

## Competition Policy, Growth and Poverty Reduction in Developing Countries

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### Introduction

There is a good degree of agreement on the notion that industrial policy, if it was to be useful, has to be combined with competition policy even if the mix between the two policies needed to vary with the level of economic development. At the same time, there has also been a growing concern both at the international and the domestic level, more particularly among the developing countries, of the need to develop a comprehensive legal framework to deal with the anti-competitive practices of firms in order to achieve an orderly marketplace leading to economic development.

A key consideration in this regard is the need to avoid the capture of industrial policy as a safeguard against policy interventions that were not actually in the public interest. Of course, trade liberalisation is also an important source of competitive pressures on firms but, as is widely acknowledged, it is not sufficient in itself. Thus, there was an apparent consensus that competition policy could play a role in the process of economic development, even if it was only one of the policies that were relevant.

The most important question in this context is how could a competitive environment serve to enhance rather than to impair economic development? By removing entry barriers, competition policy helps create an enabling environment for entrepreneurial development, an essential prerequisite for a vibrant economy with employment generating growth. Competition enables consumer's access to goods and services at reasonable prices.

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. This should result in growth, equitable distribution, and lower prices and adequate supplies to consumers. For a developing economy handicapped by resource constraints, efficient allocation of resources is absolutely essential to enable optimum utilisation of limited resources.<sup>1</sup>

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. Although a competition law may be quite narrow in its scope, competition policy is much more broad and comprehensive in its scope. Its purpose is to bring harmony in all the Government policies that may encourage or adversely affect competition, consumer welfare and development.

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<sup>1</sup>World Bank & OECD, "A Framework for the Design and Implementation of Competition Law and Policy," Washington D.C., 1999.

Competition law and regulatory regimes are used mainly to take care of firm behaviour and market failures. And governments do make interventions in a situation of market failure. Indeed it is inconceivable to find a country where there is no market regulation. But in the absence of clearly defined competition policy and regulatory mechanisms, the intervention can be arbitrary and eventually serve the vested interests and not the people at large.

At present most of the developing countries are going through a spate of regulatory reforms, which include privatisation and deregulation. Many of the state-owned enterprises enjoy monopoly power in the market. In such a situation privatisation without competition policy with adequate regulatory mechanism will mean transfer of monopoly power from the public sector to the private sector. This can harm the interests of consumers, especially the poor.

Without an effective competition policy and law, international anti-competitive practices can restrict trade in small and developing countries. 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.<sup>2</sup>

### **Competition Policy, Competitiveness and Growth**

Competition policy has a significant role to play in promoting competitiveness and growth. The term competitiveness appears to have aroused considerable controversy in recent years. On the one hand, the word has become a kind of umbrella term for a wide ranging set of policies. On the other hand, the term evokes an analogy which suggests that nation states compete in the same way that firms compete. It may be true that the nations do not compete but firms do. However, it is equally true that while nations may not compete, they could help the firms compete more effectively by following a set of macro policies, which can create an enabling environment.

The term competitiveness gained wide currency after the introduction of the Competitiveness White Papers in the UK and the European Community in 1994. The backdrop of these white papers was slow productivity growth and decline in relative economic position of the UK and Europe compared with Japan and the US. The economic malaise of the UK and European economies was thought to be poor competitiveness.

The decline in the UK's (and Europe's) relative economic performance prompted much debate about the appropriate response. In many ways this debate was not new. The UK White Papers on competitiveness start from a recognition of the UK's relative decline and identify ten policy areas that influence competitiveness. One of these ten areas is the policy related to fair and open markets. Similarly, EU White Papers highlighted four areas for priority action:

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<sup>2</sup> 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)

- The promotion of investment in intangible assets;
- The development of co-operation between firms;
- The ensurance of fair competition and
- The modernisation of public authorities

Thus we see that both the white papers on competitiveness emphasise the need of ensuring fair competition in the market as an essential ingredient for enhancement and maintenance of competitiveness in the economy. Even elsewhere, there is a growing consensus on the need for ensuring fair competition in the market as an essential ingredient for enhancement and maintenance of competitiveness in the economy. Michael Porter in his study (1990) containing a major survey of international industrial performance found that it is the firms which face strong domestic competition which performs best in international markets.<sup>3</sup> More recent work by Porter (2000) shows that in Japan only those sectors characterised by strong domestic competition remain internationally competitive following the country's recent economic downturn.<sup>4</sup>

A well-designed and properly implemented competition policy promotes economic growth by ensuring better allocation of resources. Empirical evidence, though focusing mainly on the experience of developed countries, has confirmed that barriers to competition within an economy, whether due to governmental or private restraints, lead to welfare losses. A survey of 46 firms found a significantly negative relationship between the level of per capita income and the size of mark up ratios in 1985.<sup>5</sup> Another study carried out for the Australian economy estimates the expected benefits from a package of competition promoting and deregulatory reforms to incur an annual gain in real GDP of about 5.5 percent, or \$23 billion where consumers would gain by almost \$9 billion besides having an increase in real wages, employment and government revenue.<sup>6</sup>

Evidence may not be so overwhelming, but indications suggest that competition policy and law can be beneficial to the people even in developing countries.<sup>7</sup> In the context of developing countries, there is a shortage of systematic analyses, regarding the benefits of adopting a competition policy and law. However, a relevant study of the Peruvian competition agency, Indecopi, found that in the first seven years of its operation, the economic benefits due to its operations amounted to \$120m against operating costs of \$20m.<sup>8</sup> There are few other studies that confirm a positive relationship between competition, whether induced by local or foreign firms, and economic growth.<sup>9</sup>

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<sup>3</sup> Porter, M (1990) "The Competitive Advantage of Nations", McMillan, London

<sup>4</sup> Porter, M; H Takeuchi and M Sakakibara (2000) "Can Japan Compete?", McMillan, London

<sup>5</sup> [http://www.unctad.org/en/docs/c2em\\_d10.en.pdf](http://www.unctad.org/en/docs/c2em_d10.en.pdf)

<sup>6</sup> [http://www.unctad.org/en/docs/c2em\\_d10.en.pdf](http://www.unctad.org/en/docs/c2em_d10.en.pdf)

<sup>7</sup> UNCTAD (1997). *Empirical Evidence of the Benefits from Applying Competition Law and Policy Principles to Economic Development in order to Attain Greater Efficiency in International Trade and Development* (Geneva, document TD/B/COM.2/EM/10, 1997).

<sup>8</sup> See Caceres, A (2000), "Indecopi's first seven years" in Beatriz Boza, ed., *The Role of the State in Competition and IP Policy in Latin America: towards an academic audit of Indecopi*, Lima.

<sup>9</sup> For example, Dutz (2000) empirical analysis for a number of developing and developed countries indicates a strong correlation between the effectiveness of competition policy and growth and suggests a complementary role for competition policy in stimulating growth beyond trade liberalization and international openness.

To look at the issue from a different perspective, the anti-competitive practices that operate at the global level can have serious implications for competitiveness and development of developing countries. A World Bank study has shown that in 1997, developing countries imported \$81.1bn of goods from industries in which price-fixing conspiracies have been discovered during the 1990s. These imports represented 6.7 percent of imports and 1.2 percent of GDP in developing countries.<sup>10</sup> There might have been several other price-fixing conspiracies, which remained undiscovered. Moreover, all of these cartels are made up of producers, who are mostly from industrialised countries.

But this is just one side of the story. Cartelisation is not only about some loss in consumer welfare. It hampers the development of developing countries and growth of their firms through several ways. It has been observed that producers of raw materials and capital good are more prone to cartelisation as the goods produced by them are more homogenous in nature compared to consumer goods, which are more differentiated. The infamous vitamins cartel is a glaring example. This directly affects the firms of developing countries.

Some other important international cartels that hit the developing countries very hard are those in heavy electrical equipment, steel and aluminium. Neither of the first two operated in the US but involved products very important for development. The aluminium cartel was set up with the active support of the US and the EU governments and it operated worldwide. Steel, being one of the basic goods for different industries and most of the developing countries without indigenous capacity, had to suffer because of high prices. The cartel members used their excess profits to engage in predatory pricing against newcomers, particularly from developing countries. For example, predatory pricing drove the independent local manufacturers of steel in Brazil to bankruptcy. However, on an average, the cartels maintained higher prices in developing countries than the developed countries.<sup>11</sup>

Heavy electrical equipment is another item that almost all developing countries require, to install electricity generation plants to meet their growing energy demand. Available records suggest that several developing countries were the victims of bid rigging by the heavy electrical equipment cartel members. But higher prices of heavy electrical equipment due to cartelisation significantly raised the cost of installing electricity generating plants and thereby made energy more expensive. Needless to mention that this has adversely affected the competitiveness of developing countries. The globally dominant TNCs like Microsoft can significantly damage competitiveness of any country, especially the developing countries. However, it has been hauled up for indulging in anti-competitive practices in the US or EU, but developing countries dare not touch it.<sup>12</sup>

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<sup>10</sup> 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)

<sup>11</sup> Mehta, Pradeep S and Nitya Nanda (2003), "Competition Issues with International Dimensions: How do developing countries deal with them?" in CUTS (ed.) *Competition Policy and Pro-poor Development*, CUTS, Jaipur.

<sup>12</sup> For example, the company had to pay huge fines in the US and EU, but in India, though the competition authority initiated a case against the company, it could not proceed much.

## Competition Policy and Poverty Reduction

The biggest challenge in the developing world today is to get rid of abject poverty that deprives a large section of their population a dignified life. Obviously, the policy makers of these countries remain overwhelmingly preoccupied with designing and implementing policy measures to tackle this problem. Hence, no policy response can be designed in these countries without looking at how it will affect the poor. Competition policy is no exception.

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 work for the benefit of the poor people. 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.”*

“Well-functioning” implies markets that work efficiently and without distortions i.e. competitive markets. However, “competition” is often easily distorted by the players in the market, even when there are a large number of them. It is therefore that governments enact competition laws to regulate the distortions.<sup>13</sup>

What is very often ignored is the fact that the prevalence of anti-competitive practices in markets hurt the poor more. A rich person would not mind paying a dollar more for buying a good but for people living with less a than a dollar a day getting value for money for every cent they spend is more vital. 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 a greater impact on them than other segments of the society.

The market for agricultural products is very 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, this set 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.

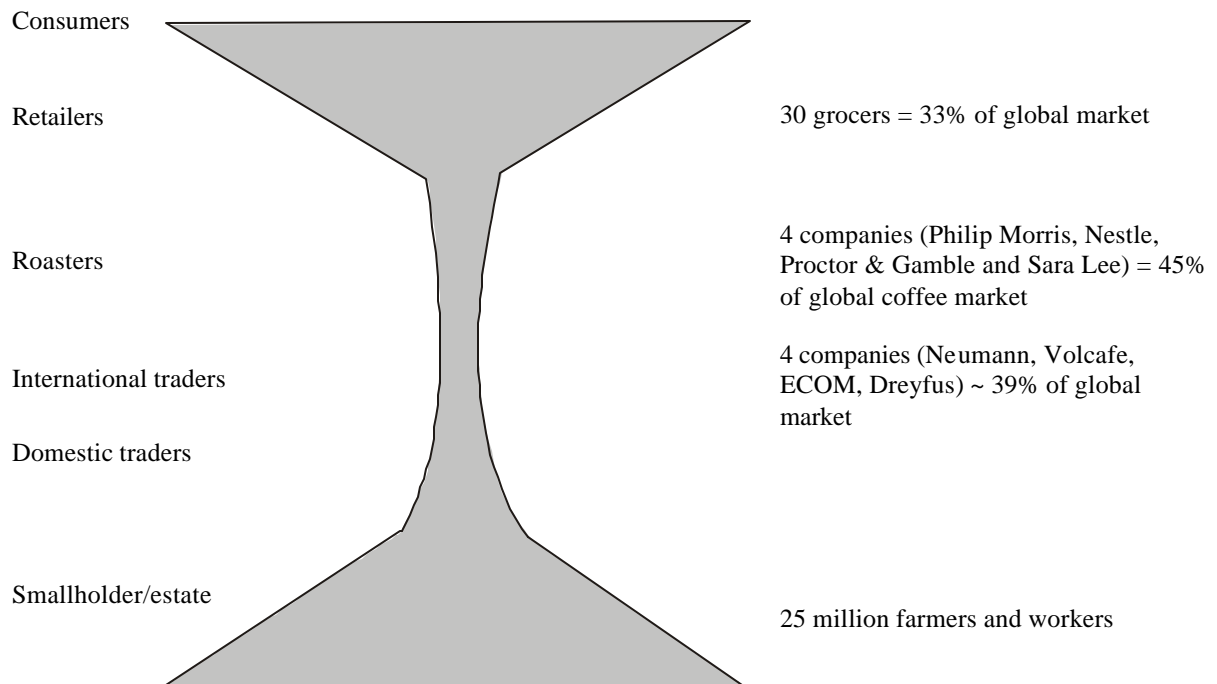
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<sup>13</sup> Mehta Pradeep S, Mahvash S Qureshi and Anjali Bansal (2003) “Competition Policy and the Poor” in CUTS (ed.) *Competition Policy & Pro-poor Development*, CUTS, Jaipur, India

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. Of the 1.2b people of the globe who live in extreme poverty, approximately 75 percent live and work in rural areas and about two thirds of them draw their livelihood directly from agriculture.<sup>14</sup> Thus, one can hardly overestimate the issue of linkage between market imperfections in agricultural goods and poverty.

A World Bank report estimated that the divergence between producer and consumer prices may have cost commodity-exporting countries more that \$100 billion a year, and suggests that imperfect competition at the intermediary level is the key factor.<sup>15</sup> The case of international coffee market is illustrative in this regard. According to a UNCTAD report, annual export earnings of coffee producing countries in the early 1990s were US\$10-12bn and global retail sales about \$30bn. About a decade later, retail sales exceeded \$70bn, but coffee producing countries received only \$5.5bn.<sup>16</sup> The main reason for this divergence is that coffee distribution is a roaster driven chain and four big roasting companies control 45 percent of the global market. The situation is illustrated in the following diagramme.<sup>17</sup>

**Figure 1: The global coffee bottleneck**



<sup>14</sup> International Fund for Agricultural Development (IFAD), Rural Poverty report 2001: The Challenge of Ending Rural Poverty, New York, OUP, 2001.

<sup>15</sup> Morriset J (1997) Unfair Trade? Empirical Evidence in World Commodity Markets Over the Past 25 Years. Foreign Investment Advisory Services ([www.worldbank.org/html/dec/Publications/Workpapers/WPS1800series/wps1815/wps1815.pdf](http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1800series/wps1815/wps1815.pdf))

<sup>16</sup> “Commodities, Markets and Rural Development”, Roundtable Meeting organized by UNCTAD, April 30, 2003, New York ([www.un.org/esa/coordination/ecosoc/hl2003/RT7%20summary.pdf](http://www.un.org/esa/coordination/ecosoc/hl2003/RT7%20summary.pdf)).

<sup>17</sup> Adopted from Bill Vorley, “Food, Inc.: Corporate concentration from farm to consumer” UK Food Group, 2003, London.

## **Concerns vis-à-vis Competition Policy and Law**

Competition, though seen as a means of attaining efficiency and fairness, may not necessarily promote these objectives. A perfectly competitive market with many small firms may achieve equality of opportunity (fairness) but may not achieve efficiency as too many firms will mean that they will not be able to enjoy economies of scale. Obviously, competition policy must deal with trade-offs in its objectives and instruments. This concern has led to a shift from a structural approach to behavioural approach in enforcing competition in market. After all, in a fiercely competitive market, even a duopoly can bring out an outcome that a perfectly competitive market generates. Thus, it may not be necessary to have a highly competitive market structure provided appropriate rules of the game can be designed and enforced so that the behaviour of the market players remain competitive.

This approach may however become ineffective when there are natural monopolies and competition cannot be maintained as such. There might also be situations where there may be a number of players in the market but the market itself is so segmented that the individual players become monopolists in the relevant market. The only way to get “competitive outcomes” in such markets is to put in place effective regulation. Thus, regulation in different sectors becomes an integral component of competition policy.

The concerns of developing countries vis-à-vis competition policy and law have been succinctly put together by Laffont: “Competition is an unambiguously good thing in the first-best world of economists. That world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, a benevolent court system to enforce contracts, and a benevolent government providing lump sum transfers to achieve any desirable redistribution. Because developing countries are so far from this ideal world, it is not always the case that competition should be encouraged in these countries.”<sup>18</sup>

There is a feeling among many that competition law is a ‘first world luxury’. It is very often argued that it is in the developed world where we find rigorous implementation of a competition law. It is also pointed out that the so-called newly industrialised countries (NICs) in Asia did develop without a competition law. However, one should not ignore the fact that the countries like the US and Canada adopted a competition law more than a hundred years ago. At that time they were at a stage of development comparable to the stage many developing countries are at today.

Moreover, it may be rather naïve to say that the NICs did not have competition policy just because they did not have a competition law. There is evidence that these countries used various policy measures to promote competition in the market place, reward the

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<sup>18</sup> Laffont, J (1999) Competition Information and Development, *Annual Conference on Development Economics*, World Bank, Washington.

efficient firms and punish the inefficient ones, which is what a properly framed competition policy does.<sup>19</sup> Many of the related concerns can be addressed, at least partially, if there are other policies, which influence competition.<sup>20</sup> It was thus just a case where bits and pieces or principles of competition policy existed in various economic policies, and was not designated as such, even without a comprehensive or stated approach. Who knows these countries could have performed even better with a properly framed competition policy and law. After all it must not be overlooked that some of these NICs continue to have high poverty despite rapid growth.

## **Conclusions**

In the light of the above discussions, it can be argued that competition policy is a vital governance instrument irrespective of the stage of development of a country. This is not to suggest that ‘one size fits all’ and that countries should adopt either the model used by a developed country or neighbour or one of the models drafted by an international body such as that formulated by the UNCTAD. On the contrary, every country needs to tailor its competition law to its own specific set of needs and conditions.

Every country has different competition concerns that will determine the nature of competition policy and law to be adopted. Even the meaning and concept of competition vary across countries.<sup>21</sup> The most important factor is that the law should be realistic and implementable. Introducing a law that cannot be properly implemented is not only futile but may be counterproductive. If the competition authority is seen as being incapable of discharging its role then people may lose faith in the effectiveness of competition law as a whole.

There is no guarantee that a good legislation will meet its aims. Creating a competition culture depends on effective implementation, a supportive policy environment and a wide public buy-in. As mentioned above, competition law is just one element of competition policy. The effectiveness of the competition law will depend on the extent to which it is harmonised with other policies and potential conflicts identified and address carefully.

A healthy competition culture is the hallmark of a good competition regime and competition advocacy is a basic pre-requisite for that. The lacklustre performance of competition policy and law in many countries is primarily due to the failure to recognise the importance of competition advocacy. A properly designed advocacy programme plays an important role in discouraging and sometimes eliminating anti-competitive practices. As prevention is always better than cure, advocacy not only reduces the incidence of anti-competitive practices but also substantially reduces the need for enforcement action thus saving cost on both counts.

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<sup>19</sup> R. Shyam Khemani and M.A. Dutz, *The Instruments of Competition Policy and their Relevance for Economic Development*, PSD Occasional Paper No. 26, The World Bank (1996).

<sup>20</sup> See World Bank & OECD (1999), “A Framework for the Design and Implementation of Competition Law and Policy,” Washington D.C.

<sup>21</sup> This was observed in a survey of competition laws in 50 countries. For further details see World Bank (2002) “World Development Report 2002 – Building Institutions for Markets”, Oxford University Press New York.

In this regard it is extremely important that the civil society, especially consumer organisations, are closely involved in the advocacy efforts of the competition authorities. It will give not only better outreach but also acceptability otherwise there is a chance that the efforts of the authorities may be taken as a mere publicity drive.

An active consumer movement makes a significant difference to the effectiveness of competition law in other ways also. Empowered consumers and representative organisations will bring anti-competitive practices including abuse of dominance and collusion to the attention of the competition authority. They will also act as a countervailing power to businesses to ensure successful implementation of the competition law. Putting the consumer at the heart of the legislation makes it more likely that the benefits of the competition policy and law will be shared widely.<sup>22</sup>

However, in this age of globalisation, the international dimension of competition challenges is becoming more prominent. As trade and investment regimes are liberalised in most developing countries, the inflow of foreign products and companies creates new challenges as many of the anti-competitive practices originate from outside the country. As noted above many of the anti-competitive practices that have serious implications for competitiveness, development as well as poverty reduction in developing countries actually operate at global level. Unfortunately, very few people in developed and developing countries appreciate the international dimension of competition policy and its integral relationship with trade, industrial democracy and consumer welfare, and national economic development.

In order to face these challenges, a well-functioning national competition regime may be necessary but not sufficient. Developing country competition authorities, in general, do not have the resources or the experience to tackle international competition challenges. Cartel cases are notoriously difficult to prove, even for the American and European authorities dealing with companies based in their territories. It will therefore be almost impossible for a developing country to carry out the tedious case work, and conduct necessary investigations leading to prosecution.

Moreover, some of the international competition problems like we have seen in the case of the coffee market or the dominance of agribusiness TNCs in general are essentially global in nature and there cannot be any local solution. Countries have entered into bilateral or regional agreements to deal with such problems. However, they can be best dealt with in a multilateral framework, rather than on a bilateral or regional basis.

The global community has been discussing the issue of a possible international framework on competition since the days of Havana Charter in the late 1940s. However, the discussions have generated much heat but not enough light. There is, by and large, an overall consensus that there is a case for a multilateral competition framework, but there is no agreement as to:

- What should be its scope and contours, and
- Where it should be situated.

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<sup>22</sup> CUTS (2002), Challenges in Implementing a Competition Policy and Law: An Agenda for Action.

Some suggest that UNCTAD already has a long history of dealing with competition issues and is a non-controversial forum. Hence it is the best place to anchor a multilateral competition framework. Some of course plug for the WTO. A third way has also been suggested, i.e. to have it in an independent forum away from the UNCTAD and the WTO. The WTO as an organisation is quite mercantilist in approach, focusing on market access issues and hence may not be the best platform for hosting a multilateral framework. The market access aspect of the issue is also important and hence a limited agreement covering the relevant areas can be reached at a later stage when the members are more comfortable.

The current proposals at the WTO focuses mainly on standards for national competition rules and international cooperation for cross-border issues, whereas a global framework that will promote development, competitiveness and poverty reduction in developing countries will require global rules on competition. Further, the demanders of a multilateral framework at the WTO appear to be asking for rules *on* competition, while the developing world would like rules *for* competition. Considering the present geo-political situation, UNCTAD maybe better suited for such a global competition regime. However the US is particularly fond of UNCTAD. Thus the international community will need to find a forum where everyone is comfortable. Perhaps the International Competition Network maybe the body! The Millennium Declaration has recognised reduction of poverty as a global challenge. A properly framed global competition framework can go a long way in facing this challenge and hence it is our shared responsibility to evolve such a framework.