Combating Cartels in Developing Countries: Implementation Challenges on the Ground

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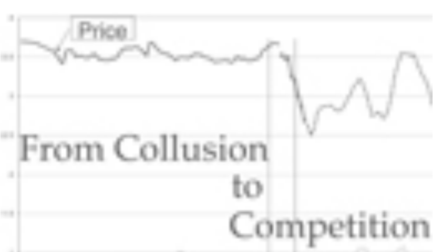

A recent literature review conducted by the World Bank provides evidence that there are significant gains from combating cartels for developing countries (Kitzmuller and Martinez Licetti, 2012). Besides increasing the cost of goods and services, cartels are associated with low labor productivity and low incentives to innovate. At the same time, tough cartel enforcement is an effective tool for reducing the adverse effects of anticompetitive behavior (Symeonidis 2008). Moreover, evidence suggests that international cartels target countries without cartel enforcement (Clarke and Evenett 2002). Evenett, Levenstein, and Suslow (2001), who analyzed a sample of 40 international cartels in the 1990s, found price drops on the order of 20 to 40 percent after cartels were broken up.

However, independently of its recognized benefits, anti-cartel enforcement continues to be a challenge in developing countries where government policies still facilitate the creation and sustainability of cartel behavior among firms. This article explores the challenges identified as part of the analytical work and technical assistance provided by the World Bank Group in the competition policy field. It also suggests a few areas to tackle in order to increase the effectiveness of anti-cartel enforcement implementation in less developed economies.

Challenges to implement effective anti-cartel enforcement rules in developing countries

In the past few years, many countries have enacted and later amended competition laws, particularly in less developed markets. A well-designed competition law is part of the competition policy framework. Nevertheless, the mere presence of a competition law is not always sufficient to create a level playing field for investors, especially in developing economies. What matters most is its effective enforcement and consequent impact on opening markets to competition and to enhance productivity growth, with subsequent effects on prices and availability of goods and services to consumers. For implementation purposes, countries have set up institutions for enforcing competition laws and/or performing other tasks in the competition policy area.[2]

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[1] The objective of the World Bank Group's Investment Climate Department's competition policy thematic group is to ensure that client countries enjoy the benefits of increased competition, open and contestable markets, and private sector investment in key sectors. The team designs and implements sector-specific and economy-wide competition policy reforms that create a level playing field, increasing the effectiveness of antitrust policies. The views expressed in this article are those of the author and do not necessarily reflect the views of the World Bank Group

[2] Currently, the International Competition Network has 107 member competition agencies from around 91 jurisdictions; 10 per cent of its members belong to low income economies, 23 per cent to lower-middle income economies and 67 percent to high-income and upper-middle income economies.

Over the past couple of years, the World Bank Group's Investment Climate Department has been working with about 40 client countries in order to increase the effectiveness of competition policy implementation. This experience has led to the identification of typical weak anti-cartel enforcement cases and their associated problems in many developing countries. This is not intended to be an exhaustive list, but only to highlight some important examples of practical challenges that have limited the ability to detect and prevent anticompetitive cartel behavior.

The legal framework for effective cartel enforcement is still incomplete

Many detractors of implementing competition policy in developing countries indicate that even though laws have been enacted and competition agencies created, there has not been any impact in market outcomes. In this view, competition policy is associated exclusively with the existence of a competition law. However, the mere existence of a law does not necessarily ensure that a country will receive the associated benefits of greater competition unless it is an effective one, with appropriate guidelines and enforcement powers. For instance, many economies of the Middle East and North Africa Region have competition laws but their legal frameworks include a wide range of exemptions. Cartels can be exempted without an explicit justification, even by ministerial decision. Agencies lack sufficient investigative powers and tools to deter anticompetitive behavior (for example, leniency, fines) and their decisions can be vetoed by sectoral ministries. Moreover, government intervention in markets through price controls and selective subsidies to incumbents is widespread. Similar situations can be found in many African, South Asian, and Eastern European economies. Thus, a law can be called a competition law but contain so many loopholes and exemptions that it ultimately has no effect.

Central elements in any anti-cartel enforcement program - such as detection, leniency programs to increase incentives to deviate from cartel agreements, and enhanced sanctions, - are still not present in many developing economies. Effective deterrence then is extremely limited.

Exemptions are widespread

Many developing countries typically adopt the competition frameworks of more advanced economies. For instance, following European Union competition rules, exemptions to horizontal agreements are included in several competition laws in the Middle East and North Africa as well as the Sub-Saharan African region. Competition laws allow exceptions to cartels based on general technical and economic progress reasoning. However, in contrast to the EU, developing countries do not have experience or a large body of jurisprudence to limit the application of these exemptions. In practice, the criteria for how exemptions will be evaluated are unclear. In some cases, this leads to the acceptance of hard-core cartel behavior.

Deterrence effect of fines is limited

In many countries, fines imposed by competition authorities remain symbolic, which hampers the deterrence effect of the competition law. In several cases such as Kenya, Armenia and Central American countries, the current structure of fines and sanctions is not conducive to deterring anticompetitive conduct. Typically, sanctions for severe anticompetitive conduct, such as price-fixing and market allocation agreements among competitors, are set at a maximum of 10 percent of a firm's turnover. However, in Armenia, maximum fines for hard-core cartels represent, on average, a highest value of 1.5 percent of the average turnover of the 100 largest taxpayers. Moreover, the response to infringements is not commensurate with the seriousness of the offense, with lower penalties for cartel behavior than for less severe transgressions

Investigative powers lack precision, and other tools to deter cartel behavior are not in place

In many cases, adequate investigative powers are not granted or are not properly defined within the competition laws, which leads to an absolute absence of powers in practice. Granting explicit powers, such as the ability to enter any premises, examine books or other business-related records, and request confidential information, is a pre-requisite for collecting evidence of cartel behavior. Likewise, rules for leniency programs and commitments, if not set in the law, have been found to be difficult to implement in practice. In practice, if the legal framework allows for criminal sanctions but there is no effective cooperation with public prosecutors, leniency provisions have limited effect. In the absence of effective leniency programs, competition authorities typically rely on indirect evidence to support their decisions, which makes them more susceptible to judicial annulment.

Tools and mandates are not necessarily applied to detect most harmful cartel behavior

Competition authorities often act as price regulators

As a response to the food crisis, many competition authorities have also been pressured to intervene in markets after price increases. In some cases, competition authorities indicate that one of their key roles is to monitor and regulate a price—which is also reflected in the legal framework. For instance, in Tunisia, the competition law excludes key markets from its application, and, at the same time, provides for administrative price control of several goods and services. So, instead of focusing on detecting and deterring anticompetitive behavior and eliminating regulations that restrict competition, emphasis is placed on price control. Price controls are intended to protect consumers, particularly of food products or fuel. However, evidence suggests that even if price controls buffer the local economy from upward spikes in international commodity prices, these administered prices do not mirror downward trends of commodity prices in international markets. This results in an effect opposite the intended policy since consumers do not benefit from lower international prices. In addition, price controls increase business risks and discourage entry of new players that could generate competitive pressure.

Moreover, in other cases, increases in prices in two consecutive periods have been considered enough evidence of explicit cartel agreements without analyzing demand and cost conditions in order to quickly respond to political and media pressure to price spikes.

Even in key sectors, such as public procurement, competition authorities do not necessarily focus on bid-rigging

In some European and Central Asian countries as well as Middle Eastern and North African regions, competition authorities have specific mandates on public procurement supervision. In these cases, we have seen that in practice competition authorities tend to focus more on public procurement violations, such as tenders with "abnormally low bids," and less on the *ex post* verification of any potential collusive practices.

When granted, investigative powers are not necessarily used wisely

Investigative powers are not necessarily used for the appropriate cases. For instance, in Romania it is common to use dawn raids for collecting evidence in simple merger cases. In Mali, the competition authority was using its inspection powers to conduct dawn raids for every single investigation raising concerns about potential corruption of government officials. Competition authorities should use their investigative powers very carefully in order to be able to effectively collect relevant information.

Government policies and self-regulations facilitate the maintenance of cartel behavior in key markets

There are several cases where horizontal agreements are validated by specific sectoral or broader government policies that limit the action of competition agencies. In some countries, more than 50 percent of anticompetitive practices, including participation in horizontal and cartel agreements, were conducted by government bodies. Many countries faced barriers to competition in non-tradable sectors due to the existence of restrictive practices imposed by trade and professional associations. This in turn affected prices of key inputs and final products markets, which are explicitly or implicitly validated by government policies.

Allowing market players to jointly set prices and decide on entry weakens effective competition in key markets of non-tradable services. In agribusiness, agreements between producers, importers, and processors of maize and rice restrict competition in Central American markets. In some cases, these agreements regularly set prices, market shares, and quality indicators for purchases, as well as mandatory purchases of national products to enable firms to import these grains. Only a small percentage of the imports quota can be assigned to importers outside the agreement. Import restrictions for specific types of products, such as maize and rice, increase production costs for animal feed. This can lessen the competitiveness of non-vertically integrated businesses that use feed as a production input (for example, prawn, tilapia, poultry, and meat producers). In this case, government policies facilitate the sustainability of this kind of agreements and even restrict entry to avoid breaking the agreement by allowing a new entrant.

In freight transport, business associations, which sometimes can handle almost 100 percent of the cargo in a particular country, set minimum prices, allocate routes and queuing system (known as the “tour de rôle” in West African Economies), and determine other contract conditions that limit competition among its members. Cargo transportation prices are typically jointly set among competitors. In some cases, no individual cargo transporter can enter main ports without the agreement of business associations. Market sharing and price fixing agreements are widely spread among transport of passengers as well and the control of routes against new entrants. This is the case of many markets in the Latin American and Caribbean region as well as South Asia and Sub-Saharan Africa.

In professional services, both the regulatory framework and the regulations imposed by professional associations lessen competition by either restricting entry (for example, fixing the number of suppliers, maintaining exclusivity in the provision of services, and imposing restrictions to practice) or aiding members in coordinating prices (for example, establishing minimum prices). In Turkey, where professional services account for 20 percent of Turkey’s total economic activity, minimum prices are in place for accounting, architecture, legal, and engineering services, while notaries regulate the exact level of pricing. Limitations on advertising apply to some of these professions, and access to several professions is foreclosed to foreign nationals.

In East Africa, domestic regulation on the entry and operations of professional service firms, presumably designed to meet social goals, undermines competition. In countries such as Mexico and Peru, competition in notary services is restricted by sectoral regulation that limits the number of notaries at the subnational level. In Costa Rica, lawyers retain a large number of exclusive rights including the capacity to advise in domestic, foreign, and international law as well as the ability to represent clients before courts and agencies. Furthermore, accountants hold the exclusive right to audits, bookkeeping, and accounting services. Specific laws governing professional services validate these practices, so competition agencies are unable to tackle this behavior through competition law.

Subnational regulations can also facilitate the development of cartel behavior

In Mexico, municipalities and state authorities in some cases require small and medium enterprises to get special permits from a business association before entering the market. The business association is also required to approve the geographic location of any new market player. Likewise, in Russia, regional programs intended to promote the development of market competition include measures that in reality promote anticompetitive behavior in the retail sector. In particular, regional authorities have promoted the signing of price agreements among firms, set shares for local products to be sold in retail network, and “tracked prices to stabilize deviations.”

Tackling implementation challenges through a pragmatic approach

While building capacity for implementation and devoting internal resources to cartel detection, competition agencies can strengthen anti-cartel enforcement by undertaking specific actions in the short and medium term.

1. *Develop secondary regulation to clarify legal criteria and increase predictability*

It is important to carefully analyze the characteristics of the legal frameworks on competition and, at least, establish the minimum conditions for its effectiveness based on international best practice. If the legal framework is not conducive to guaranteeing adequate enforcement, it will need to be amended as a preliminary step. Since revising and modifying competition legal frameworks requires longer time, it is also important to see if required changes for implementation could be handled through secondary legislation, regulations, and guidelines. This will also bring a more hands-on approach to increasing the effectiveness of implementation. For instance, exemption regulations or guidelines could limit the extent of exemptions while clarify that hard core cartels, such as price fixing and market sharing agreements, would unlikely be exempt. Likewise, fine guidelines that define criteria for sanctioning anticompetitive behavior based on its gravity could also send the right signals to market participants.

2. *Aim to reduce anticompetitive (self) regulation and government practices that facilitate cartel behavior*

Collaboration and alignment among relevant government bodies— particularly in key sectors

It is common that competition authorities sign Institutional Protocols with several public bodies (for example, sector regulators, public procurement authorities) in order to foster collaboration and coordination among institutions. Many of these collaborations seem very promising in theory, but it is actually very difficult to see tangible results in practice. At the same time, competition laws are also including more specific provisions to improve and target advocacy towards other government institutions (binding opinions, prevalence of competition law in competition matters). In this context, competition authorities could modify these protocols in order to establish targets based on successful competition promotion of (for instance, the removal of barriers to entry in the sector or elimination of anti-competitive regulation).

The World Bank Group's Investment Climate Department is supporting this work in Romania and Zambia in the public procurement sectors. In Romania, procurement officer training on how to identify the red flags of cartel behavior will be complemented by databases that track procurement conditions in selected markets. In Zambia, both authorities are cooperating in the context of leniency programs and eliminating practices that facilitate cartels and bid-rigging. This is particularly relevant for Sub-Saharan Africa, where agreements among competitors on prices, market sharing, and bids for public procurement are one of the most common anticompetitive practices. In the case of public procurement, cartel conduct can raise the cost of goods and services by 20 percent or more.

Address self-regulatory bodies, business associations and professions

Business services are key inputs for many other sectors. In the East Africa Region, input-output tables suggest that they are among the top fifth of economic sectors in direct and indirect usage. There are significant downstream linkages in minerals, manufacturing (garments, leather, paper, metal products, and chemicals), and services (business, education, distribution, and public administration). Empirical studies demonstrate that increasing utilization of professional services also increases productivity. For example, the average labor productivity of East African firms that use accounting, legal, and engineering professional services is 10 to 45 percent higher than that of firms that do not.[3] Small firms in particular benefit from strong connections between professional services and productivity. Therefore, restrictions on the supply of professional services by professional associations can have ripple effects throughout the economy.

Professional associations serve many legitimate purposes that benefit consumers by ensuring a minimum level of service quality and disseminating best practices throughout the industry. Information asymmetries in professional services markets can prevent customers from being able to make informed decisions as to the types of services they require and the volume of services that they need. Professional associations can mitigate these asymmetries.

However, certain self-regulations imposed by business and professional associations might lessen competition by either restricting entry or facilitating price coordination among members. Unduly restrictive membership rules, exchange of detailed and sensitive commercial information, exclusive or closed industry standards, marketing restrictions, and "ethical" codes regulating pricing or other trading practices that limit the members' abilities to compete freely are among the competition issues that need to be analyzed and included in competition regulations and guidelines.

Activities of trade and professional associations are established by law or find their justification in public policies. Many associations are expressly given powers to set prices or other terms and conditions for exercising a commercial activity (for instance, meeting certain standards or certification requirements).The question is whether such activities, which can entail serious price or output restrictions on the members of the associations, should be exempt from competition rules. Professional standards are relevant particularly in professions such as health, but restrictions to competition need to be justified by choosing the minimum level of potential distortion needed to maintain standards. In practice, tackling the treatment of exemptions for restrictive practices carried out by associations will reduce the ability of associations to fix prices and entry fees.

3. *Measure and communicate the harmful effects of cartel agreements to encourage support for competition policy*

[3] World Bank, 2010, "Reform and Regional Integration of Professional Services in East Africa: Time for Action".

Cartels affect key sectors of the economy and are typically overlooked in broader economic policy reforms. Policy-makers understand the importance of anti-cartel enforcement better when their negative effects on citizens and business are measured. An upcoming joint study between the World Bank Group and the Competition Authority of Kenya reveals that overcharges due to anticompetitive cartel behavior have a relatively larger impact on the poorest households. Simulations for the Kenyan sugar and maize market indicate the country's poorest households suffer a relative welfare loss about two times higher than the one felt by the richest. Rural households are even more affected by anticompetitive overcharges than urban households when changes in consumption behavior in reaction to price increases are taken into account.

In Zambia, the discovery of simply one duopolistic cartel in fertilizer has highlighted the importance of effective cartel detection for other government bodies. This cartel is estimated to have cost Zambians over $20 million during the time the two companies supplied fertilizer to the Zambian government. This type of fertilizer—key for farmers' main agricultural crops—was distributed through government procurement contracts. Public procurement and government e officials are now willing to work together with the Zambian Competition Commission in order to prevent bid rigging behavior.

Measuring is even more important when tackling anticompetitive (self) regulations. For instance, the World Bank Group's Investment Climate Department estimated potential savings in order to generate support for competition reforms in professional service markets. In Kenya, evidence suggests a large potential gain from eliminating business associations' self-regulations that allow for price coordination and increase the cost of doing business. Preliminary estimates indicate savings of nearly $18 million per year in the insurance markets due to the elimination of price agreements. In Turkey, conservative estimates indicate that reducing regulatory and competition constraints on professional and transport services would result in benefits of at least $557 million in additional value added to the economy per year.
Communicating the harmful costs of cartel behavior and articulating the benefits of more competition among firms in specific cases also helps build credibility and advocate for overall competition reforms in other markets. Competition agencies have a critical role to play in these cases. Finally, effective communication also triggers direct reform work with sector regulators in order to prevent anticompetitive behavior. This is the case of Kenya where the World Bank Group is working with the insurance regulator in updating their sectoral framework in order to eliminate possibilities of price fixing.

Conclusions

Based on the experience of the World Bank Group's Investment Climate Department, this article aims to shed light on challenges faced in implementing effective cartel enforcement rules in developing countries. In developing countries, cartels have been associated with price increases of 10–45 percent, so consumers have much to gain from effectively tackling price fixing, market sharing, and bid rigging agreements. However, policy-makers and government officials still do not necessarily recognize or are unwilling to combat the negative effects of cartel behavior. In many cases, governments decide on prices and quantities with the private sector. Agreements in key input markets (such as transportation and professional services) through business and professional associations are common practice and increase the costs of doing business. In addition, in many developing countries competition frameworks are still not adequate to effectively deter cartel agreements, and implementation capacity is relatively low.

In this context, there are several other measures, particularly in countries with newly implemented competition frameworks, which are complementary to capacity building and could have significant effects on preventing cartel behavior. Regulations that set criteria and procedures to grant exemptions to business and professional associations, guidelines on information sharing among competitors, per se prohibition of price-fixing, prohibition of entry barriers through self-regulation, and improvements to antitrust law (leniency programs, higher fines for hard cartels, increased investigatory powers) are part of the equation. Likewise, activities devoted to infuse competition principles within other government policies are key to deter facilitating practices that support cartel formation. These could include measuring the harmful effects of cartel behavior, communicating the findings to relevant bodies, and establishing specific targets to remove anticompetitive regulation.

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