2008

STATE OF COMPETITION REPORT

Competition Commission of Pakistan

The State of Competition in Pakistan 2008

Competition Commission of Pakistan

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GLOSSARY OF ACRONYMS

APCMA	All Pakistan Cement Manufacturers Association
CCP	Competition Commission of Pakistan
CO 07	Competition Ordinance, 2007
ECC	Economic Coordination Committee
EU	European Union
ICAP	Institute of Chartered Accountants of Pakistan
IMF	International Monetary Fund
ISE	Islamabad Stock Exchange
IT	Information Technology
KPT	Karachi Port Trust
KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
MOIP	Ministry of Industries and Production
MCA	Monopoly Control Authority
MRTPO	Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970
NFC	National Fertiliser Corporation
OECD	Organisation for Economic Co-operation and Development
PIDC	Pakistan Industrial Development Corporation
PSMA	Pakistan Sugar Mills Association
PEPCO	Pakistan Electric Power Company Ltd
SCP	State Cement Corporation of Pakistan
SME	Small and Medium Enterprises
WAPDA	Water and Power Development Authority
WTO	World Trade Organization

Foreword

The last two decades have seen profound change in the way both developed and developing countries manage their economies. In developed countries, the traditional balance between the public and private sectors has tilted strongly in favour of the latter. In most developing countries, central planning, large public sectors and administered prices have given way to a greater reliance on private firms competing with each other and making decisions about the production of goods and services based on market signals. Indeed, the benefits of free markets based on competition between such firms are now generally deemed to be self-evident: they lead to greater resource-allocative efficiency at the macroeconomic level and provide lower prices for consumers at the microeconomic level.

The mundane reality, however, is that markets are never, or very rarely, completely 'free' especially in developing countries and pricing and output decisions are influenced by many outside factors. For instance, in Pakistan privatized utilities are under the supervision of their sector-specific regulators with a variety of powers, while banks are subject to detailed prudential oversight from the State Bank to ensure financial stability. In some sectors, electricity and petroleum products being prominent examples, prices continue to be determined largely by the Government. In other words, regulation and oversight remain important in today's private sector-driven world.

But another, more sinister and generally unseen, form of intervention in markets is one in which firms get together to collude, formally or informally, on a price for their products or services, agree not to compete with each other and agree to keep out newcomers. This form of intervention or, more accurately, market manipulation in the form of cartelization is economically highly damaging. It leads to suboptimal production levels and is clearly against the public interest as consumers have to pay higher prices often for lower quality goods and services. Similar outcomes could also arise from exploitative conduct by a dominant undertaking as well as through arrangements or practices adopted by firms that lessen contestability. It is hardly surprising that as of 2008 more than 100 countries, including 70 developing countries, had drawn up policies and laws to counter such anti-competitive practices.

In Pakistan, the pro-competition legal framework provided by the old Monopoly and Restrictive Trade Practices Ordinance (MRTPO) has been superseded by the Competition Ordinance 2007 (CO 07) in October 2007 and the MCA (Monopoly Control Authority) has been replaced by the CCP (Competition Commission of Pakistan) with significantly enhanced powers and a wider mandate to deal with anti-competitive behaviour and practices by firms. Following the transition from the MRTPO to the CO 07 the new arrangements oblige the CCP to issue a report on the State of Competition in Pakistan as a part of its advocacy mandate. This is the first such report. The purpose of the report is both to describe and analyze the state of competition in the Pakistan economy and, arising out of this, to make policy recommendations in the area of competition issues and policy.

I should like to stress that competition issues essentially relate to the behaviour of economic agents and have a cross-cutting impact on the general level of competitiveness of the Pakistan economy - the latter is a function, among other things, of macroeconomic stability, investment in efficiency-enhancing infrastructure and improved governance. The report thus discusses competition issues in various sectors of the Pakistan economy against

the background of the current state of the economy and the short term challenges that it is confronted with. Incidentally, the bulk of the information on issues and sectors on which the report is based comes from the CCP's own internal sources and its analysis of the competition vulnerabilities existing in the economy is essentially empirical. For the CCP, any lessons drawn, or policy conclusions derived, we need first to understand the history of each sector and how we got to the situation that we are in today.

Since November 2007 when the CCP came into being it has been interesting to observe that competition policy and laws have many opponents, who are voluble, and relatively few friends who tend to be somewhat lukewarm. Given such a climate of opinion, stakeholders in the economy, especially the Government, have to be persuaded that sustainable development strategies and the public interest are ultimately under-pinned by market principles. I hope that this report will play a major role in improving public awareness of competition issues confronting the Pakistan economy and in highlighting the contribution made by the CCP in promoting a more competition-oriented business culture in the country during its short existence.

Khalid Aziz Mirza
Chairman
March 2009

Introduction

Introduction

Pakistan achieved independence some six decades ago. Over the years, the interplay of many factors - political, economic, social and cultural - have contributed to its current state of development. While much progress has been made across a broad front, significant weaknesses remain. Recent external shocks have once again rendered the economy dangerously vulnerable to macroeconomic instability. The continuing paucity of public resources manifested in the low tax-GDP ratio has meant that our social indicators remain highly unsatisfactory. International comparisons in terms of productivity in agriculture, manufacturing and services show Pakistan in a poor light.

One of several elements that have worked against achieving higher levels of efficiency and have resulted in the ensuing lack of international competitiveness of the Pakistan economy has been an anti-competition business culture in which the powers that be have tended to acquiesce. Business firms have been allowed to collaborate by forming cartels and by adopting practices such as fixing market prices to secure higher profits and consumers have been left at an obvious disadvantage. Likewise, powerful companies have held sway in their relevant markets, leaving competitors and new entrants to struggle for growth and space. In the process both consumer welfare and the growth of the economy have suffered.

Virtually across the world it is now accepted as a truism that promoting competition enables a market economy to maximize productivity and efficiency. Curtailed competition prevents an economy from achieving its true potential, instead creating inefficient monopolies and oligopolies and restricting output. The degree of competition in an economy directly or indirectly influences the overall performance of an economy, including a host of ancillary benefits such as the development of new industries, innovation, new product development, absorption of new technologies, incentives and determination to produce better quality products at lower cost, improved production and management processes and research and development to discover what the consumer really wants and prefers. But these beneficial outcomes do not flow automatically. They require sustained effort by the business community aided by the Government in the provision of crucial physical and institutional infrastructure, public goods and policies. Above all, they require a supportive environment within the Government and in the wider society.

Notwithstanding the long history of the MCA the work begun by the CCP in November 2007 is essentially new for the country. There is thus both a lack of familiarity with, and resistance to, its work. Trying to explain and justify the need for its mandate and operations, in the midst of far more menacing concerns, such as high inflation, dwindling public resources and a worsening security situation, is what the CCP is striving to achieve through this report.

Through this report, the CCP aims to describe and analyze the state of competition in Pakistan's economy and make recommendations in the areas of competition issues and policy. The CCP seeks to highlight the significance of competition in the economy and to emphasize the need to check elements that curb competition. The report explains the role played by competition in development and emphasizes the importance of competition for sustained development in the long term. The report has been designed to shed light on a number of major sectors of Pakistan's economy, giving the reader a picture of how each

sector is performing in terms of its competitive environment. Simultaneously, the report unveils the need for improvements that can be achieved by promoting competition and reducing the sway of anti-competitive forces in the economy.

The report thus forms an integral part of CCP's advocacy responsibilities. Advocacy is about promoting competition through means other than law enforcement. It depends instead upon focused analytical efforts that relate to the central role of competition in the overall economy. The main objective of advocacy is to mobilize the support of the Government, business enterprise and the public to form a strong reservoir of support in favour of the protection and promotion of competition in the country. In this regard, the principal forms of advocacy available to the CCP are raising public awareness and providing a robust analysis of key economic activities from a competition perspective. The report on the state of competition in Pakistan falls in the latter category of advocacy.

But, however ably and competently the CCP performs its advocacy duties, it cannot function effectively without active support from its stakeholders within the business and wider citizen communities. The CCP has to create and sustain credibility for itself and its work and it has to nurture an environment within which it can depend on support for its work from both its stakeholders and ordinary citizens. At a mundane level advocacy might be viewed as merely a complement to policy implementation but indirectly it plays an essential role in the establishment and propagation of a pro-competition culture in the country.

In terms of specific mechanisms to ensure that CCP's role of advocacy is performed efficaciously, a process for involving the public in its activities has to be formalized and buttressed through media announcements, seminars, published papers and relevant annual reports by the Commission. In the early years of the new competition policy embodied in the CO 07, there would consequently be a particularly critical role for the CCP to create and strengthen such networks in bringing competition to the forefront of public attention. Education and constituency-building efforts would need to be directed at pro-competition interest groups, especially exporters, grassroots entrepreneurs (new entrants and rural/smaller firms without market power) as well as consumers, who stand to benefit most from an effective competition policy. Public awareness-raising activities typically include interaction with the legal fraternity, Government officials and businesses outreach to universities, think tanks, consumer groups and the broader civil society through participation in conferences and seminars, publications of information notes and studies and, above all, a user-friendly, up-to-date website.

Attaining these objectives is bound to be both expensive and time-consuming. Specialists in competition policy and its ramifications are few in number in the country while changing public perceptions pertaining to competition issues will not happen overnight. The CCP in carrying out the advocacy function would need to deploy substantial human and material resources to the functions of research, advisory services, documentation and dissemination. There is a need, too, for greater coordination with Government agencies, sector regulators and consumer groups, for creating and maintaining accurate databases, publishing information pamphlets and other material for sharing the results of investigations and in generating support for such a wide range of work through its stakeholders. The CCP will need to carry out its advocacy function through a combination of in-house capacity and outsourcing, both to domestic as well as international institutions with the relevant research capacities. Capacity will thus be built both in the Commission and among domestic suppliers of research (universities, think tanks and consulting firms). A great deal of learning and cross-fertilization of ideas will be involved within the Commission and in Pakistan's research community in the promotion of competition issues in the public policy arena.

Against this background, The State of Competition in Pakistan attempts to provide a succinct overview of the economy in 2007/08 and of major facets and sectors of the economy from a competition perspective. The report focuses on areas and issues where there are competition concerns by looking closely at the competition vulnerabilities in each area of activity and in each sector. In addition to information on individual sectors of the economy and the monitoring of competition trends, this and succeeding reports should become one of the principal tools of advocacy by the CCP. As such, the reports will also have a prescriptive function by commenting on the existing framework of Government policy and practices and the changes needed and play a leading role in creating a more propitious environment for competition in the country.

1 The Current Economic Situation in Pakistan: Implications for Competitiveness

The Current Economic Situation in Pakistan: Implications for Competitiveness

A growing economy is by definition a more competitive economy as it opens up opportunities for new investors and entrepreneurs and brings them into the economic mainstream. Greater competitiveness at the national level is, however, also a function of how supportive is the surrounding physical and institutional infrastructure and environment for the country's investors. Thus it is hardly arguable that competitiveness is ultimately driven both by investment in roads, ports, energy and a wide variety of public goods and by the quality of support provided by public sector institutions that enable investors to operate on a level playing field and within a rule-based environment. In this regard, it is abundantly clear that public institutions that promote competition, play a critical role in eliminating entry barriers for new investors, in reducing impediments to competition and in establishing a pro-competition business environment. In this chapter we examine how the current economic situation in Pakistan is impacting on its competitiveness seen from the above perspective.

Following a lacklustre performance during much of the 1990s the Pakistan economy enjoyed a period of markedly faster output growth between 2003-04 and 2006-07, the overall GDP growth rate accelerating to an average of over 7 per cent a year compared to an average of 4 per cent in the 1990s. Much of the growth was in services which account for more than 55 per cent of GDP and was driven mainly by consumption but with a welcome and urgently needed improvement in investment expenditures becoming evident towards the end of this period. Overall, the higher GDP growth was the outcome of a combination of greater prudence in macroeconomic policies involving lower fiscal deficits, a reduction in the debt burden of the Government and a slower pace of monetary expansion that created a more conducive environment for investor confidence in the country.

These developments were accompanied by far-reaching structural changes and reforms that revolved around a major programme of privatization, creating deeper and wider financial markets, a further boost to trade liberalization and greater professionalism and independence in public sector oversight institutions, the latter having a positive impact on the overall quality of economic governance in the country. The combination of improved macroeconomic fundamentals and structural change helped provide a significant impetus to the overall investment climate with the ratio of Gross Fixed Capital Formation (GFCF) to GDP going up from under 17 per cent in 2002-03 to over 23 per cent in 2006-07, an unprecedented surge in Pakistan's economic history (see table 1).

The financial year 2007-08 and first half of the financial year 2008-09 have, however, witnessed a sharp deterioration in Pakistan's economic situation exposing it to new vulnerabilities and revealing still unaddressed structural weaknesses. A number of factors have contributed to this unwelcomed turnaround. A prolonged period of political uncertainty became superimposed upon a worsening security situation and the incidence of major external shocks, primarily a massive increase in the price of oil and of commodities such as wheat and palm oil, have strained both Government and household finances. As a result of the massive jump in oil prices major problems also arose in power generation by the IPPs (Independent Power Producers) adding to the strain on the already stretched power distribution system. The consensus of public and private forecasts now see the GDP growth rate decelerating to under 4 per cent in 2008-09 from around 6 per cent in 2007-08. But even this is predicated upon the global economy continuing to grow, albeit at a much more moderate pace compared to the recent past. In view of the turmoil in the global financial markets such an assumption may be unrealistic and demand for Pakistan's textile exports could decline substantially, especially in the United States, Pakistan's largest foreign market.

Simultaneously with slower GDP growth, the fiscal situation has worsened sharply with the budget deficit going up from 4.7 per cent in 2007-08 to an annualized 6.4 per cent by the first quarter of the fiscal year 2008-09 as the higher oil and commodity prices have dramatically increased the burden of subsidization of oil products on the Government. With the rapid pace of monetary expansion required to fund the fiscal deficit the CPI has been under growing pressure. After experiencing a relatively moderate average increase of 6.9 per cent[1] in 2006 the index rose by 12 per cent in 2007 but the year-on-year increase stood at over 24 per cent in July 2008 suggesting an average rise in the index of between 18 and 20 per cent in 2008 and beyond. More alarmingly perhaps business confidence has taken a severe knock indicated by a fall of 35 per cent (almost 50 per cent in US dollar terms) in the Karachi Stock Exchange since the beginning of the year to October 2008 with the Exchange effectively closed from late August onwards when a floor was placed for the share price index; the floor was removed on 15 December 2008. A consequence of the sharp decline in stock prices would be that the investment-GDP ratio is unlikely to match its recent performance in 2008-09 and beyond. Indeed, early indications are that it could fall substantially in 2008-09, perhaps to no more than 12 per cent.

In tandem with the fiscal deterioration, the balance of payments current account deficit has widened from 4.9 per cent of GDP in 2006-07 to 8.6 per cent on an annualized basis in 2007-08 in the first quarter of 2008-09 and the rupee-dollar exchange parity has depreciated from Rs 60.7 in September 2007 to Rs 79.3 in December 2008. It may be worth pointing out here that the exchange rate depreciation brings with it both opportunities and risks. The lower exchange rate should technically help exports over the medium term; however, it also immediately magnifies the risk of an increase in inflationary pressure as the Pakistan economy remains heavily dependent on imports of critical inputs such as oil. In the event, the widening balance of payments and fiscal deficits forced the Government to approach the IMF for stabilization assistance amounting to $ 7.6 billion which was agreed at the end of November 2008.

IMPLICATIONS FOR PAKISTAN'S COMPETITIVENESS

What implications would the current challenges have for Pakistan's internal and external competitiveness? It needs to be emphasized that none of the issues that the Pakistan economy is currently facing, their seriousness notwithstanding, are unique to the country. Pakistan, like a number of other countries, has agreed a programme with the IMF to correct its macroeconomic fundamentals. However, on virtually every measure with a direct or indirect bearing on short term competitiveness – inflation, the budget and current account deficits and productivity in the economy – despite the improved performance of the economy in the recent past, the country is at present in a significantly worse condition compared to most other developing countries in South-East and East Asia. It is therefore axiomatic that its ability to effectively address the challenges that it faces is likely to be more constrained than its competitors and progress in this important area may be slow in coming. Both the tax base and exports are fairly narrowly constricted, the export environment has worsened sharply so that reducing the fiscal and current account deficits is likely to prove more challenging than in other developing countries. Other things being equal,

[1] *Pakistan's inflation rate has been consistently higher than that of other developing countries in the Asia-Pacific*

impaired macroeconomic fundamentals are thus almost certainly likely to constitute a significant drag on the country's overall competitiveness though with varying implications for both individual sectors and individual enterprises.

Important as macroeconomic fundamentals are and correcting them rightly takes priority in the current situation, it is worth reiterating here that at the aggregate level, competitiveness is ultimately a function of how productive the economy is at any given time. In other words, Pakistan's ability to hold its own vis-à-vis its peers depends upon how efficiently it can harness and combine the standard inputs of land, labour, capital, technology and organizational skills in producing its output of goods and services. In this context, lower productivity or lower aggregate efficiency will inevitably mean that it will lose market share in global output to its more efficient peers. Rather more seriously perhaps being less efficient will mean that it will lose ground both externally in slower export growth than its peers, and internally, in faster import growth. This would further aggravate Pakistan's external imbalance. In Pakistan, total factor productivity (TFP), along with capital accumulation and growth of the labour force explain much of the growth that has taken place historically. But, according to the World Bank, TFP explains only about 20 per cent of the growth with the rest coming from the application of additional inputs rather than through the greater productivity of those inputs[2]. In other developing countries, particularly those in South-East and East Asia, TFP has played a much bigger role in sustaining growth, typically accounting for 40-50 of the growth over the years.

In this regard, however, Pakistan's export performance presents something of a conundrum in so far as competitiveness is concerned. At around 12 per cent a year the export growth rate between 2000 and 2006 rate has actually been better than its competitors with the exception of China (see table 2)[3]. The problem for Pakistan has been that the growth rate of imports has tended to match, or significantly exceeded, the growth rate of exports so that the balance of payments deficit has narrowed only with the help of official transfers. Moreover, with the huge increase in foreign ownership in telecommunications and banking large outflows of profits have also put the balance of payments under strain.

In 2007-8 the deficit has widened sharply and as a result foreign exchange reserves have declined rapidly, particularly in 2008-09. Consequently, achieving stability in the rupee exchange rate, a crucial component in longer term investment decisions with implications for competitiveness, has remained elusive except for a relatively brief period between 2004 and 2007. Furthermore, the consumption driven nature of growth has meant that Pakistan's relatively high import propensity has intensified. Chronically high inflation has also skewed incentives in the economy with most savings tending to go into real estate. It has to be noted that for a combination of social and economic reasons real estate has historically provided a more effective hedge against capital value erosion than virtually all other investments.

It needs to be pointed out that, in Pakistan as elsewhere, the relationship between competitiveness and the exchange rate is a complex one. Since about 2000 Pakistan's relatively low market share in world exports has remained broadly stable. However, it has been tending to go up steadily in terms of world imports. A probable explanation for this divergence is that there could be a degree of over-valuation of the rupee exchange rate, a view confirmed by the IMF[4]. Estimates based on the equilibrium real exchange rate suggest that the rupee is around 6 per cent over-valued than its equilibrium value and around 9 per cent over-valued than a rate consistent with stabilizing the current account deficit at its 2006 level, i.e. at around 3.5 per cent of GDP.

An economy suffering from such a combination of strains is unlikely to be able

[2] *World Bank: Pakistan Growth and Export Competitiveness, April 2006*
[3] *Other countries start with a higher base*
[4] *International Monetary Fund, Pakistan: Article IV Consultation, January 2008*

to avoid adverse consequences in respect of its competitiveness in the months ahead. Such a harsh verdict may not apply across the board in every sector of the economy and there are bound to be sub-sectors in both manufacturing and services and individual firms that are able to hold their own despite the difficult circumstances. A lack of competitiveness in the traded goods sectors would manifest itself primarily in a balance of payments deficit but inefficiency in the non-traded goods sector, too, is bound to affect overall productivity in the economy as a whole spilling over into the traded goods sector. Thus, low productivity in the non-traded goods sector, is by no means a benign phenomenon. Fundamental structural weaknesses that exhibit themselves in low average productivity in the economy will almost certainly have consequences for competitive efficiency as Pakistan grapples with a range of short term challenges in 2008 and beyond. These are outlined below.

IMPACT OF MACROECONOMIC CONSOLIDATION

There is little doubt that obtaining external help to bridge the current account in 2008-09 and, indeed, the fiscal deficit will require the implementation of a credible and realistic macroeconomic stabilization package by the Government as has been agreed with the IMF. A concerted effort at getting inflation down to, say, well below 10 per cent[5] in the latter part of 2008-09 will oblige the Government to reduce the fiscal deficit substantially by raising taxation, reducing expenditure and progressively wind down all subsidies – a tall order. On the positive side, oil prices are on a downward trend and, if the process continues, should assist in a substantial reduction of some fiscally onerous subsidies. Most commodity prices are also tending to ease and should contribute to reducing inflationary pressures in the economy. It is, however, the continuing exchange rate weakness that might nullify these otherwise positive developments. From a competition perspective it is critically important therefore that: a) the current account deficit narrows significantly during 2008-09 and b) secure arrangements are in place to finance the present deficit, including rescheduling of any external liabilities as necessary, so that the weakness in the rupee exchange rate and attrition of Pakistan's foreign exchange reserves taking place at present can be halted or even reversed.

The main policy options available to the Government and the State Bank in the short term are a smaller PSDP (Public Sector Development Programme) and a still higher cost of domestic borrowing to dampen liquidity growth in the economy, reduce imports and restrain inflationary pressures. These options would inevitably affect domestic growth. At the aggregate level, the Government thus has to weigh the trade-offs involved in temporarily sacrificing some growth in favour of a more stable macroeconomic base for growth in 2009-10. This is not an entirely straightforward economic choice as lower growth would inevitably involve adverse socio-economic consequences in the form of lower growth in employment opportunities, consequences that cannot be wished away.

From a competition standpoint a slower tempo of overall growth indicates that there would be a substantial premium on increased efficiency at both the sub-sector and individual firm levels. Those manufacturing or service sub-sectors or firms that can do well in an environment in which overall activity in the economy is slowing down would succeed in doing so only through improved efficiency that enables them to compete successfully against imports and, where relevant, win new export markets. In this latter context it is worth pointing out that Pakistan's non-traditional, i.e. non- textile exports have shown considerable buoyancy in 2007-08. There is thus encouraging evidence that there are some sectors and firms that have

[5] *Still higher than in much of South-East and East Asia and in India*

the ability to thrive, notwithstanding the current difficulties.

On the other hand, there is a real possibility that some firms could be tempted to engage in defensive, informal or formal, price agreements to survive. Indeed, there is some evidence to suggest that an upward drift of prices makes it easier for firms to camouflage cartel-like behaviour. Hence, it is very important for the Government to ensure that such anti-competitive actions in the economy are prevented. Individual firms need to understand that their long-term survival rests not on price-fixing arrangements but on boosting efficiency and their overall competitive ability through investment in skills, innovation, technological upgradation and moving up the value chain.

STRENGTHENING THE INVESTMENT ENVIRONMENT

Given the macroeconomic challenges, consistency and predictability in overall policy-making, the bedrocks of sound corporate governance and rational decision-making, are liable to continue to fall short of desired levels, at least over the short term. Both the internal security situation and the impact of the headwinds emanating from international financial turmoil remain uncertain. Furthermore, as a longer-term backdrop, Pakistan's judicial and regulatory system remains, despite efforts at improvement, largely ineffective in enforcing internationally comparable standards of corporate accountability and governance in the country. There is considerable cross-country evidence to suggest that in such a scenario, anti-competitive practices are likely to be considered the easier 'soft' option for corporate survival in Pakistan as elsewhere.

It is also regrettable to note that at the microeconomic level, vital components of a more conducive investment climate, like the cost of doing business and confidence in the overall market system, remain negative influences in the country. According to the World Bank's Doing Business indicators the costs of starting a business in Pakistan remain significantly above those observed in South-East and East Asia and well above the global average[6]. Other problem areas lie in the continuing arbitrary power of intervention that the official bureaucracy is able to exercise over enterprises, which raises their operational/compliance costs and indirectly encourages rent-seeking behaviour by them. And, it is a sad reality that the country's judicial system remains inordinately slow and is still unable to guarantee adequate redress in the matter of property rights and the enforceability of contracts despite many efforts at reform over the years.

In such an environment business enterprise could be easily tempted to resort to price fixing, production cuts and other arrangements that dilute the impact of competition in the economy. As the Government is bound to remain preoccupied with a host of difficult economic issues improvements in the investment environment are unlikely to happen in the short term. Nonetheless the Government must remain fully committed to further strengthen rules, procedures and monitoring systems in both the public and private sectors that can be universally implemented and which provide a sound basis for improved standards of governance in the economy as a whole. In this broad context, the value of a strong pro-competition regime cannot be under-estimated. Promoting competition is not an end in itself but a means to creating the wherewithal for greater efficiency in the economy and a balancing factor between the interests of the producers of goods and services and their consumers.

INFRASTRUCTURE IMPROVEMENT

Macroeconomic consolidation and the investment environment will have major repercussions on competition in the economy as outlined in the preceding paragraphs. In addition, a physical phenomenon with major implications for efficiency in both manufacturing and services is the present state of infrastructure in the country. Pakistan's

[6] *World Bank, Economic Growth in the 1990s: Learning from a Decade of Reform, 2005*

infrastructure indicators show that a relatively low proportion of the population has access to electricity, paved roads and basic municipal services. In addition, even where it exists, the quality of the infrastructure is poor; the underlying weakness being compounded by unreliability caused by insufficient expenditure on maintenance over many years.

Electricity shortages and the connected problem of circular debt (involving PEPCO, WAPDA and the IPPs) that high energy prices have created for the Government suggest that a radical new formula for burden-sharing between the Government and consumers of energy is urgently needed. Even when the physical shortfall between peak demand and peak generating capacity has been overcome, the country will need to ensure that the problem of receivables between the Government and PEPCO and between PEPCO and the IPPs does not recur if the IPPs are to contribute their share of electric power to the country's energy requirements.

All options in this regard have their pluses and minuses, none are easy and the trade-offs involved are by no means straightforward for the Government especially given its own straitened fiscal circumstances. Nonetheless some action to simultaneously reduce the fiscal deficit and deal decisively with the circular debt will be needed in the next few months as the current situation is clearly unsustainable from both an economic and political standpoint. Whether any fiscally sustainable policy action can actually resolve the power situation in a durable manner remains to be seen. The underlying reality is that neither can energy prices be subsidized to any meaningful degree and nor could the Government let them be driven unchecked by international trends. Given this difficult background, it has to be conceded that coming on top of the current problems in the generation and distribution of electricity, and a major jump in its price (that most experts concede is unavoidable) will sharply reduce competitiveness in the economy, especially in the traded goods sector of the economy.

TRADE POLICY ISSUES

The prevailing conventional wisdom and rationale of WTO's trade liberalization mandate is that over the long term countries with open, liberal trading regimes enjoy a significantly better development performance. Trade openness measured by the ratio of total trade (exports plus imports) to GDP is one of the key indicators of openness. In this regard, despite an aura of openness the Pakistan economy remains highly protected compared with many, if not most, developing countries at a comparable level of development. At more than 45 per cent Pakistan's simple average tariff is higher than that of other South Asian economies. In consequence, the ratio of total trade to GDP remains static at around 25 per cent, far lower for example than in the export-driven economies of South-East and East Asia. In other words, Pakistan has not been able to reap any dynamic efficiency gains - e.g. through scale economies – by participating in the buoyant global trading economy of recent years. A major issue for Pakistan is that customs duties provide both tariff protection for manufacturing and are a vital source of revenue to the Government. This inevitably distorts both incentives and resource allocation decisions, apart from locking in the Government in an inflexible, and for that matter regressive, mode of revenue-raising.

Pakistan's low trade-GDP ratio is essentially due to its low export-GDP ratio that has severely constrained the country's ability to follow the logic of greater openness in its import regime. The recent large rise in oil prices has made the situation dire for the country's external balance. The balance of trade deficit currently stands at around $ 22 billion or an extraordinary 17 per cent of GDP, while, despite buoyant remittances, the current account deficit is around $ 10.5 billion or 8.6 per cent of GDP. An external imbalance of this order of magnitude has inevitably put the rupee exchange rate under severe pressure in both 2007 and 2008.

A further sharp depreciation of the rupee which is theoretically indicated by the level of protection would, however, generate intolerable social and political consequences for the country. In fact, it might not even provide a sustained competitive boost to the export industries of the country. In this regard, the recent performance of the textile industry in foreign markets does not give grounds for optimism. Other industries, e.g. sports goods, have performed better but their backward linkages and impact are limited and their fortunes are too intimately linked with the less dynamic developed economies of the EU and the US than with the more buoyant economies of South-East and East Asia.

To boost its competitiveness in 2008-09 Pakistan needs to urgently diversify its exports and reduce dependence on textiles. The immediate need therefore, is to instill and promote greater professionalism at all levels in the corporate life of the country so that firms can, in the first place, compete better against imports, particularly imports of consumer goods. This would require far greater attention to quality than has hitherto been the case. But, if the trade deficit is to be bridged, competing against consumer goods imports offers the most, if not only, viable route. In the second place, winning new export markets and boosting non-textile exports, while far from easy, should be the other, supporting component of corporate strategy. Exports remove the constraints of a limited domestic market and allow economies of scale to be exploited given the right management skills. Competing in export markets also stimulates effort in improving overall corporate efficiency through its demonstration effect. In this context, it may be worthwhile to reinvigorate export promotion in order to boost exports and international competitiveness. Many younger enterprises, especially SMEs, lack the means, and indeed the self-confidence, to explore new markets. Agencies that can provide advice and assistance in this area would therefore render a very useful and cost-effective service.

FOREIGN TRADE LOGISTICS

Pakistan's overall competitiveness depends upon the quality of its domestic transport system, specifically that relating to trade logistics, and its international shipping links. Major markets are located at considerable distances from the country and important industries, e.g. textiles, are mostly located 1000 km from the nearest seaport. There are further cost disadvantages since overall export/import volumes are relatively small and shipping links between Pakistan and the rest of the world tend to be infrequent and expensive. Within Pakistan, road transport carries about 95 per cent of all cargo but travel times can be long as the average age of vehicles makes them prone to frequent breakdowns. Road links have improved of late but road haulage remains a somewhat primitive activity with little or no investment in IT to trace freight movement efficiently and with an excessive incidence of loss through spoilage of perishable goods like fruit and vegetables.

Under-investment over the years by both the public and private sectors in the physical infrastructure of trade – ports, roads and rail and road transport – means that existing production and distribution inefficiencies in the country are seriously magnified and compounded. Some of these difficulties can be reduced by faster customs clearance procedures at ports and through improved storage facilities to prevent production breaks on account of ineffective inventory control and ensure the timely dispatch of finished goods to retailers. But such improvements would essentially be in the nature of short term palliatives; longer term improvements would require sustained investment in infrastructure at a level to keep up with Pakistan's peer group of competitors. Progress in the area of trade logistics could be made quite rapidly given the political will but will require some redeployment of public sector resources from other less pressing uses, say, in the form of IT investments in customs clearance.

At the same time, however, corporate business strategies and models need to understand that longer term survival is ultimately bound up with achieving efficiency and is not determined by quasi rent-seeking behaviour in the form of periodic relief packages from the Government. Special privileges for particular industries e.g. textiles, however justified in the short run, invariably tend to distort incentives over the longer term and are an implicit anti-competitive device. In the final analysis, they merely serve to protect inefficient producers, skew incentives and assist in the misallocation of resources.

There can be little doubt that from a competition point of view, the immediate challenges facing Pakistan mean that the country must strive to meet them on a sustained basis. This will require policy action not only at the macroeconomic level or to address anti-competitive actions at the enterprise level but also a sustained programme of enhancing competitiveness nationally and at the level of the enterprise. Nationally, the immediate need is for the Government to focus on providing a more conducive, i.e. stable macroeconomic environment (lower inflation, greater exchange and interest rate stability etc.) so that business and investment decisions in the economy are more soundly based and have a longer time horizon. Competition policy becomes important in that overall context.

At the microeconomic level, firms need to operate much more professionally on the basis of realistic but more ambitious forward-looking business models that lay stress on efficiency and quality (rather than depend on a cost-plus approach which merely promotes inefficiency). While the onus of providing a stable macroeconomic foundation rests with the Government individual sectors and, for that matter, individual enterprises need to make sustained investments in improved human resources and technology and to focus more rigorously on overcoming the chronic structural weaknesses that characterize Pakistan's position in global trade. For both short term macroeconomic stabilization and longer-term growth and prosperity Pakistan needs to emulate the export-led pattern of growth, as far as practicable, followed by the economies of East and South-East Asia over the last two decades or more. For meeting this objective, the Pakistan Government and the private corporate sector need to make improved competitiveness and competition in the economy, the sine qua non of policy in 2008-09 and beyond.

BOX

Competitiveness and Development

The World Economic Forum (WEF), an independent think tank based in Switzerland, provides yearly benchmarks for individual countries which measure their international growth competitiveness against other countries[7]. In 2005 Pakistan was ranked 94th, its position having fallen from 91st in the previous year. Only Bangladesh in South Asia ranked lower than Pakistan in both years with India improving its ranking from 55th to 45th over the same period. Sri Lanka, while scoring above Pakistan in both years, did however see its position deteriorate from 73rd to 80th between 2004 and 2005. Regrettably, the discouraging trend for Pakistan has continued after 2005 with no improvement in its ranking; indeed, in 2008 it ranked 101st.

Competitiveness is not easy to measure as it subsumes within it a range of influences emanating from macroeconomic conditions, the quality of public institutions and receptiveness to new ideas, to name only three central themes in this context. Measuring such nebulous concepts as receptiveness to new ideas is particularly hard with some assessments being prone to subjective bias. Nevertheless, if a wide variety of measures is used, both quantitative and qualitative, the biases can be largely eliminated. The latest methodology used by the WEF uses ten (or twelve if goods, labour and financial market share taken separately) components or pillars of competitiveness. These are given in the table above:

Table 1

Pillars of competitiveness	
Basic requirements: 1.Institutions 2.Infrastructure 3.Macroeconomic stability economies 4.Health and primary education	Keys for **Factor-driven** economies
Efficiency enhancers: 5.Higher secondary education and vocational training 6.Efficient markets (goods, labour, financial) 7.Technological receptiveness 8.Market size	Keys for **Efficiency-driven** economies
Innovation and sophistication: 9.Business sophistication 10.Innovation	Keys for **Innovation-driven** economies

Source: World Economic Forum, The Global Competitiveness Report 2008-2009

In the factor-driven stage countries compete primarily on low prices. They sell commodities or simple products taking advantage of such factor endowments as low-cost labour and natural resources. At this stage of development the basic ingredients of competitiveness are a stable macro economy, reasonably efficient public institutions and adequate infrastructure, including basic health and educational facilities for the bulk of the population. As countries move to stage two, the efficiency-driven stage, it is important for them to develop more efficient production practices. Product quality, rather than low prices per se, drive competitiveness, which now depends increasingly upon greater efficiency in the goods, labour and financial markets and the ability of enterprises to respond to price signals so that capital and other inputs can be efficiently allocated. In the third innovation-driven stage, countries can no longer compete just by being efficient. At this stage enterprises must compete through innovation, producing new and different goods using the most sophisticated production processes and develop extensive marketing infrastructure.

While all components matter to some extent in all countries the relative importance of each depends on the country's stage of development. Indeed, in some countries some sub-sectors and almost certainly some individual enterprises could be at stages two and three while the bulk of the economy is at stage one. According to this classification Pakistan as a whole could be described as being at stage one but is on the verge of moving to stage two. The transition will need both the Government and the private sector taking competition issues more seriously.

[7] *World Economic Forum, The Global Competitiveness Index, various issues*

Table 2. Pakistan: Selected Economic Indicators, 2002/03-2007/08 1/

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Output and prices	(Annual changes in per cent)					
Real GDP at factor cost	4.7	7.5	9.0	6.6	7.0	6.5-7.0
Partner country demand (WEO definition)	4.1	4.7	4.8	4.8	4.5	4.5
Consumer prices (period average)	3.1	4.6	9.3	7.9	7.8	7.0
Consumer prices (end of period)	1.9	8.5	8.7	7.6	7.0	6.5
Pakistani rupees per U.S. dollar (period average)	4.7	-1.5	3.1	0.8	1.3	…
Saving and investment	(in per cent of GDP)					
Gross national saving	21.6	18.4	17.7	17.7	18.0	18.7
Government	1.3	1.1	0.5	1.1	1.0	2.3
Non-government (including public sector enterprises)	20.3	17.3	17.2	16.6	17.0	16.4
Gross capital formation	16.8	16.6	19.1	21.7	23.0	23.5
Government	2.7	2.8	3.5	4.8	5.0	6.0
Non-government (including public sector enterprises)	14.1	13.7	15.6	16.9	18.0	17.5
Public finances						
Revenue and grants	17.2	14.6	14.1	14.8	15.2	15.9
Expenditure (including statistical discrepancy)	18.5	16.4	17.2	18.5	19.2	19.6
Budget balance	1.3	-1.8	-3.0	-3.7	-4.0	-3.7
Budget balance (excluding grants)	3.8	-2.3	-3.3	-4.3	-4.3	-4.0
Primary balance (including grants)	2.9	1.7	0.2	-0.6	0.2	0.3
Total Government debt	74.5	67.8	62.9	57.3	54.6	51.3
External Government debt	35.6	32.1	29.4	26.6	24.6	22.8
Domestic Government debt	38.9	35.7	33.5	30.8	29.9	28.4
Implicit interest rate on Government : debt (in per cent)	5.8	5.4	5.5	5.8	8.5	8.3
External sector	*(Annual changes in per cent of initial stock of broad money, unless otherwise indicated)*					
Merchandise exports. U.S. dollars (growth rate, in per cent)	20.1	13.5	16.2	14.3	3.2	7.0
Merchandise imports. U.S. dollars (growth rate, in per cent)	20.1	21.2	38.3	31.7	8.0	7.0
Current account including official current transfers (in per cent of GDP)	4.9	1.8	-1.4	-3.9	-4.9	-4.8
	(In per cent of exports of goods and non factor services; unless otherwise indicated)					
Gross reserves (in millions of U.S. dollars) 2/	9,529	10,564	9,805	10,760	14,287	16,158
In months of next year's imports of goods and services	6.5	5.0	3.5	3.7	4.5	4.8

Sources: Economic Survey, various issues

1/ Fiscal year ends June 30.

2/ Excluding gold, foreign deposits held with the State Bank of Pakistan, and net of outstanding short - term foreign currency swab and forward contracts

Table 3. Pakistan: Balance of Payments, 2002/03-2007/08 (In millions of U.S. dollars; unless otherwise indicated)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Current account	4,061	1,811	-1,534	-5,015	-7,105	-7,757
Balance on goods	-359	-1,279	-4,514	-8,464	-9,947	-10,643
Exports, f.o.b.	10,974	12,459	14,482	16,553	17,080	18,276
Imports, f.o.b.	-11,333	-	-18,996	-25,017	-27,027	-28,919
Services(net)	-11	-1,316	-3,293	-4,432	-4,149	-4,712
Credit	2,703	2,644	3,319	3,769	4,122	4,324
Debit	-2,714	-3,960	-6,612	-8,201	-8,271	-9,035
Income (net)	-2,211	-2,207	-2,386	-2,667	-3,581	-3,840
Credit	170	187	437	784	922	1,113
Debit	-2,381	-2,394	-2,823	-3,451	-4,503	-4,953
Of which: interest payments	-1,277	-1,056	-1,036	-1,238	-1,400	-1,505
Balance on goods, services, and income	-2,581	-4,802	-10,193	-15,563	-17,677	-19,195
Of which: income on direct investment	-990	-1,228	-1,640	-2,115	-3,103	-3,448
Current transfers (net)	6,642	6,613	8,659	10,548	10,572	11,439
Credit, of which:	6,714	6,713	8,768	10,655	10,646	11,544
Official	918	549	266	715	504	500
Worker's remittances	4,237	3,871	4,168	4,600	5,494	5,906
Other private transfers	1,559	2,293	4,334	5,270	4,713	5,138
Debit	-72	-100	-109	-107	-74	-105
Memorandum items:						
Current account (in per cent of GDP; including official transfers)	4.9	1.8	-1.4	-3.9	-4.9	-4.8
Exports f.o.b. (growth rate, in per cent)	20.1	13.5	16.2	14.3	3.2	7.0
Imports f.o.b. (growth rate, in per cent)	20.1	21.2	38.3	31.7	8.0	7.0
Terms of trade (growth rate, in per cent)	-0.9	1.8	-8.3	-4.6	-0.2	-0.9
Worker's remittances and other private transfers (growth rate, in per cent)	35.1	6.3	37.9	16.1	3.4	8.2
External debt (in millions of U.S. dollars)	33,.352	33,307	34,037	35,679	37,461	39,593

Sources: IMF, International Financial Statistics, various issues

2

The Role of Competition Law and Policy in Development: The Evolution of the Legal Framework in Pakistan

The Role of Competition Law and Policy in Development: The Evolution of the Legal Framework in Pakistan

Against the background of the challenges facing the Pakistan economy in 2008 and beyond as outlined in the preceding chapter it would be worthwhile to discuss briefly how overall competitiveness and competition policy and laws are two sides of the same coin and why promoting competition is critically important from the perspective of development policy. An additional sub-text in the discussion is the recent metamorphosis of the MRTPO into the CO 07 as Pakistan has sought to enhance the effectiveness of its competition regime[8].

Standard text book analysis postulates that perfect competition is needed for resource-allocative efficiency, low prices, development of new products, innovation in production and distribution and enhancing the absorption of new technology. The analysis indicates that, broadly speaking, a country can realise most of the benefits of perfect competition, within the discipline provided by competition policy, and by doing so lay the foundation of a more competitive economy. However, the pertinent question in this context from a policy perspective is whether developing countries should lay the same stress on competition policy and issues as developed countries. For example, given the paucity of capital resources the criticism is often made that developing countries should eschew the luxury of 'wasteful' competition, at least at the initial stage of development, particularly in sectors where the minimum scale of production is large.

According to Adam Smith a market economy maximizes welfare if the market's economic agents - consumers and producers – are able to make their own choices and act in their own best interests. Producers are then able to produce at the lowest cost of production and consumers enjoy access to a choice of goods differentiated by quality and/or branding. However, in the real world, perfect competition is rarely achievable since complete information is available to neither consumers nor producers. Moreover, the entry and exit of firms are costly, time-consuming processes and most sectors are bedevilled by a mix of efficient and inefficient firms. In addition, the natural compulsion of enterprises in open economies is to expand their operations in order to capture scale economies through vertical or horizontal integration. And, in some sectors, oil refining and petrochemicals for instance, technology itself runs counter to the need for there to be many producers, as is required by perfect competition. Perfect competition is thus primarily a theoretical construct; monopolies, oligopolies and dominant companies are closer to reality.

Given these tendencies, individual enterprises become 'incentivized' to restrict rather than encourage competition. In a modern economy, regardless of its level of development, producers thus seek to generate above-normal profits by forming cartels, pursuing market dominance or indulging in other forms of anti-competitive behaviour that drive up their profits. But for the economy as a whole higher profits come at a cost. When quasi-monopolies and oligopolies form, suboptimal production levels are the norm and in place of dynamism stasis becomes established. In developing countries where the overall competition infrastructure is much weaker than in developed countries such anti-competitive tendencies are even stronger.

It should be emphasized that in competitive markets firms rely upon and encourage the exchange of information between producers and consumers. These information sets include changes in consumer preferences, the choices available for consumers, evolution of company management structures, new product development techniques, research strategies and so on. Firms constantly

[8] *Details of the activities of the Commission in 2008 are given in the Annual Report*

compete with each other for a larger market share via lower prices, or better quality, than their rivals. This gives them the incentive to streamline their management and production processes to achieve more efficient production and to develop superior products at the lowest cost. However, in developing countries with relatively low levels of literacy informational asymmetries are common and producers tend to have a freer hand in indulging in behaviour of an anti-competitive nature. Moreover, pressures for greater efficiency are minimal as substantial profits can be earned via the easier route of forming cartels.

Notwithstanding such pressures, there can be little doubt that in the pursuit of profit maximization a higher level of competition, but not necessarily perfect competition, ultimately improves a company's internal efficiency in a more durable manner as it strives to improve performance to deliver better products at lower prices and thus expand market share. As a result, there is an incentive for it to research and develop innovative and better products through improved product development techniques and the employment of more efficient and productive technologies. The success of such companies promotes the more efficient utilization of resources, lowering prices almost down to average production costs and increasing the efficiency of distribution and reduced deadweight losses, leading in turn to enhanced consumer welfare and prospects of more sustainable economic growth. However, the reality in developing countries is that competitive pressures tend to vary widely between sectors and some enterprises in some sectors are able to thrive with minimal emphasis on efficiency except when confronted by foreign competition. Indeed, the clamour then is for protection against 'unfair' competition.

Here it would be useful to consider what insights are provided by economic theory to the question of competition policies for countries at different levels of development.

Recent advances in agency theory, transaction cost analysis and information theory, have advanced our understanding of how competition and competition policy may work in economies at different stages of development. One view is that "competition is an unambiguously good thing in the first-best world of economists. That world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, a benevolent court system to enforce contracts, and a benevolent Government providing lump sum transfers to achieve any desirable redistribution. Because (most) developing countries are so far from this ideal world it is not always the case that competition should be encouraged in these countries[9]."

This view involves what economists call the notion of the 'second-best'. This notion postulates that if any of the assumptions required for validating the maxims of welfare economics are not satisfied, restricted rather than unrestricted competition may be a preferable strategy. At the initial stage of development, for example, institutions are weak and rent-seeking is widespread. It is only when efficiency considerations become important drivers of business that competition policy acquires relevance. In this regard, the example of middle income economies such as South Korea, Taiwan, Brazil and Mexico is often cited. These economies have able and competent administrators and an effective policy-making apparatus within the Government. However, even for these economies, the type of competition regimes now extant in developed countries may not be entirely appropriate. From the standpoint of development, the criterion of allocative efficiency, while important, may be too narrow and static. It is important to remember that development goes beyond short term allocative efficiency and has at least a medium term perspective. Development based on the medium or long term growth of productivity requires, among other things, high rates of investment. Investors' propensity to invest may be adversely affected if, as a result of competition, profits become too low, if only temporarily.

Such a view indicates that the pursuit of an unfettered competition regime may consequently be inappropriate for a developing country, at least at the initial stage of development. In the real world of incomplete markets in developing countries ruinous rivalry between producers could lead to under-investment. What this view of development and competition avers is that as a temporary pragmatic response developing countries would be better served by pursuing an optimal degree of competition: one that entails sufficient rivalry between producers to reduce inefficiency in the use of resources at the microeconomic, firm level, on the one hand, but not so much competition that it deters the propensity to invest, on the other. Essentially some kind of balance has to be struck in the legal arrangements between the objective of dynamic efficiency that unrestricted competition provides at the level of the firm and the longer term growth of output based on high levels of investment that might be better achieved by a different competition regime.

How strong is a country's competition ethos and infrastructure thus influences its development, both in terms of its pace and its pattern, and the level of development itself has an intimate bearing on the degree of competition prevailing in that country. Whether it fulfils the requirements of enhanced efficiency and improved consumer welfare ultimately depends upon the technical and political strength of its institutions and on the existence of a pro-competition culture in the country. The over-arching objective of competition law and policy is to enhance consumer welfare by giving consumers more product options, better product quality and lower product prices. Whether it succeeds in achieving this objective depends upon both the strength and quality of the legal arrangements and the prevailing socio-political ethos. It is worth stressing that the successful implementation of laws does not occur in a vacuum but is the outcome of a supportive cultural milieu.

For itself, the logic of competition law is to prevent firms from engaging in activities that allow competition only in name. Enforcement of competition laws means keeping a close check on the propensity of individual firms to abuse their position of dominance and exploit consumers or exclude competitor firms. It also includes the prohibition of anti-competitive agreements such as those that fix prices or quantity, supervising mergers and acquisitions, assessing their influence on limiting competition and restricting deceptive marketing practices such as dissemination of false or misleading information. But these aims need to be supported by a pro-competition political and cultural ethos.

Competition law in developing countries accordingly strives to preserve and promote competition as a means of ensuring both the efficient allocation of resources in an economy and maximizing investment expenditures. In practical terms such a legal approach should not be at odds with the needs of development; indeed, it introduces the pre-eminence of the criterion of the public interest in development policy. In an ideal world not only would the test of the public interest lead to lower prices and meet the needs of consumers but also contribute to faster overall growth in the economy. Lowering barriers to the entry of new firms should help in creating an enabling environment for entrepreneurial development - an essential prerequisite for a growing economy. Furthermore, competition laws also increase the accountability and transparency of enterprises. They provide the tools and, indeed, the rationale for firms not to engage in anti-competitive practices that restrain innovation and economic growth.

In most developing countries, specific sector regulators have been set up by the Government to establish, monitor, reform and enforce regulations specific to that

[9] *Laffont, J., Competition, Information and Development, World Bank, Washington DC, Annual Conference on Development Economics 1998*

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sector. Such regulatory arrangements are particularly important in post-privatized utilities that tend to be natural monopolies. A competition authority, on the other hand, oversees the economy as a whole with regard to competition-specific issues and provides a code of conduct as far as competition issues are concerned. Such an authority enforces competition laws in the country, ensuring that the economy as a whole abides by the rules of competition and does not work against it. Though the generic framework of specific sector regulators also emphasizes growth and development in the relevant sectors and promotes activities which would contribute towards achieving the same by promoting competition, seldom do such regulators have the needed powers that specifically deal with competition issues and curb anti-competitive practices. This is why both developed and developing countries often need a strong competition authority that cuts across the mandates of sector-specific regulators to promote competition. In this regard, in countries where institutional enforcement capacity is limited, it is all the more important for political structures recognize the importance of competition policy and to do all they can to make conditions as favourable as possible for pro-competitive behaviour as a means for development and economic growth.

Over the years, competition policy and laws have undergone a profound change in Pakistan as the economy has grown and privatization has greatly enlarged the role of the private sector. More recently, globalization which has brought a spate of cross-border mergers and the importance of a level playing field have focused attention on the need for a modern and more effective competition regime that can balance the differing emphases of competition policy and development objectives. Indeed, the history of competition policy in Pakistan can be traced back nearly five decades to the early 1960s. Back in 1963, the Government set up an anti-cartel laws study group. Its deliberations led to the enactment of the MRTPO in 1970 and the establishment of the MCA as the agency to implement the MRTPO. The following paragraphs trace the evolution of competition policy since 1970.

THE MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ORDINANCE, 1970

The MRTPO was a fairly modern piece of legislation at the time it was enacted. Its broad objectives were to provide measures to contain: (1) undue concentration of economic power; (2) monopoly power; and (3) restrictive trade practices. It spelled out the activities and behaviours that were deemed to constitute undue concentration of economic power, unreasonable monopoly power or unreasonably restrictive trade practices. It prohibited these activities and behaviours as clearly defined in the law, and empowered the MCA to collect information relevant to these situations through the process of registration.

THE MONOPOLY CONTROL AUTHORITY

Set up to implement the MRTPO the main functions of the MCA were to register undertakings, individuals and agreements; to conduct inquiries into the general economic conditions of the country, with particular reference to the concentration of economic power and the existence of (or increase in) monopoly power and restrictive trade practices; to conduct inquiries in specific cases; and to give advice to individuals or undertakings on whether or not a certain course of action was consistent with the provisions of the law. It also had discretionary, recommendatory, investigative and legislative powers. When proceeding with an inquiry, the MCA had the powers of a civil court. It was also able to make recommendations to the central or provincial Governments with regard to actions that might affect the concentration of economic power, monopolies, or restrictive trade practices.

But if the MCA's performance over the years is viewed in historical perspective, it can be seen that, apart from the initial year or so and perhaps its last year (when a partially successful attempt was made to give it more vitality), it was largely ineffective for nearly 25 years following its establishment. The nationalisation process that started in 1972 limited the scope of the MRTPO as the law had no provision to deal with public sector organisations. Consequently, during the 1970s and 1980s, the MCA's emphasis was on the diversification of the capital resources of undertakings. To this end, a few private companies were converted into public limited companies.

The MCA also suffered from a perennial and chronic shortfall in funding. Its operating requirements were met through allocations out of the federal budget, seriously curtailing its independence to act. It was also handicapped by having inadequate professional manpower, insufficient physical infrastructure and a limited database regarding market/industry related information. Being essentially civil servants, officials at the MCA lacked the necessary background and training to tackle the complex issues of assessing market power. Although the MCA strove to act in the public interest on some occasions, it was unable to communicate its achievements to the general public. It did not have any material to educate the general public on whose behalf it acted nor the capacity to undertake advocacy.

Furthermore, reinforcing its limited impact, the MCA had only nominal penal powers, almost non-existent, one could claim – it could fine a maximum of only Rs 100,000 (US$1,250) for not carrying out its orders, or, in the event of a continuing infraction, not more than Rs 10,000 (US$ 125) per day.

Apart from these penalties, the MCA had no power to grant leniency or a reprieve, which are important tools used by competition agencies worldwide today. It also could not conduct dawn raids to gather evidence. As a result, the MCA simply existed as a Government entity, devoid of any effective powers and failing to do anything substantive or worthy of mention. Whatever powers it did have were not put to any imaginative use in the public interest.

COMPETITION IN PAKISTAN: THE 1990's AND 2000's

The MCA only started asserting itself in the mid 1990s, but had to face considerable interference in carrying out its functions. But at that time, it was obvious that the agency could not accomplish much in light of changing economic and business conditions taking shape in the world and the trends affecting competition regimes. The weaknesses in the old competition regime also became apparent as Pakistan embarked on first generation reforms in the early 2000's.

The Government of Pakistan became aware that across the world, institutions such as the MCA were being replaced by competition agencies that had a broader, more progressive and more refined mandate. The work of such competition agencies hence could play a more specific role in ensuring a better quality of goods and services and lower prices for consumers.

Given the imperative to adapt better to global trends and changes, the Government formulated a new competition law under the umbrella of second generation reforms, with assistance from the World Bank. At the strategic level, an effective competition policy framework involving a multifaceted set of initiatives has been pursued by the Government with the aim of providing equal opportunities for all capable entities to participate in the economy. This competition policy framework includes: (1) a modern enabling law; (2) specific rules and regulations to make the law operational; (3) guidance for corporate behaviour; (4) education and empowerment of consumers; (5) public policy advocacy; and (6) a professional autonomous institution to enforce the law.

In doing so, the power of consumers should increase and confidence among domestic and foreign investors should be enhanced. Firms will be pressured into lowering prices and increasing the quality, choice and availability of goods and services. They will also be encouraged to observe better standards of business behaviour.

The outcome of this development has borne fruit in the CO 07, which has replaced the MRTPO. Under the new law, the CCP was established on 12 November 2007 to implement the new competition law.

THE COMPETITION ORDINANCE, 2007

The new competition law regime under CO 07 has been inspired by the principles of the Treaty of Rome that established what is now the European Union and collects together best practices from instruments such as the United Nations set of multilaterally agreed equitable principles and rules for the control of restrictive business practices, and the OECD's recommendations and best practices on competition law and policy.

The Difference in the Laws

Notable upgrades in the new law are best put in perspective when compared with the previous law.

First, unlike the MRTPO 70, the new law does not curb or reduce a dominant position. Instead, it addresses the abuse of dominance. Although the law indicates a certain minimum market share beyond which there will be a presumption of dominance – 40 per cent - this is by no means definitive; nor does a presumption (or finding) of dominance suggest in any way that the dominance is being abused. Also, depending on the facts, the new law does not rule out either dominance or abuse at lower levels of market share. Further, while the MRTPO prohibited only "restrictive" trade practices that "unreasonably" lessened competition, the new law prohibits any agreement that reduces competition within the relevant market, whether or not it is "unreasonably restrictive". In addition, the new law forbids unfair trading practices and stipulates an elaborate procedure for review and clearance of mergers and acquisitions that meet the thresholds that would be notified under the rules.

Second, the new law makes provision for the CCP to allow exceptions and also to prescribe block exemptions from prohibited agreements on the grounds of efficiency or economic merit. There was no provision for such block exemptions in the MRTPO.

Third, the new law eliminates unnecessary transactions or compliance costs. For example, the requirement for registration of agreements, undertakings and individuals that was specified in the MRTPO have been eliminated.

Fourth, the new law specifically requires the CCP to carry out studies for promoting competition in all important sectors of the economy and to engage in advocacy through various means in order to create awareness of competition issues and to promote a culture of competition. An important function of the CCP is to hold open hearings on any matter affecting the state of competition in Pakistan and to issue a non-binding opinion or edict publicly in this respect. This was not the case under the MRTPO.

Fifth, under the new law, the CCP can authorise its officers to enter and search any premises, using forcible entry if need be, under appropriate safeguards provided in the law. Leniency or a reprieve as may be merited is also possible under the law. These provisions should strengthen considerably the investigative capacity of the CCP.

Sixth, the new law gives the Members of the CCP security of tenure in order to preserve the independence of the CCP. The Members of the now defunct MCA did not enjoy this protection. Further, the new law gives the CCP tied sources of funding sufficient to meet its operational needs without having to resort to subventions from the federal budget. The MRTPO contained no such provision and the MCA was wholly dependent upon allocations from the budget.

Seventh, penalties under the new law are higher than they were under the MRTPO, with further provision for these penalties being varied by notification in the Official Gazette with the approval of the federal Government. It is noteworthy that the new law allows the CCP to penalise not only any breach of the competition law but also any disregard of its orders, whereas MCA could only impose penalties for not carrying out its orders. The CCP is also able to recover penalties through a variety of means including the attachment of property, the appointment of a receiver, and recovery from any person who is due to make payments to the defaulter.

Eighth, while the orders of the MCA were appealable to the High Court, the new law provides that any order of a Member or officer of the CCP will be appealable to an appellate bench comprising at least two Members of the CCP who have not been involved in the original decision. Of course, judicial redress can always be sought against the final order of the CCP.

Key Principles in the Application of the New Law

The new regulatory regime for competition in Pakistan is based on rules of analysis and reason administered by an institution that will be autonomous but accountable, and whose dealings are transparent, fair and in accordance with the law. Key principles that are followed in applying the new competition policy framework include:

- **Non-discrimination:** the law's non-discriminatory approach implies predictability in interpretation. The law is supportive of transparency, accountability to promote confidence in its application.
- **Protection of competition, not competitors:** the assessment of competition will be tolerant of single firm growth on the basis that competition law should not punish those who have gained dominance through efficient use of resources and innovation without resorting to exclusionary and anticompetitive tactics.
- **Facilitating business:** competition law needs to be viewed as supportive to private business, not an additional hindrance. It should promote consumer welfare without hampering the everyday activities of business undertakings.
- **Co-ordinated approach:** the responsibility for implementing the new law depends on ordinary citizens as well as business entities bringing forward complaints. Coordination will also be required with other public agencies charged with implementing Government policies, as well as with the relevant ministries analysing and making public policy which impacts on the competitive landscape; and
- **Integrity in the application of the law:** this includes (1) a collegiate body of commissioners possessing integrity, stature, ability, substantial experience and (collectively) a range of relevant expertise; (2) transparency and speed in the investigation of serious infractions without undue burdens on individuals and businesses; (3) public proceedings with safeguards for proprietary information; (4) published decisions subject to review on appeal; and (5) annual reporting based on third party audits.

Making the Competition Law Operational

Pakistan's new competition law has put the country squarely in line with international best practice by (i) adopting system which prohibits anti-competitive agreements and abuse of dominant position while requiring compulsory pre-clearance of large mergers and (ii) establishing the CCP as an administrative enforcement body, operationally independent of Government, with quasi-judicial functions, subject to appeal to the Courts. International companies operating in Pakistan will be comforted by the familiarity with both the local competition law and its institutional framework.

The operational scope of the Commission is wide-ranging enough for it to pursue: (i) enquiries into businesses for the purposes of enforcing the law, (ii) proceedings against contraventions of the law; (iii) advising businesses on compliance; and (iv) competition advocacy, including studies, hearings and opinions, to create a culture of competition in Government and the public at large.

To carry out these functions, the Commission will have the following powers:

- to make investigations, upon receiving evidence from a complainant of standing, or through evidence discovered on its own;
- to compel evidence and if necessary to enter premises;
- to issue Orders to terminate anti-competitive conduct - including interim orders while proceedings are pending;
- to require periodic information to be furnished, (e.g. for monitoring compliance) and;
- to impose penalties, including fines, up to a maximum of 15 per cent of annual turnover; and
- to hold hearings on any matter relating to the state of competition.

Like most competition authorities, however, the CCP will endeavour to make its procedures as transparent and predictable as possible. It will do this through rules notified by the Government to amplify the law, internal regulations set by the Commission to govern its work, internal procedures to operationalise the Commission's internal policies, and public guidelines to inform the consumer and business community of its intentions, approaches or views areas of public interest. In what follows, the term regulation is used generically to refer to rules, regulations and procedures, while guidance refers to publications issued by the Commission to inform the general public.

Adequacy of Sanctions

The law provides for a credible deterrence in terms of sanctions and will include the possibility of behavioural and structural remedies necessary to restore competition where violated. In order to deter violations of competition law, the loss from penalties must outweigh the expected gains from the anticompetitive, illegal acts. Penalties will encourage violators to cease illegal activities and prevent refusal or delay of the correction orders issued by the agency. Where the agency finds that there is an infringement of the competition rules, it may by decision require the undertakings concerned to bring such infringement to an end. For this purpose, it may impose behavioural or structural remedies, proportional to the infringement committed.

3 The State of Competition in Pakistan

The State of Competition in Pakistan

In Chapter I the current situation of the Pakistan economy and a range of pertinent competition and competitiveness issues arising from the challenges that have emerged in 2008/09 have been discussed. In Chapter II the importance of competition policies and laws arising from the conceptual framework of economic analysis was outlined. In this chapter we take a closer look at the state of competition in Pakistan in terms of its international position, the evolving state of play in various competition policy-related areas such as mergers, restrictive practices, abuse of dominant position, prohibited agreements and collusive behaviour. We then examine in chapter IV some of the more important sectors of the economy that have been of relevance for the CCP with respect to competition issues and what has been learnt by the Commission in the first year of its existence. The broad methodology used is based, notwithstanding data shortcomings, upon OECD's Competition Assessment Toolkit and the sectors chosen are a representative sample of industrial structures with varying degrees of concentration[10] and dynamism in the Pakistan economy.

GLOBAL COMPETITIVENESS INDEX AND PAKISTAN

While competition policies and laws have a largely domestic relevance and importance, their purpose is to make the country more efficient and, hence, more competitive from a global perspective. The Global Competitiveness Index (GCI) measures the state of competition across the industrial spectrum of each of the 134 countries which is reported annually at the World Economic Forum. Annexure 1 shows the country rankings for this year (2008-09), in which Pakistan is ranked 101st.

GCI Methodology

GCI reckons with the total factor productivity of each country by examining a set of institutions, policies, business strategies and inter-related factors that affect the rate of return on investment. The relationship between the constituent factors is represented through the schema of Porter's diamond, as shown in figure 1:

In arriving at the ranking of each country,

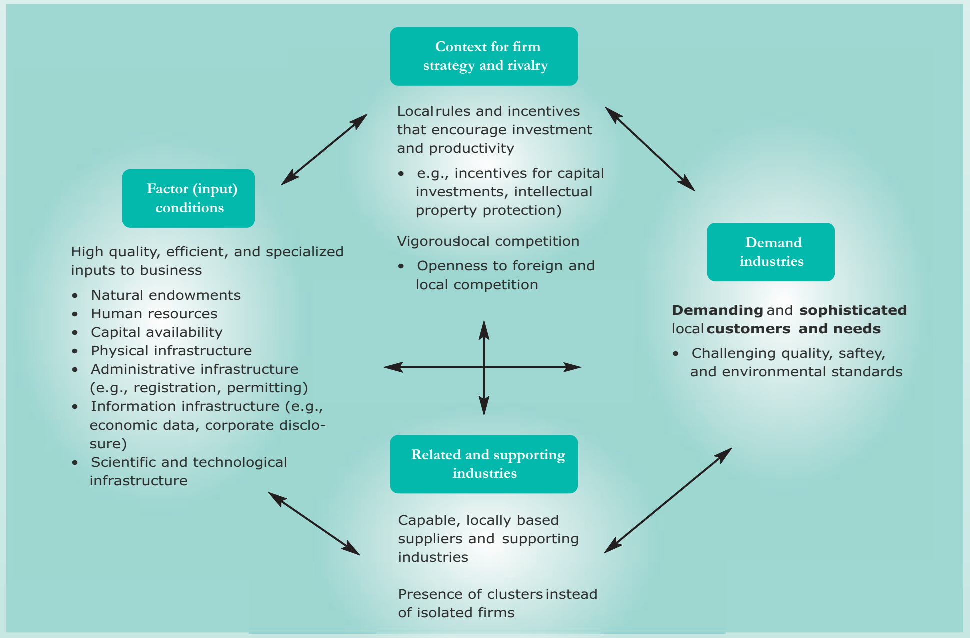

Figure 1: Business environment quality: the Diamond

[10] *In economics, industrial sector competitiveness is measured in different ways, the most frequently-used being the concentration ratio of an industry. This is an indicator of the size of firms in relation to the industry as a whole. One commonly used ratio is the four-firm concentration ratio, or C4, which depicts the market share as a percentage of the four largest firms in the industry. The C4 is highly correlated to the Herfindahl index.*

the GCI bases its conclusions on 12 pillars (see also box in Chapter I). The first four of these relate to the basic requirements, while the next six are "efficiency drivers". The last two relate to business sophistication as manifest in the innovative capability of a country. Competition is driven by investment in physical capital and infrastructure, in education and training, macroeconomic stability, good governance and the rule of law.

The GCI classifies countries according to their stages of competitive development. The three stages represent a progression, with the important assumption that countries stuck in the first phase of development, which is of a factor-driven economy, cannot be expected to have a very high measure of the characteristics associated with the next two stages, even though they might individually score highly on one or two sub-criteria[11].

Two important findings of The Global Competition Report, 2008-2009 (World Economic Forum, 2008) are highly pertinent for our purpose. The first is the observation that in a factor-driven economy firms produce commodities, not differentiated products[12]. Secondly, three indicators of goods market efficiency (namely, intensity of local competition, extent of market dominance, effectiveness of anti-monopoly policy) capture the extent of competition prevalent in the country. It is efficiency in the goods market that ensures the survival of only the fittest firms. Stage 1 countries cannot be expected to score very high marks on any of the three indicators. Not surprisingly, Pakistan scores very poorly on all three counts. A summary of Pakistan's score on all 12 pillars is shown as Annexure 2.

Although cross-sectional quantitative data of the GCI provide a statistical measure of the relative competitiveness of each country and important inferences can be drawn from it regarding relative positions[13], the index will not give any additional insight on what is happening within each industry or within a sector of a national economy. For that we need a more fine-grained methodology and a closer inspection and qualitative assessment of the kind that is provided in this Report. Moreover the GCI assumes that productive efficiency results in public welfare. In fact, it states explicitly that the nation's competitiveness reflects the extent to which it is able to provide rising prosperity to its citizens[14]. However, public welfare (salus populi) is not necessarily ensured, ipso facto, through corporate productive efficiency: any rise in prosperity can be limited to a small business community and not reach the general public[15]. Whether or not the consequential gains in public welfare have accrued (and, if so, how) need to be established through a much closer look than can be obtained from the quantification provided by the aggregate data assembled by the index.

Pakistan's Situation

As the Global Competition Report (2008-09) has shown, Pakistan is excluded from the first 100 (out of 134) countries of the world on the GCI scale. Its best score of 29th on account of its market size has not conferred upon it any competitive advantage, through economies of scale, for instance. In fact there is strong possibility that there might even be diseconomies of scale operating in its large scale industries[16]. Pakistan, like India and Bangladesh, is characterized as a factor driven economy in the first stage.

This is not surprising considering its history. Pakistan started off with hardly

[11]For instance, India is ranked 3rd in the world on availability of scientists and engineers and 4th on market size. Yet, its overall ranking in the GCI is 49 and it remains classified in the first stage of competitive development as a factor-driven economy.
[12]This has important implications for the nature of competition, as we shall see in the discussion on industrial competition in Pakistan.
[13]Countries can move up and down on the index. Thus, the UK that was ranked 2nd in the world in 2006, has dropped ten positions, to 12th rank in 2008.
[14]Global Competition Report, 2008.
[15]This may cause highly skewed income distribution of the kind witnessed in Pakistan.
[16]This point is discussed later in this Report.

any industrial infrastructure. The foundation for development was laid in the public sector with the inception of the Pakistan Industrial Development Corporation (PIDC) in 1952, through an Act of 1950. Although PIDC is not operational now, it has spawned many of the large scale industries in Pakistan, notably cement and fertilizer. PIDC set the basis for State monopoly. This was reinforced in 1972-73 by nationalization. With a strong history of national monopolies, State control over prices and a guided economy for most of its existence, Pakistan has had only perfunctory experience over the past 25 years of a market economy. It has moved towards privatization after 1991, albeit in fits and starts. Even in industries that were not set up and managed by the State, Government largesse has been evident. Since 1947, the Government has provided (until recently) licenses for setting up factories. It provided tariff protection across a range of industrial undertakings. It imposed import restrictions to protect so-called infant industries (e.g. the automobile industry). Multiple exchange rates, provision of credit and foreign exchange on concessionary terms to different businesses (especially export businesses), bonus vouchers, duty drawbacks and subsidies, could not have been conducive to a competition climate. In fact, it had all the necessary ingredients to embed rent-seeking in the business psyche.

MRTPO

The first step towards an anti-monopoly stance was the MRTPO of 1970. As explained in chapter II, the purpose of MRTPO was to break monopoly power and undue concentration. At the end of the 1960's, the Government had become alarmed by the fact that the economic development of the previous decade, spurred by import substitution, state subsidies and a very high degree of protection had led to market distortions as well as income disparities that could no longer be ignored. Industrialization was characterized by robber barons at work[17], causing the industrial wealth of the country to be accumulated in the hands of 22 families[18]. The avowed aim of MRTPO was to curb this monopoly power and to restrict unfair trade practices.

Ironically, it failed to do so, largely because, soon after its promulgation, the State stepped in to nationalize several industrial establishments and financial institutions. Even SMEs based on cotton ginning and rice husking were not spared from the over-arching State intervention. This initiative had a result opposite to that of promoting competition. All public sector enterprises, which were now the mainstay of the national economy, lay outside the purview of the MCA and MRTPO remained moribund for most of its history. It was only during the last year of its existence (2007), in the transitional period preceding its replacement with the competition law that the MRTPO burst into action --- a sign of the changing times.

MERGERS

Anti-trust legislation is an important element in promoting competition the world over. Mergers and acquisitions are its main concern and the rationale for regulatory oversight, because it is through them that firms normally gain undue economic power. MRTPO was based on the same rationale. However, with the advantage of hindsight this policy thrust appears to have been misplaced. Pakistan's experience shows that predatory acquisitions to build market power have not been the path to gain undue competitive advantage in the private sector. MRTPO's assumption that size per se led to uncompetitive behaviour, was perhaps untenable. The root cause of market imperfections lay in other restrictive practices and abuses.

[17]Gustav Papanek, Pakistan's Development: Social Goals and Private Incentives, Cambridge , Mass: Harvard University Press, 1967
[18]The famous observation, of 22 families controlling 80 per cent of the financial and industrial enterprise of the nation, made by Dr Mahbub ul Haq, then Chief Economist, later Finance Minister of Pakistan, spurred a significant national political debate, leading eventually to the nationalization of much of domestic industry and finance.

Thus, merger activity has not been a cause for alarm. Nor has the public or the Government been much concerned with it, the MRTPO notwithstanding. In Pakistan there have been two types of mergers. The first is that of SME's making similar products, getting together in order to achieve synergies or greater market penetration. These mergers can contribute towards efficiency and seldom acquire a dominant position in the market. They are therefore unexceptionable. The second category is that of diversification across industries or through investments in other product markets. These mergers do not result in a dominant position in any single relevant product market. In neither case is market power substantially increased.

During the last one year, the CCP has monitored all merger activity in the country. Since it is a requirement of the law that a prospective merger must obtain prior approval from the Commission, CCP has had occasion to review, and approve, 73 pre-merger applications. Only one merger case went into the second phase review of whether the proposed merger was lessening competition. In all other cases, no competition issue was involved[19].

Even if a merger substantially reduces competition or strengthens an already dominant position, the Commission can take a pragmatic view and may still allow it on grounds of efficiency in terms of the three gateway provisions, incorporated in Section 11(10) of the Ordinance. This clause envisages that such a lessening of competition, and corresponding increase in dominance, can be justified, firstly, on grounds of greater efficiency in the production or distribution of goods and services. Secondly, it can be legitimately argued by the dominant firm that this efficiency could not have been achieved through some less restrictive means. Thirdly, it can be claimed that the benefits of such efficiency outweigh the adverse effects of lessened competition. In other words, efficiency gains are the touchstone. Market efficiency overrides market power. But, efficiency must be clearly shown to have arisen, it cannot be inferred. There is no automatic correlation between firm size, and lower unit costs. Moreover, the onus of showing efficiency gains rests upon the firm, not the Commission. In CCP's recent hearings into the dominant position of Fauji Fertilizer Company (FFC), it was argued by the company that its large size had resulted in greater efficiency and its undue economic power was, therefore, justified. However, the Commission found that the FFC had not been able to reap any economies of scale. On the contrary, it was less efficient than smaller firms in the industry that had lower unit costs. The application of the gateway provision was therefore denied to FFC. This is discussed also in the section (later) on the fertilizer industry. Except for this case the Commission has so far not had much opportunity to delve into the questions of efficiency.

What it has examined in some detail is the question of the relevant product-market and the geographical market in determining the effect of a potential merger on competition. For instance, when the Commission allowed (16 May 2008) Siemens to participate in the bidding for 90 per cent of Pakistan's Heavy Electrical Complex (HEC), this approval was contested by Iljin Electrical Company. In subsequent proceedings before a two-member enquiry committee, the central question was the definition of the relevant product market. Following the famous Brown Shoe Co. vs. the U.S. case (370 U.S. 294; 82 S.Ct. 1502, 1962) the Commission defined the boundaries of the relevant product market to "include the competing products of each of the merging companies and to recognize competition where, in fact, competition exists." It went further to include potential supply-side substitution and complementarity in

[19]*In pre-merger applications made to be CCP, the Commission makes a substantive assessment (in each case) of what the relevant product and geographic markets of the merging firms are. Additionally, the incumbent firms, new entrants and potential entrants are identified using the strategic management perspective of positioning within the industry. More sophisticated analytical tools (quantitative statistical tests as well as behavioural assessments) might well be needed in future analyses to gauge the effects of mergers upon competition. So far the evidence has not shown adverse effects.*

production and distribution into the calculus of drawing the boundaries of the product and the industry for gauging (ex ante) the impact of a proposed merger on competition. On this basis, its Inquiry Report (of 6 October 2008) allowed Siemens to go ahead with its bid for acquisition of the State-monopoly of electrical engineering (HEC).

PROHIBITED AGREEMENTS AND EXEMPTIONS

The MRTPO prohibited "unreasonably restrictive trade practices" (including "agreements"). All agreements containing provisions that restricted competition in some manner were required to be registered with the MCA, so that their unreasonableness could be determined and monitored. The CO 07, however, dispensed with the requirement of registration, making all agreements unlawful – irrespective of whether they are unreasonably restrictive, or otherwise. Since every agreement that reduces competition (howsoever slightly) became instantly unlawful with the promulgation of CO 07, the CCP decided to overcome this anomaly, and provided a reasonable period of time to grant individual or block exemptions (as allowed under the Ordinance). The gateway provisions that allow for mergers apply essentially to exemptions that are granted under Section 5 of CO 07[20] to agreements.

In competition laws there are, in general, two kinds of agreements:

"In the first category are agreements whose nature and necessary effect are so plainly uncompetitive that no elaborate study of the industry is needed to establish their illegality --- they are "illegal per se." In the second category are agreements whose competitive effect can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reason why it was imposed. In either event, the purpose of the analysis is to form a judgment about the competitive significance of the restraint[21]."

As of December 2008, 125 undertakings had applied for exemptions and 123 had been granted[22]. These exemptions have been mostly granted for distribution or licensing agreements or for franchise agreements that did not raise significant competition issues. The fourth category that often involves notable competition issues is that of exclusive supply[23].

RESTRICTIVE PRACTICES

The GCI has noted the high cost of doing business in Pakistan. High transaction costs are always an impediment to market efficiency. In Pakistan, they arise not merely from the structure of the market (e.g. barriers to entry and exit), though that could be a contributory factor, but from restrictive practices such as price fixation, collusion, denial of goods and services. These practices have a detrimental effect not only on the public at large but also on the businesses themselves. 80 per cent of consumers are businesses (buyers of industrial commodities as inputs) who are hurt most of all when there is a refusal to supply, disruption in the supply chain, collusion to fix prices or other market constraints that drive up the cost of doing business.

Several such cases have come to the notice of CCP. Here we illustrate the nature of restrictive practices prevalent in Pakistan by noting cases of refusal to supply, of adverse discrimination, of advertised price fixation, of restriction of

[20]*The same three criteria are indicated in Section 9, for individual or block exemptions. The criteria are (i) improvements in production or distribution, (ii) promotion of technical or economic progress, and (iii) where benefits outweigh the adverse effects of lessened competition. As in the case of mergers, the onus of seeking exemption lies on the company, not the Commission.*
[21]*(435 U.S. 679, 98 S. Ct. 1355)*
[22]*They are usually for a period of 3 years, except in cases of hotel management where exemptions have been granted for 10 years.*
[23]*McDonalds that did not have any exclusive agreement but in practice was purchasing and serving only Coca Cola, was served with a show cause notice to explain as to why they were refusing to deal with local soft drinks. They gave an undertaking that they would allow local beverages. It transpired that the parent McDonalds Company did not allow its local franchise to serve beverages that the parent had not approved.*

consumer choice, of unfair tying of products, of collusive tendering, of agreements to restrict entry and competition.

REFUSAL TO SUPPLY

The foremost instance of refusal to supply that has come to the Commission's notice is that of the National Refinery of Pakistan allegedly refusing to supply asphalt. The complainant in this case was Asphatar International (Pvt) Limited, a distributor of asphalt to the Government and commercial enterprises. Since 1982, it has been getting its asphalt supplies from National Refinery Limited (NRL) and Attock Petroleum Ltd (APL), belonging to the same Attock Group of Companies, enjoying monopoly power and being exclusive suppliers of asphalt to Asphatar. In September 2007, they stopped supply apparently because of an extraneous, personal matter in connection with which NRL wanted to bring pressure to bear upon the CEO of Asphatar. The stoppage of supply did not make any business sense and APL/NRL was, prima facie, sacrificing its own profit while causing harm to an on-going business (Asphatar) and to consumers.

This case appeared to the Commission to have resonance with two landmark competition cases. The first (1951) was Lorain Journal vs. US (342, V.S. 143), while the second (1978) was the classic United Brands vs. Commission of the European Communities (27/76) case in which a small Danish distributor (Olesen) of Chiquita Bananas sued the world's largest international fruit company, United Brands, that was fined 1 million ECUs for refusal to supply. United Brands was one of the earliest cases that ran the gamut of competition issues (such as those of defining the relevant market, vertical integration, abuse of dominance, exclusionary effects and the rights of firms in protecting their rights) being faced by many competition enforcement agencies in current jurisdictions.

RESTRICTING CONSUMER CHOICE

Two other cases, both pertaining to Karachi Stock Exchange, appeared to provide further evidence of restrictive trade practices. On 27 August 2008, the Karachi Stock Exchange (KSE) placed a floor on the trading price of all securities, keeping in view the bearish trading sentiment prevailing in the securities market. This restriction foreclosed the choice of traders and created entry and exit barriers (thus effectively reducing competition). The Lahore Stock Exchange (LSE) and the Islamabad Stock Exchange (ISE) were obliged to follow suit, even though both these exchanges disapproved of this mechanism (and said so) yet replicated KSE's decision, in order to "avoid a pricing disparity". LSE averred further that "KSE does not consult the LSE on market issues" and that "the decisions of KSE are unilateral."

The effect of this decision was that for more than three months the market remained virtually frozen, as very few were willing to trade at prices above the floor prescribed by the stock exchange. This appears to be one of the reasons Pakistan was removed from the MSCI (Morgan Stanley's Capital Index) for emerging markets and its credit rating was also lowered to that of the world's second-lowest grade.

This appeared to the CCP to be a virtually unprecedented situation[24]. Moreover, it was ironic that in this case, two of the three undertakings that were party to this practice (LSE and ISE) concurred that this restriction had also "significantly impacted and shaken the confidence of the investors". Subsequently, for some reason, LSE retracted and vigorously defended the placement of the floor. In due course, CCP issued show cause notices and initiated proceedings against the three stock exchanges. It is noteworthy that eventually the Securities and Exchange

[24]*True, markets had been temporarily shut down after Black Monday (1987) because of technological problems (the computers could not handle the volume of transactions) and during the currency-related crashes of the Asian market (1997) and the Russian market (1998), and more recently in Kuwait and Iceland, but these closures, in times of crisis, were not analogous to price fixating (as in KSE's case). The CCP has not found any other instance of a similar restriction anywhere in the world.*

Commission directed that the floor be lifted on 15 December 2008.

In the other case, the Karachi Stock Exchange (KSE) seemed to deny the Islamabad and Lahore Stock Exchanges (ISE and LSE) access to a common trading platform. The modality of a common trading platform is nearly a universal practice wherever there are multiple exchanges; it stems from the fact that a commonly-listed security is, in effect, a single product. As such, it has the additional benefit of lowering transaction costs (by avoiding double brokerage fees) and introduces efficiency through competition. The Commission has taken up the complaint, which has been lodged in this regard by the ISE and LSE, and is engaged in determining where to draw the boundaries of the relevant market. The Commission also hopes to determine whether KSE's conduct is exclusionary and whether or not this is another example of the placement of restrictions on competition and of unnecessary additions to costs.

PRICE FIXING

Another issue that has come to the Commission's notice is whether the fixing of minimum hourly charge-out rates and minimum fee for audit engagements, by the Council of the Institute of Chartered Accountants of Pakistan (ICAP), was a violation of Section 4 of the Ordinance. This section effectively forbids an association from fixing fees for services. Yet, that is precisely what ICAP seems to have done.

In July 2008, ICAP fixed revised minimum charge-out rates. ICAP members were forbidden from charging a lower rate for audit engagements. The Institute expected strict observance of this stipulation and stated that it would ensure compliance. When questioned by CCP, it was contended by ICAP that it had done so in the public interest. It wanted to ensure high standards of performance from its members and that undercutting this fixed price would adversely affect the quality of service offered. Curiously, ICAP also argued that this price fixation would "increase the choices available to consumers". ICAP also argued that such price fixation was not unique to the accounting profession.

ICAP's price fixation seemed not only a restrictive practice that would lessen competition, it appeared also to be the antithesis of what it was claimed to be. Far from being justified on grounds of broadening choice and promoting the public interest, it was on the face of it the opposite of both. Competition being the best guarantor of efficiency and the greater public good, its negation was likely to be detrimental to achieving these aims. As the US Supreme Court noted in the case of National Society of Professional Engineers vs. the US (76-1767):

"The heart of our national economic policy long has been faith in the value of competition…..The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain-quality, service, safety, and durability-and just the immediate cost, are favourably affected by the free opportunity to select among alternative offers[25]."

On 4 December 2008, a single-member bench of CCP declared ICAP's price fixing requirements as void and directed it to withdraw them through a public notice by 19 December 2008, failing which a penalty of Rs 300,000 per day of continual violation would be imposed upon it. In making this decision CCP relied, inter alia, on the European Commission's decision of 24 June 2004 imposing a fine of €100,000 on the Belgian Architects Association for a similar fixation of minimum fees that had gone unnoticed for 35 years. ICAP has appealed against the decision of the single-member bench and the case is now before a two-member appellate bench.

TYING OF PRODUCTS

Two cases relating to restricting of consumer choice through tying of products have come to the Commission's notice.

[25]*(435 U.S. 679, 98 S. Ct. 1355)*

These first involves a mobile telephone company and the second a business school.

Mobilink GSM provides three mobile telephony products and services to 15,000 Pakistani customers: (i) Black Berry handset produced by RIM of Canada, (ii) internet service and (iii) mobile telecommunication services. These three are tied in such a way that if a user surrenders one, he is denied the other two. The tying is through the Subscriber Identity Module (SIM), a software lock for the mobile handset that enables the purchasers to call only the network of the mobile phone provider. This is an unreasonably restrictive trade practice through which the company charges the customer separately for their three products but denies him access to any one service (product) of a competitor.

The justification advanced by Mobilink GSM for this tying was that they were selling the handset at a loss (40per cent rebate) to earn profits from the two tied products, and could not therefore afford to unlock the SIM, even though the Blackberry handset could be used as a stand-alone product. The central issue was whether Mobilink customers had an option to switch to other RIM enabled operators of Black Berry. It was found that they did not have this choice. CCP's position was that at the very least, these customers should have been informed at the time of purchase of the handset that this choice was being denied to them. Also, this denial of choice could only be for a period, say a year, as was the practice elsewhere, and not be indefinite and without the customer's knowledge[26].

The stand taken in this case by the mobile telecom company (Mobilink) was a negation of the European Commission's stipulation to handset makers and network operators to limit the use of the SIM-lock to a specified period, to inform the customer at the time of purchase whether the handset was locked and whether this locking was offset by a subsidy or discount (if so, how much?) and also to provide a convenient unlocking procedure.

In dealing with Mobilink's SIM locking case, the CCP was faced with two important issues. The first was whether this case fell within the jurisdiction of Pakistan Telecommunication Authority (PTA), the industry regulator. Mobilink (and other respondents) were PTA licensees, but they did not press to oust CCP's jurisdiction. Tying in practices had not been regulated by PTA. On the other hand, they had been specifically prohibited under competition laws. Consequently, CCP sent a copy of its order of 25 July 2008 to PTA for an appropriate industry-wide directive with respect to SIM locking of handsets. In so doing CCP went beyond the immediate case in seeking to introduce and promote the adoption of fair trade practices throughout industry, for the benefit and overall gain of the national economy.

The second issue was about the importance of disclosure. CCP directed that, in future, all advertisements and promotional sales material would clearly and boldly display that the handsets were tied to the BlackBerry internet service and Mobilink mobile telecommunication service. Also, the company would disclose the amount of subsidy involved in each sale, disclose the time period (not exceeding one year) after which the subsidy would be deemed to have expired, disclose to the customer how this subsidy would prevent the customer from unlocking the SIM, disclose a simple unlocking procedure after that period, and to also provide an option to switch to another service, albeit upon payment of some specified (and disclosed) switching cost.

With these stipulations, the CCP's order allowed Mobilink the leniency provided for in the law, and imposed no penalty. The Commission's objective was not to be punitive but to promote competition through industry-wide removal of restrictions upon consumer choice.

Tying-in as a restrictive practice was also the central issue in the case of Bahria University that had made the sale of laptop computers to its incoming students mandatory. Having imported 4500 ACER laptops in 2006, the university was requiring all its students (during 2007 and 2008) to purchase (from the university) these laptops. Although the University claimed that it was not making a profit on these compulsory purchases by the students, the Commission found that this was an effective tying practice that foreclosed consumer choice. Under the jurisprudence developed in Europe and the U.S., the following five elements were required to be present in order to constitute a tying practice:

(I) the two products must be separate;

(II) the tying seller must have a dominant position in the tying product market, such as to distort competition in the tied product market;

(III) the element of coercion by the seller must be present;

(IV) the tie must not be of an insubstantial amount;

(V) tying seller must have some economic interest in the tied product.

All five elements were found to be present in the case. All criteria for proving a tying practice were thus met.

Bahria University pleaded that it was unaware of the CCP and equally unaware of having violated any provisions of CO 07. It promptly apologised for its conduct, extended full cooperation to the Commission, agreed to give a rebate to the students who had purchased the laptops (for a gross value of Rs10 million) and stated that, as soon as it had received CCP's notice, it had stopped the mandatory sale of laptops to the incoming students.

The Commission did not impose any penalty on Bahria University (it merely ordered the University to send in a compliance report); on the contrary, it commended the cooperation it had received. In addition it granted a rebate to the students who had suffered from the forced sale and other relief. In doing so the CCP again sought to drive home the important point that public awareness and acknowledgement of the importance of competition (and desisting from its obverse) were more important than punitive action.

BILATERAL COLLUSION

In 2004 Unilever Pakistan Limited (UPL) sold its cooking oil business to Westbury Group that formed a new company, Dalda Food Limited (DFL), to sell the premium brand cooking oil of Unilever that had become a household name ("Dalda"). All the assets of Unilever were transferred, because Unilever wished to divest itself of all its Selected Oils and Fats Business (SOFB). In addition to this sale, on mutually agreed terms, a Non-Competition Agreement was signed between the two parties, which appeared, prima facie, to be a bilateral restrictive trade practice.

Under this Agreement, Unilever would not re-enter the SOFB (cooking oil business) for five years, nor provide any help to any competition of DFL. In return for this agreement, not to compete in future, the purchaser (DFL) paid the seller Rs250 million. The question that arose was why this Agreement was necessary at all and why DFL was paying such a large sum to thwart UPL, which it had already bought out lock, stock and barrel. DFL said it was a commercial necessity. However, MCA could find no justification for the imposition of this restraint.

Under the law, UPL was entitled to sell its goodwill (business intangibles including the Dalda name) to DFL and that is what it did - there was nothing objectionable about DFL purchasing goodwill. But this was not a goodwill transaction and neither party claimed it as such; they blatantly called it a Non-Competition Agreement. The only explanation seemed to be the innate fear (on the part of DFL) that UPL might sell the know-how specific to Dalda or use it to somehow stage a re-entry in the cooking oil market with a product having precisely the same characteristics as Dalda. Hence, the need to erect a barrier to entry at a cost of Rs 250 million.

The cost of any entry barrier is recoverable

[26] *Ancillary issues that CCP examined were whether there was a technical constraint on unlocking the SIM (there was none) and whether Black Berry customers had a choice to switch (they did not).*

from the consumer. That is why the erection of entry barriers is against the public interest. This was the underlying logic of MCA's Order of 19 December, 2006 (under the old MRTPO) in which it found that the non-competition agreement restrained and lessened competition bilaterally and constituted an unreasonably restrictive trade practice. It terminated the Agreement and directed UPL to refund Rs 250 million to DFL. The order of MCA has been appealed against and is in Court.

COLLUSIVE TENDERING

The case of Karachi Port Trust (KPT) is of a somewhat different kind. KPT is a statutory body set up by the Government to construct berths within its jurisdiction and to also grant concessionary rights to promote firms to operate container terminals on its berths. KPT is alleged to have granted a concession to Hutchinson Port Holding (HPH), as a result of which it will singly control 83.4 per cent of the relevant market of container handling. The charge in this case is not one of abuse of a dominant position: KPT is not a competitor in the market, thus the question of dominance, let alone its abuse, does not arise. The allegation against the two organizations is that of collusive tendering and lack of transparency. The consultants hired by KPT to evaluate the bids were also working, allegedly, for a subsidiary of HPH. The bids were not announced in the presence of bidders. This made the Concession Agreement a prohibited agreement under Section 4 of the CCP Ordinance. At the same time, HPH merged with KPT, through the formation of a subsidiary company to operate the concession, but the pre-merger approval that was needed for this purpose was not obtained.

The case of KPT is important on two counts. Firstly, KPT is a large statutory body of the Government that is expected to be a custodian of the public interest and any adverse adjudication by the CCP will be of far-reaching import. Secondly, the possibility of the merged operating company (merger not having been pre-approved either, in contravention of the law) threatening competition in a significant market, could have serious implications. As yet, however, these are fears, not realities, since the case is still under consideration.

Nature of Collusive Behaviour

It is disturbing to note here that, in many instances of restrictive practices, mentioned in the foregoing analysis, the collusive aspect comes to the fore. Collusion on price is, of course, difficult to establish. When conclusive proof is not available (and it is seldom readily available) the Courts can only give a finding of price parallelism, and "conscious parallelism" is not enough evidence (by itself) for the existence of a price fixing agreement or cartel. The Courts will require more than such circumstantial evidence (in other words, "plus factors") to be convinced of collusive behaviour. In the case of polyester staple fibres, decided by the Commission on 10 June 2008, the manufacturers were quoting identical prices and there did exist some "plus factors" (which may or may not have been conclusive), but price-fixation could not be established, partly because the manufacturers had evidently not organized themselves in any formal association, and the informal association that did exist had not met to fix price or output.

It seems that a platform for collusion, often with the intent to raise prices or control production, is usually furnished by the industry or trade association. In fact, it is the association that usually requires its members to act collectively, even though it might not be the association's explicit intent to require its members to act in an unlawful manner. If our industries appear to reek of cartelization, it is possibly because of the high correlation between the existence of strong trade associations, sometimes with unwitting support from Government agencies, and anti-competition collusive behaviour. It is this intra-industry collusion that we take up next.

4

State of Competition: Some Sectoral Perspectives

State of Competition: Some Sectoral Perspectives

In this chapter we look at the state of competition from the perspective of the situation prevailing in individual sectors of the economy. Many of these sectors have a history of significant state involvement that began in the 1950's and continued into the 1990's, with large scale privatization occurring over the last ten years or so. Even so, it might be reasonable to depict the current phase as one of transition. While there is no formal government-industry nexus, say, in the form of an industrial policy many, if not most, of these sectors still look to the Government for support in one form or another. In cement and fertilizers, for instance, it is almost certainly the case that the Government has yet to be convinced of the virtues of market-clearing mechanisms being allowed to operate freely; sugar production, with its many intricate backward and forward linkages and blatant politicization is another sector where price determination is deemed more acceptable as a 'negotiation' between the Government and the industry rather than through competition between the producers.

Automobiles raise complex macroeconomic issues on account of their high import content and relatively limited domestic value addition. Periodic changes in the import regime for used vehicles, usually driven by the vagaries of the balance of payments position, make the determination of the relevant market size and contestability between domestic producers a set of highly fraught issues. Lastly, banking is a critical component of overall financial stability in the economy and its regulation is intimately linked to basic questions of confidence in the financial system in which the safety of customer deposits is of paramount importance. Given that, competition issues, while important, remain one amongst others, requiring policy attention. The sector is not only closely regulated but has an association that appears to encourage its members to act in concert.

CEMENT

Cement constitutes 4.1 per cent of manufacturing in Pakistan[27]. There are 29 operational units in the sector ranging from small (i.e., producing around 100,000 tonnes per annum) to fairly big even by international standards (i.e., producing more than 2.5 million tonnes per annum). In terms of its concentration ratio, it can be described as moderately concentrated. By and large, only a few (perhaps 4 or 5) units operate with up to date technology. The principal characteristic of cement is that it is a standardized product - an undifferentiated commodity that is bulky and costly to transport. Its manufacture has also been standardized, following well-known, well established technologies that are used for mass production. The resultant economies of scale (in the production process) can confer a cost advantage to the very large manufacturer. Theoretically, this cost advantage can be translated into lower prices for the consumer, but, more often than not, it is converted into a monopoly rent for the producer. Because of the economies of scale in manufacturing and in marketing the product, the minimum efficient plant sizes being large and capital intensive, barriers to entry are high in the industry. This provides producers with a further opportunity for earning above normal returns.

The cement industry world-wide is often considered to be oligopolistic in its behaviour, with a strong tendency towards cartelization. Much of it stems from the nature of the product: a

[27] *Quantum index of manufacturing 1999/00*

standardized, undifferentiated commodity, embodying a mature technology (few innovations having occurred in the recent past), serving a mass market. There are hardly any close substitutes of this product, making its demand relatively price-inelastic. Neither the product market nor the geographic market is segmented. The industry is homogenous, notorious throughout the world for absence of strong price competition. Pakistan is no exception to this norm. In fact, in Pakistan it has been uncompetitive from the start. For long periods the Government fixed cement prices and directly controlled the industry.

Much of the industrial development in Pakistan can be traced back to the PIDC that was set up to provide the nascent State with badly needed industries, including cement and fertilizer. The State Cement Corporation of Pakistan (SCP) being a wholly owned State enterprise fulfilled the need of keeping prices at the level desired by the Government. The level was not necessarily low, owing to the inefficiencies inherent in public sector commercial enterprises, over which the MCA had no jurisdiction. In this regime, prices could be regulated and lowered in the public interest, through direct market intervention by the Government, as was done in October 1992. This interventionist power was lost with the advent of unregulated privatization.

MCA has been confronted with cartelization in the cement industry several times. The first cartel of private cement manufacturers surfaced in 1992, when demand exceeded supply, cement manufacturers raised prices overnight, and restricted supply. The Economic Committee of the Cabinet (ECC) directed MCA to intervene. MCA turned to the SCP that then opened retail shops in major cities to sell at a lowered re-sale price. In the face of SCP's ability to act as a loss leader and threaten to drop prices below marginal cost, the other cement manufacturers had no choice but to oblige MCA and the Government. With SCP's subsequent loss of power through State divestiture, the cement manufacturers were heartened by better prospects. These prospects appeared to brighten further, after 1992, with the emergence of the Central Asian Republics. Demand that was expected to emerge from these new countries spurred Pakistan cement manufacturers to invest heavily in plant and machinery.

By 1998, cement manufacturing capacity in Pakistan had increased substantially, in anticipation of import orders from the Central Asian Republics and higher manufacturing demand. Both expectations turned out, however, to have been too optimistic. Domestic demand did not rise by 8 per cent as expected. There was excess idle capacity. That would normally imply a reduction in price. However, this did not happen. Instead, prices rose by Rs 100 per bag (from Rs 135/bag to Rs 235/ bag). Not only that. All manufacturers resorted to a uniform increase in price that was published in the national press and adhered to by all members of the All Pakistan Cement Manufacturing Association (APCMA). MCA initiated an inquiry (November 1998) involving APCMA, but over which MCA unfortunately had no jurisdiction. The inquiry revealed concrete evidence that the price increase was not owing to any rise in input costs or taxes, as claimed by the cement companies, or any other economic compulsion. On the contrary, input costs and taxes had, in fact, been reduced in the previous year. In its Order of 20th February 1999, MCA imposed penalties and directed the cement manufacturers to utilize their full production capacities (so as to lower overheads and unit costs) and to revert to prices that had prevailed prior to output restrictions. Only one company (out of 16) paid the penalty; the others ignored it and appealed against MCA's decision in the High Court.

In the meantime, on 15th April 1999, the ECC, acting on the advice of the Ministry of Industries and Production (MOIP), reduced the excise duty in order to facilitate the manufacturers, and agreed to the price of Rs 200 per bag, in a compromise deal that

negated MCA's efforts. The Government's decision also rendered the Court proceedings infructuous[28]. Despite this reversal, the MCA once again took suo moto notice in June 2003 when there was a public outcry (especially in the national press) against another price hike (overnight increase of Rs 35 per bag) by the cement manufacturers.

It has come to light now (in April 2008) that this price hike may possibly have been the consequence of an agreement concluded in May 2003 by all 21 member companies of APCMA essentially to fix their quotas in respect of the production and supply of cement. This agreement has apparently remained in force all these years. Significantly, it makes provision for the dispatch of cement to be monitored by a company of chartered accountants. In addition, the agreement stipulates the setting up of regional price monitoring committees in each of the provinces to enforce the cartel's "marketing arrangements" and targeted price levels.

The existence of this cartelization agreement was not known to MCA at that time. Nor was MCA in a position to inspect, or call for the record of the manufacturers association (it did not have legal jurisdiction over company associations) or seize a company's records. All it could do was to infer the existence of a cartel from a price increase or from "conscious parallelism". MCA's strong suspicion, evident from the behaviour of the participating firms, was not sufficient proof. Nevertheless, MCA decided (June 2003) to conduct a special enquiry under Section 14(1) of the MRTPO. It issued Show Cause Notices to 18 cement companies (in September 2003) and held hearings over the next 2 years[29]. Finally, when (on October 27, 2005) MCA directed companies to reduce prices by different amounts in each case, no one complied with its orders. Penalties were imposed but could not be enforced.

The manufacturers filed appeals in the Lahore, Peshawar and Sind High Courts. Simultaneously they started raising prices that peaked at Rs 350 per bag in April 2006.

In its judgment of July 26, 2006 the Lahore High Court declared that

"The Authority (MCA) has acted on the basis of a complete misunderstanding of the Ordinance and has misapplied the relevant provisions.

"The mere fact that the prices in May 2003 rose in parallel do not therefore, establish that there existed a cartel among the appellants in violation of Section 6(1). There was no basis whatsoever on which the Authority could contend that there had been a "planned" or "systematic" increase in the prices, and it was insufficient to simply rely upon the price increase itself as establishing the existence of a cartel."

The order further stated that the colluders were never identified by MCA which had found merely that a "good number" of cement manufacturers were involved. This failure of precise identification of the colluders proved fatal to MCA's case (the judge observed). It is quite possible with the advantage of hindsight that, had the agreement of 8th May 2003 (discovered on 24th April 2008) been furnished as evidence, the High Court might have taken a different view than it did in 2006.

Interestingly enough, the High Court took exception to MCA's botched attempt at fixing lowered cement prices in the public interest, on the ground that this was a function of the market mechanism and not of any governmental authority. Yet, the Government could not but do otherwise. Between November 2005 and April 2006, when MCA's case was sub-judice and the Government had facilitated the cement manufacturers by lowering excise duties, there was another price spiral of cement prices reaching around Rs 350 per bag in April 2006. In an apparently short-term measure to rectify the market, the Government subsidized cement imports - a

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[28] *In closing the case the Court observed: "The learned counsel for the parties state that the ECC has fixed the new price for the sale of cement which is acceptable to both the parties……….this appeal along with other appeals on the subject are disposed off in the above terms".*

[29] *In the meantime, however, the Government facilitated the cement manufacturers and provided them with substantial relief in central excise duty, which was not passed on to the consumers. On the contrary, price remained fixed at the higher level and production capacities remained under-utilized.*

costly and eventually futile intervention. Although the prices came down gradually over the next 6 months, from Rs 353 to Rs 195 in January 2007, in February 2007 they rose, quite suddenly, by Rs 60, to a new high of Rs 255 per bag.

The Government was now increasingly coming under pressure from various business councils, management associations and the like to compel cement manufacturers to reduce their price. The Cabinet, therefore, once again directed MCA (in March 2007) to intervene and inquire why the price of cement rose sharply in February 2007. However, the APCMA, which was acting as the secretariat of the cement companies, lay outside the jurisdiction of MCA, which in any case had to contend with the High Court's judgment, its own organizational and juridical limitations and imminent replacement by the successor organization: the Competition Commission of Pakistan. MCA had neither the investigative tools to prove a cartel formation in a court of law, neither the powers to inspect records, nor the power to induce a whistle blower. Hence no meaningful action could be taken by MCA for a year.

All this changed with the promulgation of the new law. Armed with the aforementioned powers that MCA was lacking, the CCP conducted a surprise inspection on 24th April 2008 to recover the documentary proof that had eluded it for five years.

Surprisingly, taking exception to CCP's inspection of APCMA's offices and recovery of the cartel agreement (calling it an "untimely intervention" and a "raid," whilst it was neither of the two) the MOIP complained, apparently on APCMA's behalf, to the Prime Minister in the following words:

"This raid of CCP has caused serious harassment among the cement manufacturers. Cement industry has been one of our major successes in the manufacturing sectors. Looking at the prices prevailing in the market, it can be seen that the prices have remained stable. The domestic industry has not only catering demand in the country, but also have been earning valuable foreign exchange.

"The Ministry continuously monitors demand and supply and prices of cement on regular basis and is in constant engagement with the Cement Manufacturers Association. We have not received any alarm or concern from ECC regarding prices as well as shortage of cement. In fact on a number of occasions, ECC has appreciated the export figures of cement".

Denying that there was any cause for alarm on account of bolstered cement prices, the Secretary of the MOIP alerted the Prime Minister to the danger that CCP's action might "erode confidence of the investors, particularly the foreign investors". This attitude of the MOIP may well have heartened the cement manufacturers and encouraged them to start raising prices from Rs 275 per bag in April 2008 to an all-time high of Rs 375 per bag subsequently. Quite apart from the fact that there has been no investment in cement in the last five years, nor any exit of any inefficient producer, and that the cement industry remains characterized by high entry and exit barriers and that it was not the Competition Commission that was thwarting the prospects of foreign investment (as alleged by MOIP), it appears that the MOIP is in a state of denial about there being any competition issues in this industry or that prices have been shored up[30].

The position taken by MOIP is precisely that of APCMA. Not only have they tried to take CCP to task for having initiated action against a suspected cartel, but they have also sought the Government's intervention against the quasi-judicial mandate of the Commission[31].

[30]*Officials of the Ministries of Finance and Industries have officially stated that, having analyzed cement prices, they have reported to Government that they "did not find any reason to believe that the industry was jacking up prices unjustifiably".*

[31]*The CCP considers this to be an uninformed and unwarranted interference and has told the Government so. It has also informed the Government that it finds the logic of the Ministry of Industries, that the success of the cement industry (howsoever measured) absolves it of any wrong-doing, is quite flawed and promotes the very behaviour that should be discouraged in the public interest, and also that the mandate of the CCP should not be undermined.*

At the same time, MOIP has engaged the cement industry in negotiations on cement prices and started a process of reconciliation of costing differences. CCP pointed it out to the Government, on 3 September, 2008, that it should not

take any step that encourages collusive behaviour on the part of cement manufacturers. This is precisely what is likely to occur if it is true, as indicated in newspaper reports, that the Ministry of Industries has carried out a costing exercise with regard to cement production and is reconciling (or may have already reconciled) its cost computation with that espoused by the All Pakistan Cement Manufacturers Association (APCMA). Presumably this is being done (or has been done) to determine the reasonableness or otherwise of the recent price hike in cement prices. However, proceeding thus naturally induces cement manufacturers to seek a common industry platform and forge a consensus or "collusive" view as to prices and capacity utilization (which is ipso facto cartelization). However, APCMA may well justify such behaviour on the ground that the Government has called for it!

Notwithstanding MOIP's on-going negotiations, CCP served a Show-Cause Notice on 28 October 2008, under section 30 of the Ordinance to APCMA and the cement manufacturers. In response, they have turned to the Courts. The Court has allowed CCP to continue proceedings but not to pass any adverse order until the Court gives a ruling on the manufacturers' applications.

Meanwhile, insofar as the state of competition is concerned in this industry, it can be reported that there are little prospects of product innovation, efficiency gains in production and marketing, or consumer welfare. The cement industry in Pakistan furnishes a classic example of a long-standing oligopolistic consensus apparently against the public interest. The suspected cartel resulting from the "marketing arrangements" and production quotas fixed by APCMA appears to have found favour with the MOIP. Costly interventions by the Government in order to stabilize price (e.g. through import subsidies) have failed, because they avoid addressing the central issue that is one of negation of competition.

FERTILIZER

This sector constitutes around 3.4 per cent of manufacturing in Pakistan. The imperatives that determine its degree of concentration are primarily technological as, given the size of Pakistan's overall fertilizer market, only a few units could satisfy the entire demand. Smaller units are neither technically nor commercially viable. In terms of its concentration ratio the sector is unsurprisingly considered to be highly concentrated.

Although less of an undifferentiated commodity than cement, fertilizer resembles it in other ways: it is bulky and standardized, costly to transport, serves a mass market across geographic regions. The main difference is that fertilizer comprises three distinct products: nitrogenous, phosphatic and potassic. They are difficult to substitute for one another because their demand varies according to particular soil deficiencies. This would allow for product differentiation (and competition) but in practice there is hardly any differentiation (nor a competitive need for it) because the industry has always had the characteristics of a quasi monopoly. For much of its history it was a State monopoly, set up by the PIDC and subsequently becoming the National Fertilizer Corporation (NFC).

Another noteworthy feature of the product is that its demand is seasonal: fertilizers are applied to the soil mostly during the two sowing seasons (Kharif and Rabi), though there is some topping-up required in between. Though demand is seasonal, supply (owing to the continuity of the production process) is constant. This necessitates costly off-season storage. Thus, there are huge distributional costs, in particular, transportation costs. These costs can be lessened only if small production plants were located close to the heavy consumption areas, thus minimizing freight costs, as in the case of Dawood Hercules located as it is in the heavy consumption area of Sheikhupura in Central Punjab. But this has never been the case with the large monopolistic suppliers (first National Fertilizer Company and then Fauji Fertilizer) whose plants, in Mirpur Mathelo and Goth Machi in interior Sind, are located close to the feed-stock (gas as raw material for urea production) rather than in the heavy consumption areas of Punjab[32].

Compounding this transportation problem was the Government's requirement of keeping prices fairly uniform throughout the country, or at least avoiding very huge regional discrepancies. The price equalisation formula of the NFC ensured the same selling price in the remotest parts of the Northern Areas as at the factory gate. This involved a huge subsidy to cover marketing and distribution expenses. These marketing expenses (called 'incidentals') were fixed by the Government and corresponded to a very high allowance to cover inefficiencies, inflated transportation bills and other overheads of the State enterprise. The 'incidentals' of the least efficient company (worked out on a cost plus basis) were allowed also, as marketing expenses, to the most efficient company. The latter, naturally, reaped windfall gains. In the regime of controlled prices (fixed by the Government until 1987 for urea, and until much later for other products) monopoly pricing ensured very high profitability to all industry participants – at a cost to the national exchequer and to the consumer.

On the production side, there are huge economies of scale with the minimum efficient plant size (MEPS) being around 450,000 tons. New entry, therefore, requires a large lumpy investment that might be larger than the expected growth in demand[33]. There is thus a lag between demand and supply that might take a few years in catching up. In this lag period, shortages occur, providing a further opportunity to the incumbent firms to earn above normal returns. When supply does catch up with (or exceeds) demand, with a large new plant coming on stream, prices are expected to fall, but they do not. This was so previously because the Government had fixed prices irrespective of market conditions and allowed comfortable marketing "incidentals" to the industry price-setter. In other words, monopoly pricing was the norm that has continued into the period after privatization. A State monopoly has been replaced by a private monopoly (Fauji Fertilizer).

MCA had no jurisdiction to question the State monopoly. With Fauji Fertilizer's acquisition of a large part of NFC (Pak-Saudi factory in Mirpur Mathelo) in 2003 the company gained a market dominance that could be questioned under Section 3 of the MRTPO. But it was not questioned at the time. To be fair to MCA, when FFC set out to acquire NFC's urea plant (Pak-Saudi), MCA did advise the Government (on 19 March, 2002) against allowing this merger because it would lead to an undue concentration of economic power in contravention of the MRTPO. The Cabinet Committee on Privatization completely ignored MCA's advice and the acquisition went ahead. MCA's hands were effectively tied[34].

Nevertheless, FFC's dominant position was questionable per se and actionable under Section 5 of the MRTPO and it was eventually so questioned by MCA[35]. MCA's

[32]*It would of course have made more economic sense to locate these plants in the heavy consumption areas, thereby obviating the need for incurring high transport (and storage) costs of dispatching bulky fertilizer bags to distant determinations from manufacturing factories located in the proximity of the gas fields. After all, gas pipelines could easily be accessed (for feed-stock) further from the source of gas supply. Gas is not a bulky item to transport, bags of fertilizer are.*

[33]*Fertilizer demand in Pakistan (as also elsewhere) grows in a linear fashion, while supply can be added only in large units of MEPS, not in small gradual increments corresponding to rises in demand.*

[34]*In 2005 MCA again advised the Government against FFC's further participation in the bid for NFC's next plant (Pak Arab in Multan) and also cautioned against Dawood Hercules (which also had a stake in Engro) participating in the same bid. This time MCA's advice was heeded. That is why Pak-Arab went to an outsider (Fatima).*

[35]*The case against Fauji Fertilizer was started by MCA in August 2007 but disposed of by the Competition Commission in April 2008.*

case was that Fauji Fertilizer Company (FFC) and its associated undertaking (Fauji Fertilizer Bin Qasim (FFBL), had a composite market share (in both the urea as well as the phosphatic fertilizer markets) that exceeded the threshold. The monopoly power of the joint enterprise stemmed not only from the high market share but also the fact that they had interlocking Boards of Directors (common Chairman, and common Members). FFC/FFBL pleaded that they did not fix non-competitive prices[36], had not indulged in any restrictive practice, and had in fact acted in the public interest. They also claimed that the merged entities (FFC/FFBL) had "inherent efficiencies and synergies" that qualified for exemption under the gateway provision of Section 5(2).

The Commission dealt with the question of efficiency gains on an empirical basis. Cost data pertaining to the competitors in the industry were examined and it was found that FFC/FFBL did not have lower unit costs as a result of economies of scale or synergies or other efficiencies inherent in the larger joint project. On the basis of this finding, the gateway provision could not be invoked, and was not allowed.

The fact that FFC was unable to avail of the "gateway" provision, because its costs were actually higher than those of smaller producers, reveals an important aspect of this industry. Either diseconomies of scale had set in, or the firm was oblivious of cost considerations[37]. Nevertheless, during hearings before the Commission, FFC conceded that having common Directors and Chairman for the two companies was exceptionable and offered voluntarily to dilute their power through a separation of their Boards of Directors over the next 2 years. A consent Order was accordingly passed on 29 April, 2008.In this Order, CCP has sought to reinforce transparency and good governance in the associated undertakings through the appointment of independent Directors.

It has become evident from CCP's investigation into the fertilizer industry that it has always been a closely-knit oligopoly with one dominant industry leader (first NFC, then FFC). There has been no product innovations in this industry for several decades, even though there have been new types of fertilizers introduced in many parts of the world. Hardly any attempt has been made in Pakistan to open up new market segments. No new technology has been used. The structure of the industry has remained static (NFC's market share of 58 per cent being simply replaced by FFC's 58 per cent), characterized by the same entry barriers that protected the same incumbent firms 30 years back.

Any statistical analysis of the industry (or longitudinal study) would show a very stable structure, reflecting a rigidity that might well be inhibiting market efficiency and consumer welfare. From the public interest point of view, and in order to reduce costs, the Government needs to inject some dynamic competition into this industry. In order to help the Government in this policy task the Competition Commission proposes to undertake a through analytical study of this sector. After that it will make policy recommendations based on its findings.

BANKING

More than 53 per cent of Pakistan's GDP originates in services of which banking constitutes over 8 per cent. More strikingly, gross value added in banking accounts for much of the overall GDP growth in the last few years, perhaps as much as two-thirds. Its importance in the economy in intermediating between savers and investors is substantial and growing, serving both the largest corporate customers and the smallest individual account holders. In terms

[36]*The question of price fixation or restriction of output was not examined, because the case had not been taken up under the CCPO, and hence the abuse of market power (or otherwise) was not the primary question. Undue economic power per se, as defined under the old MRTPO, was the primary issue, and this appeared to be the case, prima facie.*

[37]*This used to be the case when this industry was a State monopoly: NFC was assured that all its costs, regardless of how higher they were, would be allowed by the Government as "incidentals." It is possible that, while displacing NFC as the dominant firm, FFC might have inherited the same inefficiency. In both cases the consumer suffers*

of concentration the sector is deemed to be fairly competitive. For the last five years, financial services (banking in particular) have attracted much of the direct private investment that has been second only to that in the telecommunications sector[38]. From the perspective of competition, it would be helpful to ascertain whether the growth and seemingly greater activity of this sector has been accompanied by enhanced efficiency and what its welfare implications are.

The banking sector has already thrown up many issues. Complaints against the banks abound, especially before the Banking Ombudsman. The Consumer Rights Commission and other consumer protection agencies have also highlighted public grievances primarily relating to the poor quality of service provided by banks and apparent overcharging of customers. The CCP is concerned only with the enforcement of competition norms and not with the regulation of banking business, including prudential regulations that fall within the jurisdiction of the State Bank alone. On the other hand, the State Bank's mandate does not cover the actual promotion of competition.

The Competition Commission took suo moto notice of an announcement made on 5th November, 2007 by the Pakistan Banking Association (PBA), on behalf of its 49 members, that the banks had collectively decided to fix rates of profit and other terms and conditions of a new deposit account, including the fixation of maximum profit rates, ceilings of categories of accounts and the rates to be charged on such accounts, and restriction on the number of transactions.

The specific case that the CCP examined was that of the banks having converted customers' deposit accounts of less than Rs 20,000 into Enhanced Savings Accounts (ESA) carrying a fixed profit of 4 per cent per annum. PLS (profit and loss sharing) account holders were given no choice; their accounts were automatically converted to ESA. Not only did the forcible nature of this conversion seem objectionable, the banks were found to have created dissimilar conditions among PLS account holders. Banks had also resorted to the collusive practice of charging Rs 50 from very small account holders (balances under Rs 5,000). This appeared to have instantly deprived small savers from availing of the facility, previously given by several banks, of maintaining deposits on which they could earn some profit and pay no charge.

In effect, what the banks seemed to be colluding to do was to make very small account holders (under Rs 5,000 deposits) pay for the administrative expense of servicing larger account holders. This cross subsidy appeared to be a transfer of resources from the poorest clients to the relatively better-off ones. It was based on a compulsory levy of Rs 600 per annum (Rs 50 per month) on balances below Rs 5000. Thus a small account holder of Rs 2,500 would end up being charged 24 per cent on maintaining his account. A simple calculation showed that even if one fourth of the ESA account holders had balances below Rs 5,000 the service charge recovered from these smaller depositors would equal (and cover) the 4 per cent interest paid out to the remaining three-fourths of the somewhat larger customers. The ESA scheme covered 45.12 per cent of the total 25 million account holders. A large number of depositors appeared thus to have been adversely affected.

Interestingly enough, at the core of this collusive activity were seven banks that constituted 60 per cent of the market. The seven banks, holding Rs732 billion of deposits, were: the State-owned National Bank of Pakistan, four formerly State-owned but privatized banks – Habib Bank, MCB Bank, UBL and Allied Bank -- and two recent

[38]A large part of this has accrued through privatization. It remains to be seen whether the remainder (minus privatization proceeds, that is) of what is mostly foreign investment (FDI) has justified the cost of securing it. No economic analysis has been done on what the actual expense to the national exchequer was by way of the promotional effort that went into it. Let alone the question of opportunity cost, data are not available yet on whether the outflow (through profits and dividends or other transfers) is tending to exceed the inflow of FDI. This, however, is a question for economic and financial analysts and not for the Competition Commission.

entrants, Saudi-Pak and Atlas. The majority of the 49 banks did not actually introduce ESA. These included those who supported the Pakistan Banking Association, in principle, but had not actually acted on its advice. This led CCP to conclude that there were in fact five categories of banks. First there was the core of the seven large banks. They were fined Rs 25 million each, along with PBA that was fined Rs 30 million. Second, those who were part of the PBA cartel but had not actually implemented the scheme, were reprimanded. The third category of those banks that had applied their independent minds and not gone along with PBA's decision, were not penalized at all. Nor was any action taken against the Islamic Banks (fourth category) that had actually opposed the scheme. The last category was of DFIs to whom this scheme did not apply.

The Banks' case has shown disturbing aspects of collusive behaviour against the public interest, tending to adversely affect the rights of customers. It has also raised questions of cross-subsidies of transfer of resources from poorer segments to richer ones and of lack of access, despite proliferation of bank branches nation-wide. Inefficiencies of the banking system, reflected in the very high spread of interest rates that the State Bank has also taken serious notice of, continually come to light. A recent study on consumer financing, conducted by the Consumer Rights Commission of Pakistan and the Asia Foundation has found:

"Depositors are not getting due returns due to high difference between lending and deposit interest rates. Further, the volume of consumer complaints is rising day by day due to processing delays, service inefficiencies, hidden charges, and poor disclosure practices. For example, in the first eight months of the operation of Banking Ombudsman in 2005, about 40 percent complaints filed with the Ombudsman related to consumer products, and among these complaints, 30 percent were related to credit cards alone."

Taking note of these complaints, the CCP has commissioned a thorough study on all competition issues involved in the banking sector. We hope to report its findings later this year. Meanwhile, the Commission will continue to take notice of malpractices and restrictions on competition, including deceptive marketing practices, misleading announcements and false advertising that abound in Pakistan.

A more general question that the Commission needs to address is the possible role and standing of some trade associations in promoting restrictive practices and furnishing a platform for cartels. We have seen this in the case of cement, in banking and in the Institute of Chartered Accountants. We see this also in the case of sugar.

SUGAR

The sugar sector constitutes 4.2 per cent of manufacturing in the country. Although about the same size as cement its many backward (sugarcane growers) and forward (food processing) linkages in the economy indicate that its indirect socio-economic impact in overall terms is significantly larger than its direct contribution to GDP. In terms of concentration it is deemed to be competitive.

Sugar cane is grown and crushed during a five month period. Likewise, the mills manufacture sugar for five months but have to release their stock uniformly over the year. Stock piling thus becomes an issue. Restrictive practices are endemic. The commodity-like nature of the product (like the others discussed in this chapter), encourages an oligopolistic consensus and discourages price competition.

The CCP does not have compelling evidence of a sugar cartel, which is a pre-condition for taking legal action. However, the existence of parallel pricing is evident. The Pakistan Sugar Mills Association (PSMA), a powerful lobby, representing the interest of sugar factory owners, has often made common cause against sugarcane growers.

MCA has in the past locked horns with sugar manufacturers and PSMA. When sugar prices rose 40 per cent in the first four months of the year 2005, 72 sugar mills were served with show cause notices and several hearings were held, resulting in MCA's Order (23rd September, 2005) directing the mills "to discontinue and not to repeat the practice of withholding of stock to create artificial shortage of the commodity in the market". The mills went in appeal to the Lahore High Court, where the matter remained under adjudication for nearly three years. Eventually, on 30th July, 2008, the Islamabad High Court accepted the appeal on the grounds that MCA could not provide sufficient criteria to establish that any unreasonable restrictive trade practices had occurred. Nor did MCA have sufficient evidence to prove that stocks had been withheld by mills from the dealers upon demand.

In February 2006 it was found that 42 sugar mills had released stocks less than the stipulated provincial average, with the result that on 14th March, 2006 they were again served with a show cause notice. During the subsequent hearings, the mills contended that the "provincial average" was not a reasonable benchmark. This argument was accepted and monthly consumption of 8.33 per cent of annual dispatches was substituted as a benchmark, but it was found later that the mills were not adhering to this benchmark either and were withholding supplies. On 9th May 2006, the MCA directed them to discontinue this restrictive practice, but 22 of them went in appeal to the High Court[39]. The Court suspended MCA's orders but directed the undertakings to bring sugar into the market.

A rather more successful intervention the same year (2006) was against the Sind Sugar Manufacturers Association who were reported (in the national press) to have threatened to stop crushing if the price of sugar cane was not adjusted in accordance with their demand. The MCA took a shot across the bows and issued a questionnaire to all the mills, asking them to confirm whether or not they subscribed to the Association's threat. Every single sugar mill said that it was not aligned with the Association's threat, and, to confirm that, they continued to crush cane within the framework prescribed by the Government.

MCA/CCP has not been able to prove a cartel in the sugar industry, even though the industry has reeked of one, especially with such a strong platform as the PSMA. How competition unfolds in this market will depend significantly on how Government policy shapes up in the years to come especially with regard to the procurement price of sugarcane.

AUTOMOBILES

The assembly of cars is a relatively small but significant activity within manufacturing (less than 2 per cent) as the overwhelming bulk of the inputs used are imported in CKD (completely knocked down) condition. Some progress has been made in the last four or five years to enhance domestic value addition through the involvement of local content suppliers but compared, say, to East and South-East Asia automobile assembly remains small scale with minimal innovation in the sector. In terms of concentration all sub-sectors (cars, buses, trucks and motorcycles) within it are highly concentrated with production dominated by a handful of companies.

MCA has not been able to find any evidence of cartelization in the automobile industry, even though there have been suspicions of restrictive practices going back some years. A large number of serious complaints were received by MCA from time to time, on the basis of which a sectoral study was conducted in 2002-2003, but it was not possible to establish any wrong-doing. The main reason for this was that although high prices were prevalent, and the manufacturers were extracting high price premiums, these could be attributed to market dynamics and the inter-action of supply and demand. Neither conscious parallelism nor cartelization was evident. More importantly, much of the market behaviour was the clear result of Government policy, making this hardly a case for intervention by MCA.

The most significant policy measure was the Government's ban on import of used cars in 1994, and the integration in 1995 of all taxes and duties into a single 30 per cent duty slab on completely knocked-down vehicles and 100 per cent on completely built-up ones, progressively rising with engine size. This resulted in a price spiral on domestically manufactured cars. From 1994 to 2002, Honda, Suzuki and Toyota increased their prices at least six times, with an average increase of 75 per cent. Prices were more than double those in Pakistan's immediate neighbours. Premiums became very high when manufacturers obliged the customers to pay the full amount up-front but gave delivery up to nine months later. The huge gap between supply and demand persisted for 12 years. Consequently, in one year alone (2002), the profits of the car manufacturers doubled over the previous year. Capacity utilization in the industry on average was 39 per cent (61 per cent capacity remaining idle). On the face of it, this was restriction of supply. However, the industry had succeeded in negotiating highly favourable terms with the Government, which continued to provide it protection based on the argument that the industry was in its infancy, even though many argued against it from the point of view of public welfare and efficiency. The Government went to the extent of seeking repeated exemptions from WTO in favour of domestic car makers, even though they had not abided by their commitment to progressively delete foreign components from imported vehicle assembly kits.

The gap between demand and supply was finally bridged in 2006 when the Government allowed imports of used cars, as had been recommended by MCA several years earlier. The terms of these imports have subsequently been amended, as have some financial terms, but these policy changes are far from radical and their impact on the state of competition is not likely to have made a significant difference. The structure of the industry remains the same as it was 15 years back. Before imports were allowed, it was an oligopoly of six firms with four assemblers catering to 97 per cent of the domestic market. With imports, the market share of domestic manufacturers has substantially reduced, but their number and size distribution probably remains the same. The CCP has not yet embarked on a new study of this industry, but it appears to be a classic case of an oligopoly characterized by very high entry barriers. Its structural features determine the price and conduct of the firms, as well as their performance. A proper analysis of competition issues in this market will have to wait until CCP acquires greater investigational ability and technical capacity.

CONCLUSIONS

Restrictive practices are of course, accompanied by, and gain wider currency in, rigid market structures obtaining across the board. Whether it is in large scale manufacturing (cement, fertilizer), processing (sugar), or the service sector (banking), the market remains confined to commodities and products. Lack of product differentiation inhibits consumer choice, leaves no room for innovation and suggests the inherent danger of perpetuating a static market structure with high entry and exit barriers. Worse still, price competition, which, according to Porter[40], might be the distinguishing feature of Stage 1 factor driven economies, and which could provide some consumer benefit, has also been absent in these industries in Pakistan. Our analysis reveals an oligopolistic consensus (in the industries we have reported on) to shore up prices and keep them high in order to extract monopoly rents, with apparent impunity and with possible assistance from trade associations, and unwittingly, some agencies of the Government itself.

[39]All 22 of them were represented by the same legal consultant, in itself an indication possibly of a cartel. Alongside this case, yet another case was initiated in which a penalty of Rs 10,000 per day was imposed, this too was appealed against.

[40]Global Competition Report 2008-2009, World Economic Forum,2008

The second concern for the CCP in respect of large-scale industry is the ability of inefficient producers not only to survive over time but to succeed in thwarting new entry. The empirical fact of the existence of high entry and exit barriers, and the absence of price competition, and static market conditions (in which the number and size distribution of firms also remain stable) emits strong signals of a deep seated inertia and denial of competition. These signals have been picked up by the GCI when it notes that the continued survival of firms, including the least efficient ones, indicates competitive failure. For CCP it is the central concern.

So far the CCP has taken up cases that are in the public eye. It has gone after unreasonable trade practices and price fixations, in an attempt to send out strong signals against bad behaviour. However, CCP's intention is reformatory rather than punitive. It has in many cases abstained from investigations and the imposition of penalties in the expectation that the offending firms will, in their own enlightened self-interest, reform their conduct, rather than repeat the unlawful practice. This expectation is based on the belief that the businesses will themselves realize that competition is not only good for business and in their own best interest, but is also their best protection against an unlawful practice of which they (as industrial consumers) can be victims and must not, therefore, be its perpetrators. The CCP thus seeks to enable businesses to improve the climate of doing business in Pakistan and facilitate investment. It hopes to accomplish this through strong advocacy of the benefits of competition to all, and is accordingly building an institutional framework for this advocacy function.

Insofar as large-scale industrial and service sectors are concerned, CCP will be engaged in investigative work and sectoral studies. It cannot hope to promote competition without a thorough understanding of the processes through which it is unfolding in the country.

Detailed micro-level analysis is needed before the Commission can take a strong position or make policy recommendations to Government. In this regard, the CCP is fundamentally different from the MCA. The MCA was established to break up undue economic power and curb unreasonably restrictive trade practices. The CCP has been set up to act against abuse of dominance, not dominance, and against all competition-adverse agreements, including collusive arrangements. The CCP's methodology of underwriting efficiency and public welfare is based on the concept that competition is a public good that the State is obliged to provide to its citizens.

5 Major Competition Policy Issues: Future Steps and Recommendations

Major Competition Policy Issues: Future Steps and Recommendations

The message emerging from the first four chapters is that competition policy and the issues surrounding it relate to the effects of measures recently taken by the Government in the CO 07. These measures are expected to impact both upon the extent of potential rivalry between enterprises and the structure of the sector, i.e., degree of concentration, in which they operate. Here, it should be pointed out that in Pakistan these issues have also to be seen in the context of policies in other areas, for instance trade, and the need to see that competition policies are consistent with these other policies. Typically, such policies were not originally designed with a particular objective in mind but as part of a general reform agenda to improve overall economic performance. It is noteworthy that they now include pro-competition laws (e.g., antitrust or competition regulations) that are more specifically designed to prevent cartels or other similar price and quota fixing arrangements. As a result, competition policy is now much more important than before. It is obvious that the Government is explicitly seeking to promote competitiveness in the economy and to enhance competition in both domestic and international markets (e.g., through deregulation, trade liberalization and relaxed foreign ownership requirements). However, it is also true that this policy matrix is not yet fully understood or accepted. The success of these policies is, therefore, subject to a number of caveats and conditions over the medium term at least.

As explained in chapter II, the objective of competition policy, broadly defined, is to facilitate efficient resource allocation in the economy so as to achieve the highest output at the lowest cost. The objective is to be achieved in terms of macro-level allocative efficiency and internal firm-level efficiency on a dynamic basis so that production and capital resources do not become ossified in obsolete methods and technology and that greater productivity and efficiency is both encouraged and rewarded. In other words, greater efficiency is the ultimate objective and encouraging competition is the process; within that, competition and competitiveness, arguably, reinforce one another.

Against this conceptual background, the question is often asked: how is competition policy expected to impact on economic growth in Pakistan? At the purely theoretical level as we have seen in chapter II there is little doubt that it should play a critical role. Although difficult to measure, innovation, productivity and improved long term economic performance are likely to be significantly promoted by inter firm rivalry and, therefore, by the enforcement of competition laws. At the practical level, however, there may be a degree of uncertainty. For one thing, the case for competition rests on somewhat stylized assumptions borrowed from the developed countries; for another, in the developing world, especially in Pakistan, rival producers of the same goods and services using the same technology can vary substantially in their level of efficiency. In such circumstances, there is a risk that unfettered competition could have perverse social effects by driving inefficient producers out of the market and create unemployment and/or physical shortages of the relevant goods or services in the process. Moreover, it could also be argued that some degree of temporary market power may well be needed after a new innovation to provide firms with the incentives to undertake such innovations (it is for this reason that patents and copyright laws exist). In addition, competition policy must take into account the technological characteristics of particular markets. In other words, there can be instances in which consumers prefer a concentrated market supplier because of the positive externalities that such markets generate. Public utilities, pipeline industries and railways are prime examples.

Against this background, the principal issues that arise for the Government of Pakistan therefore are assessing the impact of policies in terms of trade-offs. In the real world such trade-offs are difficult to judge and it is almost certainly the case that the weights assigned to particular benefits and costs in such trade-offs are either politically determined or are highly subjective. It needs to be remembered, too, that all policies have long and short term and macro and micro dimensions and separating them out can be very complex; indeed, resolving such complexities are usually matters of judgment rather than a calculation based on a set of standardized criteria. Moreover, such judgments can often be overtaken by events. It is also true that virtually everywhere short term gains are preferred to longer term ones regardless of how future gains are discounted and it is the case that gains and costs are almost never assessed by the same yardstick.

Another set of issues in the implementation of competition policies is that such policies must complement trade policies in particular and other policies in general. This is the primary responsibility of the Government. At the macro level, for instance, competition policies clearly complement trade policies and regulatory reform is a critical component in the overall policy framework. While an open trade policy is expected to eliminate barriers to international trade (high import tariffs remain a contentious issue) and regulatory reforms overcome barriers to the domestic entry and exit of firms competition policy targets business conduct that tends to limit market access and reduces actual and potential competition. To produce the desired effects, the full framework of all the relevant policies must strive to be coherent and consistent.

At the macro level, competition policies are clearly a necessary adjunct to trade liberalization and it would be pointless to have one without the other. At the micro level competition policies promote efficiency at the level of the firm but their putative benefits might be nullified by well-meaning regulatory interventions that have the effect of creating high entry barriers and reducing competition. If, as has been argued here, the rationale of competition policies is that they promote efficiency in the economy they are an essential pre-requisite for long term economic growth. What needs stressing is that without being part of a larger matrix of liberalization and deregulation measures the effectiveness of competition policies is likely to be sharply reduced. It is clear therefore that all the relevant policies ideally have to move in tandem and with the same explicit objective function of promoting efficiency in the economy. The policies are the means to an end; not the end itself.

Pakistan's experience over the last 12 months and, indeed, going back to the 1970 MRTPO indicates that competition issues are still not well understood. Therefore, for a more competitive economy to emerge in the future on a dynamic basis there has to be: one, a supportive overall environment in which the Government is the principal agent in promoting macro-level efficiency and two, a more pro-competition climate of opinion in the country in which the CCP is the principal agent. It is not enough for the Government to have established the CCP; it must see that its own overall policy mix is one which encourages and supports competition. This report suggests the following specific steps.

First, at the level of the Government, actions are needed for sustained macroeconomic stability. An environment in which inflation remains endemic and the exchange rate is unstable the time horizon for investment decisions and business planning becomes severely curtailed and competitiveness and competition are casualties. In addition, with negative real interest rates there is no credible benchmark rate of discount for evaluating investment choices, especially where the payback is long. It is important, therefore, for the Government to give the

highest priority to the consolidation of its first generation reforms so that there is a stable macroeconomic environment in the country in the years ahead and the system of relative prices provides reliable signals for evaluating alternative investments.

Second, as discussed in chapter I, there is an on-going need for investment in infrastructure and in public goods to reduce transaction costs and entry barriers and to improve overall business profitability in the economy. In most developing countries, including Pakistan, the lack of development tends to manifest itself as a chronic problem of market failure in which a wide variety of goods and services are under-provided at prevailing border costs and prices because poor infrastructure segments markets, reduces economies of scale and increases transaction costs. In addition, transport and distribution bottlenecks within the country lead to severe local shortages with large price premiums being charged from customers in particular parts of the country. Such conditions can make anticompetitive behaviour almost irresistible. Pakistan has suffered from the latter conditions as few, if any, of its product or service markets could be described as being properly integrated within the country on a national basis.

Third, Pakistan has a long history of rent-seeking behaviour by the business community, a problem that has to be dealt with decisively sooner rather than later. Businessmen spend more time in cultivating political and bureaucratic contacts than in building their businesses. Moreover, political and economic uncertainty has perverted incentives to such a degree that businessmen have invested excessive amounts in inflation hedges such as real estate, not been averse to over-leveraging their enterprises and skimmed off significant amounts from the cash flows of their companies in the form of capital flight or for largely demonstration expenditures. Such practices render these companies highly vulnerable to even temporary external difficulties and make them prime candidates for anticompetitive actions.

Progress in reversing these trends cannot happen overnight but if the Government is serious in achieving the objective of a more competitive economy it must act on the need to strengthen the institutional mandates of all oversight bodies in order to reduce, and eventually eliminate, the need for rent-seeking behaviour. Above all, it must strive for a better alignment of incentives so that businessmen can see the benefits of greater efficiency in their enterprises and eschew rent-seeking behaviour in the form of cartels and other anticompetitive conduct. A few high profile convictions and punishments for wrong doing in this regard, as has happened in both the United States and EU, would have a major positive impact on investor conduct in the country.

Fourth, there is a strong need for the Government to prevent the institutional capture of oversight bodies by vested interests, a phenomenon that allows cartelization and anticompetitive actions by stealth. The Government must recognize that to be effective oversight or regulatory agencies need an appropriate degree of autonomy in their operations and are free from interference. If any redress or additional scrutiny of institutional decisions is needed it should be done by the legal system and not by a Government Ministry. Adherence to the best global standards in this regard is not a matter of choice but a necessity in today's world. If oversight agencies in Pakistan's largely deregulated environment are deemed to be too weak, or burdened by the demands of vested interests, the bulk of foreign investors are likely to turn their backs on the country. Also, the Government must desist from dealings with trade associations or groups of businessmen on questions related to product costs and pricing since this invariably encourages cartelization and other forms of collusive behaviour.

Fifth, there is little doubt that policies must be regularly re-evaluated for outcomes and results and amended when needed. In Pakistan, within the corpus of competition policies, consumer protection remains an unfamiliar concept and misleading advertising is a widespread phenomenon even by well-known corporate names. There are laws in existence that ostensibly protect the consumer but, by and large, they tend to be honoured in their breach. There is no doubt that the interests of consumers are poorly represented and are much weaker than those of producers who are able to obtain the ear of the authorities much more easily than consumers. CCP's view is that organizing and promoting consumers' rights should create a potent force for ensuring competition and in building a competition culture in the country. Indeed, at some point in the near future the impact of the Competition Ordinance on consumer rights may need to be assessed through, say, an appropriately targeted survey of public opinion.

Side by side with actions at the level of the Government the Competition Commission needs to take effective action itself at the level of building a coalition of support for its activities. In this regard, the CCP needs to continue to emphasize advocacy within a wide variety of constituencies and interest groups in the country. Unless the public at large understands and is convinced of the importance of the work that it is doing CCP's opponents will be able to paint a negative picture of the Competition Ordinance as an unaffordable luxury for Pakistan. Moreover, eventual success in advocacy is linked to the creation of a stronger pro-competition climate of opinion in the country and for the implementation of second generation reforms that are expected to propel Pakistan into the ranks of a middle income developing country in the next 5-10 years. With these objectives in view, the CCP itself needs to focus on the following measures.

First, the Commission must continue to reiterate the benefits of competition, the logic, rationale and the need for competition policy, and publicize CCP's adopted approach to fulfilling its mandate. As indicated elsewhere, the focus of CCP's work is safeguarding competition and not competitors. For this, it has adopted a non-discriminatory approach which emphasises predictability, transparency and the rule of reason as an operational raison d'etre. Moreover, every situation is to be judged by the CCP on its merits. Although the law indicates a certain minimum market share beyond which there is a presumption of dominance this is by no means definitive; nor does a presumption (or finding) of dominance automatically mean that it is being abused.

Second, to make itself more effective in the future the Commission should build strong in-house research and investigative capacity and earmark the needed resources for this. The criticism is often made that while the (usually modest) costs of a competition agency like the CCP can be measured, any gains from its activities remain either nebulous or mired in argument. Evidence from other developing countries in Asia suggests that the small budget of a competition agency can pay for itself many times over from the reduction, say, in instances of bid rigging alone. More substantial benefits are likely to flow in the form of higher output and exports as industries become competitive domestically and internationally.

Third, the CCP should over the medium term seek to achieve conditions in which competition assessment impacts/tests – like environmental impacts - become both explicit and implicit (embedded) in the organized part of the economy. There is some encouraging evidence that companies are already taking on board the importance of competition assessments of this genre. Such assessments are being initiated by the CCP despite a severe constraint on resources. Thus, for instance, if the findings of a competition assessment study prevent or discourage incumbent firms from taking steps to foreclose entry by potential rivals then such an assessment would not only have strengthened competition in a particular sector but encouraged new entrants to invest in innovation as a way of entry into the sector market. Such competition assessment studies should, ideally, also explain the need for consistency and coherence between competition policies and laws and intellectual property rights, on the one hand, and industrial, trade and investment policies, on the other.

Finally, implementing competition policies and laws should be seen in both short and long term perspectives. In the former, merely having a 'good' law is unlikely to be enough. What will matter is judicious and efficient enforcement since the deterrent effect of the law will depend on how companies' perceive the law in practice. The short term challenge is, therefore, to implement the law in a robust, fair and transparent manner in a society with traditionally close business-government relationships. This will require not only strong investigative and legal skills but also tact and wisdom. Over the longer term, based on the experience of the developed countries, as Pakistan's first generation reforms are consolidated and rent-seeking gradually diminishes, business interests should begin to realize the value of innovation and competition as business strategies rather than falling back to the formation of cartels or engaging in other competition-adverse practices. The consolidation of second generation reforms rests on such a realization.

Annexure 1

Country/Economy	GCI 2008–2009 Rank	GCI 2008–2009 Score	GCI 2008–2009 rank (among 2007 countries)*	GCI 2007–2008 rank
United States	1	5.74	1	1
Switzerland	2	5.61	2	2
Denmark	3	5.58	3	3
Sweden	4	5.53	4	4
Singapore	5	5.53	5	7
Finland	6	5.50 6	6	6
Germany	7	5.46	7	5
Netherlands	8	5.41	8	10
Japan	9	5.38	9	8
Canada	10	5.37	10	13
Hong Kong SAR	11	5.33	11	12
United Kingdom	12	5.30	12	9
Korea, Rep.	13	5.28	13	11
Austria	14	5.23	14	15
Norway	15	5.22	15	16
France	16	5.22	16	18
Taiwan, China	17	5.22	17	14
Australia	18	5.20	18	19
Belgium	19	5.14	19	20
Iceland	20	5.05	20	23
Malaysia	21	5.04	21	21
Ireland	22	4.99	22	22
Israel	23	4.97	23	17
New Zealand	24	4.93	24	24
Luxembourg	25	4.85	25	25
Qatar	26	4.83	26	31
Saudi Arabia	27	4.72	27	35
Chile	28	4.72	28	26
Spain	29	4.72	29	29
China	30	4.70	30	34
United Arab Emirates	31	4.68	31	37
Estonia	32	4.67	32	27
Czech Republic	33	4.62	33	33
Thailand	34	4.60	34	28
Kuwait	35	4.58	35	30
Tunisia	36	4.58	36	32
Bahrain	37	4.57	37	43
Oman	38	4.55	38	42
Brunei Darussalam	39	4.54	n/a	n/a
Cyprus	40	4.53	39	55
Puerto Rico	41	4.51	40	36
Slovenia	42	4.50	41	39
Portugal	43	4.47	42	40
Lithuania	44	4.45	43	38
South Africa	45	4.41	44	44
Slovak Republic	46	4.40	45	41
Barbados	47	4.40	46	50
Jordan	48	4.37	47	49
Italy	49	4.35	48	46
India	50	4.33	49	48
Russian Federation	51	4.31	50	58
Malta	52	4.31	51	56
Poland	53	4.28	52	51
Latvia	54	4.26	53	45
Indonesia	55	4.25	54	54
Botswana	56	4.25	55	76
Mauritius	57	4.25	56	60
Panama 58	4.24	57	59	
Costa Rica	59	4.23	58	63
Mexico	60	4.23	59	52
Croatia	61	4.22	60	57
Hungary	62	4.22	61	47
Turkey	63	4.15	62	53
Brazil	64	4.13	63	72
Montenegro	65	4.11	64	82
Kazakhstan	66	4.11	65	61
Greece	67	4.11	66	65
Romania	68	4.10	67	74
Azerbaijan	69	4.10	68	66
Vietnam	70	4.10	69	68
Philippines	71	4.09	70	71
Ukraine	72	4.09	71	73
Morocco	73	4.08	72	64
Colombia	74	4.05	73	69
Uruguay	75	4.04	74	75
Bulgaria	76	4.03	75	79
Sri Lanka	77	4.02	76	70
Syria	78	3.99	77	80
El Salvador	79	3.99	78	67
Namibia	80	3.99	79	89
Egypt	81	3.98	80	77
Honduras	82	3.98	81	83
Peru	83	3.95	82	86
Guatemala	84	3.94	83	87
Serbia	85	3.90	84	91
Jamaica	86	3.89	85	78
Gambia, The	87	3.88	86	102
Argentina	88	3.87	87	85
Macedonia, FYR	89	3.87	88	94
Georgia	90	3.86	89	90
Libya	91	3.85	90	88
Trinidad and Tobago	92	3.85	91	84
Kenya	93	3.84	92	99
Nigeria	94	3.81	93	95
Moldova	95	3.75	94	97
Senegal	96	3.73	95	100
Armenia	97	3.73	96	93
Dominican Republic	98	3.72	97	96
Algeria	99	3.71	98	81
Mongolia	100	3.65	99	101
Pakistan	101	3.65	100	92
Ghana	102	3.62	n/a	n/a
Suriname	103	3.58	101	113
Ecuador	104	3.58	102	103
Venezuela	105	3.56	103	98
Benin	106	3.56	104	108
Bosnia and Herzegovina	107	3.56	105	106
Albania	108	3.55	106	109
Cambodia	109	3.53	107	110
Côte d'Ivoire	110	3.51	n/a	n/a
Bangladesh	111	3.51	108	107
Zambia	112	3.49	109	122
Tanzania	113	3.49	110	104
Cameroon	114	3.48	111	116
Guyana	115	3.47	112	126
Tajikistan	116	3.46	113	117
Mali	117	3.43	114	115
Bolivia	118	3.42	115	105
Malawi	119	3.42	n/a	n/a
Nicaragua	120	3.41	116	111
Ethiopia	121	3.41	117	123
Kyrgyz Republic	122	3.40	118	119
Lesotho	123	3.40	119	124
Paraguay	124	3.40	120	121
Madagascar	125	3.38	121	118
Nepal	126	3.37	122	114
Burkina Faso	127	3.36	123	112
Uganda	128	3.35	124	120
Timor-Leste	129	3.15	125	127
Mozambique	130	3.15	126	128
Mauritania	131	3.14	127	125
Burundi	132	2.98	128	130
Zimbabwe	133	2.88	129	129
Chad	134	2.85	130	131

*One country that was included last year is not shown because of the lack of Survey data (Uzbekistan). This explains why the lowest rank in this column is 130, rather than 131.

(Cont'd.)

STATE OF COMPETITION REPORT 2008

Annexure 2

Pakistan

The Global Competitiveness Index in detail

CompetitiveAdvantage   CompetitiveDisadvantage

1st pillar: Institutions

	INDICATOR	RANK/134
1.01	Property rights	93
1.02	Intellectual property protection	84
1.03	Diversion of public funds	78
1.04	Public trust of politicians	82
1.05	Judicial independence	93
1.06	Favoritism in decisions of government officia	98
1.07	Wastefulness of government spending	90
1.08	Burden of government regulation	78
1.09	Efficiency of legal framework	94
1.10	Transparency of government policymaking	109
1.11	Business costs of terrorism	131
1.12	Business costs of crime and violence	110
1.13	Organized crime	114
1.14	Reliability of police services	107
1.15	Ethical behavior of firms	67
1.16	Strength of auditing and reporting standards	67
1.17	Efficacy of corporate boards	126
1.18	Protection of minority shareholders' interests	58

2nd pillar: Infrastructure

	INDICATOR	RANK/134
2.01	Quality of overall infrastructure	83
2.02	Quality of roads	69
2.03	Quality of railroad infrastructure	53
2.04	Quality of port infrastructure	78
2.05	Quality of air transport infrastructure	83
2.06	Available seat kilometers*	47
2.07	Quality of electricity supply	120
2.08	Telephone lines*	108

3rd pillar: Macroeconomic stability

	INDICATOR	RANK/134
3.01	Government surplus/deficit*	118
3.02	National savings rate*	91
3.03	Inflation*	95
3.04	Interest rate spread*	87
3.05	Government debt*	93

4th pillar: Health and primary education

	INDICATOR	RANK/134
4.01	Business impact of malaria	108
4.02	Malaria incidence*	94
4.03	Business impact of tuberculosis	108
4.04	Tuberculosis incidence*	102
4.05	Business impact of HIV/AIDS	94
4.06	HIV prevalence*	23
4.07	Infant mortality*	119
4.08	Life expectancy*	105
4.09	Quality of primary education	117
4.10	Primary enrollment*	122
4.11	Education expenditure*	119

5th pillar: Higher education and training

	INDICATOR	RANK/134
5.01	Secondary enrollment*	121
5.02	Tertiary enrollment*	118
5.03	Quality of the educational system	104
5.04	Quality of math and science education	109
5.05	Quality of management schools	94
5.06	Internet access in schools	81
5.07	Local availability of research and training services	103
5.08	Extent of staff training	119

6th pillar: Goods market efficiency

	INDICATOR	RANK/134
6.01	Intensity of local competition	112
6.02	Extent of market dominance	91
6.03	Effectiveness of anti-monopoly policy	67
6.04	Extent and effect of taxation	42
6.05	Total tax rate*	58
6.06	No. of procedures required to start a business*	91
6.07	Time required to start a business*	51
6.08	Agricultural policy costs	90
6.09	Prevalence of trade barriers	115
6.10	Trade-weighted tariff rate*	120
6.11	Prevalence of foreign ownership	73
6.12	Business impact of rules on FDI	29
6.13	Burden of customs procedures	84
6.14	Degree of customer orientation	109
6.15	Buyer sophistication	94

7th pillar: Labor market efficiency

	INDICATOR	RANK/134
7.01	Cooperation in labor-employer relations	88
7.02	Flexibility of wage determination	95
7.03	Non-wage labor costs*	35
7.04	Rigidity of employment*	84
7.05	Hiring and firing practices	31
7.06	Firing costs*	105
7.07	Pay and productivity	69
7.08	Reliance on professional management	104
7.09	Brain drain	92
7.10	Female participation in labor force*	127

8th pillar: Financial market sophistication

	INDICATOR	RANK/134
8.01	Financial market sophistication	79
8.02	Financing through local equity market	48
8.03	Ease of access to loans	52
8.04	Venture capital availability	86
8.05	Restriction on capital flows	70
8.06	Strength of investor protection*	19
8.07	Soundness of banks	71
8.08	Regulation of securities exchanges	89
8.09	Legal rights index*	72

9th pillar: Technological readiness

	INDICATOR	RANK/134
9.01	Availability of latest technologies	88
9.02	Firm-level technology absorption	84
9.03	Laws relating to ICT	86
9.04	FDI and technology transfer	81
9.05	Mobile telephone subscribers*	110
9.06	Internet users*	96
9.07	Personal computers*	125
9.08	Broadband Internet subscribers*	114

10th pillar: Market size

	INDICATOR	RANK/134
10.01	Domestic market size*	24
10.02	Foreign market size*	57

11th pillar: Business sophistication

	INDICATOR	RANK/134
11.01	Local supplier quantity	66
11.02	Local supplier quality	93
11.03	State of cluster development	66
11.04	Nature of competitive advantage	106
11.05	Value chain breadth	78
11.06	Control of international distribution	97
11.07	Production process sophistication	110
11.08	Extent of marketing	102
11.09	Willingness to delegate authority	74

12th pillar: Innovation

	INDICATOR	RANK/134
12.01	Capacity for innovation	73
12.02	Quality of scientific research institutions	80
12.03	Company spending on R&D	86
12.04	University-industry research collaboration	82
12.05	Gov't procurement of advanced tech products	91
12.06	Availability of scientists and engineers	89
12.07	Utility patents*	87

* Hard data

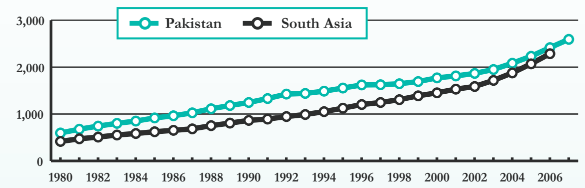
Note: For further details and explanation, please refer to the section "How to Read the Country/Economy Profiles" at the beginning of this chapter.

Pakistan

Key indicators

Total population (millions), 2007	164.6
GDP (US$ billions), 2007	143.8
GDP per capita (US$), 2007	908.9
GDP (PPP) as share (%) of world total, 2007	0.63

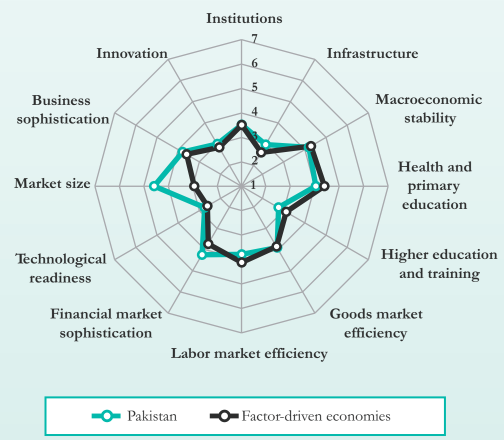
GDP (PPP US$) per capita, 1980–2007



Global Competitiveness Index

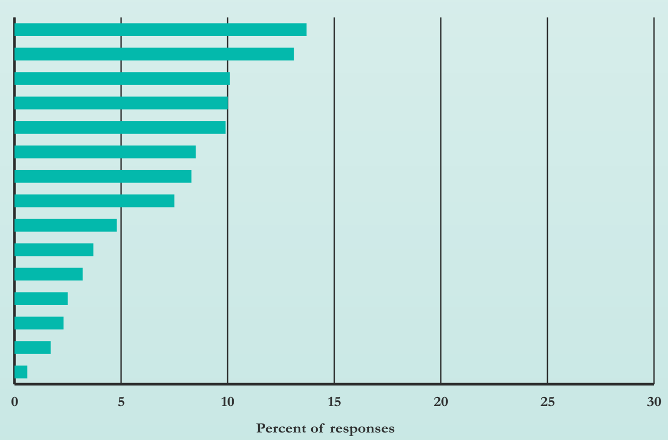
	Rank (out of 134)	Score (1–7)
GCI 2008–2009	**101**	**3.7**
GCI 2007–2008 (out of 131)	92	3.8
GCI 2006–2007 (out of 122)	83	3.8
Basic requirements	**110**	**3.7**
1st pillar: Institutions	95	3.5
2nd pillar: Infrastructure	85	3.0
3rd pillar: Macroeconomic stability	116	4.2
4th pillar: Health and primary education	116	4.0
Efficiency enhancers	**89**	**3.7**
5th pillar: Higher education and training	123	2.7
6th pillar: Goods market efficiency	100	3.9
7th pillar: Labor market efficiency	121	3.8
8th pillar: Financial market sophistication	71	4.2
9th pillar: Technological readiness	100	2.7
10th pillar: Market size	29	4.6
Innovation and sophistication factors	**85**	**3.4**
11th pillar: Business sophistication	87	3.8
12th pillar: Innovation	82	3.0

Stage of development



The most problematic factors for doing business

Government instability/coups	13.7
Corruption	13.1
Inefficient government bureaucracy	10.1
Inflation	10.0
Inadequate supply of infrastructure	9.9
Inadequately educated workforce	8.5
Policy instability	8.3
Access to financing	7.5
Crime and theft	4.8
Poor work ethic in national labor force	3.7
Tax regulations	3.2
Foreign currency regulations	2.5
Tax rates	2.3
Restrictive labor regulations	1.7
Poor public health	0.6



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

w w w . c c . g o v . p k