Project Briefing

No 42 • July 2010

The economic impact of competition

Karen Ellis and Rohit Singh

Key points

- Competitive markets deliver better market outcomes, but competition can be constrained by government policy and anti-competitive business practices, with economic costs
- Governments should assess and factor in the likely impact of their policy decisions on competition
- Competition authorities can play an important role in advocating for pro-competition reforms, investigating anti-competitive practices, and building a stronger competition culture and evidence base

Overseas Development Institute

ODI is the UK's leading independent think tank on international development and humanitarian issues.

ODI Project Briefings provide a focused and specialised summary of a project, a country study or regional analysis.

This and other ODI Project Briefings are available from www.odi.org.uk

How do government policies and business practices affect the degree of competition in a given market? How does competition, in turn, affect market outcomes, such as prices, innovation and access to services?

With funding from the UK Department for International Development, ODI has compared economic performance in four product markets – sugar, cement, beer and mobile phone services – across Bangladesh, Ghana, Kenya, Viet Nam and Zambia. These countries have very different policy frameworks and competition climates, and the study shows this has a significant impact on competition, market outcomes, and economic performance in the different countries. Here we look at the findings for each product market in turn, then discuss broader conclusions on the role of competition.

The sugar market

Sugar is an important agricultural product in many countries, and part of the staple diet in most, as well as being a source of rural livelihoods. As a result, the state is heavily involved in the sugar industry in some countries, including Bangladesh, Kenya and Viet Nam. In all three countries, however, the state-led sugar industries exhibit low productivity and poor performance, and the use of obsolete technology and inefficient farming methods mean poor cane yields and sugar outputs. All three are struggling to compete and survive in the face of competition from sugar that is either privately produced or imported. They need substantial levels of costly government subsidisation, which is unlikely to be sustainable in the long run, thus jeopardising many livelihoods.

In stark contrast, Zambia, which has a private sector-led sugar industry, produces the highest amounts of sugar per hectare of the five countries, (three times higher than Viet Nam which is the next most efficient country). This very profitable, internationally competitive industry is expanding to take advantage of new export opportunities, and has the potential to create new jobs and growth. This suggests that private sector incentives and management expertise are important for creating a successful, efficient and internationally competitive sugar industry.

Significant reform is needed to achieve a healthier sugar sector in Bangladesh, Kenya and Viet Nam but this could put some of the existing sugar mills out of business. Localised interests would make this deeply unpopular politically, and therefore hard to achieve, despite being in the best interests of the country as a whole. This demonstrates the importance of mobilising interest groups that stand to gain from reform, such as consumer groups and the business community, to offset vested interests opposed to change.

Despite Zambia's success in creating a growing, private sector-led industry, it still has very high domestic sugar prices when compared to other countries – well above the price that Zambian sugar sells for on international markets. This is the result, at least in part, of the monopolistic market structure of the industry within Zambia, where one firm wields significant market power and is protected from external competition by barriers to imports. The Zambian Competition Commission has investigated this, but has been unable to tackle the problem effectively so far, perhaps because the government may have vested interests in the industry's profitability.

Ghana also used to have a state-led sugar industry, but it collapsed in the early 1980s as a result of low productivity and poor performance. The country now imports all its sugar, and there are allegations of a cartel amongst sugar importers. These allegations are unsubstantiated, however, and cannot be properly investigated as there is no competition authority in Ghana.

The Ghanaian Government faces a dilemma as there are two potential new entrants into the sugar industry, which could generate jobs and revenue. However, these new entrants are requesting protection from sugar imports, which could increase domestic prices and undermine the competitiveness of Ghanaian-produced sugar in future. This demonstrates the possible trade-off between attracting new investment by promising protection, and promoting a market environment that will create the right incentives to ensure a good economic performance.

The cement market

The price and availability of cement matters. Cement is vital for construction and infrastructure development, which in turn underpin growth, industrialisation and private sector development, and also represent a significant proportion of government spending.

The cement sector is often highly concentrated because of its cost structure and the need for large scale production if the industry is to be efficient. As a result, the market often suffers from limited competition and has been a source of concern for competition authorities across the world. In addition, the cement sector is often dominated by multinational firms, which operate on a regional basis, often ensuring monopoly profits by agreeing not to compete with each other in the same countries. This challenge to cross border competition could be tackled through regional competition authorities, or through wider policy coordination.

The study identified a range of potential competition problems in Ghana, Kenya and Zambia:

- issues of joint ownership amongst the three Kenyan cement firms, which the Kenyan competition authority has been monitoring – the authority has been active in preventing further consolidation
- allegations about supply constraints by the monopolist cement firm in Zambia during a cement shortage which were investigated by the Zambian Competition Commission
- price hikes in Ghana, with allegations that this was due to the market dominance and price leadership of one of the two players in the market, though the absence of a competition authority in Ghana means this has not been investigated.

In comparison, there seems to be a much greater degree of both price and non-price competition in Bangladesh and Viet Nam, which have cement industries that are less highly concentrated with many different market players. The two Asian nations enjoy the lowest prices of the five countries, and significant non-price competition, with cement firms trying to attract customers by offering credit, technical support and various promotions. It seems that even though there is a high minimum efficient scale of production in cement which suggests having fewer firms is more efficient, the competitive stimulus of having many players in the market generates stronger incentives for reduced prices and efficient production.

The price of cement in Zambia has fallen by almost 10% since 2008, coinciding with the entry of a new market player in 2009 to compete with the incumbent monopoly. This happened at a time when cement prices rose in the other four countries, showing that the introduction of competition can have a significant and immediate impact on prices.

The beer market

Beer is consumed throughout much of the developing world, including by the poor. The market is usually highly concentrated, as a result of its cost structure and the importance of marketing and brand loyalty, which represent barriers to entry. It is, therefore, another industry that is plagued by anti-competitive practices in many countries, and, ideally, it needs monitoring by a competition authority.

Like the cement industry, beer prices are highest in Zambia, with its concentrated market and monopoly beer producer, and lowest in the least concentrated market (Viet Nam, with seven beer producers), and non-price competition also seems strongest in the least concentrated markets: nevertheless, competition problems abound:

- Many anti-competitive practices were identified in Kenya, including territorial allocation, exclusive dealership and price fixing. A price war had been followed by a regional carve-up, with two producers agreeing to avoid competing in Kenya and Tanzania, and to instead share in each other's monopoly profits in the other country, by buying shares in each other.
- In Zambia the competition authority has imposed conditions on the monopoly beer producer, to prevent abuse of its dominant position. They have also identified various barriers to entry, and have investigated issues relating to resale price maintenance and exclusive dealership.
- There have been allegations of price leadership in Ghana, although its two beer firms seem to compete quite fiercely and its beer prices are considerably lower than in Kenya and Zambia, which have monopolies.
- There have also been allegations of exclusive dealing and the abuse of dominance by beer players in Viet Nam, including a case where a new entrant was driven out allegedly as the result of exclusive dealing arrangements that prevented the effective distribution of their product.

The mobile telephony market

Substantial evidence now exists of the development benefits of mobile telephony. These include: improved connectivity that has enabled countries to leapfrog the need to develop fixed line infrastructure, providing connectivity to many people for

the first time; its role in reducing transaction costs for both households and enterprises; facilitating job creation and private sector development; and enhancing access to financial services.

The mobile phone market is relatively young, and evolving fast. Regulation is important for competition in this area, and regulators are grappling with how best to handle this fast changing market.

The analysis of the introduction of competition in the mobiles market in each case study country finds that competition drives rollout of services, increased market penetration, and falling prices. A competitive environment strengthens incentives to design services to meet the needs of customers, including price and product promotions for poor customers, and value added services with additional development benefits, such as money transfer services.

Until recently, Kenya has had a relatively concentrated market compared to the other four countries, and prices were relatively high. However, competition in the market increased through the entry of two new players in 2008/09, and since then tariffs have fallen by as much 50%.

Zambia has the lowest mobile penetration rate and highest tariffs of the five countries. The market is performing relatively poorly, at least in part because of a lack of competitive neutrality in relation to the government monopoly that controls the international gateway. The government charges high tariffs to private operators to access the gateway, which means that private operators have to subsidise their international calls to be price competitive with the state firm.

In Ghana there appears to be intense competition between the operators. The country has good mobile penetration and relatively low prices, and an effective regulator that has facilitated a competitive market. There has been good regulation of interconnection and the liberalisation of the international gateway, as well as an effective form of a universal access fund. The lack of these elements has slowed down market development in other countries.

The Vietnamese mobiles market is heavily dominated by state owned enterprises, but the operators do appear to compete fiercely with each other, and the sector is performing fairly well.

Bangladesh has a relatively competitive mobiles market and the lowest tariffs across the five countries. There are some regulatory concerns, however, such as a regulated price floor, which is not in line with international best practice, and has been set at less than the regulated termination charge. This puts smaller mobile operators and new entrants at a disadvantage and highlights the importance of considering potential competition impacts when taking regulatory decisions.

Overall conclusions

The study has shown that markets characterised by more competition, with more players, more dynamic entry and exit, and more intense rivalry for customers (e.g. through price promotions, special offers, and marketing campaigns etc.) tend to deliver better market outcomes. These outcomes include lower prices and better access to services for consumers, including other businesses that rely on these products as inputs for their own enterprises. It is also important to ensure that domestic production is internationally competitive, and can, therefore, generate increased exports, foreign exchange, jobs and industrial growth. The introduction of competition – or indeed even the prospect of increased competition – can have a significant and immediate impact on prices.

However, the research has also shown that competition is often constrained, for various reasons. Problems such as market dominance and anti-competitive practices are very common in some markets, and competition authorities have an important role to play in monitoring, publicising and tackling such behaviour.

It is also clear, however, that the role of the state is very important in determining competition and market outcomes – perhaps more important than the behaviour of business itself. The influence of the state can take various forms: regulation; state ownership and privatisation; price controls or subsidisation; other policy mechanisms such as import protection or industrial policy; or corrupt business deals and ownership by individual politicians or their families.

Sometimes the involvement of government is self-serving, while at other times it is essentially benevolent in nature. In some countries and markets, there is a close relationship between business and government, as government actors seek to share in some way in the profits of businesses, (e.g. through ownership or taxation etc.). This gives government an incentive to protect those businesses from competition. In these situations the relationship between business and government seems in practice to determine commercial success more than market competition, and competition authorities may face political barriers to addressing competition problems.

This kind of relationship between government and big business creates a powerful economic elite, with vested interests in opposing pro-competition, pro-growth reforms. One way to tackle vested interests who oppose reform, is to establish and facilitate coordination amongst other interest groups who stand to gain from reform. This includes household and industrial consumers and potential new entrants to the market. Competition authorities can build the evidence base, which can be used to help mobilise such interest groups to lobby for reform. Thus, where political difficulties and resourcing and capacity constraints make legal enforcement problematic for competition authorities in developing countries, they can still play a valuable role in promoting competition through advocacy and evidence building, and engagement with other government

agencies to ensure that policy is pro-competitive.

In sum, competition improves the performance of markets, generating better outcomes including lower prices, greater productivity and competitiveness leading to industrial growth and jobs, and better access to services. It can undermine the dominance of a few powerful players, allowing new enterprises to gain a foothold in the market, and underpinning private sector development and employment creation.

Appropriate policies are crucial to create the conditions within which competition can thrive, and competition authorities can help to build a culture of competition, and increase awareness of competition issues amongst policy-makers and the public.

Policy recommendations

- Government policies should create competitive market conditions. This means assessing and factoring in the competition impacts of a wide set of policies, including trade policy, industrial policy, privatisation, regulation, state ownership, subsidisation and investment promotion. Competition authorities can help by raising concerns when government policy may have negative competition impacts.
- Regulatory bodies should take into account the competition impacts of regulation to avoid undermining the market and weakening economic performance. One way to achieve this is to implement a process for regulatory impact assessment to examine the competition implications of such issues as regulation of tariffs and interconnection, infrastructure sharing, and the implementation of a universal access fund.
- Governments should consider establishing competition laws and competition authorities, which can investigate anticompetitive practices, build a stronger competition culture, and advocate for pro-competition reforms.
- Competition authorities can help to build the evidence base on competition problems and associated costs, and publicise the findings that will inform and mobilise interest groups to lobby in favour of reform, in order to offset vested interests opposed to change. These interest groups may include household and industrial consumers and potential new entrants to the market.
- Tools such as DFID's Competition Assessment Framework can be used to guide competition analysis and help build capacity and understanding of competition issues in developing countries.
- The poor performance of the state-led sugar industries in Bangladesh, Kenya and Viet Nam, as compared with the successful, internationally competitive, private sector-led sugar industry in Zambia, demonstrates the superior performance that can be achieved through private management incentives. Steps to a healthier sugar sector in these countries would include the establishment of efficient new entrants, a reduction of state intervention in the sector, an end to bail-outs, a reduction in trade protection, and an acceptance that some of the existing sugar mills will go out of business. Social safety nets and retraining programmes might help to make such reform more politically acceptable.
- Competitive neutrality between state and private sector players can help to ensure a competitive market outcome. This is likely to become an increasingly important issue in Viet Nam, which is still heavily dominated by state players, as reform continues, but is also an issue elsewhere e.g. in relation to the Zambian mobile telephony market.
- A reduction of import tariffs can help to stimulate competition where there is limited domestic competition.
- Regional competition authorities and regional cooperation are needed to tackle competition problems caused by multinational companies, who sometimes seek to minimise competition by taking a strategic approach to cross-border production decisions.

Written by Karen Ellis, Head of ODI's Business and Development programme (k.ellis@odi.org.uk) and Rohit Singh, ODI Research Officer (r.singh@odi.org.uk).

References and project information

References

Ellis, K. and Singh, R. (2010) 'Assessing the economic impact of competition'. ODI research report commissioned by DFID. London: ODI.

DFID (2008) 'Competition Assessment Framework: An operational guide for identifying barriers to competition in developing countries'. London: DFID (www.m4pnetwork.org/node/51).

Project information

This Project Briefing draws on research carried out in Bangladesh, Ghana, Kenya, Viet Nam and Zambia in 2008 and 2009. The methodology used for assessing competition in each market was in line with the approach set out in the Competition Assessment Framework published by the UK Department for International Development (DFID) in 2008. In addition to the general conclusions on the impact of competition on economic performance, the research has generated a set of findings and policy recommendations for each country, published in five separate country summary notes.

Overseas Development Institute

111 Westminster Bridge Road, London SE1 7JD

Tel +44 (0)20 7922 0300

Fax +44 (0)20 7922 0399

Email publications@odi.org.uk

Readers are encouraged to quote or reproduce material from ODI Project Briefings for their own publications, as long as they are not being sold commercially. As copyright holder, ODI requests due acknowledgement and a copy of the publication.

The views presented in this paper are those of the author(s) and do not necessarily represent the views of ODI or DFID.

© Overseas Development Institute 2010

ISSN 1756-7602