**Unclassified** **DCD/DAC/POVNET(2005)4/ANN1**

Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development **06-Apr-2005**

**English text only**

**DEVELOPMENT CO-OPERATION DIRECTORATE**
**DEVELOPMENT ASSISTANCE COMMITTEE**

**DCD/DAC/POVNET(2005)4/ANN1**
**Unclassified**

## DAC Network on Poverty Reduction

**PROGRESS REPORT BY THE TASK TEAM ON PRIVATE SECTOR DEVELOPMENT ON PREPARATION OF POLICY GUIDANCE FOR DONORS**

**Annex 1: Draft policy guidance for donors on removing barriers to formality and on competition policy**

**14-15 April 2005, OECD - La Muette, Room 5**

*This annex reproduces, as illustrations, two of the draft Hot Topic papers that the Povnet Task Team on Private Sector Development is currently preparing, on "Removing barriers to formality" and "Implementing competition policy in developing countries: The role of donors". They are circulated for INFORMATION to the Povnet under item 5.c of the 14-15 April 2005 Povnet plenary meeting agenda [DCD/DAC/POVNET/A(2005)4].*

*The progress report by the Leader of the Task Team on the group's work to prepare policy guidance for donors is circulated separately as DCD/DAC/POVNET(2005)4.*

Contact person: Michael Laird - Tel.: +33 (0) 1 45 24 90 33 - E-mail: michael.laird@oecd.org

**JT00181810**



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**TABLE OF CONTENTS**

# DRAFT HOT TOPIC PAPER 1:

# REMOVING BARRIERS TO FORMALITY[1]

## 1.1. What is the issue and why is it important?

1. The informal economy forms a large part of the economies of many developing and transition countries, providing critical employment and income to poor households. It comprises 42% of value added in Africa, 41% in Latin America and 35% in the transition economies of Europe and the former Soviet Union, compared with only 13.5% in OECD countries. The informal economy provides a safety net for many who lose or cannot find work in the formal economy, and it includes a disproportionate number of women, young people and others from disadvantaged groups. Informal employment accounts for 84% of women's employment in sub-Saharan Africa, for example.

2. There is a continuum between informality and formality, with formalisation a gradual process. Few firms follow all the rules governing enterprise behaviour, and few follow none of them. Entrepreneurs make repeated economic calculations of the costs and benefits of following the rules, and embrace formality up to the point where the costs outweigh the potential benefits.

3. Informality is not a long-term solution for poverty eradication. Countries with the highest *per capita* gross domestic product (GDP) have smaller informal sectors, while poorer countries have higher informal economy shares of total economic output[2]. Thus, while informal enterprise may provide a short-term solution to a household's problems, creating an economy with a higher proportion of formal enterprises and jobs is important to long-term welfare creation, stability and poverty reduction.

4. While formalisation by itself does not promote enterprise growth in the short run, bringing more enterprises into the formal economy over the long term should:

- Provide higher-quality, better-paid, more sustainable jobs.
- Reinforce the social contract between citizens and their state.
- Strengthen the reliability of agreements between firms.
- Build investor confidence (and increase investment).
- Broaden the tax base (potentially permitting lower tax rates).
- Increase information on local enterprises to facilitate deal-making and strengthen frameworks for policy advocacy.
- Reduce the cash economy and provide more resources for intermediation by the formal financial sector.

- Improve access to business services, formal markets and productive resources such as capital and land.

5. Formalisation also may increase welfare in some marginalised groups through confirming their rights to participate in market opportunities.

6. There is a growing body of research on business environments and their effects on economic growth and investment[3]. Many donors sponsor research and interventions involving informal economy enterprises. However, few studies and projects focus specifically on barriers to formalisation. The general assumption is that improving the enabling environment for all micro, small and medium-sized enterprises (MSMEs) will help informal firms move more into formality. This paper examines what has been learned about the main barriers to formalisation and what good practice examples exist for reducing these barriers.

### 1.2. The current evidence: Informality, economic development and growth

7. The *Doing Business* initiative of the International Finance Corporation (IFC) is generating benchmarks and indicators for different aspects of the business environment world-wide. Its 2005 report contains data for 145 economies on starting a business, hiring and firing workers, registering property, and getting credit. Countries performing better in these areas (simpler procedures, shorter waits and lower costs, etc.) have smaller informal economies. Statistical analysis undertaken as part of this study showed, however, that no single indicator is a key factor in promoting formalisation. This is because countries that did well in one aspect of the business environment also did well in others, e.g. countries with high business start-up costs also had high worker dismissal costs. The effects of the various factors are difficult to untangle statistically.

### 1.3. Barriers to formality from the entrepreneur’s perspective

8. Much of the available research focuses on barriers to growth in informal and smaller enterprises, rather than on the actual formalisation decision. Nonetheless, it is reasonable to infer from the research that some barriers to growth, i.e. those that impact on the smallest enterprises, are likely to correlate with barriers to formalisation. The sub-set of material on barriers to formalisation supports this, with regulatory and administrative barriers standing out as a particular concern. Barriers to formalisation fall into several categories, including: i) regulatory barriers; ii) administrative barriers; iii) fees and financial requirements; iv) corruption in public administration; v) socio-cultural attitudes; vi) lack of key business services and vii) criminality. There is a strong global body of evidence to suggest that regulatory, administrative and financial barriers, along with corruption, have the most direct influence on the formalisation decision. Reducing these barriers will help informal enterprises move along the continuum towards a greater degree of formality.

i) ***Regulatory barriers*** are inappropriate requirements stemming from governments that do not appreciate the impact on firms (particularly smaller firms) of additional reporting, inspection and other compliance procedures. The time entrepreneurs require to maintain and grow their business is not valued. Various studies have identified burdensome and costly government regulation as the most significant determinant of informality, and as a source of corruption. In general, years of poor quality law-making in developing countries has created a tangle of complexity and inconsistency that presents an almost insurmountable obstacle to the enterprises seeking formality. Regulatory (and administrative) burdens have a strong cumulative effect on the business environment.

ii) ***Administrative barriers*** stem from the way regulations are enforced. They include: excessive paperwork, inefficiency/delayed decisions, inaccessibility of services, bureaucratic obstruction and abuse of authority. These barriers have many sources, including over-complicated regulations, out-dated ways of working, lack of capacity, over-centralisation of authority, distrust of the private sector and – linked to all of this – corruption. In many countries, little effort has been made to raise awareness among public servants of the private sector's needs, nor to create a more service-oriented culture with respect to entrepreneurs (as opposed to a culture that sees its role as one of control and enforcement).

iii) ***Fees and financial requirements*** consist of regressive fees which penalise smaller firms, overly complex tax regulations and poor tax and tariff administration. In a number of countries, initial business registration and licensing fees are set too high. Informal enterprises shy away from joining tax regimes for other reasons: they are worried about tax levels; they do not understand how to comply with tax requirements; they fear the behaviour of revenue officials; and they do not believe they will receive services in return for payment. Unfortunately, little work on improving tax administration focuses closely enough on the informal economy to understand which of these obstacles are more difficult and in need of more urgent attention. Too little tax reform work considers alternative, more indirect approaches to income-based taxation, which is a burden to smaller firms.

Financial barriers are integrally entwined with regulatory and administrative barriers in obstacles related to the general registration of business activity and licensing for operations in specific sectors. The main registration obstacles are excessive costs and time spent dealing with bureaucracy. Registration and licensing become confused in some developing countries: registration should be a straightforward administrative process with little discretion involved, but it often takes on aspects of sector-specific licensing, such as site visits, annual re-licensing and review by committee of the application. This can act as a significant disincentive to registration. Some countries use "licences" as a primary means of annual revenue collection for local authorities (as in East Africa). In a number of countries, firms must travel to the capital or other distant towns for these procedures.

Informality is one way of avoiding labour laws and their associated costs (social insurance, etc.). In many countries businesses face major hurdles in taking on their first "formal" employee. The additional costs related to labour regulations are estimated to be the most important costs of remaining in the formal economy for small firms in Latin America[4]. Overly rigid labour laws often hurt the people they are meant to protect, keeping employees in the informal economy and inhibiting economic growth that could create new jobs.

iv) ***Corruption*** is a major factor deterring formalisation, as businesses stay off registries and tax rolls in order to minimise contact with corrupt public officials. One broad study of 69 countries found a direct link between decreasing corruption and increasing the size of the formal economy[5]. Efforts to reduce barriers to growth and formalisation will be thwarted if corruption is not also tackled. Corruption erodes the trust that businesses have in government and leads informal businesses to conclude that their long-term prospects in the formal economy are poor.

v) ***Socio-cultural barriers***. In some countries, there is a degree of resistance to formalising because of socio-cultural obstacles. The informal economy comprises strong networks of trust and interdependence, often cemented by collective historical experience, e.g. of oppression or social exclusion. When an informal entrepreneur has a history of successful trade with other informal entrepreneurs in the same social group, the motivation to formalise can be lacking. In some failed or very weak states, the informal economy is entrenched and has had for many years to self-regulate and carry out many of the functions of the state.

vi) ***Lack of key business services.*** Some argue that having more services (finance, titling, infrastructure, public procurement opportunities, management support, etc.) available for formal businesses attracts informal enterprises into the formal economy. Increasing the potential benefits for formal enterprises might correspondingly increase tolerance for the compliance costs of rules and regulations. This hypothesis is compelling. Unfortunately, it is virtually impossible to prove. Whether or not formalisation has been an explicit goal of services improvement, most monitoring and evaluation of the new services did not consider impact on formalisation, focusing instead on business income, job creation and other quality of life and work improvements. What little evidence could be found raises some doubts as to the strength of a service-driven formalisation motive.

vii) ***Criminality.*** Some individuals are reluctant to provide information about their personal wealth and circumstances to government officials, because they are concerned that this information may be passed to people involved in serious and organised crime and make them targets for criminal activity.

## 1.4. Knowledge gaps and different approaches to informality

9. While much is known about how barriers restrain private-sector growth both in the formal and informal economies, there is little specific research into why firms do not formalise. Understanding of which barriers are the most significant and how they impact on the decision-making process is limited, although much can be deduced from surveys of general barriers to growth. Nor does the research have much to say on the links between formalisation and enterprise performance, and on short-term versus long-term effects[6]. There is scope for further primary research in these and other areas.

10. The informal economy is complex and donor interventions should be based on sound research. There is a risk of making false assumptions. For example, research and interviews with donors revealed a predominant view that many informal economy workers would prefer to return to formal waged employment as soon as it became available. However, there is credible evidence to suggest that this is not necessarily the case: in a recent survey in South Africa, the majority of informal-sector respondents indicated that they would prefer to remain in business rather than take a job if one were available[7]. Another recent survey of women entrepreneurs in the MSME sector in Ethiopia found that 75% would not forego their current businesses if offered a permanent job elsewhere[8].

11. The heterogeneity of the informal economy and varying donor emphases have created a variety of approaches to understanding and addressing the informal economy. Two potential conflicts have emerged:

***Improving livelihoods within the informal economy versus encouraging formalisation.*** Some researchers and donor programmes view the informal economy as a long-term, structural feature of modern economic development. Given this, some interventions are aimed at improving the welfare of the people who find themselves in the informal economy, rather than helping them to formalise. By contrast, other donor interventions consider formalised economic growth to be a central goal of development and primary driver of poverty reduction. These are accordingly focused on encouraging formal economy growth. The challenge is to determine how interventions can be devised which improve the livelihoods of the very poorest while not removing incentives to formalisation.

***Improving employment conditions for informal economy workers versus increasing competitiveness of the local private sector.*** Some approaches view the informal economy from a labour-market perspective, and look for ways to reduce employment deficits and to improve the quality of formal work opportunities. This approach has the potential to conflict with approaches that emphasise the competitiveness of informal economy enterprises, the need for workforce flexibility to maintain comparative advantage and the need to keep employment law compliance burdens to a sensible minimum. The relatively new "Decent Work" approach seeks to strike a carefully constructed balance between helping enterprises grow while also promoting improved work conditions, but its impact is not yet well understood.

### 1.5. Good practice in removing barriers to formalisation

12. An account of current donor good practice in reducing regulatory and administrative barriers to formalisation is documented in the study that accompanies this "Hot Topic" paper. A summary of the recommendations that flow from this good practice follows:

- **Support broad programmes of regulatory reform. Introduce Regulatory Impact Assessment.** Institute programmes of reform that examine regulatory burdens from the enterprise point of view. Programmes should be informed by surveys of the barriers of most concern to enterprises, including those that are identified as barriers to formalisation. Choose sectors according to their capacity to generate growth and employment. New laws should be subject to assessments of their impact on MSMEs, including the formalisation decision.

- **Design measures to create a business-friendly culture in government and to improve service provision.** Even without significant increases in resources, there are improvements that can be made to improve the delivery of services to business by government. Donors should support efforts to create service charters in ministries and local administrations. They also should support one-stop shops in accessible locations to help firms understand and comply with their obligations.

- **Simplify official administration for businesses.** Review and reduce paperwork for businesses, make use of information technology (IT) where possible. Keep official forms to a minimum. Consider exemptions for smaller firms, or more appropriate thresholds for entering into regulatory regimes.

- **Avoid retroactive taxation for businesses that formalise.** Enterprises will be reluctant to formalise if they fear a large tax bill.

- **Simplify tax administration**. Tax administration is more often cited as a problem than tax rates. Consider single taxes for MSMEs as a way of reducing the number of payments. Offer different payments options, one-off or by instalment.

- **Share information on what taxes are used for**, and how businesses will benefit from enhanced services. Evidence suggests that compliance rates go up when businesses know what they are getting in return for their payments.

- **Rationalise business registration and licensing regimes**. Make registration a simple, administrative process. Separate registration from licensing. Use IT where possible. Separate the function of revenue generation from business registration and licensing. Remove registration from (usually overburdened) courts wherever possible.

- **Limit licensing to those activities where it is justified** on health, safety, environmental or other grounds. Avoid multiple licences and make it easier to submit applications. Eliminate licensing for as many firms as possible.

- **Make it easier to register business and producer associations.** Socio-cultural traditions can be transformed from barriers to opportunities through the formalisation of business or producers' associations. Whilst barriers to formalisation may seem insurmountable to individuals, it may be easier to encourage the formalisation of such producer groups and, through them, to make the benefits of formalisation available to individuals. Donors should proceed cautiously in this area to ensure that the focus of the association remains on serving member interests, and does not migrate to serving funder interests.

- **Reduce registration fees and statutory requirements.** Make sure that fees are set at a reasonable level, and that any requirements, e.g. for fixed premises or capital, are fully justified.

- **Promote labour law reform** which protects essential rights while making it easier to hire and fire workers and to employ people on flexible contracts.

13. In addition to these micro-level reforms, four higher-level business environment reforms are important to support efforts to encourage formalisation. First, initiating dialogue with the informal sector in order to understand its constraints (including resistance to formalisation) is vital. Town hall meetings, radio talk shows and focus groups are just some of the ways that have been used to include the informal economy in policy-making. Second, there are decentralisation initiatives underway in many parts of the world; evidence suggests, however, that many local authorities are ill-equipped to undertake greater responsibilities and that they do not understand the needs of informal entrepreneurs. Worse, some local authorities view enterprises primarily as a source of short-term revenue. Donors can support programmes that build the capacity of local government to support improved services to business, enterprise growth and formalisation. Third, efforts to tackle corruption, for the reasons discussed above, are likely to have a significant impact on restoring entrepreneurs' confidence in public administration and their willingness to formalise. Fourth, the potential for misunderstandings around issues of informality speaks to the need for donors to co-ordinate their activities affecting the informal economy permitting a complementary, gradualist approach to formalisation.

### 1.6. Policy and practice recommendations

14. In addition to the specific recommendations aimed at removing barriers and at supporting measures, there are a number of policy and practice recommendations that emerge from the research. It is recommended that donors:

- Develop a commonly shared toolkit that encompasses the full range of successful donor informal economy interventions.

- Promote formalisation by creating a regulatory environment that is generally enabling.

- At the same time, work with willing partners to remove barriers to enterprise growth and formalisation at local level. Wholesale legal reform is not always possible, but progress can still be made to streamline administration (as through one-stop shops).

- Support measures to reduce corruption at the main interfaces between government and business in the process of formalisation (particularly in registration and licensing procedures).

- Educate government officials at local and national levels about the importance of the informal economy and the role they can play in increasing formalisation by offering improved services. Demonstrate that facilitating long-term growth of the tax base is preferable to extracting short-term gains and encouraging firms to hide their activities.

- Ensure that programmes to increase welfare in the informal economy do not reduce incentives to formalise. In return for assistance, require a *quid pro quo* from informal enterprises in terms of movement towards formalisation.

- Support dialogue between government and informal enterprises (or their associations) to reveal barriers to formalisation and build trust and understanding on both sides.

- Consider the merits of longer interventions, as reforming regulatory and administrative barriers and the culture of government takes time. Where longer interventions are not possible, adopt more modest and targeted objectives.

- Assess the capacity of local governments to implement policies to reduce barriers to formalisation, and plug gaps between centrally approved initiatives and local capabilities.

- Undertake and share further research on the impact of enabling environment reform on formalisation.

## ENDNOTES

1. This Hot Topic paper was drafted by Matthew Gamser and Corey Hastings of Development Alternatives Inc.(USA) and Darren Welch and Richard Waddington of Bannock Consulting Ltd (UK), on behalf of USAID, for the POVNET Private Sector Development Task Team.

2. Bannock (2002).

3. The global body of evidence includes, but is not limited to, the following sources: ILO, UNIDO, UNDP (2002); Bannock, G. *et al.* (2002), SBP (2005); FIAS (2004). World Bank Investment Climate Surveys.

4. See Tokman, 1992. The IDB also estimated that restrictive labour laws accounted for a 6-% increase in the informal sector share of total employment in Latin America between 1990 and 1996 (cited in Krebsbach and Karen, *Global Finance*, 1999).

5. Friedman, E. *et al.* “Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries.” (Cambridge, MA, Massachusetts Institute of Technology, 1999).

6. There certainly are cases where the costs of formalisation have reduced enterprise profits in the short run, and there are cases where investment climates are improving but informal economies continue to grow in the short run. However, there is no denying the strong correlation between the proportion of the GPD in the formal economy and overall economic well-being of countries, as cited at the beginning of this paper.

7. SBP (2005).

8. IFP/SEED, ILO (2003).

## DRAFT HOT TOPIC PAPER 2:

## IMPLEMENTING COMPETITION POLICY IN DEVELOPING COUNTRIES: THE ROLE OF DONORS

### 2.1. Why is the topic important for pro-poor growth?

15. Achieving the Millennium Development Goals (MDGs) 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.

16. 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.

17. 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 (for example, in the provision of rural infrastructure), as anti-competitive practices by suppliers will reduce what governments can achieve with the funds available.

18. 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 businesses. These opportunities include export-oriented industries. “Competitiveness” is not synonymous with “competition”, but firms and sectors are far more likely to be competitive internationally if they operate within competitive domestic markets.

19. Competitive domestic markets 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.

20. 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[1]. It discusses the effects of entry and exit barriers on entrepreneurship, and the contribution made by competition to innovation and productivity.

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

21. 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.”[2]

22. 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[3].

23. 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[4]. 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"[5]. This estimate did not include the dynamic efficiency gains also expected to flow from the competition reforms.

24. 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.

25. There is increasing information on the harm anti-competitive practices in both national and international markets can do to developing countries. 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[6], and for school construction in China[7.]

b) Flower exports from a North African country being made uncompetitive by the combined effects of a trucking cartel, a freight forwarding cartel and compulsory use of the national airline[8].

c) Cartels by companies buying tea, sugar and tobacco forcing down returns to farmers in Malawi[9], and cartels for retail sales of flour, bread and poultry affecting retail prices in Peru[10].

d) "Bundling"[11] 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[12].

26. Studies of international cartels investigated by European Community and American competition authorities illustrate their large impact on poor countries. The World Bank's *Global Economic Prospects 2003* noted six international cartels that overcharged developing countries $3 to $7 billion in the 1990s. A 2001 paper[13] estimated that 16 international cartels overcharged developing countries between $16 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[14]. A study of one major cartel (vitamins) found that suppliers had overcharged developing countries that lacked a competition law more than countries that had such a law[15].

27. Competition policy, including competition law, is needed because markets do not always work well. Anti-competitive actions by firms are one cause, but inappropriate regulations by national, state and local governments also are frequent causes of market failure.

28. 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.

29. 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.

30. 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.

### 2.3. What are the big controversies?

31. 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.

- *How can poor countries find the resources to operate a competition law regime?* 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 groups, a regional competition law could enhance the impact of the domestic law. Co-operation arrangements with developed countries could provide help with staff training through exchange programmes, and through information exchanges.

- *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[16]. 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.

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

32. 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”[17].

33. Increasingly, developing countries want to adopt appropriate competition regimes, but need help. In providing the help needed it is desirable that donors harmonise their activities to avoid the possibility of

duplication, or of leaving gaps. There is significant scope for additional support from donors, in the following four major areas.

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

34. 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 Section 2.3. above.

***Culture of competition***

35. In a "culture of competition", the rules and benefits of competition are widely known and form 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.

36. 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 creating a good pro-investment climate.

37. Some non-governmental organisations (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, the United Kingdom's Department for International Development (DFID) has funded research and advocacy programmes (such as the CUTS 7-Up projects[18]) 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***

38. Help is needed 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.

39. There is scope for donors to support proposals for roundtable forums on competition policy and law for senior policy makers from developing countries[19].

***Programme funding***

40. Donors can fund the technical assistance and capacity building programmes of international and regional organisations.

41. UNCTAD has a well-established programme of technical assistance and capacity building activities[20]. 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.

42. "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[21], and UNCTAD wishes to include peer reviews of Jamaica and Kenya in its conference in November 2005.

43. 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 and negotiating on their objectives in the forthcoming EPA negotiations.

### 2.5. Recommended best practices

44. 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:

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 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.

3. Whatever division of responsibility between sector regulators and the competition authority is chosen for decisions on competition issues, there should be an effective working relationship between the regulators and the authority to assist regulators to apply sound competition principles to their sectors.

4. 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.

5. 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 an early "winner".

*Further Reading*

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The competition sections of the websites of the OECD, UNCTAD, the WTO 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.

## ENDNOTES

1. OECD (2004). *Accelerating Pro-Poor Growth through Support for Private Sector Development.* OECD, Paris.

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3. World Bank, *World Development Report 2005*, p 29.

4. Dutz, M. and Hayri, A (2002), *Does effective antitrust policy spur economic growth?* Paper presented at the OECD Global Forum on Competition, February 2002.

5. Australian Productivity Commission (1999), *Impact of Competition Policy Reform on Rural and Regional Australia*, p 38.

6. Adhikan, R. (South Asia Watch on Trade, Economics and Development, Kathmandu), Presentation at FIAS Conference, Sri Lank, June 2004.

7. OECD (2002), Global Forum on Competition 2002.

8. USAID study reported at International Competition Network Workshop, Paris, Feb. 2002.

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

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

11. "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.

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

13. Levenstein, M.C. and Suslow, V. Y. (2001) *Private International Cartels and their Effects on Developing Countries,* Background paper for the World Bank's *World Development Report 2001.*

14. Jenny, F. (2002), Paper presented at WTO Regional Workshop on Competition, Mauritius, November 2002.

15. Clarke, J. and Evenett, S. (2003) *The Deterrent Effect of National Anti-Cartel Laws: Evidence from the International Vitamins Cartel,* Antitrust Bulletin 2003.

16. 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.)

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

18. 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.

19. 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.

20. See *Competition Policy for Development: A report on UNCTAD's Capacity Building and Technical Assistance Programmes* (2004), http://unctad.org/en/subsites/cpolicy.

21. DFID funded the peer review of South Africa's competition law and policy undertaken at the OECD Global Forum on Competition in 2003.