Unclassified **DAF/COMP/GF/WD(2012)54**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **13-Feb-2012**

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/GF/WD(2012)54
Unclassified

Global Forum on Competition

COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from Pakistan

-- Session I --

This contribution is submitted by Pakistan under Session I of the Global Forum on Competition to be held on 16 and 17 February 2012.

JT03315909

Complete document available on OLIS in its original format

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- Pakistan --

1. Background

1. Price volatility can simply be defined as sharp fluctuations in prices of commodities. Others define it as "a directionless measure of the extent of the variability of a price or quantity"[1]. Volatility is a symptom of structural problems of varying stocks levels. Both high and low levels of commodities can increase the vulnerability of prices to volatility. Some economists also distinguish between the one-off production shortfalls or gains and variable stocks over a longer period.

2. Commodity prices vary generally with the forces of supply and demand, both of which can be affected by several factors. The impact of commodity price volatility is felt differently in each separate commodity market and is based on the extent to which the given production and consumption shocks translate into price volatility depends on supply and demand elasticities, that reflect the responsiveness of producers and consumers to changes in prices. These elasticities are generally low over the short run.

3. Professor Barrett[2] places more emphasis on boosting production and improving distribution systems to increase the supply of food and controlling prices. According to him, food price volatility gets addressed automatically as food supplies expand, bringing down prices and encouraging expansion of price-stabilizing stocks.

4. Stabilizing prices and maintaining an ample supply of essential commodities is an important concern for the Government of Pakistan as well. Therefore in an attempt to maintain and stabilize prices, the government of Pakistan has legislated the "Price control and prevention of profiteering and hoarding act, 1977". The main aim of the Act is to secure equitable distribution of essential commodities and their availability at fair prices to the common man.

5. In 1967, the Government established the Trading Corporation of Pakistan (TCP), as a premier international trading house, which is the principal trading arm of the Government of Pakistan. The Corporation gradually moved from barter, through commodity exchange to cash trade. TCP's main aim is to undertake import of essential commodities to help ensure their availability to the common man at affordable prices. It intervenes in the market in the larger public interest to ensure fair price to growers, as well as to preempt hoarding and profiteering. TCP's operations largely complement the private sector in meeting the demand for essential commodities in the country. It also facilitates the private sector by making its vast storage areas available to them on favorable terms, thus considerably helping improve the supply chains.

1 Gilbert, C. L., and C. W. Morgan. "Food Price Volatility." *Philosophical Transactions of The Royal Society* 365: 3023-034. Web. http://www.cepii.fr/anglaisgraph/communications/pdf/2011/10110111/S5_Ch_Gilbert.pdf

2 Christopher Barrett is a Professor of Applied Economics at Cornell University.

6. As part of its mandate, the TCP imports and supplies essential commodities at reasonable rates to the Utility Stores Corporation of Pakistan (USC) and the Canteen Stores Department (CSD) for purchase by the public. USC is an organization that operates chain stores throughout Pakistan that provide basic commodities to the general public at rates which are lower than the open market. The CSD is a chain of retail stores run by the Pakistani Ministry of Defence with presence in all major military Cantonments operated by the Pakistan Armed Forces. The CSDs sells a wide variety of products, procured in bulk and sold at concessional rates, compared to retail prices.[3]

1.1 In recent years there has been significant volatility in the prices of commodities that are important to the general population in your country?

7. Yes. The floods of both 2010 and 2011 destroyed infrastructure, crops and livestock, resulting in price volatility as demand outstripped supply. However, the floods were exceptional circumstances in the last two years. The country has also seen price volatility as a result of inflation.

8. Following the 1998-99 crisis, when the country was on the brink of default, international reserves were depleted, economic growth was anemic, debt ratios were alarmingly high and confidence of the investor community was at its lowest, inflation was reduced to below 5% by 2000 and remained stable through 2003. A tight monetary policy combined with fiscal consolidation contributed to this low-inflation.

9. With monetary growth picking up, inflation increased sharply in late 2003, and since then, has remained in double digits. This has had a considerable impact on price volatility as can be noted in the State Bank of Pakistan's *Inflation Monitor*[4]. According to the Inflation Monitor, Headline CPI inflation in December 2011 was 9.7% compared to 15.5% in December 2010.[5] However in recent years commodity prices have again witnessed sharp increases due to various factors. Prices of food commodities (wheat, rice, oil and sugar) increased due to global production shortages and panic buying by the importers in anticipation of high prices. In the non-food group, rising crude oil prices was a result of bullish sentiments regarding the global economic recovery and partially due to political unrest in Egypt and Tunisia.

1.2 Please briefly provide details (e.g., among others, on the product(s), market(s) and adjacent market(s) concerned and the magnitude and duration of this volatility, be it prices going up or down.

10. Fixing of prices and output are universally recognized as having the most detrimental effects on competition, and at times responsible for price volatility. In Pakistan for example sugar industry is overly regulated and is also prone to engage in anti-competitive activities making the price of sugar fluctuate irrespective of market forces.

11. Generally Pakistan has seen considerable volatility in both food and non-food commodities in the recent period. There is pretty much no category of food commodities that have not remained untouched by volatility and oil prices have had their concomitant impact on inflation and volatility in the country.

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3 http://www.tcp.gov.pk/Home.aspx

4 The most recent Inflation Monitor is at the time of writing is dated December 2011 and is available at HTTP://www.sbp.org.pk/publications/Inflation_Monitor/2011/ec/IM_Dec_2011.pdf. The price movement can be seen on page 5.

5 See note 8, page 1.

1.3 Are the price volatility in these commodities, and the causes of that volatility, global, regional or domestic?

12. Yes there has been price volatility in these commodities. For Pakistan, the causes of this volatility have both domestic and foreign reasons as mentioned in this document. The major domestic contributory to volatility was the floods of the 2010 and 2011 in which considerable agricultural output was destroyed. There are certain other domestic factors briefly highlighted below.

- Cartelization/collusion among market forces

  Collusion in the relevant market may result is in price fixing agreements between the relevant markets. Restricting the production or quantity of a certain product may also result in price volatility in the relevant market which eventually causes distortion to the free and fair competitive play of the market forces. The Commission has identified collusive behavior in a number of sectors and action has been taken against the parties involved.

- Energy crisis

  Power shortages are also a contributing factor towards price volatility. The current energy crisis in Pakistan has an impact on the production of consumer goods. The shortage of goods leads to increase in prices. Also constantly changing energy prices create uncertainty regarding the future path that prices will take which causes consumers to delay consumption of certain consumer durables which will eventually have an effect on prices of those commodities[6]. The energy crisis directly affects the productivity of labor. Since the fixed cost remains constant and production decreases drastically the cost per unit of a product increases immensely and therefore this leads to increase in prices of the end product. The world oil prices contributed to the energy crisis which also had a lagged impact on commodity prices[7].

- Other factors

  The distance that consumers have to travel to buy a certain commodity is also a factor which impacts the demand of a good and in turn will affect its price. For instance there are certain local markets i.e. mandis which are situated away from residential areas which may reduce the number of customers. Fuel costs also have a direct bearing here, as explained below.

  Internationally, agricultural commodities have been witness to global production shortages and speculative trading, in addition to factors such as widespread fluctuations in petroleum prices that have a trickledown effect on the prices of various essential items. Crude oil is also treated as an intermediate input in domestic production hence having an effect on the prices of consumer products and therefore contributes to the overall price volatility. Increase in the petroleum prices worldwide also means that the cost of other petroleum products including jet fuel, diesel fuel, heating oil, gasoline etc. will also increase. Variations in prices of some of these petroleum products will adversely affect price volatility as they are commonly used sources of fuels by the masses. Crude oil prices directly have an impact on the cost of transportation which yet again affects prices.

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6 Kilian, Lutz. *Oil Price Volatility: Origins and Effects*. Working paper. World Trade Organization Economic Research and Statistics Division. Web. http://www.wto.org/english/res_e/reser_e/ersd201002_e.pdf

7 http://www.infopak.gov.pk/EconomicSurvey/07-Inflation.pdf

This is also reflected in the prices of perishable commodities such as fruits, vegetables and dairy products.

Since Pakistan is an agricultural country, climatic changes have a considerable impact on production and crop yield. Weather has an impact on the supply side as well as demand side dynamics of prices of products. Unfavourable weather conditions may lead to a low crop yield which will create shortages in the market and hence have a direct impact on prices. On the other hand favourable weather conditions may even produce a bumper crop which may decrease prices in the market.

On the demand side, the consumption patterns also change according to the weather. Some items become more expensive in winters for example whereas other items may be more expensive in summers due to a rise in seasonal demand. For instance, dry fruits, nuts and eggs are expensive in winters because of a rise in weather-driven demand of such products.

1.4 Does your agency have any ongoing / pre-emptive monitoring activities in relation to these sensitive commodities? For example, do you routinely monitor prices, quantities or behaviors in these markets (both domestic and foreign markets)?

13. CCP does not routinely monitor prices, quantities or behaviors. However, the Commission has conducted various sectoral studies to assess competition concerns in the relevant commodity markets.

2. Competition enforcement and formal investigation conducted by Competition Commission of Pakistan

14. Following are a few significant law enforcement matters that CCP has dealt with in relation to commodities.

2.1 Pakistan Poultry Association- Cartelization

15. CCP took notice of media reports regarding an unprecedented hike in the prices of poultry products and possible cartelization, and initiated a *suo moto* enquiry. The Enquiry Report concluded that there was, *prima facie*, violation of Section 4 of the Act by the PPA.

16. It was observed during the hearings that the PPA had taken various decisions through its central and zonal committees and sub-committees, which had the object or effect of restricting, reducing, preventing or distorting competition through price fixing and production control in the relevant markets of parent stock, day old chicks, broiler chicken, table eggs and poultry feed. The Bench passed an Order in which it imposed a penalty of Rs. 50 million on PPA for violation of Section 4 of the Act.

2.2 Pakistan Jute Mills Association & Member Jute Mills- Cartelization

17. CCP, as part of its initiative to detect bid rigging in public procurement, sought information from Pakistan Agriculture Storage and Supply Corporation Limited (PASSCO) regarding tenders and bidding over the last few years. Scrutiny of the information received from PASSCO raised suspicion of bid rigging. CCP, taking *suo moto* notice of the information, initiated an enquiry that concluded that the PJMA had *prima facie*, taken decisions, and the jute mills had entered into an agreement, with respect to production, pricing and tendering of Pakistan Grain Sacks (PGS) to public procurement agencies, in violation of Section 4 of the Act.

18. Show cause notices were issued to the PJMA and its member mills. After hearing the parties, the Bench concluded that based on the evidence on record and the admission of the jute mills, an agreement

existed between the Jute Mills with regard to the production, supply and pricing of PGS to procuring agencies, which amounted to collusive bidding for tenders in violation of the Act.

19. The Bench took into consideration the admission of PJMA and jute mills that their actions had inadvertently resulted in non-compliance with the Act. A total penalty of PKR 23m was imposed on PJMA and 10 jute mills engaged in collusive activities.

2.3 Price fixing agreement between All Pakistan Sugar Mills Association and Ministry of Industry and Production

20. The Competition Commission of Pakistan noticed news items appearing on August 19, 2009, in leading newspapers of the country, reporting an agreement between All Pakistan Sugar Mills Association ("APSMA"), representing all the sugar production stakeholders and Ministry of Industries and Production ("MOIP"), on behalf of the Government of Pakistan, fixing the ex-mill rate of sugar at Rs.48/- per kg in Sindh and Rs.49.75/- per kg in Punjab (the "Agreement").

21. The implementation of such agreements under the auspices of the Government manifests legitimization of practices prohibited under law. The Commission was of the view that the Government must not provide any patronage to anticompetitive practices and measures that in effect promote and encourage collusive behavior on the part of the sugar mills through the platform of APSMA. Fixing of prices, output etc are universally recognized as having the most detrimental effects on competition; eradicating or seriously reducing the benefits that competitive markets deliver for consumers. While the Commission noted reports of alleged attempts to create artificial shortages of sugar, the Commission was of the opinion that this stop gap measure of 'fixing price' can at best provide temporary relief to cap the excessive price increase. However, this measure fails to benefit the sector or the economy at large. The short term benefit of fixing prices does not justify the long term loss caused by such anti-competitive policies.

22. Accordingly, the Commission recommended that the Government terminate the agreement at the earliest and desists from entering into arrangements that have the effect of encouraging collusive behaviour on the part of economic agents in any sector. However the case is still pending with the Sindh High Court.

2.3.1 Has your agency undertaken a market study into any commodity or commodities? Please explain what triggered the market study, the substance of the allegation, the analysis undertaken and the remedies imposed (if any).

23. CCP has not conducted market studies into specific commodity markets. However various sectoral studies have been conducted to assess competition concerns regarding products and relevant markets.

2.3.2 Has your agency received requests from governments or other parts of society to formally investigate commodities markets or requests for the competition authority to put downward pressure on prices where there has not been information or evidence suggesting anticompetitive behavior? What was the nature and circumstances of the request and how did your agency respond?

24. The Commission has to date not yet received any requests from the Government or other parts of society to formally investigate commodities markets. However the Commission has received various requests from the private sector regarding competition concerns in different product markets which the Commission has taken notice off and proceeded with further investigation.

3. Advocacy opportunities and challenges

25. Initiatives taken by CCP to recommend or advice on commodity price deregulation:

3.1 Opinion on Fixing a Minimum Price in the Cigarette Industry sent to Federal Board of Revenue

26. CCP took suo moto notice of advertisements, published in June 2008, by leading tobacco companies of Pakistan pertaining to pack prices of cigarette brands. The Commission also took notice of an advertisement by Federal Board of Revenue (FBR) printed in August 2008, declaring a minimum price for cigarettes and rendering it illegal to sell cigarettes below such minimum price. In the light of the subsequent public hearing and submissions made by the parties, the Commission was of the opinion that the conflict did not exist in the legal framework but rather it arose when FBR overstepped the mandate envisaged under law. The Excise Act empowers FBR to fix minimum prices only for the purposes of levying and collection of taxes and duties, and not for the purpose of determining a selling price. The restriction imposed by FBR on manufacturers and other persons associated with the cigarette business of not selling cigarettes below its prescribed minimum price is not envisaged under the law. While FBR may legally set a minimum price on cigarettes to impose tax upon, it may not stop the manufacturer's wholesalers or retailers from selling the cigarettes below that price. Thus it is the implementation and not the law that is giving rise to an anomalous situation.

27. A similar situation arose when FBR required manufacturers to print their retail prices in the newspapers, creating an automatic mechanism for manufacturers to monitor prices of their competitors, thereby preventing and restricting competition. Sharing of information such as price tables may facilitate anti-competitive behaviour since it is likely to eliminate uncertainty as to the future conduct of competitors in the relevant market and inevitably may affect future commercial policies of the undertakings. The Commission therefore recommended that all parties immediately desist from advertising cigarette prices in the print media. In the Commission's view, the imposition of such a restriction by the FBR resulted in prescribing minimum retail prices at two levels; first by FBR itself, and subsequently, by the manufacturers who while printing the manufacturer's recommended price use FBR's minimum retail price as a benchmark and prescribe the recommended price over and above FBR's minimum retail price. A random market survey revealed that in most cases, the actual retail price of different brands of cigarettes is above the manufacturer's recommended price printed on cigarette packs and published in advertisements as a result of which the manufacturer's recommended price then operates as a minimum price, enabling retailers to sell over and above such price. In this entire process neither FBR nor the consumer benefits in any manner.

28. The Commission was of the view that where manufacturers enjoy dominance in the relevant market, printing either minimum or maximum prices may have anti-competitive effects. However, if a choice has to be made, the maximum price is a better option as it has some pro-competitive effects. Perusal of the tax laws in Pakistan indicated that cigarette manufacturers are supposed to print maximum prices on cigarette packs. However, a misconception has emerged in the market that the prices printed on the cigarette packs is a minimum retail price set by the manufactures. Moreover, the retail prices published in the newspaper advertisement are likely to be misconstrued as the fixed retail price of cigarettes rather than manufactures recommended price. This appears to be in contravention of Section 10 (2) (b) of the Ordinance, which deems distribution of information lacking reasonable basis related to the price of goods as deceptive marketing. The consumer must, be clear as to what Retail Price/ MRP stands for.

29. CCP advised FBR and the manufacturers to stop publication of advertisements pertaining to minimum retail price with immediate effect. FBR, however, is empowered to intimate to the concerned undertaking what it deems the minimum price for the purposes of levying tax on the concerned goods and

collect the same accordingly. Moreover, FBR may require the undertakings to print on the cigarettes packs in unambiguous terms the maximum retail price. The Commission believes that the printing of a maximum retail price on cigarette packs would have a threefold advantage. Firstly, it would not in any manner impact FBR's attempt to plug the loopholes in the current tax collection system as FBR can continue to prescribe the minimum retail price for the purposes of levying and collecting tax. Secondly, it would prevent retailers from overcharging consumers because the price would be capped at the maximum retail price. Lastly, if at all placing the maximum price has an impact on pushing prices up that may help in deterring and discouraging consumers from use of cigarettes, thus catering for consumer protection as well as addressing Health Ministry concerns

3.2 Opinion on Exemption of Regulatory Duty on the Import of Ware Potatoes by International Fast Food Chains Franchisees

30. The Federal Board of Revenue (FBR) had made an exemption on 3rd February 2009 for the IFFC Franchises from paying the 25% regulatory duty on importing ware potatoes imposed on 29th January 2009. The Commission took notice of an article in the media on 10th March 2009 wherein the Lahore Chamber of Commerce and Industry expressed concern about the withdrawal of this regulatory only from International Fast Food Chains Franchisees (IFFC) on the and not local fast food chains which placing them at a competitive disadvantage.

31. In an open hearing held on the matter on 11th June 2009, the participants were given an opportunity to express their views on the imposition of regulatory duty on ware potatoes and its subsequent withdrawal only in favour of IFFC franchises. Representatives of IFFC franchises affirmed that the SRO is discriminatory and that they have no objection if zero regulatory duty given is rescinded by the FBR.

32. The SRO issued gives the Federal Government power to impose a regulatory duty on all goods imported or exported, as specified in the First Schedule. A mere perusal of section 18(3) makes it clear that the power to levy a regulatory duty is to be exercised in relation to goods specified in the First Schedule. The Federal Government cannot, at least under section 18(3) of the customs act, carve an exemption from paying the regulatory duty for a selected group of importers/exporters. Moreover, the regulatory duty of 25% on local importers raises the price that they have to pay vis-à-vis IFFC franchises.

33. In order to ensure free and healthy competition, and to create a level playing field for all market players, it is essential that all undertakings are treated at par. Therefore it was recommended that regulatory duty on ware potatoes should be imposed equally across the board and the notification SRO be put in its original form.

3.2.1 Has your agency been confronted by a government proposal to address pressing concerns about commodity prices that did impede competition (or would have impeded competition if it had been introduced)? What was the nature of the problem that the government was seeking to address? What was the timing and political constraints upon your opportunity to provide advocacy? What advice did the agency provide and what was the result.

34. The Commission has not yet been confronted by a government proposal of such nature.

3.2.2 Please describe any pre-emptive steps available to your agency to: Reduce the risk that commodity price volatility becoming a problem in your country?

35. The section 4 (prohibited agreements) of the Competition Act 2010, restricts and prohibits agreements and associations regarding production, supply, distribution, acquisition or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5.

3.2.3 Reduce the risk that governments or public societies seek policy responses to problematic commodity price volatility that would impede competition?

36. Section 29 (competition advocacy) of the Competition Act 2010 states that the Commission shall promote competition through advocacy which includes measures such as creating awareness promoting a competition culture. Reviewing policy frameworks for fostering competition, holding open hearings on any matter affecting the state of competition in Pakistan and affecting the country's commercial activities, are some of the other activities that the Commission conducts regularly as part of its advocacy mandate. It also posts on its website decisions made, inquiries under review and completed merger guidelines and educational material regarding competition regime in Pakistan.