Policy Brief

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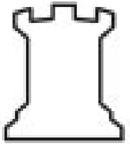
Competition and Regulatory Regimes in Small & Developing Countries

In small and developing economies, the formulation and implementation of competition policies should take into account the special characteristics associated with small domestic markets. The thrust of this policy brief is that while the main principles of competition law and regulation that have evolved in large economies are also relevant to small economies, the mode and application may have to be different in order to take into account the particular characteristics of small insular markets.



Introduction

Most reforming developed and large developing countries have tended to adopt the US or UK institutional frameworks and policies, especially for the management of competition matters and the regulation of utility industries. These governance structures and policies, however, are now being revisited, particularly as to their suitability for small developing countries.

Many small developing and emerging economies have now opted for hybrid agency frameworks demonstrating new and innovative solutions to the problems of small and micro states. For example, Malta has adopted a merger policy that is more accommodative of efficiency considerations and relies less on rigid structural variables. In the Caribbean, what is emerging are two institutional arrangements, that of 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.

Two schools of thought have been shaping competition policy – the *neo-classical* structure, conduct and performance approach stating that market behaviour is related strictly to market power and the *evolutionary approach* which does not subscribe to the view that in all situations market power can be interpreted as harmful to competition. For the latter, dynamic efficiency is more important than static efficiency.

The implication for small developing economies is that simple transfer of institutional regimes from industrialised countries, which traditionally focussed on structural remedies, may be inappropriate. In small economies, monopolies and oligopolies may have to be accommodated in that such structures may be more efficient and the focus may have to be on conduct remedies and removal of government imposed market restrictions.

Characteristics of a Small Economy

The term 'small economy' is often used when discussing small geographical entities. This term includes small independent states as well as parts of larger states with a degree of administrative autonomy, and island provinces and regions with an isolated geographical market.

The preceding section describes how the characteristics of small economies have a bearing on competition law and policy. What is construed as dominance in large economies, may not be so in small ones. Conversely, in some instances what may constitute abuse in a small market may not be so in a large market (e.g., refusal to deal). In some cases of small economies, letting dominant oligopolies indulge in discriminatory practices may be to the advantage of consumers and to forbid them would often reduce efficiency. Similarly, a seemingly excessive price may be justified in a small economy since this may be one way through which a firm could cover high import costs.

While it is important that firms face competition or at least, the threat of competition, encouraging inefficient entry generates significantly greater social costs in small economies than in large ones.

The Maltese Experience

In the case of small domestic markets, the new entrants may find themselves suddenly controlling a large share of the market, as was the case with a supermarket chain in Malta. The sudden exit of this chain from the market left many business creditors at a disadvantage and excessively destabilised the market, to the detriment of the consumers. Such destabilising effects of exit and

Characteristics	Implications for Competition and Regulation
Small size in terms of population, land area or gross domestic product	Small number of actors and small value of transactions within a given market.
Small domestic market	Limits competition possibilities, tolerance of monopolies and oligopolies, large overhead costs in sectors like power, telecommunications, gas, water, etc. not permitting more than one entity, other entry and natural barriers (including artificial barriers) and parallel behaviour between firms as family ties in business are common.
Market failures and externalities	Market forces unable to dictate demand and supply. In countries like Malta, business tends to have relatively large environmental impacts, limiting number of producers and existing producers continuing to enjoy dominance.
Limited natural resources endowments	Domination of market by undertakings monopolising import channels and resistance by existing businesses against parallel imports.
High reliance on export market	Small size renders exploitation of advantages of economies of scale difficult leading to high per unit cost of production. A critical size is required to compete in international markets and argument for rationalisation and against fragmentation is strong.
State aid	State aid is considered a distortion to competition but is necessary to permit some form of level playing field across countries.
Insularity and transport costs	For archipelagic and dispersed economies, in particular, leads to additional costs of production.
Small population pool	Chances of finding expertise to administer competition law and policy and regulatory agencies are smaller. Functions of the governments are expensive as many expenses are not divisible in proportion to users.

entry are likely to be more pronounced in small economies than in large ones.

Further, in Malta, in the case of certain agreements, restrictions are often legally permitted if it contributes towards the objective of improving production or distribution of goods and services or promoting technical or economic progress. Agreements containing anti-competitive practices escape prohibition if, on balance, the economic efficiencies they generate outweigh the negative effects. Up to 2004, Malta's Competition Act required undertakings concluding efficiency generating agreements that were not covered by block exemptions to notify such agreements to the National Competition Authority for individual exemption. This often caused delays. Now a system based on self-assessment in lieu of notification has been put in place where the possibility of delays and attendant damage to the viability of firms trying to meet competition from larger foreign competitors has been addressed.

In the case of mergers, Malta's Regulations on Control of Concentrations state that: ... "concentrations that bring about or are likely to bring about gains in efficiency that will be greater than and will offset the effects of any prevention or lessening of competition resulting from or likely to result from the concentration, shall not be prohibited if the undertakings concerned prove that such efficiency gains cannot otherwise be attained, are verifiable and likely to be passed on to consumers in the form of lower prices, or greater innovation, choice or quality of products or services".

Multi-sector Regulators

The establishment of competition and utility regulatory agencies in small states presents challenges due to their size and problems of economies of scale. In the Caribbean, the infrastructure industries of telephone and electricity have almost from inception been created and controlled by the private sector under the model of franchised monopoly and public regulation, except for the 1970s when the larger islands nationalised their utilities based on the principles of democratic socialism. The question, therefore, in the Caribbean, was what should be the appropriate institutional structure to accommodate competition agencies and industry regulatory authorities.

The goals of competition and regulatory agencies do not exist in isolation and must take into account the existing political, economic and social

institutions, practices and customs. Jamaica, Trinidad and Barbados were three of the first developing countries to establish multi-sector regulatory bodies. The Jamaica Public Utility Regulatory Commission was set up in 1965 to regulate electricity and telephones. Trinidad and Tobago went further and the Public Utility Regulatory Commission regulates both public utilities and public transport.

The arguments for multi-sector regulatory structures are savings in resources and hence costs, the opportunity to facilitate learning across common issues such as tariff setting, reduction in the risk of 'capture', reduction in the risk of political interference and reducing the risk of economic distortion due to inconsistent decisions on common issues and ability to deal with distortion due to inconsistent decisions on common issues arising from increasing blurring of the traditional sector boundaries.

The most important institutional regulatory innovation introduced by the Organisation of Eastern Caribbean States (OECS) – Box 1 is the creation of a hybrid authority, which operates both as the telecommunications regulator and telecommunications competition body, serving several small independent developing states. The structure allows for a relatively small sector regulator in the member state to draw on the centralised expertise at the sub-regional level and in doing so benefit from economies of scale and expertise. This is probably the only example of a single regulatory and competition body serving several sovereign states.

The Case of Barbados

Barbados in seeking to develop its regulatory institutional framework like the OECS also adopted another hybrid innovative institutional initiative designed to deal with the handicaps of small states and problem of small economies. Like in most developing countries, historically there has been a lack of competition culture in Barbados, which has deeply entrenched merchant and landed class that has dominated commercial activity, which resist competition law and policy measures.

The Fair Trade Commission (FTC) Act, together with the Utilities Regulation Act (URA), provides the framework, which guides the FTC in the regulation of utilities in Barbados. Under the URA, the Commission currently regulates domestic and international telephony services, electricity and natural gas. The URA gives the FTC the power to establish the principles for rate discovery, setting

Box 1: Hybrid Regulatory Agency in the OECS

The OECS comprises nine countries: Antigua and Barbados, the Commonwealth of Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines, Montserrat, British Virgin Islands and Anguilla. The single most defining characteristic of these countries is their small population, which ranges from 47,000 in St. Kitts and Nevis to 161,000 in St. Lucia and can be described as micro states. The OECS was formed in 1981 and is a part of the wider Caribbean Community and Common Market (CARICOM). OECS is administered by a central secretariat and the islands share a single common currency, the Eastern Caribbean Dollar.

Telecommunications was the first of the utilities to be considered for reform in the region commencing in 1998. The process of reform culminated in the establishment of the Eastern Caribbean Telecommunications Authority (ECTEL) – the first multinational telecommunications regulatory authority in the world – to facilitate the harmonisation of the regulatory regime.

This Agreement drew up a reform agenda, including the creation of a pro-competitive legal and regulatory framework, harmonisation of laws, negotiations with the incumbent monopoly and the establishment of a regional regulatory body. Its role was to design a transparent and investor friendly licensing and regulatory regime at the national level and to manage number and frequency allocations in each member state besides creating a forum for coordination of OECS telecommunications policies and regulations with technical assistance of ECTEL.

The deficiencies of the telecommunications sector at the time were seen to be the exclusive licence which Cable & Wireless (C&W) held, covering all the main services within the sector. The laws, licenses and agreements were ambiguous, outdated and restrictive and allowed low returns to the Government in terms of fees.

In 2001, an agreement was reached between ECTEL and C&W to terminate the company's monopoly, with the result that new licenses were issued to new entrants to the telecommunications market in 2002.

ECTEL also regulates competition matters within the telecommunications sector. In other cases, ECTEL and the national commissions share an overlapping jurisdiction that requires that matters must be coordinated between the regional and national levels.

maximum rates, setting and monitoring service standards, to hear and adjudicate on complaints and disputes related to these utilities. The Commission also has the powers to make rules after consultation with the service providers and the minister.

In the case of the telecommunications sector, regulation is done jointly with the Minister of Energy and Public Utilities. The FTC is the principal body regulating interconnection matters in the partially liberalised telecommunications market, including interconnection rates and standards for interconnection. Currently, the mobile market is liberalised and future plans call for the liberalisation of domestic fixed wireless market and the international telecommunications market.

The Telecommunications Act also provides for the establishment of Access Deficit Charge and in this regard, the FTC must consult with the co-regulator, the Ministry of Energy and Public Utilities when enforcing policies established by that Ministry. The Commission currently regulates C&W (Barbados) Ltd. in the telecommunications sector and Barbados Light and Power in the electricity sector. The Commission tries to maintain "Chinese walls" with respect to information on investigation. The different divisions of the Commission however, readily draw on and access the skills, knowledge and resources of each other.

The Consumer Protection Act came into force in 2003. The Act deals with unfair contracts and unfair consumer trading practices, such as dual pricing, bait advertising, tied selling, misleading advertising, and pyramid selling. The FTC is required to operate within the policy framework set by the Minister responsible for Commerce, Consumer Affairs and Business Development.

It is too early to assess the performance of the Commission and the problems it will face in having one agency with the responsibility to fix price, and at the same time having the power to prosecute traders for price-fixing. In Jamaica, it was the competition agency, on a number of occasions that challenged some of the practices accepted by the industry regulator in the evolution towards competitive market.

Box 2: Innovations in Barbados

The policymakers in Barbados took a position in 2000 not to establish separate institutions for the management of competition matters and utility regulation. The reasons were that of administrative costs of establishing and operating several institutions, ensuring consistency of policy application, the difficulties in finding sufficient qualified staff and the problem of control over several agencies.

The FTC under the Fair Trading Act of 2000 was established to carry out the responsibilities for both management of competition matters and the regulation of utilities. The Commission is mandated to administer and enforce several distinct pieces of legislation, such as:

- The Fair Competition Commission Act (Enabling Act)
- The Utilities Regulation Act
- The Fair Competition Act
- The Telecommunications Acts
- The Consumer Protection Act

The FTC Act gives the Commission administrative, prosecutorial, quasi-judicial and investigative powers. The Commission is made up of a Board of nine part-time commissioners, inclusive of a Chairman who must be an Attorney-at-Law of at least 10 years standing, or a person who has held high judicial office.

Conclusion

Examples and experience from Malta shows that properly weighing efficiency claims against anti-competitive effect is essential in small market economies. Collaborative or unilateral action or consolidation through external growth might be crucial for operators in small economies to reach the minimum efficient scale of operation. These considerations require a different kind of implementation, one that is tailored to the specific exigencies and the challenge is how to adopt the doctrines established in a large market to a small one.

The smaller countries of the OECS and Barbados have shown how assigning competition matters and certain economic regulatory functions to the same agency can provide an opportunity to take advantage of synergies between competition matters and economic regulation and also to take advantage of synergies between both functions and access regulation.

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