

Competition advocacy & regulated industries: Sri Lanka's experience

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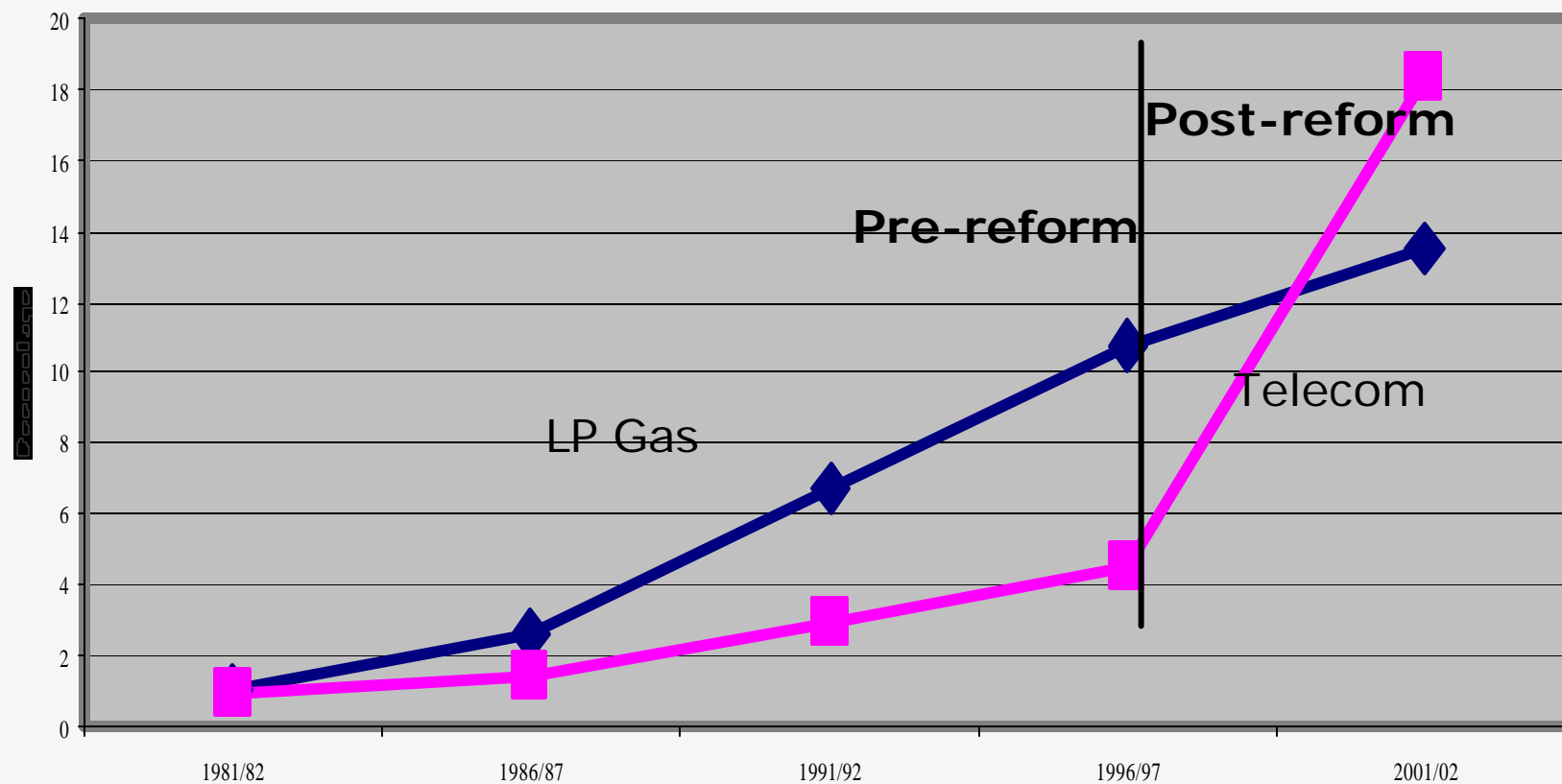
Agenda

- ❑ Public Interest Program Unit as competition advocate in reform of infrastructure industries
 - Drawing from experience in household gas and telecom reforms
 - ❑ PIPU approach: “Competition wherever possible; regulation where necessary”
 - Illustrated with work in telecom and petroleum sector
 - ❑ Competition law for regulated industries
 - ❑ Competition-friendly reforms in infrastructure industries
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Public Interest Program Unit

- Government created the PIPU in 2002 as a key component of the Ministry for Economic Reform funded by an IDA technical assistance credit
 - Vision was to balance the Public Enterprise Reform Commission (PERC), which was the transactions/privatization entity
 - Previous sector reforms were seen as by-products of privatization transactions that paid inadequate attention to sector performance
 - Telecom & household gas sectors as exemplars

LPG and telecom access by households, 1981-2002 (adj. Consumer Finance Survey)



“Connectivity” aspect of post-reform sector performance

- Telecom (sector reform + privatization)
 - 1991 corporatization & creation of regulator had no significant effect
 - 1996-98 reforms (competition/ interconnection) had dramatic effects
- Household gas (privatization; no overall reform process)
 - Privatization without competition does not result in significant growth
 - Other benefits (e.g., mandated investment)
 - Data does not capture effects of duopoly from 2001 & competition from 2003

Competition wherever possible; regulation where necessary

- PIPU motto reflects position that markets (decentralized decision making) are
 - Superior to planning in complex, dynamic systems
 - Better than planning in fostering/responding to innovation
 - Capable of yielding better performance
 - Also recognizes imperfection of infrastructure markets by allowing for regulation

Lessons from telecom reforms, 1991-2003

□ Competition is key

- Sri Lanka became a top 10 fixed-telephony growth market after competition introduced
- Allowing four mobile operators into a small market was radical in 1994, but has paid off, with 23.9% of households now having some form of telephone access
 - 115,000+ mobiles were in operation in North & East within months of ceasefire

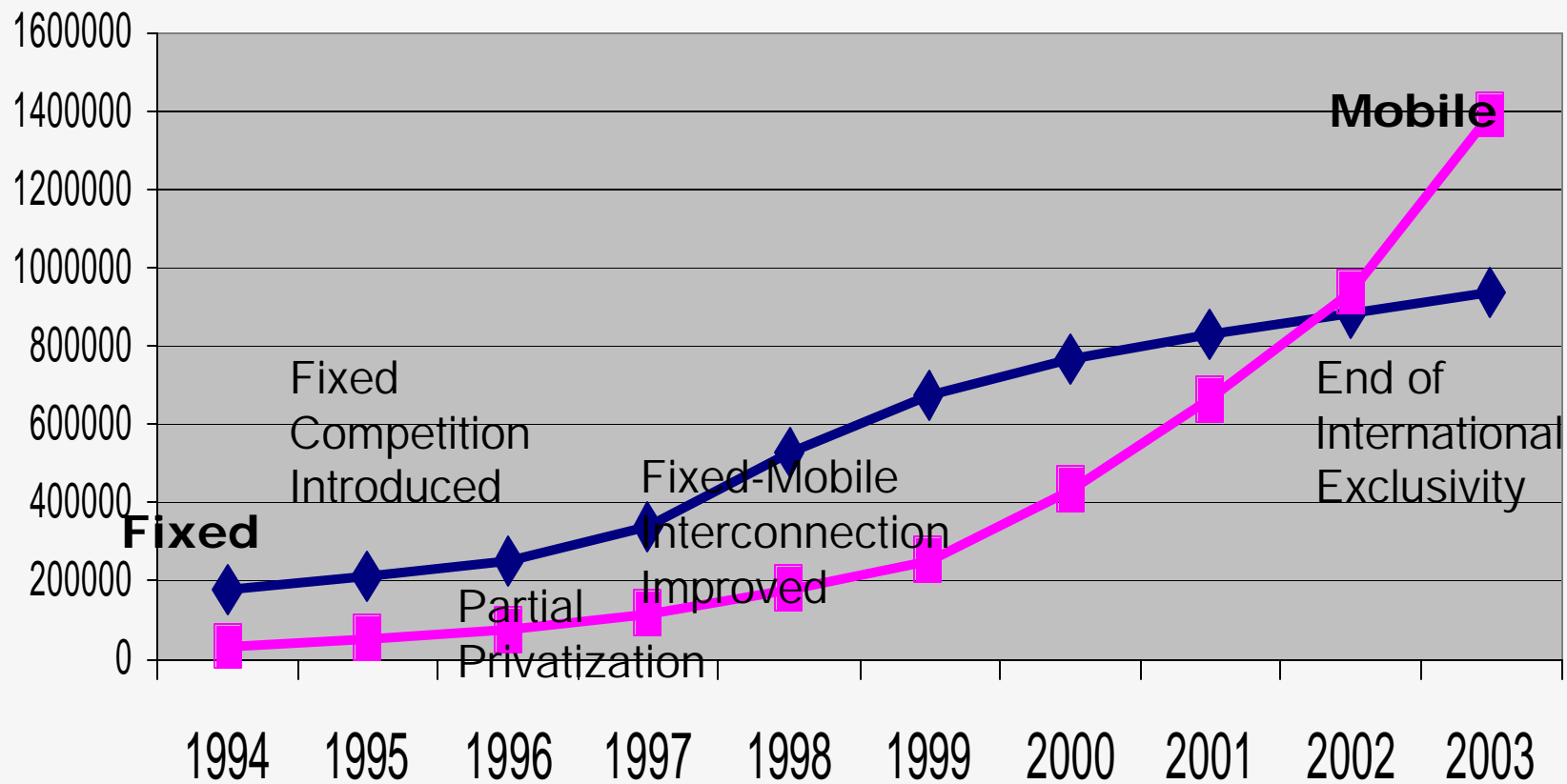
□ Monopolies are harmful

- Uncertainty created by 5-year international exclusivity harmed the entire sector, including the beneficiary
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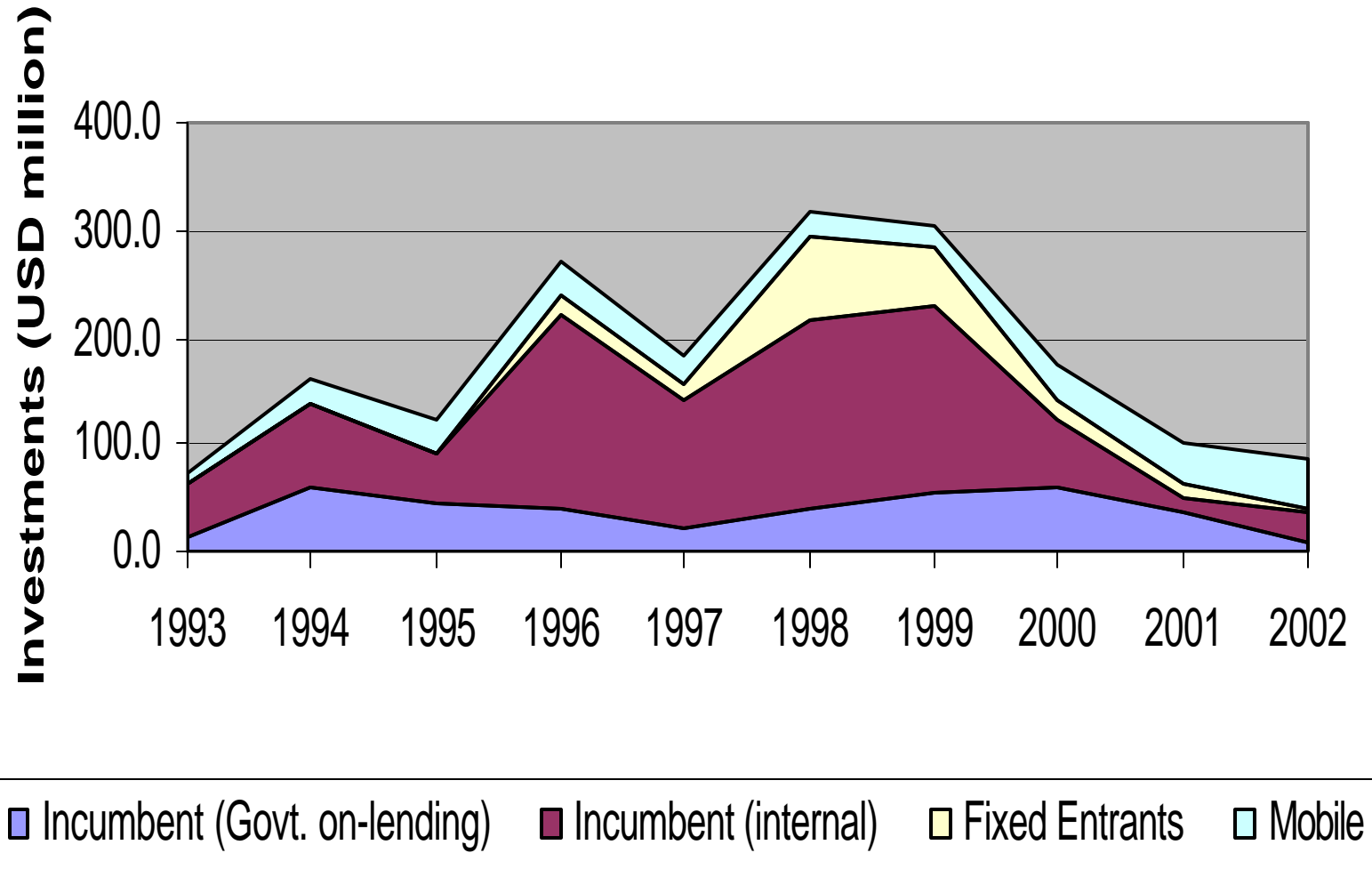
Lessons from telecom reforms, 1991-2003

- But regulation is necessary for competition and growth
 - Rapid growth in mobile assisted by implementation of better fixed-mobile interconnection in 1999 & ending of international exclusivity in 2003
 - Fixed sector growth stunted by refusal of incumbent to accept, & the government to enforce, the 1999 fixed-fixed interconnection
 - Failure was partly due to ambiguous exclusivity granted at privatization

Telecom Growth & Reforms



Telecom Investment In Sri Lanka (USD mn)



PIPU approach to reform

- Unbundling of potentially competitive elements of integrated government owned monopolies
 - Legal framework only; not actual unbundling
- Introduction of competition in markets that allow it
 - Specific focus on entry & exit conditions
 - Minimize legal barriers
 - PIPU does not do transactions
 - Responsibility of Public Enterprise Reform Commission (PERC)

PIPU approach to reform

- Regulation to ensure “level playing field” for investors and to protect consumers
 - Safeguards to prevent extension of market power into competitive markets
 - Structural vs behavioral
 - Control market power in monopoly markets
 - Asymmetric regulation
- Pragmatic approach; 2nd & 3rd best solutions better than none

Example: petroleum products

- Not a blank sheet; process started well before PIPU created
 - Lubricants (1994)
 - Privatization with 5-year exclusivity period
 - Household gas (LPG) (1996)
 - Privatization with 5-yr exclusivity
 - Strategic decision to invite state-owned IOC of India as 2nd player in petrol distribution (2002)

Petroleum sector reforms

- Unbundling in a hurry
 - Divestiture of port bunkering (2003)
 - No decision on aviation bunkering yet
- Decision to admit a 3rd player (2002)
 - Transparent process: decision (May 2004)
- Essential facilities
 - Joint venture controlled by 3 players
 - With exception of strategic Trinco facilities, which are solely Lanka IOC's

Petroleum sector reforms

- Elements of agreement with IOC
 - Retail price tied to CPC retail price formula
 - In effect, government sets prices
 - No direct price competition
 - Consent of all operators required to start a new petrol station, for 3 years

Design of draft petroleum sector reform legislation

- Allowed for pre-existing constraints but wrote in the competition-friendly regime with specific dates
 - No possibility of extending sub-optimal arrangements
 - Eliminate uncertainty that depresses investment at tail-end of exclusivity period
- Entities subject to competition law

Competition law in Sri Lanka

□ Problems

- Weak legislation (Fair Trading Act), superceded by Consumer Affairs Authority Act of 2002, with only ex-post powers
- CAA created, but funding is from government and it is under a Minister
 - Independence and capacity problematic

□ But no simple solution

Competition law in a small, trading economy

□ Context

- Most open economy in South Asia
 - Further liberalization on stream under WTO, India-SL Economic Partnership Agreement & FTAs with USA and Singapore
- Small economy that cannot be taken as unit of analysis, in most cases
 - Exception: non-tradable goods & services—most regulated industries

Public Utilities Commission Act, 35 of 2002

- ❑ Contains the strongest competition law provisions in Sri Lanka
- ❑ Applies to any industry that is brought under the PUCSL by inclusion in schedule by Parliament
 - Electricity Reform Act 34 of 2002
 - Petroleum Sector Reform Bill?
- ❑ Also addresses independence and capacity problems of CAA

Reg'ed industries competition authority: Independence

- ❑ Commission members appointed for staggered terms with concurrence of Constitutional Council
- ❑ Specified procedures for removal by Parliament
- ❑ Funded by industry levies, not consolidated fund
- ❑ Policy directions may be given only through Cabinet

Reg'ed industries competition authority: Capacity

- ❑ Funding through industry levies allows for outsourcing and adequate compensation packages
- ❑ Potential exists for an innovative organization that breaks from dysfunctional government models
- ❑ Will the potential be realized?

Competition-friendly reforms in infrastructure industries

- Clear vision with broad buy-in
 - Duration of reforms does not overlap with term of government
- Capacity
 - International best practice blended with knowledge of local circumstances
- Beyond the big bang
 - Capacity & commitment in ex-ante and ex-post regulatory agencies