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Political Economy Constraints in Regulatory Regimes in Developing Countries

- Research Discussion Note*

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I. Background

Most developing countries have adopted market-oriented reforms as part of the globalisation and liberalisation process. Nevertheless, due to various reasons, distortions[1] arise in the working of the market process. There is the need to ensure proper access to essential services, which requires effective regulation and cannot be left to market forces. Accordingly, countries are legislating and/or revising their market-regulatory regimes, which have become an integral component of governance in these countries.

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. The working of competition and regulatory regimes in developing countries shows that while good laws are being drafted, the intent gets diminished in their implementation due to peculiar political economy and governance constraints

Developing countries pose unique challenges for competition and regulatory law enforcement. Their low level of economic development, which is often accompanied by institutional design problems and complex government regulation and bureaucracy, creates real-world challenges that have to be recognized for successful implementation of competition and regulatory regime. Several of the countries suffer resource constraints, both money and people, and there is a need to make the best possible use of their available resources. Such handicaps impair effective implementation of competition and regulatory regimes in developing countries. The matter is even more critical to small developing countries where small size of their economies calls for innovative solutions.

What matters 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.

Against this backdrop, CUTS International has undertaken a research programme entitled "Competition, Regulation and Development Research Forum (CDRF)" to stimulate research and deliberations on competition and regulatory implementation issues in developing countries. The research programme is being implemented through a research cycle, with the first cycle being organised on the theme of "*Institutional Issues covering Political Economy and Governance Constraints in Implementing Regulatory Regimes in the Developing World*". The first research cycle is supported by the Department for International Development (DFID), UK and International Development Research Centre (IDRC), Canada.

This note summarises the issues and findings that have emerged from research papers shortlisted in the first cycle.

[1] Distortions to the market process arise, when, firms, while competing with one another, adopt restrictive or unfair practices. Additionally, in several cases competitive markets may not exist or yield desired results – generally because the conditions for a natural monopoly apply.

II. What Determines Effectiveness of Regulatory Regimes?

In the past, most developing economies were characterised by significant government involvement marked by dominance of large state-owned enterprises (SOEs). 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 but has been nowhere near the same economic success because cronyism and rent-seeking have characterised government-business relations.

Existing evidence suggests that other dimensions of governance, such as **government's commitment to growth as a political objective and overall political climate in a country, may matter much more**. What matters everywhere is sustained political leadership and how the political arrangements underpinned the process. In developed countries the origins of competition law can be traced 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 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 Brazil and 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 face 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 and 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 regulator. It would perhaps **make more sense if regulatory reforms in developing countries deliberately recognised the realities of political intervention and incorporated them in to agency models, rather than constantly attempt to create an unlikely autonomy.**

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. What could be the reason behind this reversal trend?

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

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 have 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 much 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 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 company (largely owned by Cable & Wireless of the UK) was given an exclusive 25-year licence, with an option to renew for a further 24 years, and several other privileges. This case provides an example of the problem faced by small states

in dealing with the divestiture process involving large multi national companies. 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.

Two related dimensions of regulation matter when it comes to avoiding disruptive renegotiations. The first one is the regulatory environment, including the very existence of a regulator from the start, but also its independence from potential political pressures. The second one 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 to the private sector and the choice of price cap therefore often went in tandem.

The need for a well-defined regulatory framework is clearly demonstrated as a precondition to 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.

KEY MESSAGES:

 # Government's commitment to growth as a political objective and overall political climate in a country matter much more.
 # Institutional endowment is central to the design and success of regulatory framework

III. Constraints that frustrate adoption and implementation of competition and regulatory regimes in developing countries

<u>1. Political Will to Adopt and Implement the Law</u>
'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 legislative books, which was inherited from Pakistan, after Bangladesh split from it. But, neither the government nor the private sector, have 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.

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 in place concurrent laws, 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!

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 will protect the market economy, and prevent the combinations that restrict or aim to restrict market freedom, or harm consumers'. No action has apparently ever been taken to legislate this directive into an enforceable law.

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 from the goals set for the State Bank of Vietnam.

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.

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 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.

 # How to align 'competition policy outcomes' and 'incentives for politicians', so that adoption of competition/regulatory law gets a political buy-in?

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.

The State sector is supported by a strong constituency of civil servants those are closely defensive of their acquired rights and consider competition/regulatory law 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 acumen.

For private domestic firms, who are the main beneficiaries of deregulation and market-oriented reforms, introduction of competition/regulatory law 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 multinational corporations (MNCs), with the additional doubt that the regulatory authority may discriminate against them.

Small and medium enterprises are expected to benefit from active implementation of competition law and opening of markets, but they are usually ill-informed about competition law and often ignore 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 well 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.

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.

 # How to reconcile the perceptions of various players and adopt competition/regulatory laws that are in accordance with the special requirements of developing countries? Is this reconciliation feasible?
 # How to spread competition culture in such an environment?
 # It is suggested that media could play an educative role to help create 'competition culture'. But in countries where there is severe lack of understanding about the nuances of competition regimes, can media play such a role?

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 a 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 organized to make their opinions heard at policy discussions. More organized industry participants often have existing 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 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 where 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, and among domestic firm themselves.

 # How feasible is the suggestion to promote Competition Law as a safety valve to garner support from its most fierce opponents?
 # Is there any other strategy that could be employed to garner support from all constituencies for adoption/implementation of Competition Law?

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 influentially business.

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 scenario, competition and regulatory policy would be looked at with suspicion and serving foreign interest. Ill informed public opinion might easily buy nationalistic argument aimed at claiming the need to protect national champions from unfair competition.

Effective competition policy needs to be constructed on state-business relations. Successful developmental states built 'growth coalitions'. These generated growth-oriented policies which allowed government the 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 to international standards through the disciplining of 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 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 indisciplined.

 # How feasible is the suggestion that in the initial stages, State should not foster competition law, rather the focus should be on building international competitiveness through targeted promotion of competition?
 # The above suggestion could precipitate demand for 'national champions' to make them internationally competitive? How to address such demands?
 # Another suggestion is to introduce competition law at the same time as market-oriented reforms to avoid giving impression to the private sector that what the State has liberalised is now again being placed under State control. Is this workable?

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 state-owned entities 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 has led 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 into 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 by government ministries, agencies and government officials. This approach has allowed Russia's competition authority in some circumstances to issue orders against ministries for adopting anti-competitive rules and taking other anticompetitive actions. Another suggestion is that regulator should use its advocacy function to persuade government to make policy changes. It is opined that advocacy function could be useful in situations where the law is new and yet to be understood by all stakeholders.

 # Should a regulator be empowered to issue orders to a government agency for adopting anti-competitive practices? Is such a role feasible, given the political economy scenario prevailing in developing and transition countries?
 # Should regulators play 'active' role in policy formulation or should their role be confined to limited policy advocacy?
 # It has been suggested that developing country governments should adopt a National Competition Policy alongwith a Competition Law to provide guiding principles in the formation and implementation of government policies. How feasible is the suggestion?

6. Public Interest Consideration

Public interest is an important policy objective for governments in developing countries, not that 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 Commission 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 ZCC.

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 prevails. As a result, Zambia has the highest domestic sugar prices in the region.

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 upon 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 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.

 # How to best align government's objective of promoting public interest and regulatory authority's objective of promoting efficient markets?
 # Should other countries follow the example of South Africa in explicitly considering public interest objectives? But then 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 above, 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. How to strike the right balance and ensure that the best decision is taken?

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.

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 Minister.

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. However, 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.

 # How to ensure competitive neutrality in situations where rules or practices are:
- In favour public enterprises, against private enterprises
- In favour of private enterprises, against public enterprises

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 and intensity of application would have to be different in order to take into account 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. In addition, 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, even if competition law of a small jurisdiction is identical to that of a larger one, these considerations require a different approach in implementation, one that is tailored to the specific exigencies of a small market.

In a similar context, most reforming developed and larger developing countries have tended to adopt US- or UK-type institutional frameworks and policies, especially for the management of competition matters and the regulation of utility industries. However, these governance structures and policies are being called in to question, particularly as to their suitability for small developing countries, where problems of scale of economies make it difficult to finance and sustain several agencies. For instance, the smaller countries of the OECS and the Barbados have rejected these institutional structures and have opted for hybrid agency frameworks demonstrating new and innovative solutions to the institutional problems of small and micro-states. What has been emerging is a typology of two institutional arrangements: multifunctional and multinational with the former combining the functions of competition and utility regulation and the latter involving the use of a single regulator by several sovereign states.

 # How to address the constraints that emerge in implementing competition and regulatory regimes in the context of small developing countries?
 # Is a "hybrid agency model" (multi-functional agency or multi-national sectoral agency or multi-national multi-sectoral agency) the best way forward for small developing countries?

9. Unsynchronised Regulations

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

As 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 license conditions required that 10% 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 was signed. The Communications Authority came up with a variation of the same undertakings and refused to authorise the transfer of the license 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 is much 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 a 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 investigations to the jurisdiction of the later. Second, there should be formal communication mechanisms 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 minimize the institutional conflicts, while promoting competition in the utility industries.

 # How to ensure regulatory coherence among various regulatory laws/agencies?
 # In case of the interface between competition authority and sector regulators, how workable is the suggestion to entrust ex-ante regulation to sector regulators and ex-post to competition authority?

10 Independence: Is it Feasible?

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:

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

The 'independent' agency model is normally favoured by western advisors, who draw from the experience of regulation in UK and US. Even in these systems it is possible to argue that the political executive retains fundamental control. In US, for instance, where the concept of independent regulatory commission was born and has evolved over the past century, regulatory agencies are not completely free from political pressures, and their information 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 for exercise of 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 in to agency models, rather than constantly attempt to create an unlikely autonomy.

The standard arrangement post-regulatory reform is to leave the development of policy framework in the hands of Ministry, whilst implementation becomes the function of the regulatory agency. The relationship between Ministry and 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 mandatory tenor in which this provision is couched leaves little doubt of the overriding influence that minister may wield over 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. The Minister then 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 management and Boards 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 state-owned enterprises (SOE) or taking measures that could impact the interest of SOEs, cases of micro-management by minister are observed, and independent regulators are perceived to be ineffective or powerless. In Kenya, when 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 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, s/he might follow her/his 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 regulator and sent to the line ministry, which scrutinises the budget and submits to Parliament. 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 not adequate. 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 reorganizing 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 civil society organizations, and ability of private parties to initiate lawsuits under the competition laws.

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. 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 natural justice as such powers tend to create insecurity of tenure for the regulator.

 # Given the political-economy scenario in developing countries, is making a distinction between 'policy' and 'regulatory' issue of any worth?
 # Is bureaucratic/ministerial intervention in regulator's functioning avoidable? Could there be a better way to reconcile this intervention so that it facilitates functioning of regulators?
 # Should line minister have a say in appointment/dismissal of regulators? What are other feasible and better methods: direct involvement of Legislature in appointment/dismissal? Active public involvement in appointment/dismissal?
 # It has been suggested to have direct subventions from the Parliament. Can a regulator bypass the line ministry in getting finances? Is it workable, considering the political-economy scenario in developing countries?

11. Regulatory Accountability: The Missing Aspect

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 specialist 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 minister. 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 that is questioned, and not regulator. This practice makes line minister assume performing functions that are otherwise delegated to a regulator by law. This assumption enables the line minister to interfere in the functioning of 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 review of regulator's specific decisions. A concern with the review process is 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 Telecom Regulatory Authority of India (TRAI) is not empowered to settle disputes; rather TDSAT has been assigned with the responsibility. This division of labour has adversely affected the performance of 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 can only entertain appeals against the decisions of the capital market regulator, Securities & Exchange Board of India. 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 lie in the judiciary; earlier the Energy Minister was the appellate authority for National Electricity Regulator.

 # Should competition and regulatory authorities be made accountable? If yes, to whom? and How?
 # What should be the right balance between independence and accountability of competition and regulatory agencies and how to ensure this?
 # What should be the nature of legislative review: confined to ensuring due process is followed or extended to settle disputes and going to technical issues?

12 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, 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.

 # Should regulator be given the powers to impose fines, summon witness, etc, which are generally considered to be interfering in the domain of 'judiciary'?

13. Priorities Of Competition and Regulatory Authorities

Often regulators in developing countries find a huge number of anti-competitive practices all around. It is physically impossible to handle all of them simultaneously due to limited resources and capabilities. Obviously, regulators need to prioritise on picking up nature and types of cases to deal with. This, however, is not an easy task. They may tend to take up cases, which are more important and harmful to the economy and society. However, these cases may be more difficult to solve and by taking up such cases, regulators may fall short in overall achievements which is so important for moving forward with their agenda.

It is argued that 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, could instil 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 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 is a constraint, 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.

 # What factors need to be considered by regulatory agencies in prioritising their work?
 # What is the influence of political-economy considerations and resource availability on prioritising the work of regulatory agencies?
 # Which practices are more damaging from developing country perspective? Which cases are easier to solve?

14. 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 governments 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 portray itself in tacit resistance to the obligations and rules of the competition law.

Not surprisingly, competition agencies 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 suitable competition cultures, it is important for competition agencies to begin the process of building one.

15. 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 maintain rather than challenge politically entrenched vested interests.

16. 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 numbers of skilled staff affects speedy decision making and often creates an impression of a regulator being "anti-business".

Recruitment of professional and technical staff is a particular challenge. The competition agency have to arrange for *relevant* training for its personnel. The vast majority of developing countries do not offer courses and or continuing 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 setup process.

IV. In lieu of Conclusion

The CDRF research programme was initiated 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 and 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.

This 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?

Several of the contributions have come from researchers based in developing countries and in this way the programme has provided a platform to developing country researchers. Furthermore, the research papers cover experiences of wide-range of developing countries and transition economies including Kenya, South Africa, Zambia, India, Brazil, Chile, Turkey, Caribbean Community (CARICOM) countries, Malta, etc.

This discussion note seeks to facilitate deliberations on the above issues and help identify better solutions, suitable to the requirements of developing countries. Additionally, several research questions have emerged, which would have to be taken up in greater detail in future cycles.

Among the research questions that could be taken up in future cycles are:

- How to align 'competition policy outcomes' and 'incentives for politicians', so that adoption of competition/regulatory law gets a political buy-in?
- What strategy should be employed to garner support from all constituencies for adoption/implementation of Regulatory Laws?
- How to align the objective of promoting public interest and regulatory authority's objective of promoting efficient markets?
- How to ensure regulatory coherence among various regulatory laws/agencies?

Surely, the current deliberations and future research cycles would throw interesting and useful insights to address these issues so that the solutions identified are suitable to the conditions prevailing in developing countries.