BRIEFING PAPER

CUTS Centre for Competition, Investment & Economic Regulation
CUTS C-CIER

No. 1/2011

Competition Law Enforcement in LDCs
Benefits Outweigh Costs

– Cornelius Dube & Siddhartha Mitra

One of the distinctive characteristics of least developed countries (LDCs) is low economic growth rates and high levels of poverty. Whilst a lot of possible measures to solve the problems have been suggested and even though some of these suggestions have been adopted, there has not been much improvement in the countries. Although it is now widely accepted that competition reforms are critical for economic development and also a critical component of poverty alleviation strategies, not much has been done in exploring the extent to which competition reforms in LDCs could also help. This is the objective of this paper. It seeks to analyse the extent to which competition reforms have been adopted across LDCs and how relevant it is in the interest of these countries to include competition reforms within their overall development strategies.

Introduction

According to the United Nations there are about 49 countries in the world that are classified as LDCs. The regional distribution of the countries is shown in the table below.

By definition, poverty alleviation and rapid and sustained economic growth should be the principal economic objectives of LDCs.[1] These objectives have been given formal shape in the *Brussels Programme of Action* adopted by the *Third United Nations Conference on the Least Developed Countries* (LDC-III) held in May 2001.[2] The United Nations General Assembly in 2008 resolved to reaffirm the commitment to the mentioned objectives, review the progress made in regard to these objectives, and plan for their future attainment in LDC-IV which will be held in 2011 in Istanbul to yield the *Istanbul Programme of Action*[3].

Geographic location	Countries
Africa	Angola, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Senegal, Sierra Leone, Somalia, Sudan, Togo, Uganda, Tanzania, Zambia
Asia	Afghanistan, Bangladesh, Bhutan, Cambodia, Lao PDR, Myanmar, Nepal, Yemen
Island nations	Comoros, Kiribati, Maldives, Samoa, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu
Americas	Haiti

Given the significance of poverty alleviation and sustained economic growth for LDCs, this briefing paper argues that evolution of competition policy (formal coordination of all economic policies – industrial, trade, labour, sector specific policies, etc. to promote competition in all sectors of the economy) and effective enforcement of a competition law (which facilitates regulation of anti-competitive practices such as collusion, abuse of dominance, competition reducing mergers and other anti-competitive agreements) can indeed help LDCs meet these objectives.

This paper is structured as follows. First, it provides some statistics with regard to the depth of poverty and the inadequacy of economic growth in LDCs to highlight the importance of efforts to alleviate poverty. Second, it demonstrates, on the basis of both analytical reasoning and reference to empirical studies, how competition (which can be enhanced through sound implementation of competition law and policy) can have positive implications for both economic growth and poverty alleviation. Third, it highlights the need for competition law and policy in LDCs by pointing to the significant incidence of anticompetitive practices and concentration in these economies. Finally, on the basis of the discussion in this paper, the conclusion points to the need for programmes to usher in competition culture and rigorous enforcement/use of competition law/policy.

Poverty and Inadequate Economic Growth in LDCs: Major Causes for Concern

According to the 2010 UNCTAD Least Developed Countries report, 53 percent of the population of all the LDCs live in extreme poverty, defined as living on less than US$1.25 a day, while 78 percent lived on less than US$2 a day in 2007. The report also estimate that there were 421 million people living in extreme poverty in these countries. Looking at regional variations of incidence of poverty, it was established that the percentage of the total population living below the poverty line of US$1.25 per day was higher in African LDCs, which had 59 percent, followed by Asian LDCs at 41 percent.

The trends of poverty in LDCs measured between 1980 and 2007 fall into three major periods. The incidence of poverty was on the rise in both Africa and Asian LDCs during the period between the 1980s and the mid-1990s, while there was a noticeable decline between 1994 and 2000. However by 2007, the number of people living in extreme poverty was twice as high as it was in 1980 despite noticeable periods of decline. One of the possible reasons for this could be rapidly rising population.[4]

One of the imperatives for sustained poverty alleviation is sustained rapid economic growth. However, the rate at which the economies have been growing in the LDCs has not been adequate enough for sustained poverty alleviation. It is estimated that during the period 2002-2007, the real gross domestic product (GDP) of the LDCs as a group grew by more than seven percent per annum, believed to be the strongest and longest growth acceleration achieved by LDCs since 1970. This growth was however not witnessed across all LDCs; about 14 countries saw GDP per capita decline or grow sluggishly, largely due to the high rate of population growth in them.[5] The above illustrates that economic growth and poverty alleviation needs a boost in most of the LDCs.

Market Competition: An Effective Stimulus for Economic Growth and Poverty Alleviation

It has been widely accepted that the process of competition rarely occurs naturally, as groups with vested interests have an incentive to stifle competition. Competition in any market thus has to be properly nurtured. One of the ways of doing this is through effective enforcement of competition law. One of the benefits of competitive markets is greater interest among economic agents to participate in markets which leads to enhanced economic growth and reduction in poverty.

The positive linkages between the extent of competition, on the one hand, and economic growth, on the other are robust. Central to the issue of competition is the availability of alternative producers or sellers whom consumers also turn to in deciding transactions. Competition renders price increase as a tool for profit making unviable as this will be equivalent to driving away buyers to rivals. As a result, firms would have to innovate in order to reduce costs and produce more output at prevailing market prices. This directly leads to increased production and new methods of production, which boost the economy.

Under competition, managers strive for better incentives and there would be a general reduction in slackness and inefficiencies. Competition thus stimulates increased efficiency in innovation, production, and resource use, which in turn leads to enterprise development and increased aggregate welfare. Further, competitive markets provide macroeconomic benefits. Competition provides enterprises with incentives to adjust to internal and external shocks, and these individual adjustments help reduce the cost of such shocks to the macro economy (Lipimile, G, 2004).

Competition as an incentive for innovation has often been doubted on the argument that it is generally the expectation of some form of market power that gives the incentive to innovate. This has however not been supported by evidence on the ground as examples from the automobile, banking and air transport sectors have shown the extent to which owners can go to investment in alternative methods under conditions of competition. It has also been argued that supernormal profits enjoyed by monopolies are important as sources of investment, making monopolies ideal. However, this would be the case only if markets are imperfect, as generally the finance for investments also comes from borrowing rather than profits.

The relationship between competition policy enforcement and poverty reduction can also be explored. Competition enforcement punishes anticompetitive behaviour by firms, resulting in more competition prevailing in the market. First, the mentioned fall in prices due to competition has positive implications for the real incomes of the poor and thus has the potential to push many in the population over the poverty line. Second, expansion of output caused by an increase in competition would be associated with greater employment opportunities which would automatically induce poverty alleviation. Third, increase in competition is necessarily associated with removal of barriers to entry in many sectors of the economy. In many cases, this implies new market opportunities for small entrepreneurs such as farmers, who eke out their subsistence through incomes that fall below or lie marginally above the poverty line. The result is poverty alleviation accompanied by economic growth, i.e. the phenomenon of inclusive growth.

Competition, by inducing economic growth, also leads to an increase in government resources raised through taxation. When these additional resources are spent on development programmes, poverty alleviation is given a boost. Competition also aids in good governance by tackling corrupt practices such as those prevailing in government procurement through collusive practices.

The attainment of competitive markets due to competition policy also brings with it a lot of benefits to consumers, which also help address poverty. Competition policy ensures that a fair environment is created for each firm to participate in, which helps in poverty reduction. Consumers are only happy and content in exchange if more products are available at low prices and good quality with access to those products being easy. In competitive markets, producers must gain new sales and new clientele, by satisfying consumer needs and by increasing range of choices available, given that if consumers dislike the products offered by one seller they can always turn to the other. In addition to the analytical arguments made, enough empirical evidence exists on the mentioned positive linkages.

Cross country studies have found industrial concentration, which depicts lack of competition, to depress technical efficiency.[6] Similarly, evidence from Tanzanian firm level performance indicators shows a definite positive linkage between government measures to stimulate competition and the competitiveness of the Tanzanian economy.[7] In the same vein, adoption of a national competition policy in 1995 by Australia was seen as having a clear link to enhanced productivity and economic growth in the period, 1990-2005.[8]

Some country specific examples in Tanzania, where competition introduced in sanitation services resulted in lower charges and increased access. In addition, competition introduced in generic drugs in South Africa resulted in prices for antiretroviral drugs falling by up to 88 percent since 2003 and access increased from 20,000 to 155,000[9].

Impact of Anti-Competitive Practices on Poor Consumers: Some Evidence

Examples of anticompetitive practices and how they have harmed consumers can be drawn across various countries. The most harmful of these are cartels, which are very damaging to consumers. A successful cartel raises price above the competitive level and reduces output. Consumers would have no option but to pay the higher price for the cartelised product as they can not forgo it, as these are mostly essential products. The presence of a cartel also shelters cartel members from full exposure to competition, thereby reducing incentives for them to innovate, which hampers consumer welfare due to compromise on quality and inability to produce better goods at lower prices.

Evidence has been found on the potential benefits of establishing a competition law. It can also be argued that the mere presence of a competition law even without implementation also acts as a deterrent factor for cartels. Clarke and Evenett[10] found that there were significant reductions in overcharges on vitamins by the associated cartel due to anti-cartel laws in the 1990s. In Zambia, the average annual reduction in overcharges was about US$10,000 while the reductions were about US$20,000, US$180,000 and US$9.91mn in Tanzania, Kenya and South Africa respectively.

In addition to cartels, other anticompetitive practices also have disastrous consequences on the general consumers. A study of media reports in sub-Saharan Africa identified allegations of 617 anti-competitive practices between 1995 and 2004, in 41 business sectors and in 34 countries. These anticompetitive practices had caused considerable harm to consumers, especially since they affected sectors that are considered critical for the population. For example, the food and beverage sector exhibited the most allegations (148), which led to high prices with a direct impact on the welfare of the poor, who spend a higher proportion of their income on necessities like food.[11]

Empirical studies have been conducted to produce various estimates on the harmful effects of cartels to consumers. Through a study, it is estimated that the harm caused by cartels, particularly international cartels amounts to billions of dollars annually[12], with the harm being felt across all countries, including LDCs. This was largely in the form of overcharges, which can be calculated as the difference between the cartel price and what could have prevailed in the absence of such a cartel. It was shown that the median cartel overcharge was 30-33 percent for international cartels, implying that on average the cartels were resulting in prices increasing by over 30 percent.

One of the critical areas that the poor spend a significant proportion of their income is transport, which sadly has been a target for cartelisation. In addition, basic commodities such as bread and sugar have also been found to be a target for cartelisation. In India, several cartels cases were handled during the Monopolies and Restrictive Trade Practices (MRTP) era, and examples which are most serious include the transport sector cartels. These transport sector cartels operated through associations, most of which were officially recognised.

In Baddi, Himachal Pradesh (India), it was discovered that the Baddi Nalagarh Truck Operator Cooperative Transport Society, monopolised the movement of goods from the state, being controlled by the local MLA. The cartel charged 30 percent higher on the Baddi-Delhi route and 15-20 percent on the Baddi-Mumbai route. Trucks coming in with supplies went back empty, because they were not allowed to pick up freight, which only adds to the cost. Thus, travellers had to pay these extra costs due to the cartel. Similarly, in another state Orissa, the Angul Truck-owners Association, a Government registered body operating at the National Aluminium Co. Ltd.'s factory charged as much as 200 percent more for transportation of ingots with the blessing of the authorities. Such official cartels were also known to exist in other parts of Orissa like in Sukinda Mines, Paradeep Port and Balasore.

In Derabassi (Punjab), truck unions had drafted their own tariffs, increasing costs of production for local units, thus rendering them uncompetitive.[13]

In South Africa, a price fixing bread cartel was investigated by the Competition Commission after it was alleged that Blue Ribbon, Albany, Sasko and Duens bakeries had simultaneously increased the price of bread by 30 to 35 cents per loaf before Christmas, and reduced and fixed the discount awarded to independent distributors to a maximum of 75 cents per loaf, irrespective of the volumes purchased. The Commission acted on information from Premier Foods, trading as Blue Ribbon Bakery, which received conditional immunity under the Commission's corporate leniency programme.[14]

The benefits of a competition law which is fully enforced can also be drawn from the Zambian experience. The intervention by the Zambia Competition Commission (ZCC) led to significant benefits to consumers and led to the creation or preservation of jobs. The abolishment of the exclusive dealership agreements in the beverage and soft drinks sector opened the industry to employment in the informal sector. In the Zambia dairy sector, a monopoly company was directed to purchase milk from the small diary farmers, leading to the expansion of a market that was not viable. The monopoly retailer (Shoprite of South Africa) was also directed by ZCC to purchase farm produce from the small scale farmers, as against the practice it was adopting of importing, which was also inflating prices.[15]

Evidence in Select LDCs

A look at the situation on the ground in some select LDCs shows that there is clear under provision of this national public good (competition enforcement) and therefore the need to enhance its presence. For instance, a review of literature indicates widespread incidence of cartelisation and other anti-competitive practices in the Nepalese economy.[16]

In its research projects, CUTS also revealed many instances of anticompetitive practices affecting LDCs. These include abuse of monopsony and dominance in the agriculture sector, such as grain purchase in Laos where only one state-sanctioned buyer was available and abused this privilege through unfair terms and pricing to grain farmers.[17]

The same trend is also apparent in Malawi, where tobacco growers face limited number of buyers who collude during the tobacco auction, and cotton growers compete with each other when selling their cotton but face a cartel of buyers who fix prices paid to the growers.[18] It was also alleged that in The Gambia, the main importers of rice, onion, Irish potatoes and flour conspire to fix high retail prices.[19]

In Nepal it was reported that truck unions also operated as syndicates which the business sector in general resented.[20] It was on that basis that the business sector indicated that it supported a competition law, a complete contrast to expectations as businesses have opposed a competition law in many developing countries.

Cartels with harmful effects on consumers were also identified through a CUTS study. In Bangladesh, a cartel of bus owners (RSPOG), threatened some operators who wanted to reduce fares to a certain town after a new 55km road, shortening the distance by 85km, had been constructed. A notice threatening a fine of Tk500 per ticket and closure for five days for reducing fares below Tk200 for the route was hung at the bus stand, depriving consumers of a reduced fare. Cartels in Lao under the guise of associations, e.g the Vientiane Private Colleges Association and the Vientiane Drinking Water Group (VDWG) forced compliance harshly, with three water companies that refused VDWG orders to increase prices being closed. In Cambodia, after noticing that competition had wiped profits, eight boat operators from tourist resort Siem Reap cartelised in fixing prices and allocating markets (departure schedules).[21]

An opinion survey by the World Bank in 2003 in Bangladesh among civil society, politicians, journalists, businessmen, academics and bankers identified telecommunications, power and energy, transport and communication, banking and finance, and pharmaceutical sectors as being significantly affected by anticompetitive practices.[22] Africa which accounts for 33 of the world's 50 LDCs is disadvantaged by a lack of competition in the transport sector[23] and widespread anti-competitive practices by sellers of sugar, flour and agricultural inputs, and buyers of cotton, tea, coffee and tobacco at the farm gate.[24]

Out of the 49 LDCs[25] only 10 had competition agencies for enforcing competition laws in 2007[26] – around 20 percent as opposed to more than 55 percent of the 193 sovereign countries which constitute the world today. Moreover, although some few LDCs such as Malawi and Mozambique are also included among the countries worldwide that have adopted a competition policy, it can be established that the policy is not currently being fully implemented. In fact, it can be said that no LDC has fully implemented its national competition policy to date[27], which is also negatively affecting the extent to which the countries can succeed in increasing productivity and economic growth. Thus in general, on of the tools that LDCs can easily have at their disposal towards fighting poverty, competition law, is being underutilised.

Conclusion & Way Forward

This paper demonstrates the potential of competition policy and law as an instrument for facilitating poverty alleviation and sustained and rapid economic growth in LDCs, which by definition are characterised by both widespread and severe poverty and low incomes. These countries are not only characterised by significant concentration in various sectors of the economy but also by high incidence of anticompetitive practices in many of them. However, the use of competition law and policy remains limited in these countries despite an urgent need for it.

A first step would be to motivate LDC governments through well-demonstrated examples of the potential of this instrument for stimulating sustained, inclusive economic growth. Simultaneously, interest among non-state actors on competition reforms would need to be enhanced to ensure spreading a culture of competition as a precursor to initiating these reforms.

There is an urgent need to raise awareness of all stakeholders on the need for competition reforms by demonstrating the harmful effects of anticompetitive practices both on citizens welfare and state of the economy. Of particular interest is to sensitise politicians on why competition reforms should be part of the development and poverty alleviation frameworks (and also their political manifestos), as competition infringements negate poverty alleviation efforts. It is critical that competition policy be linked with other public policy issues for better comprehension and to inspire wider public opinion and support for competition and regulatory reforms in LDCs.

This is not an easy task, especially given the availability of limited resources in LDCs. So, a gradual approach – rather than a concerted effort to competition reforms in LDCs could be promoted. Involvement of intergovernmental organisations and the international community would be critical for supporting such a process.

CUTS calls on the delegates of the UN LDC-IV conference and the *UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States* (OHRLLS) to recognise the significance of promoting and enforcing competition reforms in LDCs and include a relevant action point in the emerging *Istanbul Programme of Action*.

References

- CUTS (2007), 'From the Bottom Up', CUTS Centre for Competition, Investment & Economic Regulation
- Lipimile, G.K (2004), 'Competition Policy as a Stimulus for Enterprise Development', in Competition, Competitiveness and development: Lessons from developing Countries, UNCTAD/DITC/CLP/2004/1

Endnotes

1 The United Nations definition of a least developed country stresses on three characteristics: low incomes, human resource weakness and vulnerability (http://www.unohrlls.org/en/ldc/related/59/)

2 http://www.unohrlls.org/UserFiles/File/LDC%20Documents/Report%20of%20the%20LDC%20III_E.pdf

3 http://pfcmc.com/News/Press/docs/2011/dev2864.doc.htm

4 Obtained from the UNCTAD Least Developed Countries Report, 2010

5 *Ibid*

6 Khemani Shyam (1997), "Competition Policy and Economic Development", Policy Options, October 1997.

7 Phillipe Brusick et al, Concluding Chapter in *Competition, Competitiveness and Development: Restating the Case*, UNCTAD/DITC/CLP/2004/1

8 John Feil, March 2010, "Up a Down Escalator: National Competition Policy – A Little History and a Glance Forward", *Network*, Issue 35.

9 Nellist, R (2008), Competition Policy, Growth and Poverty Reduction, a presentation during the CUTS' 7Up4 Launch Conference, Accra, Ghana, 19th June 2008, Accra

10 Clarke J L and Evenett S. J. (2002), 'The Deterrent Effects of National Anti-Cartel Laws: Evidence from the International Vitamins Cartel'

11 Evenett S, Jenny F and Meir (2006), 'Allegations of Anti-competitive Practices in Sub-Saharan Africa', at: www.evenett.com/ssafrica.htm

12 Sweeney, Brendan (2006), "The Role of Damages in Regulating Horizontal Price-Fixing: Comparing the Situation in the United States, Europe and Australia", Melbourne University Law Review, 2006.

13 Mehta Pradeep S (2006), "Towards a Functional Competition Policy for India", CUTS, Jaipur, India

14 CUTS (2010), 'Cartel Prevalence in Africa: A Diagnostic Study', CUTS International, Jaipur, India.

15 Lipimile, G, 2009, Former Executive Director of Zambia Competition Commission during a presentation at the Interim Review Workshop for the project 'Strengthening Constituencies for Effective Competition Regimes in Select West African Countries', (7Up4), funded by DFID and IDRC

16 Ratnakar Adhikari, 'Prerequisite for Development Oriented Competition Policy Implementation: A Case Study of Nepal', in *Competition, Competitiveness and Development: Restating the Case*, UNCTAD/DITC/CLP/2004/1

17 See CUTS (2006)

18 See CUTS (2007)

19 Pro-Poor Advocacy Group (2009), in a report on the state of competition in The Gambia, in CUTS 2010, 'A time for Action', Jaipur, India.

20 CUTS, (2006), 'Fairplay Please! (Advocacy and Capacity Building on Competition policy and law in Asia: The 7Up2 project)', CUTS International, Jaipur, India.

21 *Ibid*

22 Wali I Mondal and AK.Monaw- war U. Ahmad, December 15, 2006, 'Government Policy and Competitive Business Environment in Bangladesh: A Case Study', International Journal of Quality and Productivity Management, Vol. 06, No. 1

23 H. Broadman (2007), 'Africa's Silk Road', Washington, World Bank.

24 Nick Godfrey (2008), 'Why is competition important for growth and poverty reduction?' OECD Global Forum VII on Investment

25 *Least Developed Countries Report 2008*, United Nations (Statistical Annex)

26 See *Directory of Competition Authorities*, 2007 (TD/B/COM.2/CLP/56) published by the UNCTAD Secretariat for an exhaustive list of competition authorities the world over

27 Although Zambia recently adopted a competition policy, it is still in its early stages of enforcement

This Briefing Paper has been prepared by **Cornelius Dube** and **Siddhartha Mitra** of and for CUTS International.