



Politics Trumps Economics

- Lessons and experiences on
competition and regulatory regimes
from developing countries

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CUTS Centre for Competition,
Investment & Economic Regulation
CUTS C-CIER



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Executive Summary

In the past, most developing economies were characterised by significant government intervention, which included involvement marked with dominance of large state-owned enterprises (SOEs); licensing; permits; quotas; and price controls. This was the pattern followed by most developing countries as their economic management paradigm of a welfare state through command and control measures, believing that the state is the guarantor of freedoms and provider of all needs. Since economic liberalisation began during 1980s and 1990s, there have been considerable policy changes, with increased reliance on market forces. Along with policy changes, several developing and transition economies have adopted competition laws as a sequel to their market oriented economic reforms and many a times after the liberalisation measure were adopted. In principle, sequencing was haphazard and did not follow any logic. Most of these developing countries have adopted regulatory laws in several sectors, opened up for private players, which were hitherto reserved for public sector only. This upsurge in interest in competition and regulatory laws in developing economies reflects the substantial changes that have been taking place in their economic governance system.

But how important has this new form of economic governance been for growth and other developmental objectives? The answer to this question is unfortunately patchy. China, for instance, approved a competition law in June 2006, almost 30 years after it began economic reforms, yet the country has moved at extraordinary speed from low to middle-income status. Neither of the two major success stories on growth: Botswana and Mauritius had a formal competition law until Mauritius passed its Competition Act in April 2003, though that too is under a revision. By comparison, Kenya passed the Restrictive Trade Practice, Monopolies and Price Control Act in 1989 but has been nowhere near the same economic success. It is currently considering a new law.

Existing evidence suggests that other dimensions of governance, such as government's commitment to growth as a political objective, political maturity and overall political climate in a country may matter much more.

'Political will' turns out to be a key factor that determines successful adoption and effective implementation of competition and regulatory laws. In Malawi, although the government claimed to support competition, the enactment of relevant laws to deal with anticompetitive practices was not followed with the establishment of institutions. It took the country eight years to establish the Competition Commission. Worse, in Bangladesh, the Monopolies and Restrictive Trade Practices Ordinance, 1969 remains on the statute books, which was inherited from Pakistan, after Bangladesh split from it in 1971. But the Bangladesh Government has never attempted to implement this law; even the private sector showed no enthusiasm. And consumers remained quite unaware of any such law, and therefore, have not been the vocal demander.

In Zambia, the political will to get rid of the financially drained SOEs overshadowed other economic priorities. The focus appeared unidimensional, as the government appeared to be in a hurry in privatising the SOEs without bothering to put concurrent laws in place, which were required to monitor, control and prohibit anti-competitive practices. Though the Competition and Fair Trading Act was passed in May 1994 following donor insistence, the competition authority itself was operationalised only in May 1997. In contrast, it took only a few months to draft and enact the Privatisation Act, as well as establish the Zambia Privatisation Agency.

Functioning of regulatory regimes in telecom and banking sectors in Vietnam provides an interesting insight. In banking, the functioning of central bank has been constrained by government intervention in various ways. In contrast, functioning of the Ministry of Posts and Telematics (MPT, also the telecom sector regulator) has done wonders. In telecom, government objectives are clearly laid down in various government documents, which have provided necessary guidance for MPT to facilitate orderly growth of telecom services. However, in banking, there are conflicts in policy objectives – objectives of government are at variance with the goals set of the State Bank of Vietnam, and thus there is some confusion.

Political will to create a strong regulatory agency from the outset is crucial for future success, as a strong regulator will be able to balance the demands

of various interest groups, among other challenges. Unfortunately, in most cases, the politicians and bureaucrats responsible for the state administration may try to further their interests by creating a weak regulatory institution over which they can continue to exert control.

Since regulatory reforms are largely concentrated in public utilities where there is a strong public interest factor, including political sensitivity to both policy reforms and to regulatory practice, it is difficult to envisage how regulatory reforms would be insulated from overriding political considerations. It appears to be a matter of 'Common Practice' that a regulator is made to consider public interest in its decision making process. The inherent conflict between the objectives of economic efficiency and public interest often leads to situations of trade-off, which are politically quite sensitive.

In South Africa, competition law explicitly includes public interest objectives alongside efficiency objectives as a test to determine competition matters. Anyhow, the number of cases where public interest considerations have made a material difference is small. Interestingly, the most important issue is that explicit inclusion of public interest objectives has raised the profile of these policy imperatives, which seek to ensure policy coherence across diverse policy areas. In addition, their inclusion has put these issues on the agenda of firms.

Nonetheless, governance challenges are likely to arise when competition authorities assess explicit non-competition criteria without transparent processes for doing so. In such cases, administrative discretion in interpreting concepts such as 'fair' competition is often the starting point for distortions and corruption in developing countries.

One needs to acknowledge and appreciate that a democratic set up requires politicians and their parties to win elections to reach to policy-making positions. Therefore, they must satisfy aspirations of their electorates whom they have to go back, at intervals, to seek a fresh mandate. Reasons for politicians not allowing implementation of competition principles are well known (e.g. fear of losing certain powers, which they had been using to satisfy certain interest groups). However, little efforts have been made to identify potential gains for politicians out of promoting competition measures i.e. how competition regime outcomes could help them retain and enhance their public image and increase their support base.

Implementation of competition and regulatory laws also faces road bumps in the form of opposition from various constituencies. Even those who are expected to benefit from open markets and competition, viz. consumers and new businesses are indifferent towards reforms.

Civil servants are closely defensive of their acquired rights and consider competition/regulatory laws as an attempt to reduce their existing prerogatives, other than being influenced by businesses. In Tanzania when a brewery was challenged by the competition authority for abuse of dominance in 1998, the Permanent Secretary of the Ministry of Trade and Industry scuttled the move, as he sat on the board of the brewery company. The civil servants usually oppose, or extend lukewarm response towards market-oriented economic reforms. Moreover, bureaucracy, weaned on a control and command economy, tends to perpetuate itself in regulatory roles for which it may not have the necessary acumen.

Business and their associations generally oppose competition regimes, as they feel that it would reduce their market share and hence business profits. Hence, adoption and implementation of a competition regime may easily be captured or sidelined by powerful interest groups. In Egypt, the opposition to a competition law came from a powerful Member of Parliament, who owned a dominant steel company. It took quite an effort for the government to pass a competition law much later. In Thailand, though the government enacted a second competition law in 1999, after scrapping an old and ineffective one, till date it has had very limited impact due to the construct of the authority, which is a consequence of an unholy nexus between politicians and businessmen.

Rampant political capture is another principal obstacle to the creation of effective competition and regulatory regimes in developing countries. Competition law may covertly protect politically well-connected companies from 'fair' competitive forces, as in the case of the Tanzania brewery case mentioned above, guaranteeing monopoly rents thus negating any efforts to innovate. Garnering support from such players is essential to ensure effectiveness of regulatory reforms. A government that is committed to competition law, and any regulator that is entrusted with the task of enforcing that law must not only direct advocacy efforts towards consumers, but also towards the influential industry participants.

In most developing countries, competition and regulatory laws are entirely new concepts. In several cases, such laws have been adopted due to external pressure (e.g. Zambia competition law). Consequently, very few officials in the public service and political establishment appear to have understood what the new regime means and what it takes to have a well functioning regulator.

While the cornerstone of the new development paradigm is a private sector led growth strategy, implementing economic reforms in developing countries becomes quite a challenging task also due to lack of rule of law and property rights, weak judicial institutions, and ineffective or non-existent commercial codes and bankruptcy laws.

There are a host of political economy and governance constraints that frustrate successful implementation of regulatory laws in developing countries. At present, most developing countries have passed the stage of contemplating whether they would want to have competition or regulatory laws or not, and have reached the stage where the debate focuses on how to structure their laws and how best to implement an effective enforcement regime within given constraints.

I. Background

Most developing countries have adopted market-oriented reforms as part of the globalisation and liberalisation process but due to various reasons, distortions arise in the working of the market process. Nevertheless, the mere adoption of regulatory laws is a necessary but not a sufficient condition for it to be part of the market reform agenda. Implementation is equally important.

Developing countries pose unique challenges for competition and regulatory law enforcement. Their low level of economic development, which is often accompanied with institutional design problems and complex government regulation and bureaucracy, creates real-world challenges that have to be recognised for successful implementation of competition and regulatory regime.

What matters most is proper design and implementation of competition and regulatory regime, suitable to the needs of developing countries. There are both good and bad examples in the developing world, but these are not captured in research as cogently as would be desirable for institutions elsewhere to emulate and apply in their own context. Research on regulatory implementation issues in the context of developing countries remains limited.

The CUTS Competition, Regulation and Development Research Forum (CDRF) research programme is initiated by CUTS International against the background that there is a vacuum for undertaking focused and cogent research on issues concerning implementation of competition and regulatory regimes in the developing world. More importantly, CDRF is aimed to provide a platform to strengthen research capacity in developing countries. The programme is being implemented through research cycles comprising of writing of research papers (based on an open call for papers), a symposium to discuss papers and the publication of a research volume.

The first research cycle has been organised on the theme of 'Institutional Issues in Implementing Regulatory Regimes in the Developing World'. Following research questions were considered in this cycle:

- Identifying and Overcoming Political Economy and Governance Constraints to the Effective Implementation of Competition and Regulatory Laws.
- Independence of Competition and Regulatory Agencies: Feasibility? Practicality? and Necessity?
- What should be the Priorities of Competition and Regulatory Authorities?

A large number of contributions have been received from researchers based in developing countries. This way the programme has provided a platform to developing country researchers. These research papers cover a wide range experiences from developing countries and transition economies including Kenya, South Africa, Zambia, India, Brazil, Chile, Turkey, Caribbean Community (CARICOM) countries, Malta, etc.

II. What Determines Effectiveness of Regulatory Regimes?

In the past, most developing economies were characterised by significant government intervention, which included involvement marked with dominance of large state-owned enterprises (SOEs); licensing; permits; quotas; and price controls. This was the pattern followed by most developing countries as their economic management paradigm of a welfare state through command and control measures, believing that the state is the guarantor of freedoms and provider of all needs. Since economic liberalisation started during 1980s and 1990s, there have been considerable policy changes, with increased reliance on market forces. Along with policy changes, several developing and transition economies have adopted competition laws as a follow up to their market-oriented economic reforms. Additionally, most of these countries have adopted regulatory laws in several sectors, opened up for private players, which were hitherto reserved for public sector only. This upsurge in interest in competition and regulatory laws in developing economies reflects the substantial changes that have been taking place in their economic governance system.

But, how important has this new form of economic governance been for growth and other developmental objectives?

The answer to this question is unfortunately patchy. China, for instance, approved a competition law in June 2006, almost 30 years after it began economic reforms, yet the country has moved at extraordinary speed from low to middle-income status. Neither of the two major success stories on growth, Botswana and Mauritius, had a formal competition law until Mauritius passed its Competition Act in April 2003. By comparison, Kenya passed the Restrictive Trade Practice, Monopolies and Price Control Act in 1989 and Zambia adopted the Competition and Fair Trading Act in 1994 but neither of the two has been nowhere near the same economic success because

cronyism, rent-seeking and state control have characterised government-business relations.

Political Will

Existing evidence suggests that other dimensions of governance, such as government's commitment to growth as a political objective, political maturity and overall political climate in a country, may matter much more. What matters everywhere is sustained political leadership and how the political arrangements underpin the process. In developed countries, the origins of competition law can be traced back to the political concern not for market competition and competitiveness but for the impact on democracy's stability of excessive economic influence. The effectiveness of competition law in developed countries has clearly been dependent on the political climate. For instance, US antitrust enforcement has often been motivated by political pressures unrelated to economic welfare, such as stopping mergers that would result in job losses in particular politicians' constituencies.

In developing countries, adoption and implementation of competition and regulatory laws is even more politically charged, as its objective is to constrain concentrated political and economic power while helping the more diffuse interests of ordinary, often poor, consumers and producers. Little is understood of how political processes shape the complex trade-offs between competition and public interest over distributional outcomes in low-income economies. In these cases, weak markets, immature cultures of competition, sizeable informal sectors, information asymmetries, and higher transaction costs cause market distortions, considerable inequalities and weak or non-existent institutional capacities producing much higher risks of 'state capture'. In countries where there is substantial national commitment towards market reforms, such as Chile (leading example in sectoral reform) and Mexico (leading example in price fixing and merger enforcement), regulatory agencies have been quite successful. In contrast, in Argentina, where the political and social commitment to market reforms has been more ambivalent or where other priorities prevail, regulatory agencies appear to have been less successful.

In Kenya, the design of regulatory institution has not taken into account the power wielded by the political system. Therefore, regulatory bodies such as Communications Commission of Kenya faces difficulty in implementing their mandate. As against this, the Kenya Electricity Regulatory Board is found to be effective in implementing its mandate. Interestingly, the electricity

regulator enjoys relatively low degree of independence from the line minister as against the telecom regulator: Kenya Minister of Energy determines financial resources, takes decisions on key issues, while the role of regulator is advisory in nature. The success of electricity regulator as against telecom regulator indicates perhaps a cordial relationship between the minister and the regulator due to the nature of power wielded by the minister over the regulatory system. It would perhaps make more sense if regulatory reforms in developing countries deliberately recognise the realities of political intervention and incorporated them into agency models, rather than attempt to create an unlikely autonomy, which can render it quite ineffective.

In this context, an interesting case study from India is in the telecom sector. When established in 1997, after considerable delay, the Telecom Regulatory Authority of India (TRAI) used the rulebook with near vengeance without appreciating the political economy. Further, TRAI reported to the Ministry of Communications, Government of India, which itself was in the business of telecom as the biggest player. As a result the Commerce Minister was quite mad, and hence the law was amended in 2000, which turned the regulatory authority mainly into an advisory body, and created an appellate and disputes settlement tribunal to deal with contentious issues arising out of regulatory and market practices.

Privatisation

During 1990s, the Latin American region was the most important beneficiary of the huge flow of private investments for infrastructure worldwide. However, since late 1990s, investors' appetites waned, public support to privatisation decreased and the role of public investments in provision of infrastructure services has gained momentum again.

It emerges that privatisation generated important improvements, but the progressive changes were neither extended beyond the transition period around the privatisation event nor always transferred to consumers. Public perceptions of the outcomes are not often very positive. Whether privatisation and regulation serve the public interest depends on the appropriate decisions taken *vis-à-vis* the method and sequence of privatisation, the industry structure provided at the time of privatisation and the oversight powers of the regulator.

A great majority of the privatisation cases in Latin America took the form of concession contracts. This was mostly to avoid political, legal and

sometimes constitutional impediments to the outright sale of state assets to private operators that were often foreign firms. However, concession contracts suffered from a number of problems, the most serious of which has been renegotiation. The Latin American region witnessed frequent renegotiation of infrastructure contracts. Most of the renegotiations were opportunistic, with politicians during or after an election campaign reneging on previous contracts to please their constituencies. Cancellations of water concessions in 2005 in Bolivia and the ongoing renegotiations of most concessions in Argentina after the 2001 crisis are the telling examples.

In contrast, privatisation of telecommunications industry in Jamaica was handled with care. The regulatory system established to facilitate privatisation was essentially one of contract, with very little room for regulatory discretion. Given the nature of Jamaica's politics and political system, legislation-based regulatory mechanism (e.g. U.S. regulatory style) constitutes an implicit contract that is too flexible and incomplete to provide the required safeguards for investment and growth. Instead, regulatory mechanism based on specific long-term contracts between the government and the companies is, if properly designed, likely to provide such safeguards. All long-term contracts are incomplete agreements; hence changed circumstances may require the need for renegotiation initiated either by the investor or the government.

Developing countries like Jamaica find themselves in weak negotiating position when selling state assets to overseas firms, which require large capital investment. These firms seek rent and unreasonable terms and conditions. The privatised telecom company (largely owned by Cable & Wireless of the UK) was given an exclusive 25-year licence, with an option to renew it for a further 24 years, including other privileges. This case provides an example of the problem faced by small states in dealing with the divestiture process involving large multinational corporations (MNCs). Anyhow, in early 1990s, the public began to express concern regarding the long exclusivity period, the pricing formula and the absence of an independent regulator. Although a multi-sector regulatory agency was established in 1997 its role was essentially advisory to the sector minister. Finally, an agreement was reached with the government of Jamaica in 1999 providing for phased liberalisation of the entire industry over a period of three years. The understanding also provided for independent regulation by the multi-sector Office of Utilities Regulation. Since then, the telecom sector has witnessed dramatic growth, significant improvements in labour productivity, and consumers have derived huge benefits.

The Jamaican case suggests that though the licence was eventually changed, the fact that the structure was underpinned by contract law precluded the government from embarking on opportunistic action and the final outcome was one of mutual agreement with respect to the licence changes. This however was not the case in Latin America.

Institutional Endowment

Two related dimensions of regulation matter when it comes to avoiding disruptive renegotiations: first is the regulatory environment, including not only the existence of a regulator from the very beginning, but also its independence from potential political pressures; and second is the type of price regulation itself. Indeed, price cap regulation has often been the salient choice of governments lacking previous experience with regulation, because it appeared to be less informationally demanding. The absence of a regulatory mechanism, when initiating transfers of infrastructure assets to the private sector and the policy choice of price cap, therefore, often goes in tandem.

The need for a well-defined regulatory framework is clearly demonstrated as a precondition for privatisation of the infrastructure and utility enterprises. Regulatory methods, which are appropriate in one environment may differ in another. Transplanting structures from the UK, the US or other developed countries in the name of best international practice is clearly not the ideal solution. Institutional endowment is central to the design of regulatory framework.

Keeping in view the institutional endowment of a country, it has been argued that competition law may not be desirable in certain circumstances. In case of Egypt, for instance, it has been asserted that adoption of a competition law with a weak policy and institutional infrastructure, absence of incentives among major stakeholders and weak collective actions among potential gainers from adoption of such law is likely to result in a failure of enacting the law.

III. Constraints that Frustrate Adoption and Implementation of Competition and Regulatory Regimes in Developing Countries

1. Political Will to Adopt and Implement the Law

'Political will' turns out to be a key factor that determines successful adoption and effective implementation of competition and regulatory laws. In Malawi, although the government claimed to support competition, the enactment of relevant laws was not followed with the establishment of institutions. It took the country eight years to establish the Competition Commission! Worse, in Bangladesh, the Monopolies and Restrictive Trade Practices Ordinance remains on the statute books, which was inherited from Pakistan, after Bangladesh split from it. But the government has not attempted to implement this law. In an environment where other key national issues such as employment, public health, education and housing are key priorities, the consideration of competition enforcement would appear secondary. However, to deal with inflationary pressures the Bangladesh Government is now in the process of preparing a competition law with the assistance of World Bank and DFID, UK.

In Zambia, the political will to get rid of the financially drained SOEs overshadowed other economic priorities. The focus appeared uni-dimensional as the government appeared to be in a hurry in privatising the SOEs without bothering to put concurrent laws in place, required to monitor, control and prohibit anti-competitive practices. Though the Competition and Fair Trading Act was passed in May 1994 following donor insistence, the competition authority itself was operationalised only in May 1997. In contrast, it took only a few months to draft and enact the Privatisation Act, as well as establish the Zambia Privatisation Agency. Even after adopting the Competition Law and reforms, the state retained control over certain key industries such as

telecommunications. These entities were exempted from the application of competition law thus obstructing the benefits of competition to become broad based.¹

Without the right political climate, laws will have little or no effect. In Guatemala, for instance, where the economy has been dominated by a very small economic elite, article 130 of the Constitution declares that “The State shall protect the market economy, and prevent the combinations that restrict or aim to restrict market freedom, or harm consumers”. No action, however, has apparently ever been taken to legislate this directive into an enforceable law. There are various similar cases from other countries as well. National Constitutions always carry such provisions, but they are not translated into laws to provide the necessary enforcement backing.

Functioning of regulatory regimes in telecom and banking sectors in Vietnam provides an interesting insight. In banking, the functioning of central bank has been constrained by government intervention in various ways. In contrast, functioning of the Ministry of Posts and Telematics (MPT, also the telecom sector regulator) has done wonders. In telecom, government objectives are clearly laid down in various government documents, which have provided necessary guidance for MPT to facilitate orderly growth of telecom services. However, in banking, there are conflicts in policy objectives – objectives of government are at variance with the goals set for the State Bank of Vietnam.

One needs to acknowledge and appreciate that a democratic set up requires politicians and their parties to win elections to reach to policy-making positions. Even if this is not the case in Vietnam, which has a one party rule; in other countries, they must satisfy aspirations of their electorates whom they have to go back, at intervals, to seek a fresh mandate. Reasons for politicians not allowing implementation of competition principles are well known (e.g. fear of losing certain powers, which they had been using to satisfy certain vested interests). However, little efforts have been made to identify potential gains for politicians out of promoting competition measures i.e. how competition regime outcomes could help them retain/enhance their public image/support-base.

Political will to create a strong regulatory agency from the outset is crucial for future success, as a strong regulator will be able to balance the demands of various interest groups, among other challenges. Unfortunately, in most

cases, the state may try to further its interests by creating a weak regulatory institution over which it can continue to exert control. However, mere adoption of competition and regulatory laws is not going to be enough. It is equally important to put appropriate institutional mechanisms in place for enforcement and review. For this, the value of 'political will' is very important. Equally important is the creation of a competition culture and the simultaneous involvement of the consumers in the entire process to successfully leverage the advantages of market based competition.²

The competition policy and law would enhance opportunities for larger participation in the economy of sections of the society that had previously been disenfranchised. In addition, the law would create a predictable regulatory environment for both producers and consumers. The role of consumer advocacy and the media are necessary constituents to improve governance and create the right checks and balances in the system. Media plays an important role as a countervailing force against the nexus between government and business. In this context, the role of the consumer movement is also vital. Here one has to admit that the consumer movement does not exist in all countries. Even where it does exist, it may not have sufficient capability, financial and skills, to be able to advocate effectively. However, there are other types of civil society organisations (CSOs), which often fill this gap.

If competition law and policy is to yield all the envisaged benefits, political will and consensus for reform is necessary. Adopting or strengthening an existing law by itself will not help. As political will is not created in vacuum, international efforts do make a difference. As a result of these multifarious efforts, some countries have adopted or amended competition laws, while others are making significant progress towards this end.

Beside the domestic and international levels, there is another dimension to political economy constraints i.e. the regional dimension. By joining forces at the regional level, developing countries have an additional opportunity to improve their regulatory regimes. For example, the lack of competition laws in some members of Andean Community has been compensated by the application of the existing regional competition legislation³. A similar situation exists in other regional groupings such as in COMESA or is under active consideration in CARICOM.

2. Opposition from Main Constituencies to Adoption of a New Law

For various reasons, market-oriented regulatory reforms, especially competition and regulatory laws are often viewed with apprehension by most constituencies in developing countries. Even those who are expected to benefit from open markets and competition, in particular, consumers and new businesses created after deregulation of previously reserved markets, are reluctant towards reforms due to sheer misinformation or ignorance.

The state sector is supported by a strong constituency of civil servants those are closely defensive of their acquired rights and consider competition and regulatory laws as an attempt to reduce their existing prerogatives. They usually oppose or extend lukewarm response towards market-oriented economic reforms. Moreover, bureaucracy tends to perpetuate itself in regulatory roles, for which it may not have the necessary skills and mindset.

For private domestic firms, who are the main beneficiaries of deregulation and market-oriented reforms, introduction of competition and regulatory laws may easily be considered as a new attempt by the state to control a sector that has just recently acquired the right to exist or to grow. Business circles would be suspicious towards attempts by the state to interfere in their daily decisions and suspect regulatory authority officials of being “anti-business”, inefficient, capable of taking erratic or misconceived, political decisions, and even in some cases motivated by corruption and eager to be influenced. The same suspicion can be expected from MNCs, with the additional doubt that the regulatory authority may discriminate against them.

Small and medium-sized enterprises (SMEs) are expected to benefit from active implementation of competition law and opening of markets, but they are usually ill-informed of competition law and also often ignorant whether a competition law exists in their country and how they can obtain redress for infringements. In particular, competition law might work in favour of SMEs, and against the dominant firms, but it is the latter’s view against introduction of competition law, which often prevails, as they are able to lobby in numbers with the government.

The real beneficiary from competition law is the individual consumer, who obviously gains from more choice, better service and lower prices resulting from domestic and import competition. However, *consumers are reluctant to demand more competition*. One often hears that competition is a new

concept, which is unfamiliar in many developing countries where cooperation is preferred to rivalry. During 1995-2005, sections of the civil society in many developing countries and the sympathetic rich country NGOs opposed a domestic competition law because it was being discussed at the WTO with an intention of crafting a multilateral agreement. The opposition was part of a rubric of opposing any new WTO agreements, which included an accord on investment also. It was thus publicised that a competition law will enable MNCs from the rich world to be able to come and devour local enterprises. These views often pervaded the public discourse thus preventing any progressive move.

In effect, the role of regulatory authorities is not well understood and there is a severe lack of competition culture, which constrains both adoption and implementation of competition and regulatory regimes.

There is need for developing countries to create effective and distinctive institutional mechanisms for successfully implementing competition and regulatory policy. In certain developing countries, the problem gets exacerbated as a result of weak institutional foundations. The first step is to design a sound and robust competition and regulatory policy that goes beyond being 'business friendly' to being stakeholder friendly. It should explicitly recognise and incorporate consumer interests and unambiguously include advocacy as a tool for promoting awareness among all stakeholders⁴.

3. Business Opposition to Adoption and Implementation of Competition Regime

Business and their associations generally oppose competition regimes as they feel that it would reduce their market share and hence business profits. In most developing countries, economic power is concentrated and such businesses usually fund political activities and have great influence over economic decisions that politicians make. Under the circumstances, adoption and implementation of competition regime may easily fall prey to being captured or sidelined by powerful vested interests. In Thailand, for instance, though the government enacted its second competition law in 1999, to date it has had very limited impact due to the unholy nexus between politicians and businessmen and cronyism.

Garnering support from such players is essential to ensure its effectiveness and to achieve the benefits of a competition law. As a widely dispersed group,

the ultimate beneficiaries of an effective competition law, i.e. consumers are often the most difficult to target advocacy efforts towards, and are the least organised to make their opinions heard at policy fora. More organised industry participants often have closer relationships with decision makers and thus have greater influence and awareness, of the effect of policy and legislative changes such as the introduction of a competition law⁵. Thereby, often competition benefits get directed to the well-connected and entrenched parties.

When economic vested interests dominate political power they also limit growth dynamics and curtail economic opportunities for poverty reduction in developing countries. Furthermore, the situation also creates entry barriers for new entrants. Competition policy should be judged explicitly against its contribution to tackling ‘the tyranny of vested interests’ for poverty reduction outcomes. However, the vested interests among entrenched producer groups are also not homogeneous. The nexus between business and government may be difficult to break⁶. Invoking the ‘public interest’ objective to deal with vested interests requires a precise definition of the former, including the trade off, if any, between public interest in the short run versus the long run.

However, situations change only with pain and it is critical not to underestimate the role of the social order in this process. The ‘rising tide lifts all boats’ paradigm works only with the existence of a social order that has a social security system in place and a large middle class. Therefore the success of implementing competition law in most developing economies will depend upon how the gains are distributed, rather than on growth per se⁷.

Whether enactment of competition policy and law will result in growth and/or poverty reduction is an issue that require an empirical analysis, which is rather difficult. If such a linkage exists it should be made explicit. Here the example of Australia can be given, where one of the stated objectives of competition law is to raise the welfare of Australians. Ever since Australia began reforming its competition rules in 1995⁸, they have registered a much higher growth rate than what they would have done without such effective rules. Therefore if competition policy and law is to be used as an instrument for protection of the poor and thus eradicate poverty: this should be enshrined in the law.

A government that is committed to competition law, and any regulator that is entrusted with the task of enforcing that law, must not only direct advocacy efforts towards consumers, but also towards the influential industry participants. In particular, garnering the support of domestic industry is crucial to the success of a competition law, and it is here business welfare outcomes of a law need to be drummed.

The approach of promoting the existence of anti-dumping measures as a tool available to the domestic industry to protect itself from any significant harm that may arise due to economic reform process, and thus reducing opposition to carrying on increased reforms appears to have been effective in some contexts. A similar approach could be adopted in the competition law context: by advocating competition law as a tool which can ensure a 'level playing field' between foreign competitors and domestic firms, as well as among domestic firm themselves.

4. State Capture

Rampant political capture is another principal obstacle to the creation of effective competition and regulatory regimes in developing countries. Competition law may covertly protect politically well-connected companies from 'fair' competitive forces, guaranteeing monopoly rents without efforts to innovate. At the same time, such law and policy may disguise unfair government attacks on legitimate companies, which represent real competition to politically influential business. Thus regulatory agencies in developing countries may be susceptible to capture by the regulated industry, or to political capture by the government.⁹

State institutions in many developing countries, particularly in Africa, appear poorly aligned for inclusive economic development because of this trend of 'neo-patrimonialism' i.e. the political process by which elites are rewarded for their ability to grant favours to supporters and interest groups by systematically appropriating state resources to maintain themselves in power. Furthermore, governments might be induced to favour creation of 'national champions'. In such a scenario, competition and regulatory policy would be looked at with suspicion and serving foreign interest. Ill-informed public opinion might easily buy nationalistic arguments aimed at claiming the need to protect national champions from (unfair) competition.

Effective competition policy needs to be constructed on the anvil of state-business relations. Successful developmental states built ‘growth coalitions’. These generated growth-oriented policies, which allowed the government a political space to balance protecting firms from and disciplining them through competition. The political balance between government and business appears to have been decisive for Japan and South Korea’s industrialisation. High growth industrial economies have emerged through effective state intervention to create international economic competitiveness, but in no case did a competition agency form part of this successful transformation.

Therefore, the key capacity of the state at early stages of economic growth appears to be not fostering a competition law, but targeted competition for developing enough competitiveness domestically to raise productivity in line with international standards by disciplining the selective recipients of industrial policy support. Competition law at too early a stage could compromise the government’s ability to manage this transformative process.

However, it is noteworthy that both Japan and Korea, which followed a pure industrial policy strategy in early stages, now are engaged in strengthening their existing competition laws to deal with high concentration and huge number of anti-competitive practices in their economies. These have arisen because of the nature of their huge companies, which have grown up through a protective strategy but are now fairly undisciplined.

5. Government Policies/Regulations Not Conducive to Competition

Extensive involvement of government in economic activity often leads to entrenched business laws, regulations and pronouncements that foreclose entry and/or restrict competition. Several developing countries are characterised by extensive government involvement in the economy, either as policy and lawmaker or as provider of services through SOEs in competition with the private sector. This is a source of potential problem. As lawmakers, government might introduce laws and regulations that stifle competition in pursuit of other socio-economic and political objectives. This would lead to a situation where competition principles are not strictly followed.

The 2005 Commission for Africa suggested that it is governments that “make markets and competition work”. Governments can introduce competition principles to policy making and their own commercial activity. Some aspects

of this do not depend on competition law. It is nevertheless argued that Competition Law may make an effective start by seeking to prohibit anti-competitive activity through government ministries, agencies and government officials. This approach has allowed Russia's competition authority in some circumstances to issue orders against government ministries for adopting anti-competitive rules and taking other anti-competitive actions. Another suggestion is that regulator should use its advocacy function to persuade government to make policy changes. It is appropriate that advocacy function could be useful in situations where the law is new and yet to be understood by all stakeholders¹⁰.

6. Public Interest Consideration

Public interest is an important policy objective for governments in developing countries, not because it is exclusive to them. Since regulatory reforms are largely concentrated in public utilities where there is a strong public interest factor, and therefore, political sensitivity to both policy reforms and to regulatory practice, it is difficult to envisage how regulatory reforms would be insulated from overriding political considerations. It appears to be a matter of 'Common Practice' that a regulator is made to consider public interest in its decision making process. The inherent conflict between the objectives of economic efficiency and public interest often leads to situations of trade-off, which are politically quite sensitive.

In a case in Zambia, the multinational cement giant, Lafarge Group had proposed to take over Chilanga Cement Plc, the only cement company in Zambia. The government wanted to clear the takeover because of huge investments promised by the Lafarge Group and the potential increase in employment opportunities. Notwithstanding the public interest issue, the Zambian Competition Commission (ZCC) refused to allow the takeover unless Lafarge agreed to certain undertakings. The ZCC was concerned that the takeover would foreclose entry for prospective players and strengthen the existing monopoly. The takeover took place only after Lafarge gave undertakings as desired by the ZCC¹¹.

Nevertheless, in another related case, the result was contrasting. In 2006, ZCC investigated sugar prices in Zambia, which were higher as against prevailing regional prices and export prices. Sugar industry in Zambia is a monopoly of Zambia Sugar Plc. After studying the market dynamics, ZCC proposed removal of the statutory requirement of having sugar fortified

with Vitamin A for consumption in Zambia. This statutory requirement had led to the foreclosure of imports, as trading partners did not fortify their sugar and engendered the monopoly of Zambia Sugar Plc. The government defended fortification on account of overriding public health interests and status quo prevailed. As a result, Zambia has the highest domestic sugar prices in the region¹².

Governance challenges are likely to arise when competition authorities assess explicit non-competition criteria without transparent processes for doing so. In such cases, administrative discretion in interpreting concepts such as ‘fair’ competition is often the starting point for corruption in developing countries.

Here it is worth reviewing the experience of South Africa. The South African Competition Act emphasises the promotion of small businesses, greater participation in the economy (especially by previously disadvantaged individuals), and promotion of a greater spread of ownership, thus attempting to balance efficiency concerns and broader development priorities within a competition framework. Anyhow, the number of cases where public interest considerations have made a material difference is small. Interestingly, explicit inclusion of public interest objectives has raised the profile of these policy imperatives, which seek to ensure policy coherence across diverse policy areas. In addition, their inclusion has put these issues on the active agenda of firms.

7. Lack of Competitive Neutrality

Competitive Neutrality is about adopting policies, which establish a ‘level playing field’ in areas where public sector competes with the private sector. In practice, it is difficult to ensure competitive neutrality in sectors where government or its agencies retain control or insist upon retaining control. For example, in Zambia, the state-owned telecom operator Zamtel has been exempted from various taxes, which are paid by private telecom players. Such exemptions put private telecom operators at a relative disadvantage when it comes to competing with the state-owned incumbent. In India, for example, the SOE: Life Insurance Corporation of India’s (LIC’s) policies get a sovereign guarantee against failure to pay¹³. The same is not available to the private life insurance companies, which have recently entered the market.

Furthermore, so long as a regulator remains vulnerable to the discretionary powers exercised by officials of a ministry to whom state-owned incumbents also report, it would be difficult to expect the regulator to ensure competitive neutrality between the state-owned incumbent and other private operators. For instance, the Indian telecom regulator, TRAI has not been successful in reining the market power of the state-owned incumbent: Bharat Sanchar Nigam Ltd (BSNL), which has thwarted many decisions that are critical to maintaining a level playing field. For example, the decisions relating to accounting separation, asymmetric regulation, bundling of services, etc., which are critical for competition to thrive, remain unimplemented for a variety of reasons including litigation by BSNL. Incidentally both TRAI and BSNL report to the Communications Ministry.

There are also cases of reverse competitive neutrality i.e. where private sector is in a relatively advantageous position as against public sector enterprises. For instance, for several years public sector airlines in India were trying to procure aircrafts to expand their fleet, their proposals were doing the rounds of the government departments in search for a final approval. At the same time, private sector players were expanding their fleet size and grabbing a larger share of the market, at the cost of the public sector incumbent. There are various such examples, which go on to exhibit the influence of business over the polity.

8. Competition and Regulation in Small Economies

While the main principles of competition law that have evolved in larger economies are relevant also to smaller economies; the mode, style and intensity of application would have to be different in order to accommodate the particular characteristics of small insular markets.

Small markets tend to be characterised by monopolies and oligopolies. In addition, in such markets, utilities are provided by natural monopolies, due to the relatively large overhead costs, which do not permit more than one entity to viably supply the service. In small jurisdictions, the culture of competition may not easily take root due to the fear that intense competition may destabilise a small fragile and thin market. Moreover, the advantages of business consolidation and the disadvantages associated with business fragmentation often lead authorities of small jurisdictions to justify monopolistic and oligopolistic structures. Maximising consumer welfare should (in small jurisdictions) require an economic analysis, which takes into

account the issue of smallness and insularity. Consequently, implementing large country prescriptions for small developing countries may be counterproductive; other policy instruments could be considered complementary to establishing regulatory regimes.

If the size of the market makes it inefficient to establish single sector or single country regulators, two possibilities exist. Either one could have a multi sector regulator in a small country like Barbados or a multinational, single sector regulator through regional cooperation arrangements as in the Caribbean. The other problem in a small economy is that the community is small and people know each other making it difficult to enforce the mandate of a competition law.

It is important that regulatory endowment effect i.e. institutional design should be rooted in the specificities of the local conditions. Adopting US or UK style governance structures are being questioned in smaller jurisdictions. One of the objectives of competition law is to promote competition. But this may not be possible in small economies like Malta because of the limited size of the market. Therefore the prescription is to apply competition law in a less stringent manner, for example, while evaluating mergers and also use complementary instruments such as trade policy to promote competition in the local market. For the Caribbean institutional indivisibilities and high fixed costs preclude adopting large country regulatory models. In this situation, regional agreements are optimal since they allow sharing of the 5 Es i.e. Expertise, Evidence, Enforcement, Externalities and Education in the design of multifunctional or multinational institutional arrangements¹⁴.

Thus small developing countries need to craft regulatory institutions based on the situation that obtains in each context. However, we have to further examine the question whether size matters or whether it is the combination of size and isolation that matters¹⁵.

9. Unsynchronised Regulations

Apart from political interference, the existence of a large number of sectoral regulators together with a competition authority may raise issue of overlap and friction. Government in most developing countries have not put in place a mechanism to synchronise regulatory activities. The multiplicity of regulations and concurrent jurisdiction could lead to forum shopping. Where a case comes under the purview of both the sector regulatory law and

competition legislation, parties to the case might have to approach both the regulators for clearance, thereby increasing transaction costs. Hence, the lack of coordination often leads to policy discrepancy, which creates regulatory uncertainty for stakeholders concerned.

Efficiency is associated with competition. In order to maintain competitive conditions, following three things are prerequisite:

- First, there should be appropriate competition laws to prevent market abuse. This is preventive in character.
- Second, this must be supplemented by competition policy, which will ensure that all government policies tend to promote competition. This has a positive dimension.
- Third, sectoral regulation becomes important in areas where there are natural monopolies. Under such circumstances, it is necessary to establish appropriate relationship between sectoral regulators and the competition authority.

The political economy constraints need to be taken into account while framing competition laws and more importantly in drafting competition policy. But if the government is truly committed to a process of liberalisation, this should become less of a problem. On the other hand, only if reform is introduced by stealth it becomes a hurdle.

In a case in Zambia, a leading South African mobile cellular service provider, MTN, notified the Zambia Competition Commission of its intention to acquire the second largest mobile cellular service provider in Zambia, Telecel Zambia Limited in April 2005. The Commission assessed the transaction and found no competition concerns. However, the licence conditions required that 10 percent of the shares be offloaded to the Zambian public. The Commission addressed this issue with the parties to the transaction, of which modalities were worked out and a Memorandum of Undertakings (MoU) was signed. The Communications Authority came up with a variation of the same undertaking and refused to authorise the transfer of the licence until the parties had addressed their version of the undertakings! The concurrent competition enforcement in Zambia has not assisted in churning out the benefits of the regulatory confluence in enforcement strategies despite the fact that there were many formal and informal contacts between the staff of the two institutions.

To address such concerns, regulatory agencies in South Africa have entered into an MoU to bring about regulatory convergence. Turkey's experience in telecommunications markets suggests that co-existence of independent regulation and competition authority may be beneficial to make utilities industries competitive provided some conditions are fulfilled. First, there should be a clear division of powers between regulatory and competition authorities, preferably by law or a joint communiqué, leaving ex-ante regulation to the jurisdiction of former and ex-post competitive enforcement to the jurisdiction of the latter. Second, there should be a formal communication channel between two bodies; and lastly, the availability of a competitive market should be examined at the privatisation stage. This co-existence model is likely to minimise the institutional conflicts, while promoting competition in the utility industries.

The solution to the overlapping jurisdiction could be to legislate clear mandates for regulators and the competition authority. It is best to leave the determination of behavioural issues to competition authorities and structural issues to the regulatory authorities. Across sectors, some basic principles of competition must prevail.

10. Efficiency and Effectiveness

As already discussed, several factors exist that have a varying degree of influence on the functioning of regulatory agencies in developing countries and that affect their efficiency and effectiveness. It is important to deal with such issues and identify appropriate measures to enhance efficiency and efficacy of regulatory agencies.

Using data from Latin American countries with meaningful privatisation programmes in their main infrastructure sectors, the research¹⁶ suggests that quality of regulation matters. However, there is lack of empirical evidence in this regard. In this research, regulatory quality is proxied by legal solidity, financial strength and decision making autonomy while outcomes are analysed on the basis of the role of regulation to align prices with cost, on its effect on productivity and on reducing renegotiating opportunities. Another finding of this research is that the impact of the regulator is stronger in weak governance environments.

In infrastructure sectors, market failure is likely be pervasive and lasting. Therefore in a sector such as water, regulation is essential if private

participation exists. The options include regulation by agency, regulation by contract or a hybrid model. The existing theoretical literature has focused on the polar cases, while existing regulatory systems in several developing countries fall in between these two poles. The case studies from the water sector in four South East Asian countries establish that welfare outcomes from Public Private Partnership (PPP) contracts are superior in the presence of a regulatory agency. The conclusion is especially applicable when other institutional arrangements are not adequate to regulate opportunistic behaviour by parties to the contract¹⁷.

Generally, a well managed regulatory system is going to be subject of intense criticism by most groups because of the trade-offs it involves. However, unless models that seek to measure regulatory effectiveness capture the consequences on variables that are most important to consumer-price, quality of service and access these models are not going to be attractive for consumers. Further, it is important to disengage the regulatory impact on market outcomes from the impact that other variables may have on that outcome. For example, FDI could be influenced by the competition regime but it will be equally influenced by the macro-economic environment¹⁸.

Efficiency of regulatory agencies is a difficult variable to estimate. However, benchmarking could be a solution but it also suffers from a similar infirmity i.e. who should one benchmark with. There is need for further research in this area, especially the need to develop country and sector specific case studies that could provide lessons for the future.

11. Independence

Institutional arrangement of a regulatory authority and the powers given to it are both a political economy and a governance issue. Independence should not be understood as autonomy for taking actions ignoring the government, rather as the probability of implementing policies without interference of political agents or agents of private sector. There are primarily three facets of independence, including:

- independence from the government;
- independence of stakeholders; and
- autonomy of the organisation in terms of resources.

Independence does have two dimensions – formal independence and ‘real’ independence. The existing literature has focused on formal independence i.e. the ability of the regulatory authority to take decisions that are free from the interest of the agents. Although it has been difficult to establish the effects of independence on the performance of the agencies or the sector, the hypothesis has been that there are benefits from the presence of this characteristic. Thus measurement of independence, particularly real independence is a valuable exercise. The evidence suggests that there appears to be no correlation between development level of a country and independence of regulatory agencies. Independence is influenced by several historical factors and therefore, national and sectoral studies may reveal important characteristics of regulatory agencies.

The ‘independent’ agency model is normally favoured by western advisors, who draw from the experience of regulation in rich countries. Even in these systems it is possible to argue that the political executive retains fundamental control. In US, for instance, where the concept of an independent regulatory commission was born, and which has evolved over the past century, regulatory agencies are not completely free from political pressures, and their knowledge and staff expertise are often inadequate. If we apply this more politically sensitive analysis to developing countries we simply cannot expect creation of arms-length agencies. Since privatisation and regulatory reforms are largely concentrated in public utilities where there is a strong public interest factor and therefore political sensitivity to both policy reforms and to regulatory practice, it is difficult to envisage what ‘independent regulation’ could possibly mean, or how it might be insulated from overriding political considerations. Where regulators, and even in many cases judges, owe their positions to the political-bureaucratic elite, the possibilities of exercise for independent judgement and action are considerably reduced, or may be non-existent. It would make more sense if regulatory reforms deliberately recognised these realities and incorporated them into agency models, rather than constantly attempting to create an unlikely autonomy. The standard arrangement post-regulatory reform is to leave the development of policy framework in the hands of the government, whilst implementation becomes the function of the regulatory agency. The relationship between the line ministry and the regulator should thus be mutually supportive, as the two are guided by a common vision.

In most cases, the line ministry is empowered by law to issue policy directives to regulator. This should not be a matter of concern, as government has the sovereign power to formulate policies and set regulatory objectives. However, because of the socio-political-economy triggers, government departments have a tendency to intervene in operational aspects of regulation in the name of issuing policy directives. For instance, the Bank of Zambia Act provides that “the Minister may convey to the Governor such general or particular Government policies as may affect the conduct of the affairs of the Bank and the Bank shall implement or give effect to such policies”. The tenor in which this provision is couched leaves little doubt about the overriding influence that the Finance Minister may wield over the central bank on some policy matters.

Interestingly, there are cases where the regulator has been successful in preserving its independence. In Zambia, the Minister of Transport and Communications purported to appoint the Chief Executive of the Road Safety and Transport Agency (RSTA), a function that is by statute reserved for the Agency Board (which is appointed by the Minister). The Chairman of the Board, surprisingly, challenged the decision of the Minister. In retaliation, the Minister dismissed the Chairman, who in reaction sought Court’s intervention by obtaining leave for judicial review, which in effect acted as an injunction to stay the Minister’s order. This is a rare occurrence in Zambia’s governance structure and a development that has been welcomed by many legal observers as good for regulatory independence in decision-making. The events at the RSTA showed that Board managements that properly understand their role and relationship with the policy makers could fight for their operational independence or autonomy effectively to challenge the seemingly excessive powers of the ministers.

When it comes to regulating the SOEs or taking measures that could impact the interest of SOEs, cases of micro-management by the minister are observed, and independent regulators are perceived to be ineffective or powerless. In Kenya, when the Minister for Communications disbanded the telecom regulator, it was alleged that decision was prompted because regulator was handling various disputes involving Telkom Kenya, the SOE incumbent, and some of the rulings had gone against the parastatal. Such scenarios are likely to dent private investors’ confidence in the regulatory regime, and thus private investment may hit a roadblock stalling growth of the sector.

Industry regulators are susceptible to regulatory capture and the public may tend to look to the regulatory authority for guidance in matters of competition and fair trading. Regulatory capture generally is less likely to be problematic in competition law enforcement since the competition authority does not involve repeated interactions to the same extent as sector regulation. However, it is likely that as staff remain in their positions for a long time and mingle with the same big business officials particularly in a small economy, regulatory capture may affect the competition authority officials as well. There may also be a principal-agent problem. The regulator might not implement the policy, which is needed to cope with the market failure problem. Instead, the regulator might follow its own bureaucratic agenda.

Regulators are often made to rely on government subventions for their operations, which are usually below the projected budget. In general, budget is prepared by the regulator and sent to the line ministry, which does the scrutiny of the budget and submits it to the Parliament as component of its own overall budget. After Parliament's approval, the line ministry determines final appropriation to the regulator after considering all other priorities of the ministry. If competition/regulation is not a priority compared to other areas under the ministerial purview, then disbursements are inadequate. Lack of sufficient funds makes some of the critical activities such as court process/litigation, business and consumer awareness being sidelined.

Resources at the disposal of regulator helps in enhancing its effectiveness, nevertheless it is not the only means. In fact, econometric evidence shows that reorganising agencies' spending priorities as well as developing extra-agency initiatives can be complementary means to enhance effectiveness. Examples of extra-agency initiatives include active role by CSOs and ability of private parties to initiate lawsuits under the competition laws.

There are concerns related to the funding of regulatory agencies and their hiring (and firing) practices. Kenya example highlights that how difficult it is for governments not to get involved in funding and in hiring decisions of regulatory agencies. There is need for capacity building particularly in the area of enforcement and case handling. The tripod of independence (autonomy), expertise, and accountability is a *sine qua non* for the effectiveness and efficiency of the regulator in the larger interest of the consumer and the economy. What is surprising, however, is that the Belgium study echoes similar concerns for developed countries and interestingly states that as far as the

institutional framework for regulation is concerned, Belgium is like a developing country.

Thus, while principles of independence, accountability and capacity are universally accepted for regulatory institutions, how they evolve in a particular jurisdiction will, to a large extent, be determined by the genesis and the politics of that particular country. The extent of restraints that are put on autonomy of regulators will also depend upon the larger environment of public opinion that exists in that country i.e. it is very country/culture specific. Thus the importation of 'cookie cutter' approaches to institutional design for developing countries is subject to scepticism.

Regulation is recognised to be a business in which people make a difference i.e. implementation of regulation is a human and not simply a technical function. The Indian example reinforces the view and also recommends that appointments to the Commission should be based on a collegiums approach. This requires having in place proper mechanisms to ensure appointment of experts as regulators. In several countries, the line minister plays a decisive role in appointment. Ministerial powers to hire and fire regulators have been criticised for want of the tenets of fair play and natural justice as such powers tend to create insecurity of tenure for the regulator.

12. Regulatory Accountability: The Missing Aspect

Accountability is the flip side of independence and accountability of agency is equally important. Independence without accountability will not work. Independence must go hand in hand with accountability, which is often ignored in such discussions. Appropriate mechanisms are required to make independent regulatory agencies accountable. Accountability could be political and legal in form. Political accountability includes submitting reports to legislature, which may have a special committee to scrutinise and debate its contents. Legal accountability enables those aggrieved by a decision to issue a formal complaint or appeal. Here one observes a divergence between countries, which establish specialised commissions or tribunals, having powers to determine disputes only within a sector, or a related sector and those, which rely exclusively on institutions such as judiciary having competence over general administrative matters.

In general, regulatory bodies are required to submit their annual reports and/or audited accounts to the legislature. In most such cases, regulatory

bodies are made accountable to legislature through the line ministry. Legislative oversight over regulators' performance does not seem to be effective, as annual reports submitted by regulator are not always discussed with any seriousness. Regulator's actions are questioned only when there is an impending crisis or a serious debate in a country. In fact, in most such cases it is the line minister who is questioned, and not the regulator. This practice makes line minister assume performing functions that are otherwise delegated to a regulator by law. This assumption enables and provides a sound alibi to the line minister to interfere in the functioning of the regulatory body.

There are very few instances in project countries where stakeholders are involved in evaluating the performance of a regulator. One such is the case in Kenya, where Capital Markets Authority, the capital markets regulator has an institutionalised annual review forum, which allows stakeholders to review its progress as well as raise any issues or suggestions to help stimulate domestic capital markets.

Another mechanism to oversee the actions of a regulator is by having an appeals provision, which allows the review of regulator's specific decisions. A concern with the review process is that if gates of review are opened too widely, the administrative costs of regulation may escalate and private interests might have an incentive to exploit the process for tactical purposes. It is important to ensure that the review process does not create a second layer of regulation, as is currently experienced in the telecom sector in India.

In India's telecom sector, the role of appellate tribunal, Telecom Disputes Settlement and Appellate Tribunal (TDSAT) is quite wide. The TRAI is not empowered to settle disputes; rather the TDSAT has been assigned with the responsibility. This division of labour has adversely affected the performance of the telecom regulator, as any issue can be presented as a 'dispute'. Nevertheless, judicial review is considered important in guarding against decisions by a regulatory agency that fall outside of its statutory mandate or that fail to follow established administrative procedures. Taking the example of telecom sector in India again, TDSAT is found to have taken decisions in certain cases where TRAI was observed to have not followed due process. On the contrary, the Securities Appellate Tribunal in India can only entertain appeals against the decisions of the capital market regulator, Securities & Exchange Board of India (SEBI). The latter has powers to take decisions, which include penalties etc.

In cases where appellate power lies with the minister, it could make regulatory decision-making process discretionary and undermine credibility of regulatory regime. In Zambia, for instance, in case of capital market regulator, parties aggrieved by a regulator's decision in specific circumstances could appeal to line minister concerned. In South Africa, appeals against energy regulator's decisions can be placed before the judiciary; earlier the Energy Minister was the appellate authority for National Electricity Regulator.

13. Limits to Speedy Resolution

In several countries, the enabling Act does not provide the regulator with powers to impose fines and the power to summon witnesses and call for submission of information (e.g. Zambia's Competition Act). In such cases, the regulator has to take the guilty firms to court before fines and other penalties are imposed. While this may appear to provide for due process and accountability, it is observed that this has an adverse effect by limiting speedy resolution and enforcement decisions.

14. Priorities of Competition and Regulatory Authorities

In terms of effectiveness of Competition Authorities, especially young ones, the dilemma relates to the choice of nature and types of cases to address from the many that may be awaiting disposal. This choice will be determined by the goals the Authority has set for itself. These could be either one or more of the following:

- a) to promote efficiency,
- b) to be well known;
- c) to be accepted;
- d) to be understood; or
- e) to maximise social impact.

It is impossible for authorities to simultaneously handle all the anti-competitive cases that come up for hearing; even prioritising is no easy task. The authority could end up choosing cases that are important, but perhaps require more time, and therefore, the trade-off could be a long waiting list of cases. The choice depends upon the authority's objective, but the vital message for young competition authorities is that this choice will have to be made. However, a competition authority should focus on cases with strong public interest element so as to build the credibility of the agency, rather than focus on economic impacts¹⁹. The South African example demonstrates that public

interest objectives cannot be ignored especially in their socio-economic context. The new Competition Act of 1998 in South Africa articulates public policy objectives along side the goal of economic efficiency. Thus black empowerment and employment generation are development objectives incorporated in all policy initiatives, including competition law.

The independence is important in itself but that it might be difficult to capture empirically in a quantitative measure. Nevertheless it is important to create a database of studies at national and sectoral levels in order to understand how regulatory agencies behave under different situations and contexts. However, prosecutorial discretion will always exist since complaints are going to increase and therefore the competition authority will need to strategise. In Brazil, a simple method based on expertise and evidence is adopted. The choice naturally will differ across jurisdictions, and the choice confronting an authority between tackling easy cases versus those with the most harmful impact will itself require scarce resources²⁰. In addition, between the competition advocacy role of the authority and enforcement, the priority should be given to the advocacy promotion, as it is important to create a culture of competition in the country. Opinion on whether to use competition law and policy for public interest objectives is divided; one set preferring its use for promoting efficiency only, while suggesting that public interest concerns be addressed by other policy measures.

As discussed above, Competition Advocacy should be the first priority for developing countries before actual enforcement of competition law. Dialogue between the competition authority and policy makers at early stages of reforms would ensure that competition provides the foundation for all other market-enabling legislations. Liberalisation heightens the activity of interest groups as they lobby for lost privileges. Competition authorities, through advocacy, can instill competitive values in sector-specific regulation, reducing the possibility of regulatory capture. Competition advocacy should seek to address state-imposed barriers to competitive outcomes and enhance coherence among public policies.

The central dilemma that developing countries face is that competition advocacy is especially important for new market economies, but that it is particularly difficult for them. In order to establish a foundation for competition advocacy, developing countries must focus on three prerequisites: independence; resources; and credibility, which in itself are constraints, thus getting trapped into a vicious cycle.

Enforcement priorities would vary depending on a country's underlying regulatory infrastructure, the perception of the role of competition in its political and economic culture, and its resource availability. In economies with limited enforcement resources, it may well be advisable to keep the new competition law focused on the behaviour that is clearly the most harmful to consumers. For example, if the economy has a number of long-established cartels, a strong initial enforcement effort may be required to bust them.

In countries where competition law has not been in force, another key task of new enforcement agencies is educating the public. The general feeling among competition agencies in developing countries is that these countries should prioritise their work to cases that could bring the greatest economic effect and public awareness to the country. Therefore, there is still currently a sense that the role of the competition authorities is still not well appreciated and hence acceptance is required by the general public and in the political arena. Effective competition law enforcement, including bringing cases of demonstrable benefit to consumers, is the most effective means of developing a healthy competition culture in the country.

15. Absence of a Competition Culture

Competition culture refers to the awareness of the general public, including the business community, politicians and civil servants about competition law and the benefits of competition. In some countries, however, understanding of competition policy and law among the government and people appears to be insufficient.

The lack of an understanding among large segments of the business community, with regard to the purpose of competition law and the benefits of more effective business competition, can result in tacit resistance to the obligations and rules of the competition law. Creating a culture of competition is very important, including the simultaneous involvement of consumers in the entire process to successfully leverage the advantages of market based competition.

Not surprisingly, competition agencies and the wider public in developing countries sometimes have special training needs that grow out of their countries' historical lack of competition culture. And since most developing countries lack a suitable competition culture, it is important for competition

agencies to begin the process of building one through effective advocacy programmes.

It is also important to note that awareness generation cannot be accomplished in a generic manner and in isolation i.e. without any cases studies. Until such time that a competition authority builds up its own armoury of case studies, it can rely upon cases studies from other jurisdictions, particularly from other developing countries for establishing some credibility, to illustrate the points.

16. Lack of Basic Institutional Infrastructure

Implementation of regulatory reforms could be a challenging task in developing countries where there is a lack of rule of law and property rights, weak judicial institutions, and ineffective or non-existent commercial codes and bankruptcy laws. The judicial system in many developing countries is often slow, sometimes resistant to competition law enforcement and corrupt. Also, regulation, bureaucracy and transparency factors impinge on the competition authority's ability to operate. Implementing competition/regulatory law in a weak governance context could be counter-productive, where lack of accountability and transparency would prevail rather than challenge politically entrenched vested interests.

There is need to create an effective and distinctive institutional infrastructure for successfully implementing competition and regulatory policies. While market friendly reforms have become common across almost all developing countries, so have market failures. In order to address these failures, a sound competition and regulatory policy needs to be put in place along with efficient enforcement mechanisms. This is however not an easy task at the best of times. And in certain developing countries, the problem gets exacerbated as a result of weak institutional infrastructure.

17. Capacity Constraints

In most developing countries, competition and regulatory laws are entirely new concepts. In several cases, such laws have been adopted due to external pressure (e.g. Zambia Competition Law). Consequently, very few officials in the public service and political establishment appear to have understood what the new regime means and what it takes to have a well functioning regulator.

When agencies are poorly staffed, a greater likelihood exists of pursuing enforcement priorities that lead to errors in mistaken prosecution of pro-competitive conduct or non-prosecution of anti-competitive conduct. These enforcement errors reduce both public and government confidence in the competition authority. Furthermore, insufficient number of skilled staff affects speedy decision making and often creates an impression of a regulator being “anti-business”.

Recruitment of professional and technical staff and building their capacity is a particular challenge. The competition agency has to arrange for *relevant* training for its personnel. The vast majority of developing countries do not offer courses and/or continue with legal education programmes specific to competition/regulatory law and its enforcement. Determining how best to design technical assistance programmes to interact with nascent and financially constrained competition agencies is a difficult and complex matter. Effectiveness of technical assistance programmes improves substantially when both donor and recipient are sufficiently involved in the initiation process.

Building capacity of young antitrust institutions in developing countries is a means to improving policing capabilities against anti competitive conduct by entities. Many countries have augmented their capacity with Technical Assistance (TA) from developed countries. Undoubtedly, TA is necessary for countries that are financially constrained to establish credible regulatory regimes.

The study²¹ uses responses from 38 competition agencies to identify factors that increase the effectiveness of TA and therefore the effectiveness of the recipient agency. Timing of TA comes out to be a significant variable, as does the absorptive capacity of the recipient. “Over involvement” of the donor is considered good for the objective at hand. However a strong message remains that there are no ‘recipes for success’ and that each TA programme has to be designed keeping the unique issues and challenges in mind. In the larger context, an effective competition law regime requires supportive institutions such as an independent judiciary, political will and effective enforcement. TA is most effective when set to the recipients’ needs and not to donor’s expertise or standards.

IV. Sectoral Case Studies

The sectoral case studies presented in this project focused on constraints faced in introducing competition and implementing regulatory regimes in Electricity, Telecommunications and Financial Services sectors. Most of the above-discussed issues affecting the quality of regulation in developing countries are in fact confirmed by the sectoral studies. Hiring practices and expertise, asymmetric information between the multiple stakeholders, accountability, weak institutional structure and political interference have been documented in the sector case studies as important barriers to creation of competitive markets.

The Indian electricity sector poses the biggest challenge, largely due to the monopoly characteristics of the industry and the associated difficulties in introducing competition in the sector. Another important issue in the electricity sector, although germane to other sectors as well, is the distance between ‘regulators’ and the consumers. It is crucial to know the nature of complaints and quality of service issues affecting the consumer for the regulator to do a good job. Thus the Department of Consumer Affairs and the Regulator should work closely on such matters²². A related issue is the weak consumer participation in the regulatory process. Consumer organisations are not well resourced and/or organised and/or not well represented. A regulator is more likely to succeed when it is lobbied by all sides, rather than by only one party. In the latter case, the regulator is most likely to be captured by the group, which is exerting the maximum pressure. The solution lies in building consumer organisations and consumer advocacy to ensure that their interests are well articulated and presented before the authority.

In the financial sector in India, the evolution of the mutual fund industry provides a lesson for the banking industry in promoting competition. MFs have been successful because of the sound regulatory system established by SEBI and if banking in India is to see increased competition, entry barriers

must be reduced. However, the efficiency objective of promoting entry has to be traded off against public interest concerns in the banking sector. These concerns relate to universal service i.e. rural banking and the overwhelming role of public sector in fulfilling this objective.

In the telecom sector, the issues are similar to that of electricity sector in promoting competition, such as open access, mandatory provision of interconnection, unbundling of network elements etc., with the important distinction that technological progress in the telecom sector across the world has made it easier to camouflage regulatory failures than in electricity.

V. In Lieu of Conclusion

While market friendly reforms have become common across almost all developing countries, so have market failures. In order to address these failures, a sound competition and regulatory policy needs to be put in place along with efficient enforcement mechanisms. The first step is to design a sound and robust competition and regulatory policy that goes beyond being 'business friendly' to being stakeholder friendly. It should explicitly recognise and incorporate consumer interests and unambiguously include advocacy as a tool for promoting awareness among consumers. Institutional endowment is central to the design and success of regulatory framework; so it is equally important to put in place appropriate institutional mechanisms for enforcement and review. However, if competition law and policy is to yield all the envisaged benefits, political will and consensus for reform is necessary. Changing the law by itself will not help. The government's commitment to growth as a political objective, political maturity and overall political climate in a country matters. Competition policy outcomes and incentives for politicians are to be aligned properly so that adoption of competition/regulatory law gets a political buy-in.

In addition, creating a culture of competition, and the simultaneous involvement of consumers in the entire process to successfully leverage the advantages of market-based competition is essential. The reconciliation of the perceptions of various players is essential and developing countries should adopt competition/regulatory laws that are in accordance with their special characteristics and requirements. However, media and the consumer movement can play an educative role to help create 'competition culture'. But in countries where there is severe lack of understanding on the nuances of competition regimes, it may not be that effective. Competition law can also be promoted as a safety valve to garner support from its most fierce opponents.

It may be difficult to coordinate between the government's objective of promoting public interest and regulatory authority's objective of promoting efficient markets. Here the issue is: how to balance the trade-offs between efficiency and public interest objectives, which may not be specifically mentioned in the law. In the cement takeover case mentioned earlier, ZCC stuck to its stand and did not go by government's thinking. But the same may not be true for regulatory agencies in other countries. Moreover, regulatory authorities may not be able to do much in situations that call for change in government policy/rules. In such cases the authority has to distinguish between public interest and the vested interest and strike the right balance and ensure that the best decision is taken.

For small economies institutional design should be rooted in the specificities of the local conditions. Adopting rich country-style governance structures are being questioned in a developing country and smaller jurisdictions. One of the objectives of competition law is to promote competition. But this may not be possible in small economies like Malta because of the limiting size of the market. Therefore it is better to apply competition law in a less stringent manner. Since institutional indivisibilities and high fixed costs preclude adopting large country regulatory models, regional agreements are optimal as they allow sharing of the 5 Es i.e. Expertise, Evidence, Enforcement, Externalities and Education in the design of multifunctional or multinational institutional arrangements.

The evidence suggests that there appears to be no correlation between the development level and independence of regulatory agencies. Independence is influenced by several historical factors and therefore, national and sectoral studies may reveal important characteristics of regulatory agencies. The tripod of independence (autonomy), expertise, and accountability is a *sine qua non* for the effectiveness and efficiency of the regulator in the larger interest of the consumers and the economy. Thus, while principles of independence, accountability and capacity are universally accepted for regulatory institutions, how they evolve in a particular jurisdiction will to a large extent be determined by the genesis and the politics of that particular country. The extent of restraints that are put on autonomy of regulators will also depend upon the larger environment of public opinion that exists in that country i.e. it is very country/culture specific. Thus the importation of 'cookie cutter' approaches to institutional design for developing countries is subject to scepticism.

One will need to be cautious and make a distinction between regulation and control and ensure that the former does not degenerate into the latter. In this spirit, regulation should be an exception and not the rule. It may be a good idea to introduce competition law at the same time as market-oriented reforms to avoid giving impression to the private sector what the state has liberalised is now again being placed under state control. Another attribute of good regulation is accountability and transparency of the regulator, and in this context the Reserve Bank of India (RBI) can be cited as an example where certain standards of disclosure are prescribed. This promotes transparency and better responsible behaviour in the regulatory agency. Similarly laws like the Right to Information Act (RTI) in India can play an important role in enhancing transparency and therefore accountability of regulators and the process. It is also important to create a set of universally accepted standards for regulators across different sectors along the lines of Basel norms created by the Bank of International Settlements, an international organisation, which fosters international monetary and financial cooperation and serves as a bank for central banks.

Thus the cross cutting issues are:

- (i) Political will is a necessary condition for establishing good competition regimes
- (ii) Consumer advocacy and empowerment is crucial since it will provide countervailing force to existing producer interests
- (iii) It is important to create a culture of competition
- (iv) Developing countries context is different from developed countries and therefore customisation is necessary.

VI. Recommendations for Future Research

It is important to know how agencies use or could use their discretion in the design of good rules. External constraints or commitments can foster good domestic policies, by providing guarantees against the reversal of current policies or lending credibility to promise of future returns. Such pre-commitments could help strike a balance between the reluctance to unleash competition immediately and the desire not to be held hostage to vested interests or weak domestic industries. While this line of inquiry is standard in the public choice literature, it would be interesting to extend and examine whether it could be useful in the ‘optimal’ design of regulatory agencies in developing countries.

Another area of enquiry could be the ranking of policy options for developing countries and related to this is the additional question of what constitutes good policy advice. Since ‘one size does not fit all’ may not produce desired results, the next logical step would be to attempt to find sets of policies that work under different contexts and cultures. The underlying idea is not to develop policy options that are unique to each and every country, but to map a broad set of policy options that have been known to work in certain contexts and to analyse whether and to what extent these are scalable and replicable. However, analysis of deeper political economy issues, including the nature of entrenched vested interest is very important. For this purpose, empirical studies at the ground level/micro level can be taken up. It is equally important that future research should focus on probing the diverse pattern in evolution of the political economy of competition and regulatory regimes across select countries.

Further, it is essential to focus further research on quality aspects of regulation and regulatory regimes in developing countries. Future work could *inter alia*, address questions such as:

- i) do regulators do what they are supposed to do? and
- ii) whether what they are supposed to do is right?

Perceived successes and failures could be studied as cases to learn from such experiences. The domain of regulatory outcomes also require further research i.e. whether the regulatory agencies are giving 'value for money' or whether they are merely another bureaucratic process.

Endnotes

- 1 Thula Kaira: “Identifying and Overcoming Political Economy and Governance Constraints to the Effective Implementation of Competition & Regulatory Law- the case of Zambia”, CUTS Symposium on “Political Economy Constraints in Regulatory Regimes in Developing Countries”, New Delhi, 22-24, March 2007
- 2 Dr C Rangarajan, Chairman, Economic Advisory Council to the Prime Minister of India at the Symposium
- 3 Dr Supachai Panitchpakdi, Secretary General of UNCTAD at the Symposium
- 4 Frederic Jenny at the Symposium
- 5 Pranav Bardhan at the Symposium
- 6 Max Everest Phillips, “Tackling the ‘Tyranny of Vested Interests’: Competition Policy as Political Governance” presented at the Symposium
- 7 R. Shyam Khemani at the Symposium
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- 9 Peter Muchoki Njorge at the Symposium
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- 14 Cezley Sampson, “Competition and Regulatory Institutional Structures in Micro States: The Case Study of the Caribbean” at the Symposium
- 15 Pierre Jacquet at the Symposium
- 16 J. Luis Guasch: “Does Regulation and Institutional Design Matter for Infrastructure Sector Performance” presented at the Symposium
- 17 Olivia Jenson: “The Role of Regulatory Agencies in Developing Countries: A Game Theoretic Approach to the Regulation of Public-Private Contracts”, presented at the Symposium
- 18 Simon Evenett at the Symposium
- 19 Sitiesh Bhojani at the Symposium
- 20 Eleanor Fox at the Symposium
- 21 Michael W. Nicholson: “Technical Assistance for Law and Economics: An Empirical Analysis in Antitrust/Competition Policy”, at the Symposium
- 22 Devendra Kodwani: “Competitive Electricity Markets in India: A Regulatory Challenge”, at the Symposium

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