

Case study commissioned by the Department for International Development, UK

A Contribution to WDR 2005 on Investment Climate, Growth and Poverty

**Some Lessons from the CUTS 7-Up  
Comparative Competitive Policy Project**

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**Key Messages**

1. Developing country competition authorities (CA's) can be effective, but the existence of an agency and a law is not sufficient for policy to be successful.
2. If the necessary conditions are met a competition policy does seem likely to bring benefits to the economy rather than be a vehicle for special interests.
3. Effectiveness depends in large measure on the energy of the CA and requires at least passive support of the State, including an adequate budget; and personalities matter
4. The cases involving FDI that were researched suggested that foreign investors did respect a credible CA, and that competition policy should not be seen as an additional bureaucratic burden.

The views and opinions expressed in this study are those of the author and do not necessarily correspond to the views or policies of the Department for International Development (DFID), UK.

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This note is written by a member of the advisory group and any opinions expressed or errors made are those of the author of this paper not those of the original research team. At the same time the author would like to take this opportunity to thank the CUTS team, the other advisers and DFID, who funded the project, for all their work, including comments on this text

## **Introduction**

1. The 7-Up Project funded by DFID made a comparative study of the competition regimes of seven developing countries, four in sub-Saharan Africa (South Africa, Zambia, Kenya and Tanzania), and three in Southern Asia (India, Pakistan and Sri Lanka). All had some sort of competition law and authority in place, and all were undergoing some sort of process of transition. These were all Commonwealth members that used English as an administrative language. There were also significant differences between the countries including level of economic development, and the maturity of the competition regime itself.

2. As noted above, they all had experience of some sort of a competition law, though in Tanzania this had only just been introduced. There were thus enough elements in common that a genuine comparison was possible, but enough differences that one could at least try to assess the effectiveness of different regimes. Of course the countries were at very different levels of development and differed greatly in size.

3. A detailed case study methodology was adopted, so that a small sample size was inevitable. However the study was not conducted in isolation. Experts and practitioners from a number of other countries were involved, and a wider comparative perspective was present. Observers from several countries including Peru, Bangladesh and Zimbabwe attended meetings as well as officials from the WTO, UNCTAD and the OECD. Advisers from the academic community were also involved.

4. The study was carried out by the Consumers Unity & Trust Society (CUTS) based in Jaipur, India, in association with a large network of research associates and advisers. The final output was a report by CUTS, but, the project involved much more than a research study of competition policy: it sought to engage researchers from civil society directly with the competition policy process, to give consumer groups in the selected countries experience of and training in work on competition issues and to raise public awareness of the importance of competition policy. Public meetings were held with “National Reference Groups”.

5. It was always planned that the research would be carried out by CUTS (India) who would write the final report in association with partners in each of the case study countries. In each 7-Up country there would be a team consisting of two partners, one an established economic and social research institution and the other a consumer organisation. The objective was that the experience of engaging in research about the policy process would create expertise in civil society to engage in research-based policy dialogue, such as that very successfully undertaken by the UK Consumers Association, who were heavily involved in the advisory committee of the project. The highest point in this interaction came when in the second phase of the project the Sri Lankan team asked their Fair Trade Commission if an analysis had been carried out of the Glaxo Smith Klein Beecham (GSKB) merger. The FTC responded that they did not feel capable of doing this but asked the researchers to do a pilot analysis for them.

6. The research had strong assistance and support from several competition agencies, notably those of Zambia, South Africa and Pakistan, all of whom sent representatives to project meetings. The entire project was funded by the UK Dept for International Development whose staff played a very active part in the project's Advisory Board along with experts from OECD WTO and the World Bank as well as the international consumer movement.

7. The project was divided into two phases: the first was a mapping exercise to collect data on the operations of the competition systems in the seven countries. It was largely institutional description, but analysed a number of process issues. The second phase was strictly process oriented. The research group identified a number of common and, where possible, cross border issues and cases, and examined how these had been treated in the different countries.

8. The study was initially intended to be descriptive. It aimed to get accurate comparative information on the workings of competition regimes across the different countries, in terms of the nature of the laws, procedures, costs, staffing etc. At the same time judgements could be made on the effectiveness of the various approaches. It must be recognised that the objective was essentially to look at the

administrative effectiveness rather than the economic impact. It was not within the scope of the study to collect data on the consequences of the competition policies observed; paradoxically therefore the study was obliged to focus on the costs of competition policy more than the benefits!

### **Lessons from Phase I of the Project**

9. The small scale of the study makes generalisations difficult, but one can nevertheless see certain tendencies that one feels are likely to be observed more widely. From a strictly logical point of view it is easier to disprove certain propositions than to make generalisations: for example we can reject the claim that a competition authority (CCA) cannot possibly function in a least developed economy; and we can reject the claim that a good law is sufficient to ensure that an effective policy is implemented; most interestingly we can reject the proposition that a competition authority in a less developed country will never dare even attempt to stand up to a sceptical government.

10. A key obstacle to the effective implementation of competition policy is lack of political will. It became evident that there are several layers of support, all of which must exist before competition policy becomes effective:

- (i) There must be political willingness to act to sustain competition.
- (ii) A formal legal framework must be put in place.
- (iii) Adequate resources must be provided.
- (iv) The CA must itself have well-qualified and motivated staff.
- (v) The combination of these factors must be strong enough to resist powerful business interests.

11. The finding emerged from the studies that these are all independent variables, and that an effective competition policy can be blocked if any of these conditions are not met. In particular we see that the mere existence of an adequate law is not enough to ensure that it is implemented.

12. India has had some sort of competition law for many years, but the government does not appear to have given this policy a high priority, and the agency has not been pro-active. Though the authority had more personnel than other CAs, these were mostly support staff and not professionals.

13. In several instances we observed that even where a law existed and the authority was active, the state authorities were willing to override proposals from the CA. Very strikingly we had instances of the competition authorities in Pakistan and Kenya making recommendations in the face of hostility from the government. In the Kenyan case the Minister did have the right to overturn the decision of the competition authorities (and the CUTS researchers considered his judgement to be reasonable), but in the Pakistan case the legal basis of the government's decision was open to question.

14. In some cases the business pressures came from directly within government: one case was blocked due to the intervention of a minister who was on the board of the company in question.

15. These negative lessons have a positive side to them: where there is a will to act and a combination of favourable factors, a developing country competition agency is not condemned to be a passive observer.

16. The study of course confirmed rather than revealed that the South African competition authorities have an impressive track record. There are many possible explanations for this including:

- (i) South Africa is richer than the other states covered by the study.
- (ii) The South African government has made an explicit commitment to use competition policy as a tool to undermine concentrations of economic power.
- (iii) The system is well resourced and is staffed by well-qualified people who command high respect internationally, and were able to obtain important technical assistance in the cases examined in the study.

17. In South Africa the legal framework, which separates investigation and adjudication is well thought out. Social objectives have been carefully integrated into the process, rather than used to overturn decisions of the competition authorities at a later stage. The authorities have thought seriously about how to achieve the goal of assisting historically disadvantaged people without necessarily discriminating against foreign owned firms.

18. In addition research revealed that the South African authorities had achieved a high level of credibility, partly through a consistent respect for due process. After a few years of operation private firms began to treat notifications to the CA (for mergers and acquisitions etc) as a necessity.

19. On the other hand we observed that Zambia also had a relatively effective competition agency despite its low level of development. Again we have a multiplicity of factors at work:

- (i) The personality of the executive director clearly played an important part.
- (ii) The agency was relatively well resourced compared to other least developed countries, (a source of some political sensitivity it seems).
- (iii) Zambia benefited from significant formal and informal technical assistance.
- (iv) Zambia had a consumer movement, the Zambia Consumers' Association.
- (v) The activities of the CA were widely publicised.
- (vi) The legal framework gave an effective role to the CA.

20. It is not clear however how far the CA benefited from an autonomous political support for competition as was the case in South Africa or whether this was also a *result* of the vigour of the Zambia Competition Commission.

21. India, the home country of the study, provided some rather negative lessons. The study concluded that competition policy had not been effective in India, once again for multiple reasons. Regulation rather than the pursuit of strong competition had been the key element of Indian economic policy and this implicitly affected the mandate of the Monopolies and Restrictive Trade Practices Commission (MRTPC).

The personnel within the agency were felt by many to be insufficiently pro-active, and though the agency was relatively well funded the resources were not necessarily of the right sort. Unlike some of the African countries this cannot be explained away by scarcity of qualified people in the country: India is of course one of the best equipped countries in the world in terms of economists and lawyers with an understanding of trade and competition matters.

22. The hesitancy of the MRTPC to act was illustrated by the CUTS researchers themselves. During the course of their work CUTS obtained information about the international vitamin cartel that had been prosecuted in the US and the EU was known to be operating internationally. Prompted by a World Bank expert, the research team wrote to the firms concerned, asking for an undertaking that illegal price fixing was not being carried out in India, and sent information on this cartel to the MRTPC, but got no effective response from anyone.

23. However, the pessimistic lesson of this case should not go without qualification. The competition law is being changed and may become more effective. It would not be true to say that fundamental social factors prevent the securing of consumer rights in the face of producer power in India. CUTS research and campaigning activity reports successful use of consumer protection laws in local tribunals, even though national competition intervention is limited.

### **Lessons from Phase II of the Project**

24. The second part of the project found that although the costs of intervention were not prohibitive, the 7-Up country authorities, including South Africa, had difficulty in effectively addressing cross-border issues. In many cases it seemed that an improvement could be made through fuller use of the “effects doctrine”, under which a government may claim jurisdiction over all actions, which affect their economy wherever the contested conduct may have been physically located<sup>1</sup>, and greater international cooperation and assistance. More support from governments would again be called for in most countries.

25. Similar cases were often observed in different countries, (for example concerning soda ash and cement suppliers).

26. It was notable that several of the CAs observed felt that they were wholly powerless to intervene in the case of mergers by multi-national firms operating in their markets. On the other hand those that did seek to intervene found that they could do so effectively. In the GSKB case the South African CA was able to secure advance information on how the EU proposed to define relevant markets and what remedies it would seek. It was therefore able to demand divestiture of certain brands in the South African market as a condition of authorisation of the merger. The question arises as to whether a less sophisticated authority would have been able to do the same. We do however know that Zimbabwe was able to impose divestiture conditions on some multi-national company mergers affecting its market. We do not know what the effect of such rules or rulings is on FDI: econometric work by Evenett 2002a suggests that there may be a negative effect of strict mergers laws on inward M&A activity, a form of FDI. Such a result would not imply merger control is undesirable however, as Evenett 2002b notes. It may in fact enhance the *quality* of inward investment, especially where there are few economies of scale to be gained to offset consumer losses from anti-competitive mergers.<sup>2</sup>

27. Even where the government had the power to override autonomous pro-competitive intervention by the competition authorities, we did observe several cases where the CA attempted to act. From this it can be concluded that a CA in a developing country does not automatically abandon any ambitions to be rigorous. However a hostile government can have the power to prevent a CA from being effective, as the case of Pakistan shows.

28. If the government is merely indifferent to competition a strong willed CA can be effective. The impetus for the promotion of an active competition policy clearly comes from the Zambia Competition Commission (ZCC), and not the Zambian government, but it is the latter's indifference rather than hostility that has allowed the ZCC to be very active.

29. The Zimbabwean experience is inclined to support this thesis. We can be reasonably confident that the promotion of competition does not figure at the top of the Zimbabwean government's priorities. And yet having established a competition authority the government is not actually opposed to its activities and has allowed a number of controversial decisions to go through.

30. A further observation that may reflect the general situation is that the personality of the head of the CA seems to be very important in developing country authorities. The force of the Zambian Competition Commission was clearly drawn not only from its relatively large budget compared to other CAs in Africa (except South Africa), but also from the personality of its executive director. The impact of the South African competition agency was clearly derived from the respect for senior figures at a more general level. This was observed more widely in other developing countries whose experience was fed into the study, notably Peru and to some extent Zimbabwe. On the other hand it was widely reported that the leadership of the Indian CA was extremely cautious in its approach.

31. A further feature that stood out from the case studies was that in almost all of the countries studied the role of the competition authority was affected by the political-economic circumstances, in that the countries were transition economies moving to a market economy from state-led economic management. In several cases this literally meant that the share of state-owned and parastatal enterprises had been very high and, there was a privatisation process, which risked replacing state monopolies by private ones if action were not taken. In others there was a history of bureaucratic regulation and/or close political ties between the government (or previous administrations) and private business. The question of the relationship between the CAs and sectoral regulators posed itself in a particularly acute form in several of the cases, including South Africa, Tanzania and Sri Lanka. There was a clear inclination at the start of the privatisation processes to create separate sectoral regulators who were less oriented towards competition, both in terms of their legal mandate and by inclination. In addition it is clear that a single sector regulator is more prone to capture. Several instances were observed of conflicts between sectoral regulators and CAs: typically the competition agency would take a more pro-

competitive stance. The CA thus had an important but unquantifiable role to play in promoting a “competition culture”<sup>3</sup>. The CA therefore has an advocacy role to play both in changing other aspects of public policy but also in modifying expectations of firms and consumers about what they should expect.

32. Another issue that surfaced regularly in the cases was the relationship between intellectual property rights (IPRs) and competition law. This is clearly very important in the context of TRIPS,<sup>4</sup> where the conditions for issuing compulsory licenses under article 31 are substantially modified where a finding is made that there has been an abuse of competition law (art 31 k). Some of the 7-Up countries exempted anti-competitive practices undertaken to enforce IPRs from the provisions of their competition law. This was explicit in the Zambian case. In India and Kenya the law effectively created such a situation, though this has been rectified in the Indian case. South Africa appeared to have a situation in which the CA could provide exemption if they chose to do so. As is well known, South Africa has been extremely hostile to abuses of IPRs in the pharmaceutical sector, and the Competition Commission and Tribunal have been in the forefront of this. Marketing arrangements and vertical restraints have been severely attacked by the CAs.

33. Another theme that came up quite frequently was the issue of “unfair competition”. In Africa there was a widespread anxiety that dominant firms from South Africa might be able to engage in some form of predatory behaviour, and in India the Soda Ash case revealed a complex set of trade and competition issues around allegations of predatory behaviour that were dealt with under competition rather than anti-dumping rules, leading to trade friction with the US. Economists have always been extremely reluctant to admit the possibility of predatory pricing; in particular it is common to argue that it is so unlikely that even if it occurs occasionally more harm than good would be done by responding to complaints of predation. That is to say economists believe that the harm likely to come from falsely accepting charges that vigorous competition is predation will be much greater than that done by leaving some real cases of predation untouched. This may be true but the 7-Up cases suggest that there are quite strong pressures on both the trade and the competition authorities in developing countries to respond to what is perceived as

predatory dumping. Other than the Soda Ash cases – in both India and South Africa - the study did not report any concrete instances, but it was noted that several of the 7-Up countries were or were becoming increasingly enthusiastic users of anti-dumping measures. The widely held view that anti-dumping activity could be curbed by giving power instead to CAs has problems: it creates the risk that the CA would be pressed to become an instrument of protectionism.

34. This leads to the issue of capture. It is a feature of the public choice critique of competition policy that it is likely to be captured by producers, and diverted from competition or consumer protection aims. If there was a sign of political influence within the 7-Up countries it was more towards inaction than to take steps to benefit certain lobbyists. The 7-UP researchers concluded that the risk of capture was least when the objectives of the law and the agency were more precise and narrowly defined, i.e. where consumer welfare alone was the criterion, and when infringements were defined in *per se* terms. It was also concluded that the placing of the burden of proof in the case of “rule of reason”<sup>5</sup> was important. A particular problem for the Sri Lanka CA was that even if it had proved a certain anti-competitive practice had occurred, it still had to prove that it was against the public interest.

## Conclusions

The main conclusions of the study were as follows:

- (i) Developing country competition authorities *can* be effective, but the existence of an agency and a law is not sufficient for policy to be successful.
- (ii) If the necessary conditions are met a competition policy does seem likely to bring benefits to the economy rather than be a vehicle for special interests.
- (iii) Where developing countries have characteristics of transition economies, as most did here, the existence of a competition culture was important for the success of CA. Absence of a vigorous civil society was a problem but cause and effect are mixed up.

- (iv) Effectiveness depends in a large measure on the energy of the CA and requires at least passive support by the state, including an adequate budget; and personalities matter.
- (v) Many of the developing country agencies observed did less than they could on cross-border issues, perhaps due to a lack of awareness of the instruments available. Where informal cooperation took place it was very valuable, e.g. between the EU and South Africa.
- (vi) The research concluded that in general the use of competition policy to achieve non-competition objectives was likely to weaken the effectiveness of competition policy, but the South African example showed that it was possible to incorporate social objectives such as “to promote a greater spread of business ownership, in particular to include historically disadvantaged people.”<sup>6</sup>
- (vii) The evidence in the study does not allow us to draw direct conclusions about the impact of competition policy on inward investment. The evidence that competition policy *can* be made to work in developing countries indicates that it can have a positive impact on the overall institutional environment. The cases involving FDI that were researched suggested that foreign investors did respect a credible CA, and that competition policy should *not* be seen as an additional bureaucratic obstacle to entry.

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## Notes

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<sup>1</sup> The European Commission has used this doctrine to prosecute cartels operating outside the EU but exporting to it.

<sup>2</sup> See Tybout (2000)

<sup>3</sup> This has been defined as “an awareness among both the public at large and economic actors of the rules of competition.” *Building a Competition Culture* Presentation by Sally Southey, Assistant Commissioner, Communications Competition Bureau (Canada) <http://strategis.ic.gc.ca/pics/ct/ct02475e.pdf>

<sup>4</sup> TRIPS: the WTO agreement on Trade-related aspects of Intellectual Property Rights.

<sup>5</sup> I.e. where a particular potentially anticompetitive practice, such as price agreements, is not illegal *per se* but is separately evaluated in each instance for its effects on the economy.

<sup>6</sup> “What is the Competition Act”

[http://www.compcom.co.za/documents/Publications/Brochure/Brochure1/pages/04\\_chapter1.htm](http://www.compcom.co.za/documents/Publications/Brochure/Brochure1/pages/04_chapter1.htm)