit the poor.

2. The introduction of competition policy and law should be reflected in the annual and medium-term plans and budgets of governments. Activities supported by donors should be adequately planned, and appropriately monitored.

3. The focus of a competition law should stay as close as possible to the objective of fostering competition in markets. Other social and political objectives should, ideally, be targeted through more specific measures in other legislation. Exceptions and exemptions should be minimised, as competition law is most effective when applied broadly to the economy, including to state-owned enterprises.

4. There is a range of possible divisions of responsibility between sector regulators and the competition authority for decisions on competition issues. Whatever structure
is adopted, there should be an effective working relationship between the regulators and the competition authority to assist regulators to apply sound competition principles to their sectors.

5. A competition authority should be independent of government in its day-to-day decisions. This has implications for the selection of people to be appointed to the authority. The authority should have an adequate budget, and should be staffed by competent officials.

6. A new competition authority needs to prioritise its work carefully. A good rule of thumb, at least initially, is to concentrate on cases where entry barriers seem high, where prices seem high, and where consumers will benefit most. These initial targets should include those with the least substantial vested interests that would oppose change. That is, to improve support from consumers and politicians for the new competition law, the competition authority should choose early “winners”.
Further Reading


DFID (Department for International Development, UK) (2004) *How to support competition policy and law.* A “How to…” note in the “working with the private sector” series. Available from DFID.


The competition sections of the websites of the OECD, the WTO, UNCTAD and the World Bank, and the website of the International Competition Network (ICN) contain extensive information that includes material on the development impacts of competition policy and law.

References

1 http://rru.worldbank.org/Themes/SmallMediumEnterprises
2 UNCTAD (2003), *Model Law on Competition*, United Nations, Geneva,


vii We are of course aware that there are practical implications of transition, and that in addition to the need for a balanced sequencing of policy changes, it will be necessary to adopt appropriate measures to help any groups affected adversely by the changes to adjust.


CUTS (Consumer Unity and Trust Society, India) (2003), *Spine Chilling Experiences of Anti-Competitive Practices in Malawi*.

CUTS (2002), *Challenges in Implementing a Competition Policy and Law*.

‘Bundling’ involves a dominant firm compelling purchasers of the product for which it is dominant to buy another product as well, which they might not want or might be able to obtain more cheaply elsewhere.

CUTS (2002), *Competition Policy and Law Made Easy*.


A ‘natural monopoly’ is one based on “an overwhelming cost advantage for the incumbent firm. This may be because it possesses some unique natural resource…or because of past capital installations which would have to be duplicated by a competition, for example domestic electric supply. This is contrasted with a statutory monopoly, where the incumbent’s position is based on laws to exclude possible rivals.” (*Oxford Dictionary of Economics*, 1997.)

*Competition, Competitiveness and Development: Lessons from developing countries*, Brusick, P. et al (eds) p 330

CUTS (The Consumer Unity and Trust Society) is an NGO based in Jaipur, India. The first ‘7-Up’ project undertook research and advocacy on competition policy in seven developing countries that had adopted competition law (four in sub-Saharan Africa and three in south-Asia). This two-year project, funded by DFID, concluded in February 2003. CUTS is currently undertaking ‘7-Up 2’, a study of competition policy in several countries in Asia. This project is funded by SECO (the State Secretariat for Economic affairs of Switzerland) and DFID. CUTS recently commenced ‘7-Up 3’, which will undertake research and advocacy on competition policy in seven countries in sub-Saharan Africa, and which is being co-funded by NORAD and DFID.

DFID held an International Round Table on Competition Policy and Law in London in July 2000. It was chaired by the Secretary of State, and included participants from a range of backgrounds, including developing country officials, academics, journalists and NGO representatives. DFID is considering organising a second Round Table.
