

Unclassified

CCNM/GF/COMP/WD(2004)17



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

09-Jan-2004

English - Or. English

**CENTRE FOR CO-OPERATION WITH NON-MEMBERS
DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS**

CCNM/GF/COMP/WD(2004)17
Unclassified

OECD Global Forum on Competition

CHALLENGES/OBSTACLES FACED BY COMPETITION AUTHORITIES IN ACHIEVING GREATER ECONOMIC DEVELOPMENT THROUGH THE PROMOTION OF COMPETITION

Contribution from Pakistan

-- Session II --

This contribution is submitted by Pakistan under Session II of the Global Forum on Competition to be held on 12 and 13 February 2004.

JT00156499

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

CHALLENGES/OBSTACLES FACED BY COMPETITION AUTHORITIES IN ACHIEVING GREATER ECONOMIC DEVELOPMENT THROUGH THE PROMOTION OF COMPETITION

Introduction

1. A dynamic competitive environment supported by effective competition policy and law is considered to be an essential element of a successful market economy. Many developing and transition economies that have undertaken significant market-based reforms - trade liberalisation, privatisation and deregulation – are also recognising the need to implement rules to safeguard competition. The reason being primarily to get the benefits that flow from competition i.e., increased economic efficiency, innovation and consumer welfare.

2. Competition policy involves continuous efforts to reduce barriers to market entry and exit, to reform anticompetitive regulations and to expose government-owned businesses to competitive market forces in a competitively neutral manner. Competition reforms also offer a further means to reduce market inefficiencies – principally through a comprehensive regulatory reform program. However, competition policy is a relatively new area for most developing countries; for instance, since 90s over 40 developing and transition market economies have enacted or substantially revised existing competition laws including most of the former centrally planned countries/republics in central and Eastern Europe and the former Soviet Union. Industrialised economies too have recently revamped and began to vigorously apply their competition laws, for instance Canada, European Union, New Zealand and the United States. Notwithstanding these developments, the majority of countries have yet to adopt the competition law, even in the South Asian region: out of seven countries, four do not have competition law in place.

3. In this background, this paper is an effort to look at the competition process from a purely developing country perspective – to find out the factors restraining competition and expansion of competition policy as a developmental tool. Scheme of the paper is such that Point I looks into the restraining factors – and concludes that major reasons are embodied into the very design of economic policy and management of the developing countries. Some other constraints are discussed in Point II.

1. Restraining factors: The design of economic management policies

4. In most developing countries, there seems to be a conflict between competition policy (CP), on the one hand, and trade policy, industrial policy etc. on the other hand. These policies are characterised by a tendency of state intervention that is not in line with the principles of competition policy. Such policies are not bad *per se*, however, the main problem is in striking the right balance so that the dynamic force of competition is not paralysed. In case of developing countries, the governmental policies are continually shrivelled with the temptation to react with *ad-hoc* interventions, individual problems and to achieve immediate results. The objectives of competition policy are best achieved with public support and deep-rooted competition culture in a long time period.

5. For economic management, the governments rely on several policy tools e.g., trade policy, FDI policy and regulatory policy, to ensure competitiveness in the markets and optimal allocation of resources. These policy tools comprise of rules and regulations that serve purposes other than maintaining competition, with a view to fostering efficiency. CP, on the other hand, relates specifically to rules and regulations implemented by competition agencies (CAs) with respect to arrangements among firms/suppliers and the conduct of individual firms/suppliers. The concept of competition policy includes competition laws in addition to other measures promoting competition, such as sectoral regulations and privatisation policies.

6. Firstly, in most developing countries, competition is restrained by industrial policy as it tends to reduce the impact of competition through government's desire to enhance international competitiveness of specific sectors/enterprises, especially by subsidising the so-called "national champions", or to protect the labour force against the risks of dismissal in the case of failing industries¹. These subsidies to specific industrial sectors cannot be condemned *per se*. They may, and will sometimes, have positive effects for a short-term period. But in the long run, the negative repercussions will however, prevail. Businesses cannot be competitive on international markets if they are not exposed to competition in national markets.

7. Secondly, until late seventies, nationalisation and public sector ownership was seen as the best way of preventing concentration of wealth and other practices that were perceived to act against public interest. The state-owned enterprises were found to be the major borrowers in domestic and world credit markets; and commanded a sizeable share in the budget. However, in many developing countries, this performance did not meet the set standards. Inefficiency started creeping in the performance of the public sector enterprises which got manifested in the form of declining productivity, overstaffing/reduced profitability as well as losses. Investments that were expected to spur growth and provide profits/tax revenues to the governments became a drag on the economy and drain on the treasury. It was realised around the world that privatisation can create market discipline without running the risk of concentrating ownership. Concerns grew that through the use of newly developed capital market methodologies, State Owned Enterprises (SOEs) can be sold to small investors and employees. The attention was diverted from expanding the role of SOEs and improving their performance, to identifying the ways and means to tap private managerial and financial resources to accomplish public ends. Out of these concerns came a rising interest in the divestiture of state enterprises, as well as their rehabilitation and reform.

8. The policy of privatisation leading to transfer of assets held by the State gradually became a hallmark of large number of countries. However, government's intervention as a regulator of industries still reduces/hampers the dynamic forces of competition mainly due to 'regulatory capture'. Therefore, in developing countries that previously relied on the state ownership, direct control over production and pricing decisions, the development of a regulatory system is difficult but essential.

9. Equally related with privatisation are the inherent conflict between sectoral regulators (SR) and the CAs. The issue is the appropriate demarcation of jurisdiction between the two so as to eliminate instances of overlapping or conflict, while assuring efficient functioning of the markets. There are essentially four tasks faced by the developing countries, during and after transition from government ownership to greater reliance on market forces - these are firstly, "competition protection" i.e., controlling anticompetitive conduct; secondly, "access regulation" i.e., ensuring non-discriminatory access to necessary inputs (e.g. network infrastructure); thirdly, 'economic regulation' i.e., adopting cost based measures to control monopoly pricing; and lastly, "technical regulation" i.e., setting and monitoring standards ensuring compatibility and to address safety and environmental protection concerns.

10. CAs has expertise in eradicating market power which, if left unchecked, would greatly reduce benefits of regulatory reform itself. However, things are not so clear when it comes to access regulation, where the objective is to promote/protect competition in situations where access to a portion of a vertically integrated company's assets is needed for satisfactory level of competition. On one hand, because of experience with abuse of dominance cases, competition agencies are better suited to perform this task than are sectoral regulators. On the other hand, ensuring a level playing field requires processing a large volume of technical data in order to set access terms, and then following up with continuous monitoring to ensure compliance with those terms- these are functions that seem more in tune with what SRs could do better. Consistent application of competition policy balanced with sectoral interests and vice versa require: reduced risk of regulatory capture and well defined areas of expertise - this is one of the challenges being faced by the CA.

11. Thirdly, one of the restraints are the governmental activities, where the government does not act at the same level as that of a private natural/legal person but as a superior. The State may also restrain/distort competition when it acts commercially, as a seller or buyer of goods and services sometimes as a monopolist and sometimes competing with other sellers or buyers. A prevailing example is government acting as a seller, and thereby - unfairly discouraging, competition is government holding a legal monopoly - say in telecommunications- and extending its activities beyond the legal limits of this monopoly in new other related activities, and by subsidising this market entry from its monopoly income.

12. Fourthly, monetary policies and distortions in exchange rates have remained common phenomena in most developing countries - that essentially affects competition in a major way. It is understandable that as a government follows policies leading to under-valuation of currency it facilitates exports. Overvaluation of currency, on the other hand, enhances import competition thereby increasing competitive pressure on domestic enterprises.

13. Next, structural policies pursued by the developing countries have easily restrained and distorted effective competition, for instance, by encouraging concentration favouring big enterprises in order to strengthen the competitiveness of those enterprises in international markets. Other policies may also strengthen such trends, e.g. regional policies which may favour an inefficient and marginal part of a certain sector of the economy and, thereby, discourage an efficient part of the same sector located in another area.

2. Other factors: Obstacles faced by competition authorities in the developing countries

14. Apart from conflicts with various policy objectives, competition policy and law in most developing countries face several general constraints affecting the overall environment within which the competition rules operate. Some of these are: an overall lack of awareness regarding benefits of 'competition culture' on part of governments, consumers and businesses; competition does not fall in the 'priority list' of those responsible for economic management of the countries; small size of market as compared to investment requirements to achieve economies of scale; and 'starvation' for investment thereby having a loose control over business activities. Then, there are specific constraints i.e., those relating to a CA include: deficiencies in competition legislation/impediments in amendments; non-involvement of stakeholders in the enforcement and 'voluntary compliance'; lack of financial resources with the competition agencies; lack of human resource development/training.

15. These constraints create a situation whereby competition legislation/enforcement in most developing countries remain weak enough to make a difference at the market place – this in turn serves as a major impediment to receive any priority either for budgetary grants or else to introduce changes to make the law effective. The budgets of the CAs are generally low in absolute terms. A major component is the salaries of employees leaving very low or negligible amounts for the research/training activities. This is combined with a higher ratio of administrative/support staff as compared to technical/professionals (lawyers, economists, accountants). Low comparative salaries cannot attract high caliber staff so as to ensure high quality of investigations, enforcement and compliance.

16. To elaborate, some South Asian case studies are illustrated in the paragraphs to follow. To start with, Bangladesh has a pre-dominantly agricultural economy with a few big industries like fertiliser, gas, electricity, water supply, shipping, airlines, cement, sugar and ready-made garments. A situation of state monopoly of industries originated when the government nationalised all big industries in 1970s. During the last decade or so denationalisation is taking place for some of above mentioned sectors. As far as policy frictions are concerned, it is interesting to note that the Bangladesh Tax Policy provides newly established industries to enjoy tax holidays initially for a period of 6 to 9 years. As a result, it is more profitable for the investors to go for establishing new industrial units rather than going for take-over and cartels. State monopoly of big industries, on the other hand was considered a blessing since consumers benefited

through subsidies/low prices of gas, airlines, electricity, fertilizer and telephone. However, as long as the subsidies were financed by external grants it was acceptable. With the drying up of foreign aid, the cost of the subsidies will fall on other sectors of the economy thereby increasing the costs. In this background, the need for anti-monopoly law was not felt deeply in Bangladesh. However, the situation changed during the last decade due to the substantial liberalisation trade/finance in Bangladesh. In the face of globalisation, the need for anti-monopoly laws is being felt to ensure fair competition and protection of consumers' interest.

17. Secondly, Bhutan is a landlocked country depending on agriculture and mainly electricity. There is no competition framework and consumer protection policy. However, the Ministry of Trade and Industry (MTI) and some other government departments take steps to protect the interests of the consumers in their respective spheres. Government has monopoly in the supply of basic amenities and essential services to the people e.g., telecommunication, power, health, financial services and other civic amenities. Thus small size of economy did not call for a need of competition rules. However, later it was felt that market abusive practices (like under-measurement, charging excess price, sale of defective goods, collective price fixation in some products and unfair trade practices) are prevailing. This resulted into the desire to have a competition and consumer protection legislation in the form of 'Bhutan Consumer Protection Bill, 2001'².

18. In case of Maldives, it is only due to recent developments in the trade and financial sector that the need for the competition rules is being felt. The law on fair-trading until recently was in the process of drafting. Throughout the phase of economic development, the Government's objective has been to restrict its involvement in commercial activities to necessary interventions in the public interests and to ensure such operations are conducted on a strictly commercial basis. Still there are publicly owned commercial enterprises: in electricity, industrial fisheries and State Trading Organisation.

19. These specific instances relate to small developing countries that are feeling the need to have competition frameworks. The situation however has been somewhat different in case of India and Pakistan. Both the countries have established competition laws dating back to 1969 and 1970, respectively. In India, it was noted that the provisions of the Monopolies Act were not sufficient to deal with the anticompetitive practices and the consumers' grievances at large. The government of India set up a High Level Committee (Raghavan Committee) to propose a modern competition law after an examination of the MRTPA. The Report of the Committee pointed out that due to WTO regime, introduction of a domestic competition law would prevent international cartels from indulging in ACPs in India³. The new Competition regime covers all types of enterprises and persons and all areas of commercial activity including professionals. It establishes a Competition Commission to prevent practices that may have adverse effect on competition.

20. In case of Pakistan, by the time the law became operative in 1972, the 'phenomenon' that the competition law was to regulate, entered a state of fundamental change. Beginning early in 1972, there followed the widespread nationalisation of the 1970s. However, in the late 1980s, a pro-market shift in the stance of economic policy became manifest and three significant components of this shift were: firstly, the privatisation of state-controlled units, secondly, the deregulation and liberalisation, thirdly opening up of economy for foreign investment. These policies of the Government gave boost to the private sector again and, hence, the need to have strong regulatory framework was felt. As a result, the amendments in the Law are under consideration.

21. This shows that developing countries have specific reasons for not having competition law or its inadequate application. However, most are now recognising to have rules and to modify them to be used effectively towards economic development.

NOTES

1. Same is true even for developed countries, the US safeguard measures on import of steel is a classic example.
2. The Bill recognizes the rights of consumers including the right to basic goods and services, which guarantee dignified living – food, clothing, health care, drinking water and sanitation, shelter, education, energy and transport.
3. Report of the High Level Committee on Competition Policy, Vol.1, May, 2000.