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COMPETITION AND POVERTY REDUCTION

Contribution from CUTS

-- Session I --

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COMPETITION AND POVERTY REDUCTION

-- CUTS* --

1. Introduction

1. Competition in markets ensure that scarce resources are allocated efficiently resulting in improvement in productivity, cost savings and innovations leading to lowered prices, better availability and improved choices of goods and services for consumers.

2. Analyses show that differences in the level of competition between the Euro area and United States accounts for more than 50 per cent of the current gap in GDP per capita between these two areas. (Bayoumi *et. al.* 2004). A report by the Australian Productivity Commission quantifies the expected benefits from competition reforms as an annual gain in real GDP of 5.5%, consumer gains by AU\$ 9bn (2007). Furthermore, a 2007 UK Office of Fair Trading Report titled “Does Competition Reduce Inflation?” shows a robust and significant negative link between competition and inflation both at aggregate and sectoral levels.

3. However this is not just true for the developed countries. In the book, the Power of Productivity, author William Lewis emphasises on the need for lesser developed countries to have a robust competition regime. In doing so, he dispels the commonly held myth that competition policy and law are tools for the rich alone. He argues that if such countries could eliminate the policies that distort competition, they could grow rapidly.

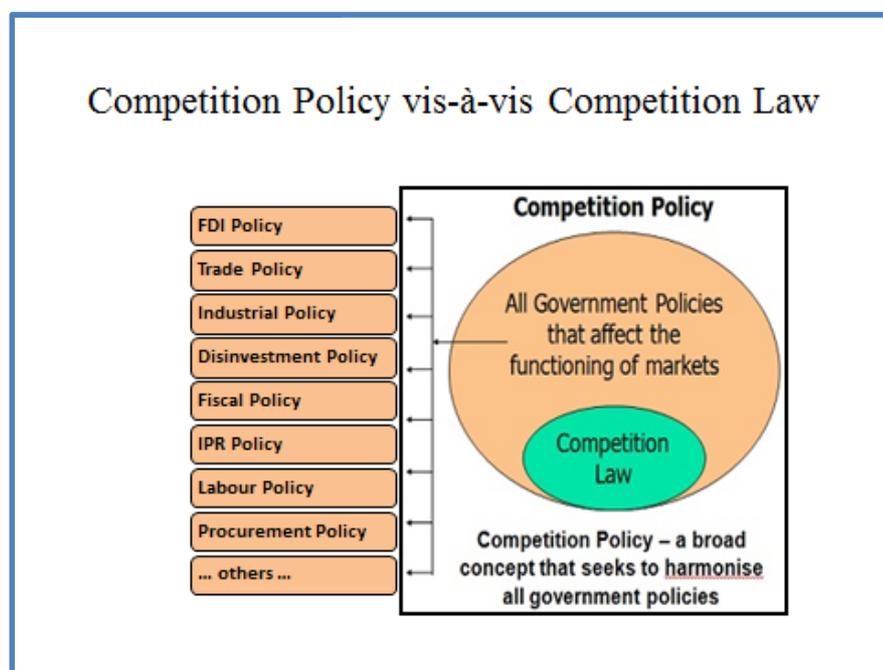
4. A 2007 World Bank Study found that the world’s poorest countries tend to have low levels of competition in domestic markets and a high degree of market dominance. Similarly, for e.g. when competition was introduced in generic drugs in South Africa, prices for antiretroviral drugs fell by up to 88% since 2003 and access increased from 20,000 to 155,000 units. The main objective of competition policy and law is to preserve and promote competition as a means to ensure the efficient allocation of resources in an economy. Nobel Laureate, Joseph Stiglitz asserted that “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.”

5. Without an effective competition policy and law, international anti-competitive practices can restrict trade in small and developing countries as well. The available evidence suggests that international cartels and other restrictive practices by private firms operating in international markets – designed to limit competition in international trade do exist. These arrangements can be quite durable and detrimental to economic development of countries that do not have a strong domestic competition regime.¹

* Consumer Unity & Trust Society.

¹ Levenstein, Margaret and Valerie Suslow, Private International Cartels and Their Effect on Developing Countries (Background Paper for the World Bank's World Development Report 2001, 9 January 2001)

6. There are two components of a competition regime: (a) competition policy and (b) competition law. While competition law is the regulatory framework to check anti-competitive practices in the market, competition policy is understood as the full set of measures necessary for ensuring competitive market structures/behaviours.² It includes several economic policies, as explained below in the graph³.



7. There are complex inter-relationships between competition policy and other economic policies. This factor has a direct bearing on the extent to which competition policy objectives can be pursued without being constrained by or conflict with other public policy objectives, especially in key markets. Although a competition law may be quite narrow in its scope, competition policy is more broad and comprehensive. Its purpose is to bring harmony in all government policies that may encourage or adversely affect competition, consumer welfare and economic development.

2. Competition Policy and Poverty Reduction

8. The biggest challenge in the developing world today is to get rid of abject poverty that deprives a large section of the population a dignified life. Policymakers in these countries need to design and implement policy measures to tackle this problem. Public policy responses designed and implemented in these countries without such considerations will not benefit them in the long run. Competition policy should be no exception to this maxim.

9. An important approach to poverty reduction is to empower the poor, provide them with productive employment and increase their access to land, capital and other productive resources. But this approach may not be successful unless these people are linked to the markets and markets are made to

² CUTS (2001), 'Competition Policy & Law – Made Easy, available at <http://www.cuts-international.org/pdf/cplme.pdf>

³ Mehta, Pradeep S (2007), 'Competition and Regulation in India, 2007', available at http://www.pradeepsmehta.com/pdf/Competition_and_Regulation_in_India_2007.pdf

work for the benefit of the poor. This would open economic vistas for them, providing them with economic empowerment and freedom that is so crucial for their survival and well-being. As stated in the World Development Report 2000-01, “Markets work for the poor because poor people rely on formal and informal markets to sell their labour and products, to finance investment, and to insure against risks. Well-functioning markets are important in generating growth and expanding opportunities for poor people.”

10. Competition is not an automatic outcome of market reform measures, and needs to be nurtured. Market processes can be distorted by players in the market, even when there are a large number of them. Governments enact national competition laws to regulate such distortions.

11. What gets very often ignored is the fact that prevalence of anti-competitive practices in certain ‘key markets’ hurt the poor more. Identifying these ‘key markets’ and curbing such malpractices should be a priority for developing country governments. A rich person would not mind paying a dollar more for a certain good or service, but for people living at less than ‘a dollar a day’ - getting value for money for every cent they spend is crucial. Individuals and families with lower incomes have to spend a greater proportion of their income on goods and services, and therefore, high prices arising from anti-competitive practices will have greater impacts on them than other segments of society.

12. The sectoral composition of growth can determine the impact that growth will have on poverty. For example, it is often argued that in countries where most of the poor live in rural areas, agricultural growth reduces poverty because it generates income for poor farmers and increases the demand for goods and services that can easily be produced by the poor. This is true, if, the agricultural markets are functioning competitively, which unfortunately is seldom the case. Market distortions are common both in the inputs markets (seeds, fertilisers, pesticides) and outputs markets (given low bargaining power of a producer vis-à-vis intermediaries/buyers in the outputs market). High cost of inputs and price manipulation at the outputs stage results in reduced margins for most developing country producers.

13. Inflation, especially when it is a result of excessive pricing or cartel pricing, is a regressive and arbitrary tax, the burden of which is typically borne disproportionately by the poor. The reason is two-fold.

- a. First, the poor tend to hold most of their financial assets in the form of cash rather than in interest-bearing assets.
- b. Second, they are generally less able than are the better off to protect the real value of their incomes and assets (Bruno and Easterly, 1998). In consequence, price jumps generally erode the real wages and assets of the poor more than those of the non-poor. This phenomenon typically operates through shocks to the human capital of the poor (Forbes, 2000; Li, Xie and Zou, 1999; Masson et al, 1997).

14. In addition, other anti-competitive practices such as cartels, abuse of dominance, anti-competitive mergers etc. result in higher prices, low quality and less variety, leaving the whole economy to suffer.

Imperfect agriculture markets and high food prices!

The market of agricultural producers is often considered to be an example of a perfectly competitive market. This might be the case for farmers as there is large number of them. However for consumers the experience is different. Farmers do not reach the consumers directly and there is a chain of intermediaries. Unfortunately, these sets of intermediaries do not always work in a competitive manner. Thus, the final consumers of agricultural products do not get the advantage of a competitive market. Hence a huge gap exists between the prices the consumers pay and the prices the primary producers receive. This kind of a situation is not restricted to some particular countries, but has become a global feature. These intermediaries abuse their monopolistic dominance in the market for final products while in the markets for primary products they abuse their monopsonistic dominance.

Apart from adversely impacting the final consumers, they also have a negative impact on the farmers who draw their livelihood directly from agriculture.

Tebas District, Sambas Municipality in West Kalimantan Province was one of the wealthiest districts in Indonesia. The agriculture sector, especially the 'Pontianak Orange', contributed about Rupiah1.5bn to the local government treasury, a big amount of money until the rupiah devaluated due to a monetary crisis. Due to its high quality 'Pontianak Orange' hardly had competitors, and thus dominated the market. In 1991, the Central Government decided to take over the trade of these oranges, and issued regulations that required all harvested oranges should be channelled through a company called Bina Citra Mandiri (BCM). This company, rather than being a state-owned company, belonged to a close family member of the President. Farmers or merchants who tried to sell directly in the open market could be charged for smuggling and put into jail. Besides, BCM also regulated the price and quotas in distribution. Farmers and merchants were allowed to sell 10 percent of the harvest in the market, while the remaining 90 percent was to be sold to BCM.

This monopsonistic system resulted in a great loss for farmers. Consequently, they decided to stop harvesting their orange crop, because it was un-remunerative. By not harvesting the oranges, the rotting crop led to virus infection. Within a very a short time, 7.6mn trees located in 19,000 hectares had to be cut down in order to curb the disease. Later, the Ministry of Agriculture and the National University of Tanjungpura Pontianak had to work hard to recover from the situation. It took some time before the team could even gain support from the farmers who had experienced such a trauma.

Source: Indonesia Country report in 'Competition Regimes in the the World – a Civil Society report', 2005, pg. 60

3. Benefits of competition for poor consumers and small producers

15. A series of projects using the 7Up model⁴ were implemented by CUTS from 2001. These were a multi-country projects combining research, advocacy and capacity building on competition policy and law and implemented in developing and least developed countries of Africa and Asia. Below are findings from some of the 7Up project that substantiate the prime argument that this submission makes on the positive link between competition reforms and poverty reduction.

3.1 Namibia

16. The Namibian Consumer Association (NCA) led a campaign in 2006-07 pointing out how Namibian banks were charging high service charges/bank fees for the customers. This campaign of NCA (the only consumer organization in Namibia) was strengthened by research undertaken by NEPRU (Namibia Economic Policy Research Unit), a premier think-tank in the country which provided the

⁴ CUTS 7Up Model: Application of a bottom-up, advocacy-based approach to build a culture of competition, and a wider understanding of the benefits of competition (<http://cuts-ccier.org/7Up-model.htm>)

evidence to substantiate NCA's claim⁵. A large number of Namibians (nearly 45%) remained un-banked owing to such high charges which made banking unaffordable for the ordinary Namibians. NEPRU had been implementing a project in cooperation with CUTS (known as 7Up3) in Namibia over this period and highlighted a low-level of competition in retail banking (as one of the factors) contributing to high bank charges in the country (especially among the four leading banks)⁶. It was also reported that often the banks were not very clear and/or transparent about these charges. So a large number of ordinary Namibians (using the facility of these banks) were being adversely afflicted due to such practices of the banks.

17. As a result of evidence provided by NEPRU and the constant lobbying by NCA, the matter reached the Parliamentary Standing Committee on Economics, Natural Resources and Public Administration of Namibia. The Committee recommended all banks to become more transparent while dealing with their customers and to state their charges upfront while servicing them⁷.

3.2 *India*

18. In India, in 2005-6, CUTS undertook a study of competition in various Indian markets including cement, telecom, steel, pharma, transport, etc. under the project Towards a Functional Competition Policy for India (FunComp project)⁸. The study raised alarm about the existence of a cartel in the Indian cement industry and recommended the government (especially the incoming Competition Commission of India) to take immediate action⁹. CUTS initiated a press campaign subsequently to push the government into investigating the cartel in the cement sector. Eventually in 2008, MRTP undertook the investigation as a result of mounting pressure from CUTS and others (a complaint had also been brought by the Builders Association of India), and was able to unearth the existence of a cartel among 10 major players in the cement market operating on the platform provided by the Cement Manufacturing Association¹⁰ and the MRTP Commission had ordered the companies to cease and desist only.

19. Recently, the Competition Commission of India(CCI) passed an order in June 2012, wherein it found 11 cement manufacturers guilty of cartelization and imposition of high prices as a result, and has imposed a penalty at the rate of 0.5 times of their profit for the year 2009-10 and 2010-11 for violation under Section 3 of the Competition Act, 2002. The penalty amounts to more than Rs. 6,306.59 crore (Nearly \$1.14 billion). The CCI also imposed an additional penalty on the Cement Manufacturers Association. At present, the Competition Appellate Tribunal (COMPAT) is adjudicating the case.¹¹

⁵ Source: The Namibian, 17.07.2006

⁶ Refer www.nepru.org.na; and 7Up3 Country Research Report for Namibia (downloadable from <http://www.cuts-ccier.org/7up3/pdf/CRR-Namibia.pdf>)

⁷ Source: The Namibian, 28.11.2006

⁸ <http://www.cuts-international.org/pdf/compol.pdf>

⁹ Mehta, P.S. (Eds), "Towards a Functional Competition Policy for India", Academic Foundation, Delhi, 2001, pp 165-174

¹⁰ <http://www.baionline.in/media/data/MRTP2.pdf>

¹¹ The demand of low-income and lower-middle income housing in urban India has increased exponentially in recent times. Thus it will help facilitate construction of homes for the large number of urban poor across the country - currently living in abject, unhealthy living conditions.

3.3 *Mauritius*

20. Mauritius had to rely on powdered milk to meet their and their children's nutritional demand as fresh milk was unavailable in the country prior to 2006. The powdered milk market was dominated by a handful of players. One of them enjoying 60% of the market share (clearly a dominant position) decided to raise the price of the product abruptly. The price rose to a peak of Mauritius Rupees (MUR) 190 per kilogram during the period 2004-06. The company was enjoying a profit margin of nearly 41% in the retail market, then.

21. At this point of time, as a result of CUTS project on competition policy and law issues (7Up3 project) the level of awareness and understanding on competition issues in the country had improved considerably. Impact of anti-competitive practices on consumers' daily lives was being discussed in public platforms/media, etc. This was largely due to the outreach made possible by the advocacy partner of CUTS for the 7Up3 project in Mauritius, Institute for Consumer Protection (ICP). Pursued by continuous lobbying by ICP, the government eventually intervened in the market and fixed the margin of profit for the sector at 14%¹². This led to a decrease of price, which later stabilized between MUR 90-120 per kilogram across the country.

3.4 *Zambia*

22. A CUTS project earlier in 2000-02 (7Up1 - <http://www.cuts-ccier.org/7up1/>) noted with concern that the competition authority of Zambia was engaged mainly with big business and did not look at the problems of small businesses. The Zambia Competition Commission (ZCC) personnel felt that their law restricted it to act on business malpractices that had significant impact on the economy. This point was debated on during the meeting of the National Reference Group (NRG), held on 22nd of November, 2001. The purpose of the meeting was to come up with recommendations, which the project would seek to have addressed by influencing the relevant stakeholders. As a result of this concern, although it was noted that the less of focus was a result of the Act, the NRG members recommended that "ZCC should address the concerns of small-scale sector"¹³. ZCC was represented in the meeting and agreed to take the issue forward. Following the project, there was a noticeable change in approach of ZCC towards the small scale sector. Examples include ZCC directing a monopoly retailer (Shoprite of South Africa) to purchase farm produce from the small scale farmers rather than importing and ZCC holding discussions with the multinationals in the tobacco, cotton and poultry sectors to stop abusive practices against small scale farmers¹⁴.

23. The cotton example can be elaborated on. In 2005, ZCC saw a report in a local newspaper, The Post, where women farmers in Katete were calling for a review of farming contracts as they were being abused by the dominant firms. Two multinationals (Dunavat and Cargill Cotton) were dominating the market with a CR2 of 83.49% and abused the outgrower scheme by charging high input prices and paying a low final price. Before ZCC's intervention, they paid a price of ZK850/kg for grade 'A' cotton while charging the input prices at ZK40,000 per pack. While investigations were still underway, Dunavat indicated that they were now reducing input prices to ZK36,000 while increasing the planting price to

¹² <http://www.cuts-international.org/7up3/7Up3-enevnsIV.htm>

¹³ CUTS, 2002, Enforcing Competition Law in Zambia page 42, a report published as a part of the 7-Up Project supported by DFID, UK.

¹⁴ George Lipimile, 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 available at http://www.cuts-ccier.org/7up4/ppt/PPT-IRM-Contribution_Of_Competition_To_Growth_And_Poverty_Reduction.ppt

ZK1,000/kg. Cargill also decreased input price for the 2006 season by 28% and increased the buying price to ZK1,120/kg. According to Cargill's estimates, the changes gave an average farmer an additional net income increment of 75% compared to the previous year¹⁵. One can well imagine the huge multiplier effects of these systemic changes on poor people and particularly their livelihoods.

4. **Garnering greater support for competition reforms in DCs**

24. A healthy competition culture is the ideal outcome of an effective competition regime and effective competition advocacy. The need for strengthening the overall capacity of competition agencies cannot be underestimated as the foremost requirement for the benefits of competition reforms to trickle down to the poor is to ensure a strong institution to enforce the competition regime in the first place.

25. Experiences gathered from Africa and Asia has strengthened CUTS belief in the *ability of competition reforms for improving consumer welfare and producer benefits in DCs*. Greater thrust is needed for taking the competition reform processes forward in DCs, especially given that competition policy and law is still an evolving public policy area in many of them. Many of these countries have realised the difficulties in implementing their competition law, relying only on the ability of the national competition enforcement agency, especially in the wake of imposing policy impediments, stakeholder ignorance and considerable vested interests. It is essential to expand the frontiers of the competition policy implementation process in developing countries, in order to make it more effective.

26. With this background, CUTS has designed a project entitled Competition Reforms in Key Markets for Enhancing Social and Economic Welfare in Developing Countries (referred to as CREW Project)_to be implemented over a period of three years in four countries with focus on two sectors. This project would help develop an approach (with a suggested combination of - indicators, metrics and tools), which would help (under specific conditions) in assessing benefits of competition reforms on consumers and producers in specific developing country markets.

27. One of the main goals of this project is to demonstrate the benefits of competition reforms to developing country policymakers and politicians, so that they can provide greater attention to this issue. The CREW project would also provide guidance on how to design and implement such a reforms programme to DC policymakers.

¹⁵ The specific details on the prices were obtained from Kaira T (ZCC Executive Director), "The Role of Competition Law and Policy in Alleviating Poverty – The Case of Zambia" in 'The effects of anti-competitive business practices on developing countries and their development prospects', UNCTAD, 2008.