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LATIN AMERICAN COMPETITION FORUM

Session I: Competition and Poverty Reduction

Background Note

18-19 September 2012, Santo Domingo, Dominican Republic

This Background Note by the OECD Secretariat is circulated FOR DISCUSSION under Session I of the Latin American Competition Forum at its forthcoming meeting to be held on 18-19 September 2012 in Santo Domingo, Dominican Republic.

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LATIN AMERICAN COMPETITION FORUM

-- 18-19 September 2012, Santo Domingo (Dominican Republic) --

Session I: Competition and Poverty Reduction

Background Note by the OECD Secretariat

DOES COMPETITION IN MARKETS FOR ESSENTIAL GOODS AND SERVICES REDUCE POVERTY?*

1. Introduction

1. Despite substantial progress in recent years, poverty reduction remains an important challenge in Latin America. One out of every three Latin Americans (180 million people) lives below the poverty line and ten Latin American economies rank among the 15 most unequal economies in the world.¹ Governments are continually looking in many policy areas, including competition policy, for answers that will help them to reduce poverty further. To help competition agencies address that concern, this session of the 2012 Latin American Competition Forum will explore the impact of competition on impoverished consumers in markets for essential goods and services.

2. In this context, “essential goods and services” means, among other things, basic foods such as chicken, rice, beans, and tortillas; building materials, such as cement, for public infrastructure and housing; financial services like small loans, savings accounts and money transfers; and mobile communications products and services. We are excluding traditionally regulated utilities like water, electricity, and fixed-line telecommunications, as well as prescription drugs.

* This paper was written by Zsófia Tari and Jeremy West, OECD Competition Division.

¹ OECD, Latin American Economic Outlook 2012, p. 9, available at: www.oecd.org/dev/latinamericaandthecaribbean/48965859.pdf.

3. A country's poorest people may not always be viewed primarily as consumers, yet they necessarily consume things to live. Like the rest of the population, impoverished people need essential goods and services. But for the poor, the money they spend on such things is a greater – and often far greater – share of their income than it is for wealthier consumers. Therefore, when essential goods and services cost more than they should, poor consumers suffer disproportionately. For them, higher prices can deepen their poverty by making essential items altogether unaffordable, or they might require the sacrifice of another item that is also greatly needed. On the other hand, lower prices on essential items have the potential to relieve poverty by putting previously unaffordable items (or greater quantities of items) within their reach. That is why it is intuitively appealing to look toward competition policy as an agent for poverty reduction.

4. Granted, higher prices have many possible causes, such as economy-wide inflation or supply failures. But when prices rise because essential goods or services providers merge with their rivals, unilaterally and anticompetitively stifle those rivals, or form a cartel with them, greater competition can lead to substantially lower prices. Other factors, such as overly restrictive or biased regulations, may also lead to unnecessarily low levels of competition and artificially high prices. Ironically, some government policies might be motivated by pro-poor concerns but can wind up doing more harm than good, such as implementing government-provided financial services or mandating transportation services on infrequently-used routes. Competition authorities may be able to identify such policies and advocate pro-competitive change as well as the use of competitive principles in the pro-poor policymaking process generally.

5. Whether greater competition actually reduces poverty, however, depends on several framework conditions other than the quality and strength of competition enforcement and advocacy. Those conditions are sometimes part of the problem rather than part of the solution. For example, if corruption and non-transparency are widespread within a government, greater competition may not lead to better results for those below the poverty line. Alternatively, it may be difficult for a competition authority to act in the first place. In some developing countries, for example, competition laws that could be used to fix a competition problem are in place but they are not always adequately enforced. That may be because the competition authority lacks sufficient political power and influence to fight multinational corporations, for instance, which can be well connected to other parts of the government.

6. Part 2 of this paper sets up the rest of the discussion by reviewing various ways to define poverty. In Part 3, we quickly review the ways in which competition is expected to affect poverty in essential goods and services markets according to economic principles. Then we explore how competition has actually affected poor consumers in real life. Part 4 examines the question of whether interventionist measures like price controls, import barriers, and subsidies might be better for poor consumers than competition. Part 5 addresses the issue of competition's potentially mixed effects on poverty, given that in some markets both the buyers and sellers are impoverished. Finally, Part 6 contains some suggestions for what competition authorities can do to help reduce poverty in essential goods and services markets.²

² Please note that, with the exception of Part 5 on mixed effects, this paper does not address the effect of competition on the poor as workers and small business owners. In other words, the paper does not dwell on the effect of competition on impoverished people's ability to *earn* money or topics such as whether competition enforcement can lift people out of poverty by preventing dominant firms from stifling small enterprises. Those issues will be addressed at the OECD's February 2013 Global Forum on Competition in Paris.

2. Definitions of Poverty

7. While there is widespread agreement on the desirability of poverty reduction, defining poverty is more controversial. There is no objectively correct definition of poverty and most commentators accept that any definition must be understood in relation to specific political, economic or social contexts.³ For example, poverty is a problem not only for developing countries but for most developed countries, as well, but the official poverty line is usually higher in the developed countries.⁴

8. Poverty can be defined by using three different concepts: income, basic needs and capability. Of these, the most commonly used concept is income, according to which a person is poor if her income is below a certain amount. The basic needs concept considers the material requirements for a minimally fulfilling life. These are normally understood to include factors such as basic health care and education. The capability perspective concentrates on basic needs such as adequate nutrition, clothing, and shelter, but also considers social aspects such as partaking in the life of a community.

9. For each of the above concepts there are two measurement methods: drawing an absolute poverty line or choosing a relative poverty threshold. Developing countries, where poverty tends to be a more widespread problem, usually use absolute poverty lines, whereas developed countries often prefer relative poverty measurements tailored to their inhabitants and their particular society's standards.⁵

2.1. Absolute Poverty Lines

10. An absolute poverty line is a level below which the minimum requirements for an adequate life are not being met. With respect to the income concept of poverty, absolute poverty lines are typically defined by either a state or an international organisation. For example, in 1990 the World Bank defined poverty as the inability to attain a minimum standard of living and established an international poverty line at US\$1 per day to help track the global incidence of extreme poverty.⁶ The \$1 per day standard was widely adopted.

11. To set that poverty line, the World Bank examined national poverty lines in low-income countries. The poverty lines were converted to a common currency to make it easier to compare them. In making the conversions, the Bank used purchasing-power parity (PPP) exchange rates to take into account the variations in purchasing power of different currencies in domestic markets. The World Bank found

³ Ruth Lister, *Poverty (Key Concepts)*, Polity Press (2004), Chapter 1.

⁴ An article that appeared in *The Economist* in 2005 illustrates this point. The article compared the lives of an unemployed truck driver in the coal mining industry of the US's Appalachia region and a doctor in the Democratic Republic of Congo. At US\$521 and US\$250-\$600 per month, respectively, the incomes of the two men were roughly similar, but the American truck driver was considered desperately poor while the Congolese doctor was deemed to be very well-off. In the US, the median annual income in 2004 was \$44,389. More often than not, even "impoverished" American families had at least one television in their home, their children usually attended school, and they typically did not have to grow their own food to survive. In contrast, the average annual income in Congo was US\$673 and even basic utilities such as running water and electricity were rare. "The Mountain Man and the Surgeon: Reflections on Relative Poverty in North America and Africa," *The Economist* (20 December, 2005), available at: www.economist.com/node/5323888.

⁵ Martin Ravallion, "Poverty Lines across the World," World Bank Policy Research Working Paper 5284 (2010), p. 3.

⁶ World Bank, *World Development Report on Poverty* (1990), p. 26, available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2000/12/13/000178830_98101903345649/Rendered/PDF/multi_page.pdf.

that poverty lines varied between \$275 and \$360 per year in PPP terms, using the 1985 prices of commodities. Because these values are quite close to \$1 per day, that benchmark prevailed as a popular poverty line.⁷ The advantage of using an absolute line and the PPP concept for defining poverty is that any two people with the same purchasing power over commodities are treated the same way, even if they live in different countries.⁸

12. The \$1 per day definition has drawn fierce criticism for not reflecting the real cost of meeting basic requirements for a human being. However, almost one fifth of the total population in developing countries still lives below even that line.

2.2. *Relative Poverty Thresholds*

13. Relative poverty thresholds tend to be used by developed countries. These thresholds track the people with the lowest resources in the country and the benchmark for this comparison is always either the median or average of all the country's inhabitants. Typically, relative poverty thresholds are set at 40-60 percent of the national median. Relative poverty thresholds vary by country and they also change over time. Therefore, the thresholds will rise if the country becomes richer. Unlike absolute lines, "relative lines do not claim to represent physiological minima and are instead (typically) set at a constant proportion of current mean income or consumption."⁹ Because relative thresholds are always based on a benchmark of the population's median or average income, poverty can never be eliminated under this definition (unless income distribution is perfectly or near-perfectly uniform).

14. Sociologist Peter Townsend uses a more subjective definition of relative poverty:

Individuals, families and groups in the population can be said to be in poverty when they lack the resources to obtain the type of diet, participate in the activities and have the living conditions and the amenities which are customary, or at least widely encouraged or approved in the societies to which they belong. Their resources are so seriously below those commanded by the average family that they are in effect excluded from the ordinary living patterns, customs, and activities.¹⁰

15. The European Commission's definition, adopted in 1975, is very similar to Townsend's, but the social participation dimension is not explicitly mentioned: "The poor shall be taken to mean persons, families and groups of persons whose resources (material, cultural and social) are so limited to exclude them from the minimum acceptable way of life in the Member State in which they live."¹¹

2.3. *The Holistic Approach*

16. Some approaches integrate the absolute and relative methods without setting an exact threshold. Most of the international organisations that have a part in alleviating poverty publish a general definition or

⁷ The figure was revised in 2008 to \$1.25 per day at 2005 PPP. Martin Ravallion, Shaohua Chen & Prem Sangraula, "Dollar a Day Revisited", World Bank Policy Research Working Paper 4620 (2008).

⁸ Martin Ravallion & Shaohua Chen, "Weakly Relative Poverty", World Bank Policy Research Paper 4844 (2009), p. 3.

⁹ Ravallion, *supra* n.5 at 3.

¹⁰ Peter Townsend, *Poverty in the United Kingdom*, University of California Press (1979).

¹¹ This definition of poverty was elaborated by the European Commission during its first Anti-poverty Programme (1975-1980). It may be found in the Joint Report by the Commission and the Council on Social Inclusion, available at: http://ec.europa.eu/employment_social/soc-prot/soc-incl/final_joint_inclusion_report_2003_en.pdf at p. 8.

explanation of poverty. These are usually holistic definitions that consider not only food scarcity but social and psychological aspects of poverty, as well.

17. The OECD does not endorse a specific definition of poverty, but in its Poverty Reduction Guidelines the Organisation's Development Assistance Committee summarizes poverty as follows:

The concept of poverty includes different dimensions of deprivation. In general, it is the inability of people to meet economic, social and other standards of well-being. The multidimensionality of poverty is now widely accepted. It is based solidly on research that includes major participatory studies of what poor people mean by poverty. It covers measures of *absolute poverty* such as child and infant mortality rates, and *relative poverty*, as defined by the differing standards of each society.¹²

18. According to the World Bank, “[p]overty is pronounced deprivation in wellbeing. . . . To be poor is to be hungry, to lack shelter and clothing, to be sick and not cared for, to be illiterate and not schooled. . . . Poor people are particularly vulnerable to adverse events outside their control.”¹³ “The main focus is on whether households or individuals have enough resources to meet their needs. . . . Do they have enough food? Or shelter? Or health care? Or education?”¹⁴

19. The United Nations (UN) Economic and Social Council has a similar definition that emphasizes an inability to participate in a society:

[P]overty is a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society. It means not having enough to feed and clothe a family, not having a school or clinic to go to, not having the land on which to grow one's food or a job to earn one's living, not having access to credit. It means insecurity, powerlessness and exclusion of individuals, households and communities. It means susceptibility to violence, and it often implies living in marginal or fragile environments, without access to clean water or sanitation.¹⁵

2.4. The Human Poverty and Multidimensional Poverty Indices

20. The Human Poverty Index (HPI) was developed by the UN to indicate the standard of living in a country. According to the UN, poverty means that the opportunities and choices that are most basic to human development are denied, so the HPI focuses on the deprivation of three basic elements of human life: longevity, knowledge and a decent living standard.¹⁶ Because poverty can have very different meanings in developed and developing countries, there are two different ways to calculate this index.

¹² OECD, Poverty Reduction, Development Assistance Committee Guidelines (2001), p. 37, available at: <http://publications.oecd.org/acrobatbook/4301091e.pdf>.

¹³ World Bank, World Development Report 2000/2001: Attacking Poverty, p. 15, available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2001/09/18/000094946_01083004025527/Rendered/PDF/multi0page.pdf.

¹⁴ Jonathan Houghton & Shahidu Khandker, Handbook on Poverty and Inequality, World Bank (2009), p. 2, available at: <http://issuu.com/world.bank.publications/docs/9780821376133>.

¹⁵ United Nations Statement, June 1998 (this definition of poverty is also available at: http://www.un.org/esa/socdev/unyin/documents/ydiDavidGordon_poverty.pdf).

¹⁶ *Id.*

21. The index for developing countries takes into consideration the probability at birth of not surviving to the age of 40, the adult illiteracy rate, the unweighted average of the population without sustainable access to a decent water source, and the unweighted average of undernourished children. The index for developed countries sets the life expectancy at age 60 and considers the proportion of adults lacking functional literacy skills and the population below the income poverty line (50 percent of the median household's income) as well as the long term (12 months or more) unemployment rate.

22. The UN replaced the HPI with a Multidimensional Poverty Index (MPI) in 2010. The three basic elements remain the same, but the MPI also uses ten indicators of critical "deprivations", such as education, health, sanitation, assets and services (electricity, drinking water). Taken together, these indicators provide a fuller portrait of acute poverty than either simple income measures or the HPI. A household is identified as multidimensionally poor if it is deprived in some combination of indicator categories whose weighted sum exceeds 30 percent of all the types of deprivations that are tracked.¹⁷

2.5. *Some Alternative Approaches to Measuring Poverty*

23. As we have seen, poverty can be defined in multiple ways, but a good definition should also correspond well with the population's conception of poverty. A newer term, the "social subjective poverty line"¹⁸, acknowledges that there is an income above which people tend to think they are not poor anymore and below which they usually think they are poor.

24. Poor people sometimes believe that they cannot escape from poverty because of factors beyond their control that contribute to a lack of opportunities. Whether to have impoverished parents or not, for example, is obviously not a choice that a child can make, but if a child does have parents who are poor, that will certainly have an effect on the child's opportunities. Recognizing that fact, the World Bank developed an alternative index to measure how external factors affect one's opportunities for having an acceptable life.

25. The Human Opportunity Index (HOI)¹⁹ considers how personal circumstances (birthplace, wealth, race or gender) affect a child's probability of access to basic goods and services. The HOI indicates how many opportunities (e.g. overall access to primary education, clean water, etc.) are available in a given country or region and how equitably those opportunities are distributed between rich and poor people. With the numeric representation of differences in opportunities, it becomes possible to measure a society's progress in moving toward universal access.

¹⁷ Sabina Alkire & Maria Emma Santos, Oxford Poverty and Human Development Initiative Multidimensional Poverty Index (July 2010), available at: www.ophi.org.uk/wp-content/uploads/OPHI-MPI-Brief.pdf

¹⁸ Martin Ravallion, Shaohua Chen and Prem Sangraula, "Dollar a Day Revisited," World Bank Policy Research Working Paper 4620, 2008, p.4.

¹⁹ José Molinas, Ricardo Paes de Barros, Jaime Saavedra & Marcelo Giugale, "Do our Children Have a Chance? The 2010 Human Opportunity Report for Latin America and the Caribbean," The International Bank for Reconstruction and Development/The World Bank, available at: http://siteresources.worldbank.org/INTLACREGTOPPOVANA/Resources/840442-1260809819258/6645553-1273515611898/Livro2010_final.pdf

3. Competition's Effect on Poor Consumers of Essential Items, in Theory and in Practice

3.1. Theoretical Effects

26. From a standard microeconomic theory perspective, the effect of competition on markets is straightforward: competition drives markets toward the equilibrium of supply and demand, eliminates inefficiency, and eventually results in prices that are equal to the most efficient firms' marginal cost. If a market is less than perfectly competitive to begin with, then greater competition should bring about lower prices, higher output, better quality, and possibly more innovation. These results are generally to be expected in all markets, not just essential goods and services markets, and they benefit all consumers, including impoverished ones.

27. For example, if a rice cartel is dismantled by a competition authority's intervention, we would expect poor consumers to benefit from lower prices and higher quantities in the rice market because the cartel members are no longer coordinating with each other to restrict their output and keep prices artificially high. Similarly, if a proposed 3 to 2 or 2 to 1 merger between two mobile phone service providers is blocked, we would probably expect the prices of mobile phone calls and text messages to remain lower than they would have been had the merger been permitted because the two firms involved will have to continue to compete for customers. In the longer run, the competition that was preserved may also lead to more productivity growth – and thus relatively lower prices – as the firms vie with one another by innovating to cut costs and raise quality/service.

28. The poor can also benefit indirectly from greater competition. Suppose that a country has programs in place to fight poverty, but that its public procurement operations are generally plagued by bid-rigging. The contractors would be siphoning off money that could otherwise be used to fund programs, including the anti-poverty measures. The artificially high premiums charged by the big-riggers might mean, for example, that a supplemental nutrition program for poor children has to be cancelled due to lack of funds, or that only two new job training centres can be built instead of three. Ending the collusion and making the contractors compete again would lower costs, putting the savings back into the government's budget.

29. Moreover, competition can have a kind of cleansing effect that eliminates the harm caused by corrupt and inefficient practices like nepotism and other forms of non-merit-based favouritism. Businesses facing competitive constraints are less able to afford to staff well-paid posts with the poorly qualified cousin or son-in-law of an executive officer or a well-connected customer. Likewise, under competition, successful companies are those with the best products and prices, not those paying the biggest bribes or managed by people from favoured ethnic groups, etc.

30. If we put theory aside, though, do we know much about the actual effects that competition has had on poor consumers?

3.2. Actual Effects

3.2.1. Competition problems also exist outside of developed countries

31. One way to establish that competition has actually helped poor consumers is to show that a lack of competition has harmed them. But first we have to show that insufficient competition is a problem that can affect all market economies, not just developed ones. The competition community tends to accept as fundamental truths the ideas that wherever there are markets there is always a possibility that competition problems will occur, that such problems can indeed be found in virtually all market economies, and that they cause substantial harm to consumers. At times, however, officials from other policy domains and backgrounds, particularly in developing countries, have expressed scepticism about whether those ideas

really hold true in their jurisdictions. To help change that attitude, Simon Evenett, Julian Clark and Frédéric Jenny amassed databases of actual and alleged anticompetitive conduct in developing countries around the world, including in Latin America.²⁰

32. Their information shows not only that there is plenty of anticompetitive conduct in the developing world, but that much of it affects markets for essential goods and services. For instance, Peruvian poultry farms and their trade association have conspired to block entry and eliminate competitors. Likewise, 11 Peruvian wheat flour producers and their trade association formed a cartel to end a price war. Zambian poultry firms have demanded that their biggest customer stay out of the production market – and the customer complied. Cartels and boycotting agreements have been discovered and prosecuted in the baking, milling, sugar and milk industries. Anticompetitive practices are endemic in public transportation markets such as bus and taxi services, on which many poor consumers depend. The cement industry, on which so much public infrastructure – including public housing – relies, is riddled with cartels and abuse of dominant positions.²¹ These problems are not specific to a small group of developing countries but rather are widespread throughout the developing world. (In fact, a closely related sector, construction, is perennially one of the most cartel-infested industries across the developed world, as well.²²)

33. At a more detailed level, OECD peer reviews of Latin American countries that have been conducted over the years reveal numerous instances of anticompetitive conduct in essential goods and services markets. In Argentina, for example, six cement companies were alleged to have engaged in a nationwide market allocation scheme for a period of almost 20 years. A 1999 news article describing cartel activity in the sector sparked an investigation, which ultimately generated enough evidence to prove the conduct. The agreement was coordinated by the cement manufacturers’ business association. Its members exchanged detailed, company-specific, and current information on production, shipments and sales. Five of the six producers were fined a total of US\$106 million.²³

34. In 2008, the competition authority in Honduras opened an investigation of the cement market to determine whether an agreement existed between the country’s two cement producers to fix prices and share markets. The authority determined that the firms had colluded, given the regular communications between them that had taken place through the Cement Institute Foundation (Fundación Instituto del Cemento), their parallel behaviour in setting and changing prices, the fact that there were only two competitors in the market, and the lack of a rational explanation by the larger firm for the fact that it charged the same prices as its competitor despite having lower production costs. The Commission imposed a fine of L 51.896.000 (approximately US\$2,730,000) on one firm and L 35.515.000 (approximately US\$1,869,000) on the other.²⁴

²⁰ Frederic Jenny, “Cartels and Collusion in Developing Countries: Lessons from Empirical Evidence,” 29 *World Competition* 109 (2006); *see also* Eleanor Fox, “Economic Development, Poverty and Antitrust: The Other Path,” 13 *Southwestern Journal of Law and Trade Policy in the Americas* 211, 224 (2007) (reviewing Jenny’s and Evenett’s work).

²¹ *Id.*

²² OECD, *Competition in the Construction Industry*, DAF/COMP(2008)36, available at www.oecd.org/daf/competition/liberalisationandcompetitioninterventioninregulatedsectors/41765075.pdf.

²³ OECD, *Competition Law and Policy in Argentina: A Peer Review* (2006), available at www.oecd.org/daf/competition/prosecutionandlawenforcement/37970045.pdf.

²⁴ OECD, *Competition Law and Policy in Honduras: A Peer Review* (2011), available at www.oecd.org/daf/competition/liberalisationandcompetitioninterventioninregulatedsectors/competitionlawandpolicyinhonduras-2011.htm.

35. Another 2008 case in Honduras involved the sugar industry. The competition authority investigated whether the sector's leading six firms were colluding. The evidence included the uniformity of price levels and price movements, despite variations in the firms' costs. Several market characteristics facilitated collusion, including the lack of substitutes, a homogeneous product, and inelastic demand. In their defence, the investigated firms claimed that the Ministry of Industry and Trade invited them to regulate and agree upon sale prices to the wholesaler Central de Ingenios S.A. Nevertheless, in addition to imposing a fine on each of the firms ranging from L.6,514,306 (US\$324,000) to L.20,204,899 (US\$1,095,000), the Commission prohibited them from participating in meetings at the Ministry of Industry and Trade for the purpose of regulating market prices.²⁵

3.2.2. *A lack of competition harms the poor – and it does so disproportionately*

36. Once we accept that significant anticompetitive conduct occurs in both developed and developing countries, we can implicitly argue that competition helps poor consumers by showing that a lack of competition harms them. There is evidence for that proposition. As Eleanor Fox observes, the data compiled by Evenett and Jenny leave no room for doubt that consumers in developing countries are harmed by elevated prices arising from cartels, mergers and monopolistic practices,²⁶ and because some of the anticompetitive conduct affects essential goods and services, poor consumers suffer, too. Jenny describes the information in the databases as “stunning with respect to the scope and importance of anticompetitive practices revealed in developing countries.”²⁷ Connecting this finding with poverty and how greater competition can alleviate it, he observes:

[A]nticompetitive practices such as price fixing in the retail sector or in the consumer goods sector clearly impose a large cost on consumers, and in particular the poorest consumers, by artificially increasing the price of basic necessities[.] If a sizeable portion of these goods [is] beset by competition problems and subject to overcharges of 10 to 15 percent, the problems of the poor will be compounded and their lives made worse. Thus, the fight against extortionary anticompetitive strategies should rightly be a part of pro-poor policies.²⁸

37. Separately, academics like John Connor have studied the impact of cartels in Latin America. In one study, he found that during the period 1990 to 2007 Latin American consumers paid at least US\$35 billion in overcharges due to price fixing by international cartels.²⁹ Of course, that amount was paid by all consumers, not just the poor. Then again, the figure represents only the harm due to the cartels that were actually detected, and it ignores domestic cartels.

38. Moreover, some studies show that low levels of competition tend to harm poor consumers disproportionately. Creedy and Dixon, for example, have studied the relative burden of monopolies in certain commodities markets on Australian households from diverse income groups. The authors examined data from the Australian Household Expenditure Survey to see how the households spent money on products in 14 commodity groups such as food, non-alcoholic beverages, and housing costs. Creedy and Dixon were able to calculate the static loss of consumer surplus due to monopoly across the commodity and income groups. They found not only that there were welfare losses associated with

²⁵ OECD, *supra* n.24. See United Nations, *Implementing Competition-Related Provisions in Regional Trade Agreements: Is It Possible to Obtain Development Gains?* (2007) for more examples.

²⁶ Fox, *supra* n.20 at 226.

²⁷ Jenny, *supra* n.20 at 113.

²⁸ *Id.* at 134.

²⁹ John Connor, “Latin America Cartel Control” (2008), available at <http://ssrn.com/abstract=1156401>.

monopoly power across all the income groups, but that the losses as a relative percentage of consumer surplus were higher for low-income households than for high-income households.³⁰ In other words, the study showed that monopoly increases inequality among consumers. In fact, the data showed that the burden on the poorest ten percent of households was 46 percent higher than the burden on the richest ten percent. That finding did not change from market to market, leading Creedy and Dixon to conclude that regardless of the absolute size of the welfare loss due to monopoly, there may be a disproportionate impact on poorer consumers.³¹

39. Carlos Urzúa reached similar results in a study carried out for the OECD in 2008.³² Using data from Mexico's National Survey of Income and Expenditure of Households, he studied the impact of market power on levels of household spending on staple products like tortillas, chicken, and milk. The data showed, as it did in Australia, that the relative negative effect of monopoly power is greatest among the poorest ten percent of households. In urban areas, those households suffer a relative welfare loss that is nearly 20 percent higher than that suffered by the wealthiest ten percent of households. This discrepancy is even more pronounced in rural areas, at nearly 23 percent.

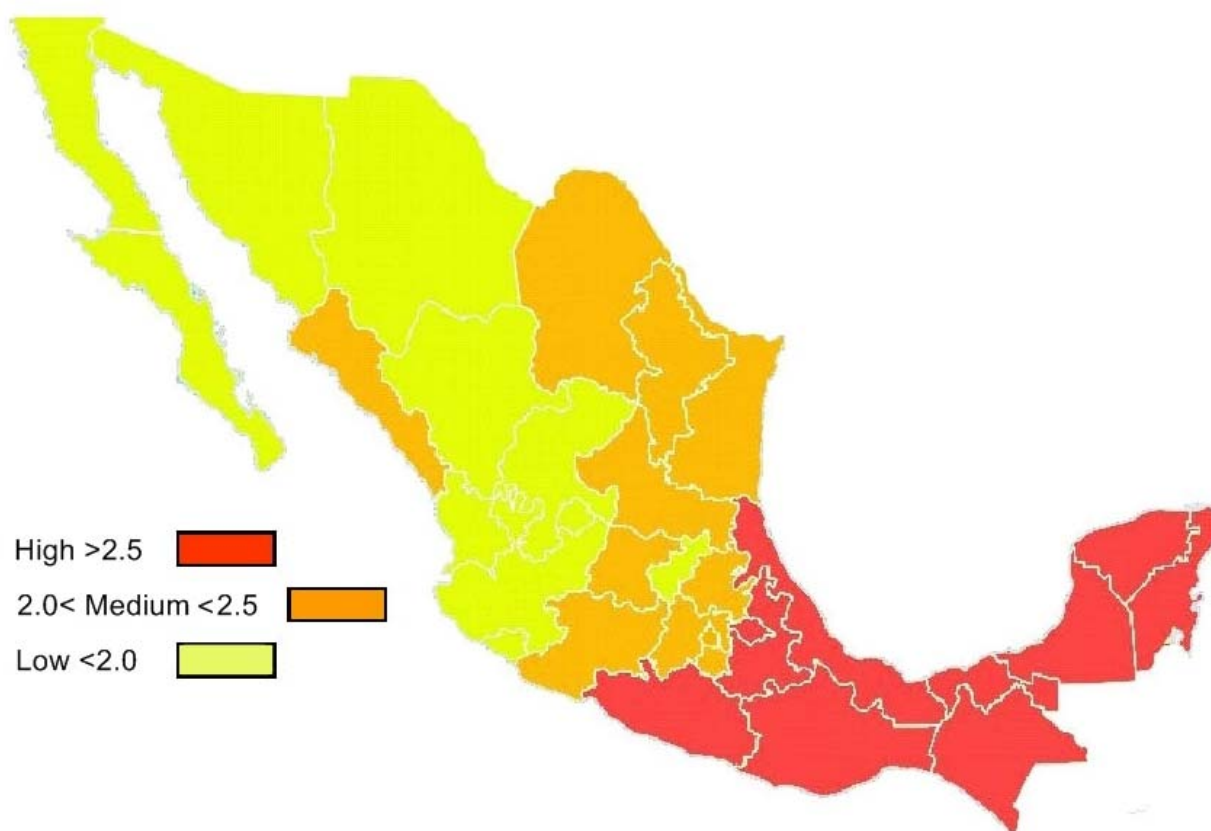
40. Urzúa also created a map, reproduced below, that compares the welfare losses of each Mexican state relative to the state with the lowest loss, Baja California (in the upper northwest corner of the map). On the map, the red states (which look dark grey in black and white versions of this paper) have losses more than 2.5 times higher than Baja's loss, the orange states (medium grey) have losses that are 2 to 2.5 times higher, and the yellow states (light grey) have losses less than twice Baja's. It is easy to see that the southern states – many of which are among the poorest in Mexico – have the highest relative welfare losses.

³⁰ John Creedy & Robert Dixon, "The Relative Burden of Monopoly on Households with Different Incomes," 65 *Economica* 285 (1998).

³¹ A year later, Creedy and Dixon followed up with a study that examined the same issue but used a better method for measuring welfare and a concept of the lack of competition that was broader than the extreme case of a single seller. The main results and the authors' conclusions were the same as in the earlier study, however. John Creedy & Robert Dixon, "The Distributional Effects of Monopoly," 38 *Australian Economic Papers* 223 (1999).

³² Carlos Urzúa, "Evaluation of the Distributional and Spatial Effects of Companies with Market Power in Mexico", available at www.oecd.org/dataoecd/43/20/45047597.pdf.

Figure 1. Relative Social Welfare Loss Due to Monopoly Power in Mexico, by State



Source: Carlos Urzúa, “Evaluation of the Distributional and Spatial Effects of Companies with Market Power in Mexico”.

41. Such findings appear to be consistent from country to country as well as from market to market. Hausman and Sidak obtained similar results when they studied the relative burden on poor consumers of the low level of competition in the US residential telecommunications market. They found that poor and less educated consumers pay more for long distance telephone calls than wealthier and better educated consumers, even after controlling for differences in levels of usage. Although the data available at the time was insufficient to prove it, the authors suspected that the discrepancy between what the two sets of consumers pay would shrink as a result of new entry.³³

42. Given the especially strong and negative effect of market power on poor consumers, these studies strongly suggest that attacking cartels, abuses of dominant positions, and anticompetitive mergers in markets for essential goods would not only yield benefits to poor consumers, but that those benefits would be relatively strong.

3.2.3. *A sample of cases showing that competition benefits poor consumers*

43. Currently, there is not a large amount of publicly available data concerning the direct effect of competition in essential goods and services markets on poor consumers. This could be a fruitful area of study for competition authorities, who may be in the best position to examine the effects of their past

³³ Jerry Hausman & Gregory Sidak, “Why Do the Poor and the Less-Educated Pay More for Long-Distance Phone Calls?”, 3 Contributions in Economic and Policy Research 1 (2004).

interventions on consumers. At least some helpful information is available, though. This section of the paper focuses on two markets, banking and mobile telecommunications services, which provide clear illustrations of the benefits that competition can bring to poor consumers.

3.2.3.1. Banking services

44. When he was Secretary-General of the United Nations, Kofi Annan observed that

[b]uilding inclusive financial sectors improves people's lives, in particular those of the poor. A small loan, a savings account or an insurance policy can make a great difference to a low-income family. They enable people to invest in better nutrition, housing, health and education for their children. They ease the strain of coping with difficult times caused by crop failures, illness or death. They help people plan for the future.³⁴

45. Relatively few poor households in the world are connected to formal banking services (i.e. services provided by a regulated financial institution), though. A survey by Banerjee and Duflo, for example, found that in Panama and Peru less than one percent of poor households (defined as those living on under US\$2 per day) have savings accounts. But an important point is that poor people in general do manage to save money. Furthermore, many of them *want* to save money. One survey of urban adults in Brazil, for example, found that 64 percent of the respondents who did not have bank accounts were interested in having one. Yet poor people tend to keep the extra cash they accumulate in unsecure places because formal savings accounts are either too expensive or not even available to them.³⁵

46. Access to formal and semiformal credit is also needed but rare for the poor in Latin America and the Caribbean; an IDB survey found that only 3.3 percent of the region's poor population has it. Impoverished people therefore tend to obtain loans, if at all, from informal sources like unregulated moneylenders.³⁶

47. Credit from informal sources, however, is expensive relative to what banks charge,³⁷ and in any event formal financial institutions typically do not go out of their way to serve the poor. It is a cruel irony that the relative cost of providing banking services to the poor is high, in large part, because the poor have so little money. With very low amounts at stake in each account, the profit available for banks in providing traditional savings accounts and loans to the poor is quickly eaten up by transaction costs. Another problem is that many of the poor live in thinly populated rural areas. The banks, being profit maximizers, seek economies of scale, so they are mainly interested in serving wealthier clients who live in large urban areas with dense populations. As a result, geographic distance, unsuitable terms and conditions, and unrealistic minimum balance and deposit size requirements all inhibit the poor from

³⁴ United Nations, "Building Inclusive Financial Sectors for Development" (2006) at iii, available at: www.uncdf.org/sites/default/files/Download/bluebook_0.pdf.

³⁵ *Id.* at 36.

³⁶ Abhijit Banerjee & Esther Dufo, "The Economic Lives of the Poor," 21 *Journal of Economic Perspectives* 141, 155-56 (2007); Luis Moreno, "Extending Financial Services to Latin America's Poor," *McKinsey Quarterly* 83, 85-86 (2007); Luis Tejerina, César Bouillón & Edgardo Demaestri (eds.), *Financial Services and Poverty Reduction in Latin America and the Caribbean*, Inter-American Development Bank (2006) at vii; Loïc Sadoulet, "Savings and Deposit Services for the Poor," in Luis Tejerina, César Bouillón & Edgardo Demaestri (eds.), *Financial Services and Poverty Reduction in Latin America and the Caribbean*, Inter-American Development Bank (2006).

³⁷ Banerjee & Dufo, *supra* n.36 at 155.

engaging in the formal banking industry even when the opportunity to do so is technically available to them.

48. Nevertheless, and even though participation in the formal banking sector is still rare among poor customers, things are better than they used to be and a major reason for that is competition. Many Latin American financial markets were liberalized in the 1990s, allowing foreign banks into the region. The resulting increase in competition motivated banks to find progressively smaller-scale customers, which has helped some low-income families.³⁸ Furthermore, the United Nations has reported that microcredit interest rates fall quickly in areas where competition in the market increases.³⁹

49. More competition would probably be even more helpful. Fortunately, the advance of technology is making that happen. Smart cards and text messages sent and received by prepaid mobile phones have emerged as ways for poor consumers to complete financial transactions while bypassing the formal banking infrastructure. For example, if the recipient of a money-bearing SMS does not have a bank account, the remitted sum can be converted into a pre-paid debit card that can then be used to make purchases. Or a line of credit can be opened at a local retail outlet with password protection that works via SMS. Governments such as South Africa's have advocated these systems, using them for many types of payments, including conditional transfers to low-income recipients. The smart card and the mobile phone are not only faster than traditional transaction media like cheques, they are cheaper and more secure, too, both for the sender and the receiver.⁴⁰

50. Mobile payment systems have also been very successful in Kenya. Safaricom Limited, a private telecoms company backed by Vodafone, introduced a mobile payment system called M-Pesa in 2007. M-Pesa is a low-cost, SMS-based, person-to-person money transfer service that requires neither senders nor recipients to have bank accounts. Senders can buy digital funds at any M-PESA agent and send electronic cash to any other mobile phone user in Kenya. Recipients redeem the SMS for conventional cash or else use their M-PESA-enabled phones as an electronic wallet. Phones are permitted to hold up to 100,000 Kenyan shillings (about US\$1170 at the current exchange rate). Within two years of M-Pesa's launch, its subscriber base exploded from about 100,000 to more than 7 million and during that time it moved approximately 130 billion Kenyan shillings (approximately US\$1.5 billion). There are now at least 17 million registered M-Pesa accounts in Kenya.⁴¹

51. Mobile payment technology has also given poor consumers a fast and safe alternative to traditional and considerably more expensive money transfer services like Western Union's. Remittances – loosely defined as payments sent home by a family member who is working abroad – have grown tremendously over the years. The IDB estimated that 2006 inflows to Latin America and the Caribbean from remittances amounted to more than US\$60 billion per year, which was more than three percent of the region's GDP at the time.⁴² Remittances usually go to low-income recipients and are primarily used to finance consumption, so they are indeed an essential service for many poor people. Because relatively few of the senders or beneficiaries of remittances have formal bank accounts, they have historically relied

³⁸ Moreno, *supra* n.36 at 90.

³⁹ United Nations, *supra* n.34 at 103.

⁴⁰ Moreno, *supra* n.36 at 88-89; Sahba Sobhani & Subathirai Sivakumaran, "Beyond Microfinance: Can Government Cash Transfers Scale Up Financial Access for the Poorest?", *Business Fights Poverty* (26 March, 2012), available at: www.businessfightspoverty.org/profiles/blogs/beyond-microfinance-can-government-cash-transfers-scale-up.

⁴¹ "CCK Releases 2nd Quarter ICT Sector Statistics for 2011/2012," Communications Commission of Kenya, (17 April 2012), available at www.cck.go.ke/news/2012/sector_statistics.html.

⁴² Tejerina, Bouillón & Demaestri, *supra* n.36 at vii.

heavily on money transfer services like Western Union, which has many locations around the world but is quite costly, having claimed as much as 20 percent of the amount transferred in the late 1990s.⁴³ The ability to send and receive payments on a cheap, prepaid mobile phone via text message destroys Western Union's old-economy advantage of having many convenient physical locations while undercutting its price. Once again, competition brought about by technology was the key to breaking that market open and reducing prices.

52. The success of these innovative payment systems shows that greater competition can help to extend financial services to Latin America's poor, and thanks to superior technology it can also be profitable. Seizing on that theme in a 2007 article, the IDB's President, Luis Alberto Moreno, urged financial institutions not to sit on the sidelines but to join in the process of coming up with innovative and profitable ways to serve impoverished customers:

It is time for financial institutions to accelerate the development of innovative mechanisms and new programs to reach the microfinance, remittance, and other underserved markets. If Latin American financial institutions exploit this opportunity, we will have taken a major step toward improving the lives and possibilities of the majority of the region's inhabitants. From the standpoint of financial institutions, such moves represent an opportunity to open up a potentially enormous and profitable market.⁴⁴

3.2.3.2. Mobile telecommunications services

53. We have just seen how competition from mobile telecommunications services has helped poor consumers in the context of banking and payments services. But as everyone knows, mobile phones also provide a means of communicating by voice, and smartphones can provide internet access. These features have been very useful to impoverished consumers, as well, and competition has made them more accessible.

54. In contrast to formal banking services, access to mobile telecommunications services has spread to poor populations around the world with great speed. Mobile phone subscriptions in Latin America have overtaken fixed line subscriptions as the preferred method of communication. As of 2009, more than 88 percent of the population in Latin America had a mobile subscription, while fixed line penetration was below 20 percent.⁴⁵

55. Much of the growth in mobile phone subscriptions in Latin America and the Caribbean, where mobile penetration is also very high, is due to competitive deals that target low-income consumers. Pay-as-you-go deals are often cheaper than installing a fixed line, especially in rural areas where fixed line service may not even be offered at any price. Before the introduction of mobile phones, telephone service had simply been out of reach for many poor people – an unavailable or unaffordable luxury. But mobile phones have come to be viewed as essential goods, even for many of the poor. Furthermore, mobile phone services have made broadband internet access possible for many of the world's poor people, especially those in difficult-to-reach areas where there is no DSL or cable coverage. It is therefore hard to deny that in this case, at least, competition has benefited the poor, and once again the catalyst was technological development.

⁴³ United Nations, *supra* n.34 at 39.

⁴⁴ Moreno, *supra* n.36 at 89.

⁴⁵ "Latin America Enjoys Mobile Telephone Boom," Euromonitor International (28 May, 2010). Available at <http://blog.euromonitor.com/2010/05/regional-focus-latin-america-enjoys-mobile-telephone-boom.html>.

56. One comparative study of competition in the mobile telecommunications markets in five countries showed that greater competition drives the introduction of new services, brings those services to more people, and lowers prices. A competitive environment also strengthens incentives to offer services that meet the needs of poor customers, including price and product promotions designed specifically for them. Some of the services that competition helps to bring about have additional development benefits, too, such as money transfer services. A noteworthy example in the study is Kenya, which until recently had a concentrated mobile telecommunications market with relatively high prices. When two new service providers entered in 2008-2009, though, the additional competition they brought caused tariffs to fall by as much as 50 percent.⁴⁶

3.2.4. *An arguable example of competition harming poor consumers*

57. Although competition has certainly reduced poverty in many essential goods and services markets, one cannot realistically claim that competition has served the poor well in each and every instance throughout history. An extreme example occurred in Bolivia's microcredit market and is described in a report issued by the United Nations.⁴⁷ After the hyperinflation crisis of the mid-1980s and the strong structural adjustment policies that followed, small-scale enterprise grew dramatically as employment in traditional mining and state enterprises declined. That shift provided a golden opportunity for microfinance to serve this emerging market. The early microcredit organizations worked with banking authorities and donors to transform into banks and non-bank financial intermediaries.

58. Problems arose in the late 1990s, however, when Bolivian consumer credit companies also began to enter the microcredit market. Because these credit companies did not understand how to analyze a client's ability to pay very well, they simply relied on the fact that an applicant for credit had borrowed or had a current loan from a microfinance institution as proof of creditworthiness. Clients then took advantage of the multitude of lenders, often maintaining two or more loans at a time and borrowing more than they could handle. Some of them were late making their payments or "bicycled" their loans. That is, they used the proceeds of one loan to pay off another.

59. The increase in excessively risky lending coincided with the arrival of a major recession and soon borrowers found themselves with unmanageable levels of debt. Heightened social unrest in Bolivia followed, with mass protests over the prices of basic utilities like water and electricity. The microfinance institutions' relations with clients worsened, too, as they struggled to get their clients to pay.

60. In that tense atmosphere, two borrower associations formed out of people's growing desperation. Both of them worked on the same principle: for a fixed membership fee of roughly US\$8.50, they promised debt relief through borrower revolts. Their appeal was powerful and their memberships swelled. With municipal elections approaching, political parties were attracted to this cause because it enjoyed so much popular support.

61. Subsequently, the debtors' associations threw their own leaders in jail. In one association, the leaders had illegally collected debt service payments owed to the microlenders and used them to make their own loans. After a few months, the associations resurfaced with new leaders and new demands. In addition to debt forgiveness, they wanted prohibitions against certain collection practices, extended grace periods, longer loan terms, and annual interest rates of two per cent. Their tactics escalated, too. In the most extreme example, demonstrators carrying dynamite took over the Superintendency of Banks in July 2001, holding employees hostage and threatening to blow up the building.

⁴⁶ Karen Ellis & Rojit Singh, "Assessing the Economic Impact of Competition," Overseas Development Institute (July 2010) at p. 56, available at www.odi.org.uk/resources/docs/6056.pdf.

⁴⁷ United Nations, *supra* n.34 at 35.

62. It is not really fair to blame competition for the result in this case, though. Competition did not cause the credit companies to do a poor job of analyzing creditworthiness; it merely encouraged them to enter the market. They failed to make wise lending choices and all of the participants in the market suffered because of it. One could just as well blame inadequate banking regulation for the predicament in which the debtors found themselves, as more prudent lending policies would have prevented them from becoming so mired in obligations.

3.2.5. *Other conditions may prevent competition from helping poor consumers*

63. Even assuming that a country's competition authority is adequately vested with financial resources, professional expertise, and investigative and remedial powers, competition still depends on a number of other framework conditions and policies to thrive and function properly. If those conditions are not conducive, competition will not operate in the way that textbooks predict. The conditions include the effective rule of law, a reasonably transparent and corruption-free government, adequately staffed and funded courts and police forces, a liberalized trade regime, and a certain degree of macroeconomic stability. The absence of any one of those conditions can undermine competition's ability to work – and therefore undermine its ability to help poor consumers.

3.2.5.1. *Cosy relationships between influential firms and government officials*

64. The recent work of Karen Ellis and Rohit Singh highlights this problem in the context of developing countries. Ellis notes that one of competition's virtues is that it can balance the power between businesses and the government.⁴⁸ Where competition is weak, however, that balance may tilt in a dominant firm's favour and enable it to convince politicians to help prevent competition from emerging in a market. The typical results are sustained supra-competitive prices, persistently inferior quality, and/or stifled innovation, all of which harm consumers, including the poor.

65. Ellis elaborates, noting that large multinational firms with substantial market power are often well connected with government officials, particularly in underdeveloped countries, and that such firms may have considerable influence over governments for a variety of reasons. A nation may badly need a company's products, investment capital, and know-how, for example. But a class of economic elites can arise when well-connected politicians and business people join forces to extract the economic rents in a market at the expense of the rest of society. Public works projects may be steered toward favoured contractors even if other firms submit more competitive bids. Alternatively, potential entrants might be willing to compete in a market but they can be deterred with tools like import/export barriers, regulations that make it difficult and expensive to acquire business permits, or preferential tax rates for incumbents. Regardless of the particular strategy chosen, the intention and the effect is to stop competition from functioning, thereby enabling incumbent firms to keep their prices higher and their quality lower. Furthermore, in one way or another, the government officials in these extractive alliances will take a share of the profits. The relationship may involve full or partial state ownership of the business, or some degree of ownership by politicians or their families, for instance.

66. Notably, it is not only large multinational firms that can affect competition by influencing governments. Khemani points out that in many developing countries it is normal for major corporations to be family-owned or controlled by a small group of powerful investors. These corporations and families may control multiple companies in a pyramid ownership structure or one that has interlocking

⁴⁸ Karen Ellis, "Making Markets Work: Can You Compete with the Elite?" ODI Opinion 123 (January 2009), available at www.odi.org.uk/opinion/details.asp?id=2778&title=business-competition-politics-elite-development.

directorates.⁴⁹ Such closely held or family-owned corporate groups may have a strong effect not only on particular markets but on the general economy, too, which can translate into an outsized influence on the government. Fox agrees that excessively snug relationships between businesses and governments are a serious problem in developing countries, noting that markets there “are pock-marked by state intervention and control. Whether the intervention is through state measures, state-owned enterprises, or enterprises licensed or privileged by the state, these enterprises are likely to run on principles of privilege, preference, and cronyism.”⁵⁰

67. Ellis’s and Singh’s field work reveals many examples of this type of close relationship between powerful firms and the governments of developing countries. In fact, the fortunes of those firms are frequently determined by the strength of that relationship rather than the crucible of market competition. Some of them enjoy the government’s protection and largesse for a while, but they are replaced by new favourites if they do something to fall out of favour. For instance, Ellis mentions a company that was asked by one government to provide its product at discounted rates to a new foreign company in another industry. The government wanted to help that company to get established within its borders. The first company refused and claimed that the government punished it by licensing a new entrant to compete with it, thereby eroding what had been a safe and mature monopoly position. “Thus competition itself becomes a bargaining chip in a power game between government and business[.]”⁵¹

3.2.5.2. An example: the Zambian sugar market

68. A superb example of governments getting in the way of competition in an essential goods market is provided by Ellis’s and Singh’s study of the refined sugar industry. Sugar is part of the staple diet in most countries and is also a source of income in many rural populations. Consequently, governments are heavily involved in the sugar industry in some countries, including Bangladesh, Kenya and Viet Nam. In various ways, those governments support, operate, protect, or control the business of sugar in their respective countries. But even though the motives for that involvement may have been benign, such as promoting rural development and job creation, the state-led sugar industries in those countries perform poorly. They use obsolete technology and inefficient farming methods that result in comparatively low productivity. The sugar industries in all three countries are struggling to survive against competition from privately produced and imported sugar. The approach of direct intervention by governments is close to failure.⁵² But that conclusion is just part of the backdrop for a more surprising finding in the study.

69. Continuing to set the stage, Ellis and Singh note that in contrast to the first three countries, Zambia has a sugar industry that is led by the private sector. It produces the highest amounts of sugar per hectare of the five countries they studied.⁵³ Indeed, Zambia’s output per hectare is three times higher than Viet Nam’s, the second most efficient country in the group, and its cost of production is one of the lowest in the world (US\$169 per ton vs. the world average cost of US\$263 per ton). The Zambian sugar industry is very profitable, internationally competitive, and is expanding to take advantage of new export

⁴⁹ R. Khemani, “Interplay and Implications of High Product, Ownership and Financial Market Concentration” in The World Bank, *Competition Policy and Promotion of Investment, Economic Growth and Poverty Alleviation in Least Developed Countries*, ch. 2 (2007).

⁵⁰ Fox, *supra* n.20 at 229-230.

⁵¹ Ellis, *supra* n.48 at 2.

⁵² Karen Ellis & Rojit Singh, “The Economic Impact of Competition,” Overseas Development Institute Project Briefing no. 42 (July 2010); Ellis & Singh, *supra* n.46 at 88.

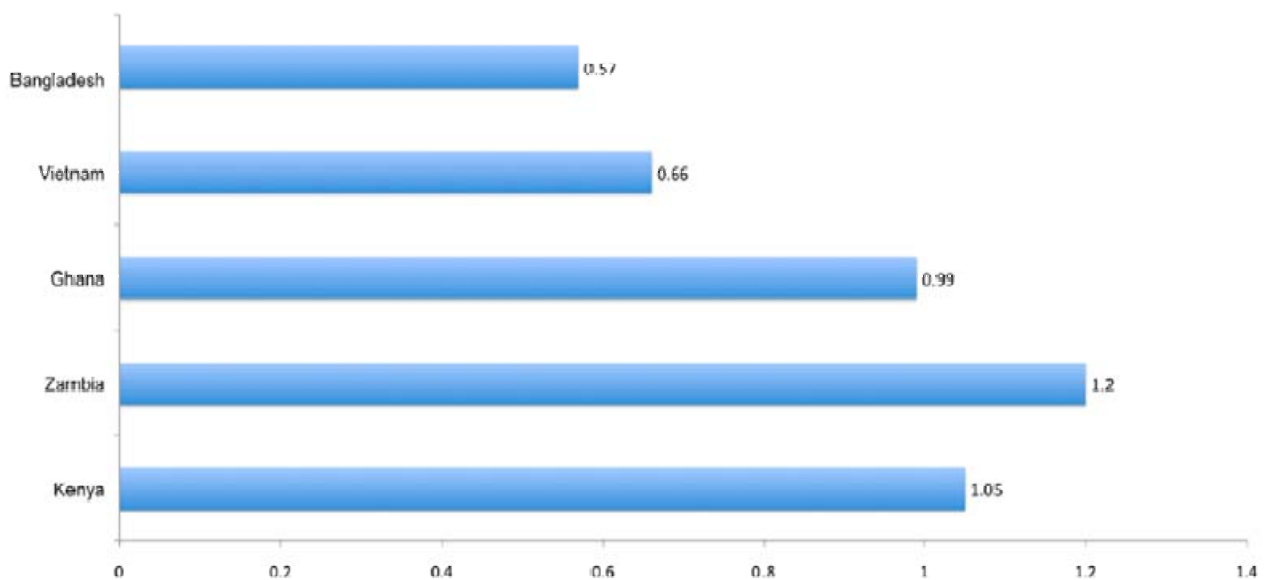
⁵³ The fifth country was Ghana.

opportunities. These results imply that private sector incentives and management expertise are superior to those of governments, at least in the sugar industry.⁵⁴

70. Significant reforms are needed to improve the performance of the sugar industries in Bangladesh, Kenya and Viet Nam. Because reforms could put some existing sugar mills out of business, however, local interests would make this politically unpopular and thus difficult to accomplish even though it would be in the best interests of consumers and the country as a whole.

71. And what is the surprising part of the Ellis and Singh study? Zambia's vastly superior productivity suggests that Zambian consumers should be faring much better in the sugar market than their counterparts in the less efficient countries. But Zambian consumers actually pay more for sugar than consumers in every other country in the study:

Figure 2. 2008 Retail Spot Market Prices for Sugar, in US\$/kg



Source: SS at 14.

72. Sugar prices are not only higher in Zambia than in other countries, they are well above the price at which Zambian sugar sells on international markets. That is at least partially due to the monopolistic structure of the industry in Zambia, where one large, multinational firm has an estimated market share of 93 percent and is protected from foreign competition by non-tariff import barriers. Sugar importers wishing to do business in Zambia must acquire permits in a process that Ellis and Singh describe as “bureaucratic and non-transparent . . . with the Ministry of Agriculture, the Ministry of Health, and the Ministry of Commerce all having to clear the import of sugar”. The Zambian Competition Commission has investigated but was unable to fix the problem. Ellis and Singh tersely observe that “the government may have vested interests in the industry’s profitability.”⁵⁵

73. On the other hand, where genuine market competition does manage to take root in spite of a cosy relationship between an incumbent and a government – say, due to a breakthrough innovation that enables

⁵⁴ Ellis & Singh, *supra* n.52; Ellis & Singh, *supra* n.46 at 13.

⁵⁵ Ellis & Singh, *supra* n.52; Ellis & Singh, *supra* n.46 at 14, 17-18.

a new firm to enter the market in spite of the barriers put in place to protect the incumbent – it may result in the favoured incumbent being outperformed. That, in turn, can break down the anti-competitive alliances formed by the economic elites, combat cronyism, and reduce the profitability of corruption.⁵⁶ Competition has the ability to do a variety of great things – if it is allowed to flourish.

3.2.5.3. Benevolent motives for interfering with competition

74. A complicating factor is that the motives of the government officials involved in these “partnerships” are not always rooted in corruption, but may be benevolent. In fact, their motive may be precisely to reduce poverty. Thus government officials might ask, in exchange for helping to block competition, that a protected incumbent provide a certain number of jobs or that it provide health or education services for employees and their families. Or the goal might be to diversify the economy, foster regional integration, or pursue some other legitimate goal that happens to be something other than the traditional objectives of competition policy in developed countries, i.e. maximizing efficiency and consumer welfare. Alternatively, officials might ask a company to give the government a discount on public procurement projects. They might also simply have their eyes on the greatly-needed tax revenue that a company generates, which will be even more substantial if it earns heavy profits due to a low level of competition. Similarly, it has not been uncommon for privatization programs to result in the sale of state-owned monopolies to the highest bidder, with the understanding that there will be little or no real regulatory oversight, so as to maximize the sale’s proceeds for the state.⁵⁷ But this means that a public monopoly is transformed into a private monopoly, with consumers ultimately paying for the premium received by the government on the sale of the enterprise. Even if the sale is accompanied by the creation of a regulatory authority that is charged with preventing the now-private monopoly from abusing its dominant position, a well-documented problem with regulatory agencies (whether they are in developed or developing countries) is that they are vulnerable to being captured by the industries they are supposed to control.⁵⁸

75. Of course, a major problem with these types of benevolently motivated arrangements is that consumers are paying for the profits that drive the deals, and in essential goods and services markets, it is the poor consumers who are most heavily affected. In any event, Ellis’s and Singh’s evidence suggests that the risk that these kinds of influence-peddling partnerships will be misused for rent-seeking purposes is substantial.⁵⁹

3.2.5.4. Some of competition’s effect on poverty depends on the poor themselves

76. Another type of practical problem that may get in the way of competition’s ability to reduce poverty is simply that the poor might not take advantage of what competition has to offer them. This problem can occur, for example, if poor consumers are less informed or more easily manipulated than other consumers. As an illustration of that possibility, consider that the study of the US residential telecommunications market by Hausman and Sidak,⁶⁰ mentioned earlier, could also be interpreted in a

⁵⁶ Ellis, *supra* n.48; Nick Godfrey, “Why is Competition Important for Growth and Poverty Reduction?”, paper submitted to OECD Global Forum on International Investment (2008) at p. 4, available at www.oecd.org/investment/globalforum/40315399.pdf

⁵⁷ Philippe Brusick & Simon Evenett, “Should Developing Countries Worry about Abuse of Dominant Power?” 2008 Wisconsin Law Review 269, 276.

⁵⁸ *Id.* at 281.

⁵⁹ Ellis, *supra* n.48.

⁶⁰ Jerry Hausman & Gregory Sidak, “Why Do the Poor and the Less-Educated Pay More for Long-Distance Phone Calls?”, 3 Contributions in Economic and Policy Research 1 (2004).

different way. The fact that wealthier and better educated consumers were able to obtain lower prices than poor consumers could be viewed as suggesting that there must have been some competition in the market. Therefore, it implies that the problem for the poor and undereducated group might not have been a lack of competition so much as an inability or a disinclination to capitalize on that competition. If that is correct, then this is another reason why making markets more competitive will not necessarily be enough to help the poor. They may need help with learning how to be savvier buyers, how to compare complicated offers, or – if they are being intentionally deceived – they will need the help of a consumer protection agency.

77. Indeed, the deception problem figured prominently in the collapse of the US real estate market bubble that triggered the 2008 global financial crisis. So-called predatory lenders were competing so fiercely with one another that they had begun to market loans to poor homebuyers with very high risk profiles. In their eagerness to finalize more and more loans, the lenders engaged in deceptive practices that enticed poor customers to accept the loans even though the lenders knew the financial terms were so onerous and the customers' ability to pay so weak that the likelihood of default was high. When they were ultimately unable to keep up with their mortgage payments, many borrowers lost what little savings they had, sliding deeper into poverty or moving below the poverty line for the first time.⁶¹

78. The University of Michigan Professor Aneel Karnani bristles at what he perceives as a fashionable assumption that poor people are rational, well-informed and willing participants in free market economies. He calls this “romanticizing the poor” and contends that it leads to an over-reliance on unfettered, market-based approaches to poverty alleviation, which in turn allows governments and corporations to deny poor people the legal and regulatory protections they need.⁶² Karnani, to be perfectly clear on this point, is *not* saying that the poor are incapable of making rational choices. Neither is he advocating heavy-handed government interventions, tightly regulated markets, or the old-fashioned notion that government officials should take all important choices out of the poor's hands in a paternalistic fashion. But he does believe that governments should impose some limits on free markets to help prevent the exploitation of the poor. He also points out that even when the poor avoid deceptive sellers and take advantage of the lower prices made possible by competitive markets, they often decide to spend the money they save on things that do not reduce their poverty in the long term.

79. In fact, he argues, poor consumers often make decisions that appear to be against their self-interest. For example, suppose that competition lowers prices in some essential goods market. Even that result will not necessarily reduce poverty. Whether it does depends on what poor consumers do with the extra money. As any person might do, the poor could choose to spend it on a “vice” product like alcohol or tobacco. In the case of the poor, though, making that choice might mean that their children continue to be malnourished, that their leaky roof does not get patched, or that their bicycle – which might be necessary for getting to and from a job – continues to be out of service due to a punctured tire. In addition, too much alcohol or tobacco can damage people's health and keep them out of work. Seen in that light, it is possible that greater competition could harm the poor precisely because it can reduce prices on essential goods.

80. Karnani's point is, essentially, that while policymakers need to adopt measures to reduce poverty, including promoting competition, they should also acknowledge that “the poor lack the education, information, and other economic, cultural, and social capital that would allow them to take advantage of –

⁶¹ E.g., James Pulliam, “Good Cop, Bad Cop: Market Competitors, UDAP Consumer Protection Laws, and the U.S. Mortgage Crisis,” 43 *Loyola of Los Angeles Law Review* 1251 (2010); Timothy Johnston, “Mortgage Marketing Practices and the U.S. Credit Crisis,” 13 *Academy of Marketing Studies Journal* (2009).

⁶² Aneel Karnani, “Romanticizing the Poor,” 7 *Stanford Social Innovation Review* 38 (2009).

and shield themselves against – the vagaries of the free market.”⁶³ While that description is probably too stark (e.g. the poor certainly do not *always* lack information), he does have some support for his argument.

81. He notes, for example, that the economists Banerjee and Duflo found that because the poor typically do not have bank accounts, they are more likely to spend any available cash on impulse purchases.⁶⁴ Furthermore, the hardships that poor people are more likely to face, such as hunger and violence, often lead them to do whatever they can to ease their suffering in the short term rather than focusing on advancing their long term economic prospects. Karnani points to research showing that the less income people have, the more likely they are to try to draw some comfort from smoking, drinking alcohol to excess, eating unhealthy diets, and splurging on ceremonies and festivals.⁶⁵ Notably, he presents this in a sympathetic rather than a sanctimonious manner, citing Banerjee’s and Duflo’s observation that “Perhaps at some level this [escapism] is emotionally wise. Thinking about the economic problems of life must make it harder to avoid confronting the sheer inadequacy of the standard of living.”⁶⁶

82. We cannot expect too much of competition alone, in other words. Many other factors can get in the way of reducing poverty. But competition can at least create more opportunities and resources for helping the poor and for enabling them to help themselves.

4. Are “Pro-Poor” Government Interventions Better than Competition?

83. Whether the stated motive is to fight poverty, stabilize prices, help domestic businesses grow, or something else, governments are sometimes tempted to interfere directly in markets rather than entrust them to the forces of competition. The interventions may take the form of imposing price controls or trade barriers, granting subsidies, or setting up government-owned businesses to serve “poor” markets, to name a few examples. Even when well-intended, though, interventionist policies usually are not superior long term alternatives to liberalized, competitive markets. As one speaker noted at the OECD Global Forum on Competition (GFC) earlier this year, interventions like price controls might initially improve the lives of poor consumers who have difficulty affording necessities, but the strategy is ultimately likely to backfire because it interferes with the signalling effect that prices have on market participants.

84. Price caps, for example, usually reduce the incomes of farmers and therefore tend to reduce farmers’ incentives to produce more food, which is exactly what would have helped poor consumers. A viable strategy to stabilize and reduce food prices must somehow involve finding a way to increase agricultural production, not decrease it. Another problem is that price caps do not only reduce prices for poor consumers, they reduce prices for *all* consumers – even those who can afford higher prices. Price caps therefore divert resources toward people who do not actually need help.⁶⁷ Furthermore, price caps

⁶³ Karnani, *supra* n.62 at 40.

⁶⁴ Abhijit Banerjee & Esther Duflo, “The Economic Lives of the Poor,” 21 *Journal of Economic Perspectives* 141 (2007).

⁶⁵ Karnani, *supra* n.62 at 40-41 (citing John Lynch, George Kaplan & Jukka Salonen, “Why Do Poor People Behave Poorly? Variation in Adult Health Behaviours and Psychosocial Characteristics by Stages of the Socioeconomic Lifecourse,” 44 *Social Science & Medicine* 809 (1997); Abhijit Banerjee, Angus Deaton & Esther Duflo, “Wealth, Health, and Health Services in Rural Rajasthan,” 94 *American Economic Review* 326 (2004); Shubhashis Gangopadhyay & Wilima Wadhwa, *Changing Pattern of Household Consumption Expenditure*, New Delhi: Society for Economic Research & Financial Analysis (2004).

⁶⁶ Karnani, *supra* n.62 at 41.

⁶⁷ Bibek Debroy, contribution to session on Competition and Commodity Price Volatility at OECD Global Forum on Competition (2012) at p. 5, DAF/COMP/GF(2012)3 (citing Joachim von Braun, “Rising Food Prices, What Should Be Done?”, IFPRI Policy Brief (April 2008), available at www.ifpri.org/sites/default/files/publications/bp001.pdf).

may result in shortages due to the reduced incentive to produce more of the item. It does little good to keep an item's price lower if the item is not actually available for purchase. Subsidies for agricultural inputs and outputs are similarly distortive and inefficient because the lion's share of the aid winds up going to large farmers who are least in need of assistance.⁶⁸

85. Even worse, these interventions have a snowball effect that makes them more and more costly to maintain. Suppose a government decides to subsidize the price of bread. That will encourage more consumption, as intended, but the greater demand will also put upward pressure on the price of bread, meaning that the government will have to spend even more on subsidies to keep the effective price constant.

86. That is exactly what happened in Mexico when the government subsidized the price of tortillas, which account for more than half the daily calories and protein of the poor in that country. The tortilla subsidy became more and more of a financial burden on the government. In 1994, it was projected to cost US\$1 billion per year within two years unless the subsidy was limited. It was, gradually, and the costs came down. Price controls, which had also been in effect, were gradually lifted and then removed altogether in 1999.⁶⁹

87. Granted, letting retail food prices remain too high for starving people to afford may not be the most humane thing to do in the short run. But the signals that high prices send to both consumers and producers are vital to positive change, and some types of "pro-poor" market interference (e.g. price controls) can cause shortages, which do not help starving people, either. One way or another, shortages will cause rationing until production is increased or alternative products are found and consumed. A high price is one type of rationing mechanism. It has some efficiency benefits compared to the alternatives, but we may not like the distributional effects of how it does its job, i.e. it cuts out the poor. So we might prefer to use price controls together with enforced rationing instead, especially in the short term. If a government simply controls prices but lets people buy as much as they want at those prices, the rationing will be achieved when shops run out of the item in question at some point during the day. New costs will appear in the form of long queues. Sometimes an intermediate solution appears, as when shopkeepers do the rationing, allowing people to buy only a certain amount of bread, etc. But one way or another, a good in short supply must be rationed.

88. In sum, high prices tell consumers that certain products are relatively expensive to produce, motivating them to find cheaper alternatives. At the same time, high prices tell producers that they should invest in increasing production. These responses will jointly move the market toward a new equilibrium with more food and lower prices. If prices are held artificially low, though, consumers and producers will respond differently and the result will eventually be shortages.

89. Some countries have laws that require agricultural products to be sold to marketing boards that are governed by grower representatives or that set prices for staple foods. These laws implicitly centralise the determination of prices and quantities with mandatory, state-sanctioned frameworks that would be illegal if undertaken by private businesses on their own. There is a danger that such arrangements are subject to capture by the larger growers.

90. At a general level it is partially understandable why countries sometimes decide to put open competition on hold in agricultural markets. In many developing countries, property rights remain uncertain, agricultural industries may not yet be part of the taxation system, and rural populations may not

⁶⁸ Scott Davenport, contribution to session on Competition and Commodity Price Volatility at OECD Global Forum on Competition (2012), DAF/COMP/GF(2012)1 at p. 5.

⁶⁹ "Mexico's Economy: Monopolies and Tortillas," *The Economist* (19 January 2007).

yet be able to fully participate in education or have access to medical and other basic services. In other words, there may simply be other urgent priorities. Carefully sequencing the order of market reforms can be important.⁷⁰ But waiting to implement a competition law, to let markets work with minimal interference from the State, and to develop a culture of competition has real costs, too. The sooner competition is allowed to work, the sooner its benefits will accrue.

5. Mixed Effects on Poverty

91. Although this paper is about the effect of competition on the poor as consumers of essential items, many poor people also produce essential items. Competition can therefore have mixed effects on poverty. It may move consumer welfare in one direction while moving producer welfare in the opposite direction. For example, imagine that for some reason there is an increase in competition in the corn market, resulting in lower wholesale prices. Poor consumers who buy corn-based products like tortillas may benefit. But lower prices will also reduce the incomes of poor farmers who produce corn. Alternatively, an increase in wholesale corn prices would make the farmers better off, but it might also harm consumers.

92. Does this mean that whenever there are poor people on both sides of a market – supply and demand – the overall effect of competition on poverty is indeterminate? Is it therefore impossible to claim that competition policy can help to reduce poverty in such markets?

93. The answer to both of those questions seems to be no, at least with respect to most staple food markets. (Staple foods are highly relevant to our topic, since the poor spend the majority of their income on those goods.⁷¹) Ivanic and Martin studied the impact on poverty of higher staple food prices in nine low-income countries. Although the effects varied by commodity and by country, net poverty increased much more frequently and substantially than it declined.⁷² We can therefore infer that lower food prices – which are an expected consequence of greater competition – would reduce net poverty more frequently and more substantially than they would increase it.

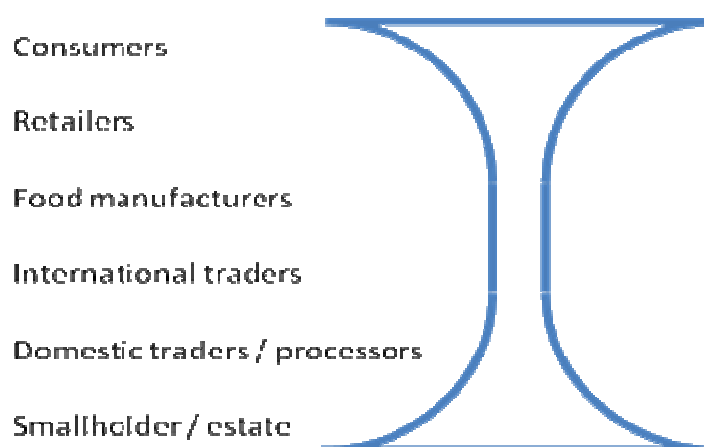
94. In fact, we can further infer that Ivanic and Martin’s results would be even stronger in cases where the lower prices are caused specifically by greater competition. The reason is that poor farmers often do not enjoy much of the benefit of higher food prices anyway. That means they have less to lose when prices decline. As the 2012 GFC clarified, where market power exists on the supply side of staple food markets, it is usually in the form of either a large agribusiness that pays poor people wages to work the company’s farmland or a large firm acting as a middleman between a large number of small, poor farmers on one side and small shops that distribute the goods on the other. The large firms in the middle have most of the leverage so they extract most of the available profit.

95. This hourglass shape represents a common situation in wheat, rice, poultry, coffee, and many other markets:

⁷⁰ Nicolas Taylor & Michal Petr, OECD DAF/COMP/GF(2012)2/REV1, Background Note for session on Competition and Commodity Price Volatility at 2012 Global Forum on Competition, at p. 20.

⁷¹ Maros Ivanic & Will Martin, “Implications of Higher Global Food Prices for Poverty in Low-Income Countries,” World Bank Policy Research Paper no. 4594 at pp. 1-2 (stating that the poorest consumers spend about 75 percent of their income on staple foods) (citing J. Cranfield, P. Preckel & T. Hertel, “Poverty Analysis Using an International Cross-Country Demand System,” Policy Research Working Paper Series 4285, The World Bank (2007)).

⁷² *Id.* The staple products in the study included wheat, rice, maize, sugar, and poultry. The nine countries included Bolivia, Nicaragua, and Peru.

Figure 3. Common Bottlenecks in Agriculture

Source: OECD

96. Higher or lower food prices in these markets will not alter the incomes of the poor on the supply side very much.⁷³ Consequently, we have another reason to expect the main effect of lower prices on poverty to be felt by consumers, who will benefit from them.

6. What Can Competition Authorities Do to Reduce Poverty?

97. First and foremost, they can continue to do their jobs. That means enforcing competition laws, working to improve them as needed, lobbying for more resources where appropriate, and – critically – using advocacy to create a culture of competition in their economies.

98. That culture should extend beyond the private sector to encompass the public sector, too. “The competition agency can play an important role in calling attention to anticompetitive and unproductive state measures and their costs to society. It should probably be the nation’s ‘strongest public voice on promoting competition and articulating the competition perspective.’”⁷⁴ Because so many different policies affect competition, part of the authority’s attention should be focused on considering how policies that are largely or wholly formed in other parts of the government – like trade policy, industrial policy, state ownership, regulation, investment promotion, and anti-corruption – affect competition. When the effects are harmful (or expected to be harmful), the competition authority should let its concerns be known.

99. In particular, competition authorities can explain to their colleagues in other parts of the government the distortive harm that interventionist policies like price controls cause. If the government is contemplating taking over the supply of some essential good or service – unless there is clear evidence that the government’s intervention is critical (e.g. there are insufficient transport options for moving food where it is desperately needed) – the authority can point out that governments are not better at running businesses than the private sector and that their intervention may only wind up causing shortages and deterring private firms from entering and solving the problem.

⁷³ Taylor & Petr, *supra* n.70 at 15.

⁷⁴ Fox, *supra* n.20 at 233, quoting Mark Dutz & R. Shyam Khemani, *Competition Law & Policy: Challenges in South Asia* 28 (2007).

100. Moreover, competition authorities can work to persuade regulatory bodies to take the competition impacts of their policies into account. One way to do so is to implement a process for impact assessment that examines the competition implications of regulations. The OECD has developed a system that is specifically designed to help governments do that. It is called the Competition Assessment Toolkit and has already been used by a wide variety of countries.⁷⁵

101. Of course, competition officials offering advice in some of these circumstances will be doing so in rather sensitive political contexts, so they will have to strike a careful balance between sound competition policy advice and ensuring that they do not come across as uncaring or out of touch with the reality of what impoverished citizens are going through. Indeed, it can be emphasized that a strong motive for sharing their advice is the welfare of those citizens.

102. But what can be done in situations where those things are not adequate?

103. One such situation can occur when there are cosy relationships between influential firms and government officials, as described in Part 3.2.5.1. Strong vested interests will fight hard to prevent pro-competitive changes from taking place. To overcome them, Ellis and Singh suggest that competition authorities consider aiding or even setting up interest groups that would benefit from pro-competitive reforms. Such groups could include consumers (both household and commercial) who would gain from lower prices, as well as potential entrants who have been blocked by current policies but remain interested in participating in a market. Both consumer groups and business associations might already exist, so the agency might need only to support them rather than establish them. That support could include coordinating the groups' efforts, publicising the problems at issue and providing evidence that pro-competitive reforms would help consumers. With the authority's help, such groups might succeed in counterbalancing the political forces that maintain the status quo.⁷⁶

104. Brusick and Evenett note that such endeavours will probably be quite challenging, but that amassing large groups of interested individuals and businesses is the right approach:

[I]njecting the discipline of competition and limiting the exercise of market power into economies where vested interests have strong links to policy makers is unlikely to be easy in developing countries (and in industrialized countries for that matter). . . . Proponents of such measures ought to marshal a wide base of support within society and not solely focus on the important technocratic details that these measures entail.⁷⁷

7. Conclusion

105. For competition to benefit poor consumers in essential goods and services markets, a good competition law is not enough. A good competition authority is not enough, either. Undoubtedly, a sound competition law is necessary and it has to be enforced effectively. But a culture of competition must also take root in a country, not only among sellers and buyers, but among courts, politicians, and government agencies. Competition needs a supportive policy environment and adequate framework conditions to work properly. There has to be a genuine market economy in which governments take into account the effect of other legislation and regulations on competition. Not least of all, local realities have to be acknowledged, not only in terms of institutional capabilities but with regard to both the skills and the vulnerabilities of the poor population.

⁷⁵ See www.oecd.org/daf/competition/competitionassessmenttoolkit.htm.

⁷⁶ Ellis, *supra* n.48 at 2; Ellis & Singh, *supra* n.52.

⁷⁷ Brusick & Evenett, *supra* n.57 at 294.

106. To study the actual effects of competition on poor consumers more thoroughly, more empirical research is needed. The before-and-after welfare of poor consumers in essential goods or services markets that experienced greater (or lesser) competition for some reasons – whether it was an intervention by the competition authority, normal entry or exit, or something else – have to be systematically analyzed over time, in several countries and in several product/service markets. This would be a fruitful area of study for academics or for competition authorities, who may find that their influence grows if they can establish a firmer link between their work and the lives of the poor.