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**CONSUMER PROTECTION, COMPETITION, COMPETITIVENESS
AND DEVELOPMENT**

Note by the UNCTAD secretariat

Executive summary

This note reviews a set of issues relating to consumer protection, competition and competitiveness from both a national and an international perspective. It raises questions relating to the new dimensions of consumer concerns, especially in developing countries and economies in transition, resulting from globalization and liberalization, such as the effects of privatization of utilities on consumers, deregulation and increased competition, consumer representation, and consumer access to financial services, as well as questions relating to capacity-building for rule-making and enforcement. Issues in international cooperation in the enforcement of consumer protection are also raised.

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FOREWORD

1. UNCTAD X requested UNCTAD to "strengthen the capacity of public institutions for competition and consumer protection in developing countries and help them to educate the public and representatives of the private sector in this field" (Plan of Action, para.141). The Fourth United Nations Conference to Review All Aspects of the Set of Multilaterally Agreed Equitable Principles and Rules for Control of Restrictive Business Practices (25-29 September 2000) decided in its resolution that UNCTAD should:

- "(a) Provide support to public authorities on competition and on consumer protection and assist them in educating the public and representatives of the government and private sectors in the field of competition law and policy"; and
- "(b) Study the feasibility of establishing a UN World Competition and Consumer Day as a means of publicizing benefits to consumers of competition policy and educating the public at large."

2. In addition, the Conference invited UNCTAD "to consider convening an Expert Meeting on Consumer Policy as a distinct body from the Intergovernmental Group of Experts on Competition Law and Policy".

3. Taking into account the existing United Nations Guidelines on Consumer Protection (A/C.2/54/L.24), the Expert Meeting will examine the new dimensions of consumer concerns, especially in developing countries and economies in transition, resulting from globalization and liberalization. To assist it in this task, the Expert Meeting will have before it the conclusions and recommendations of four regional meetings, held in Cartagena, Colombia (23-25 July 2001); in Accra, Ghana (20-21 August 2001); in Goa, India (10-11 September 2001); and in Bishkek, Kyrgyzstan (1-2 October 2001).

Chapter I

GLOBALIZATION, COMPETITION, COMPETITIVENESS AND CONSUMER PROTECTION

1.1 Global competition and consumer concerns

4. The term "globalization", which is intimately associated with the process of liberalization, has come to dominate discussion of development, markets, competition, consumer policy and the environment. Driven by technological advances and reduced costs of transport, globalization has led to greater interdependence among countries. Also, the large-scale movement of goods, services, capital, people and information across national boundaries has led to the spread of technology and ideas as well as to the evolution of global values and an elaborate set of global agreements, treaties and norms. On the supply side, perhaps the most obvious indicator of the impact of globalization can be seen in the increasing importance of transnational corporations (TNCs). On the demand side, the market for goods and services is rapidly becoming borderless and competitiveness is being increasingly determined by diverse factors such as quality, and the ability to innovate, deliver on time and adjust to changing market conditions.

5. Globalization may have positive effects by promoting competition and by widening consumer choice in terms of quality and service. However, it may also be associated with anti-competitive behaviour, or give rise to new forms of such behaviour and be detrimental to consumers' welfare.

6. There is a growing consensus amongst policy-makers that a precondition for sustainable development is the emergence of well-functioning markets. Until recently, the main emphasis was on the removal of obstacles to market forces, and relatively little attention was paid to social welfare. Whilst in many countries the circumstances of consumers may have improved, the emergence of market economies and the process of economic liberalization have also generated unexpected social problems. The economic reforms implemented from the 1980s onwards in many countries have paid little attention to the consequences of such reforms for consumers. It is now becoming increasingly accepted that to secure the benefits of global integration while reducing or eliminating its negative impacts, developing countries need both efficient markets and effective governance of commerce. This is especially true of economies that are more open to trade and international capital markets.

7. The focus of competition law and policy is the market-dominating behaviour of businesses through *inter alia* price fixing or market-sharing cartels, abuses by leading firms and merger control. The main objective is to promote competition as a means of assisting in the creation of markets responsive to consumer signals, and ensuring the efficient allocation of resources in the economy and efficient production with incentives for innovation. This results in the best possible choice of quality, the lowest prices and adequate supplies to consumers, leading to increased consumer welfare. Efficient allocation and utilization of resources also lead to increased competitiveness, resulting in substantial growth and development. There is

considerable evidence that competition is an essential ingredient for enhancement and maintenance of competitiveness in the economy.¹

8. Standard economic theory also tells us that competitive forces work best and deliver the expected outcomes when there exists a market that is not overridden by distortions.² In most developing countries, the conditions for perfect competition are far from being met and the benefits of enhancing economic efficiency do not necessarily always translate into increases in consumer welfare. The relationship between increased competitiveness and development consequently becomes blurred. For example, the consumer welfare and developmental benefits from increased competition resulting from trade and investment liberalization and privatization have been questioned in the light of the experiences of many developing countries.³

1.2 Competition and competitiveness

9. The notion of competitiveness may be viewed at two levels: at the level of the firm and at the level of the economy as a whole. At the level of the firm, competitiveness is described as the ability to produce goods and services of the right quality, at the right price and at the right time. It means meeting customers' needs more efficiently than other firms. In a liberalizing and globalizing world economy, firms and industry competitiveness demand innovation and flexibility to meet the challenges of constantly changing market conditions. Continuous improvement in product, process, technology and organization has thus become the key to sustained competitiveness in a globalizing economy.

10. The need to continuously innovate requires a far larger production capacity and substantial knowledge and financial resources, which have implications for the optimal scale of enterprises. This poses a serious dilemma for small economies. If their firms have to grow to be competitive, what are the implications for the local economy in terms of size and the potential for monopolistic tendencies to emerge? Does it mean that they become too big in a small economy? In this situation, should firms be encouraged to aggressively seek markets abroad, and if so, is the price of domestic concentration acceptable and will there be a concurrent loss to consumer welfare? If firms are prevented from growing too big or entering into agreements with other firms, do policy-makers and consumers fully understand what benefits they are forgoing (if any)? To what extent does success in achieving international competitiveness result in employment, growth and development? Can the dilemma of

¹ In a study containing a major survey of international industrial performance, Porter (1990) found that it is the firms that face strong domestic competition which perform best in international markets. More recent work by Porter (2000) shows that in Japan only those industries characterized by strong domestic competition remain internationally competitive following the country's recent economic downturn – examples include producers of consumer goods such as cameras, automobiles and audio equipment.

² "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." Singh A. and Dhumale R. (1999).

³ O.M. Chanda, "Water sector reforms and the low-income consumers in urban areas", paper presented at an Economic Council for Africa workshop held in Nairobi, Kenya, 19-22 June 2000.

market concentration be resolved by focusing on the regional economy rather than the national economy?

11. Consumer protection policy, on the other hand, seeks to ensure that the efficiencies and innovation benefits brought about by competition are not retained by producers through misleading and deceptive conduct or unfair practices, but are instead shared with consumers. It provides an important safety net in markets where vigorous competition might tempt some businesses to cut corners to gain an unfair competitive advantage.

12. Effective enforcement of legislation prohibiting misleading or deceptive conduct can assist the competitive process. Strong consumer protection regimes with empowered consumers can also remove managerial slackness and make firms more efficient and competitive in terms of quality and prices. While the objectives of both policies are essentially the same, competition policy is more of a proactive policy that attempts to promote consumer interest in a market place, whereas consumer protection policy puts forward mainly a reactive agenda to protect the interests of consumers, and provide access to redress for abuses.

13. The level of competition in a market may affect the level of consumer protection required. If a competitive market is seen as delivering choices in terms of prices and quality, regulatory intervention on behalf of consumers may need to be strategically targeted so that there is little, if any, negative impact on the competitive process. It is important that consumer protection not hinder competition by, for example, imposing excessive compliance costs on businesses, which are likely to be ultimately passed on to consumers.

14. In some instances, globalization has created or intensified difficulties in the implementation of both competition and consumer protection policies. Particular competition concerns for consumers are in the areas of international cartels, and cross-border mergers and acquisitions. There appears to have been a sharp increase in the extent of global cartel activity, or at least in its detection, in the past few years. This is partly due to the impact of trade liberalization, which may have increased the pressure on firms that have traditionally dominated particular local markets without much international competition to collude with producers in other countries to divide up world markets and to agree on prices and output.⁴ Whatever the motives for mergers and acquisitions, this growing phenomenon creates additional burden, in terms of resources, information and enforcement, on national authorities seeking to implement an effective competition and consumer protection policies.

⁴ A World Bank study has shown that, in 1997, developing countries imported \$81.1 billion of goods from industries in which price-fixing conspiracies were subsequently discovered. These imports represented 6.7 per cent of total imports to developing countries and 1.2 per cent of the gross domestic product (GDP). They represented an even larger fraction of trade for the poorest developing countries, for which these products represented 8.8 per cent of imports. There may have been several other price-fixing conspiracies, which remained undiscovered. Moreover, all these cartels are made up of producers, mostly from industrialized countries belonging to the Organisation for Economic Co-operation and Development.

Issues for discussion

Globalization, competition and consumer concerns

How do cross-border mergers and acquisitions affect competition and the welfare of consumers? What have been the experiences of competition and consumer protection authorities in monitoring and controlling cross-border conduct?

1.3 Borderless markets, competition and consumer welfare

15. In a world of borderless markets, Governments are faced with questions about how best to protect their citizens without inhibiting the growth of the evolving global market place. They must determine whether current rules and practices are applicable and sufficient to protect consumers, particularly in the area of electronic commerce; if they are not, they must develop and implement effective and practicable consumer protections. Addressing these challenges requires an understanding of the advantages and limitations of the new technology and the existing consumer protection framework, as well as determining the appropriate balance between government intervention and industry self-regulation in achieving the desired goals.

16. Many of the traditional fraudulent commercial practices are being globalized through borderless markets. These include pyramid schemes and fraudulent business opportunities or products that either do not materialize or fail to meet consumer expectations. Fraudulent operators are taking advantage of the novelty of the electronic media and their marketing capabilities to reach millions of consumers worldwide. Cooperative law enforcement, coupled with business and consumer education about the risks of fraudulent behaviour and how consumers can best protect themselves, is proving to be an effective consumer protection strategy against fraud.

17. The growth of borderless markets and the global expansion of digital and network technologies encourage information exchange, increase consumer choice, and facilitate the ways in which data can be generated, accessed, compiled, processed, linked and stored on global networks. Governments, the private sector and consumer representatives should work to ensure that commercial activities conducted over global networks are at least consistent with the effective implementation of the United Nations Guidelines for Consumer Protection.⁵

18. Education is an essential aspect of consumer protection, and electronic networks, television and radio are well suited to help provide comprehensive and up-to-date information and advice. Digital computer and network technologies can be used to help fight fraud and educate consumers and business.

⁵ A/C.2/54/L.24, as expanded in 1999.

Chapter II

NATIONAL COMPETITION LAW AND POLICY, DEREGULATION AND CONSUMER WELFARE

2.1 Effects of deregulation and increased competition on consumers

19. It is beyond the scope of this note to discuss all aspects of the interface between deregulation, competition and consumer protection issues in all the sectors mentioned above. Instead, a set of selected issues in the professional services sector, airline industry, financial sector and privatization are addressed to flag some important issues concerning this topic.

20. A large number of developing countries have undertaken regulatory reforms aimed at ensuring that regulations better serve public interests and reinforce competition in the market place. These reforms have been introduced in industries such as communications, transportation, water/sewerage, agriculture, and financial and professional services. They have included privatization and the liberalization of restrictions on market entry, and have also related to prices and business practices as well as universal service obligations, although there are important differences across countries and industries. One of the principal objectives of these reforms has been to broaden the scope for markets to allocate resources, and improve general consumer welfare and economic efficiency. Given these considerations, there is a clear interface between competition law and policy, deregulation and consumer welfare (see box below). Often a public choice would need to be made between the extension of economic regulation and consumer protection under the competition laws in order to avoid potential conflict between these two policies and promote consumer welfare. Competition agencies are equally affected by and interested in the regulatory reforms and many have played and continue to perform important advocacy and consumer protection roles in the regulatory reform process. Competition agencies have also been instrumental in drawing attention to how regulation has unnecessarily restricted competition and how part of the solution to this problem may lie in the universal application of general competition law. For example, some countries have removed exemptions applying to the financial services sector or rationalized regulation so as to permit greater competition among banks, insurance companies and pension funds. In other sectors, regulation has even led to anti-competitive practices. In professional services, for instance, there have been cases where regulation has been used to set common fees and prohibit the advertising of prices. Furthermore, when consumers are unable to assess the quality of services, there is a danger that competition will drive down the quality of services delivered to consumers.

Competition law and policy and regulation

Competition law and policy and regulation basically aim at defending the public interest against monopoly power. Competition law and regulation are not identical. There are four ways in which competition law and policy and regulatory problems can interact:

- *Regulation can contradict competition policy.* Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price coordination, prevented advertising or required territorial market division. Other examples include laws banning sales below costs, which purport to promote competition but are often interpreted in anti-competitive ways, and the very broad category of regulations that restrict competition more than necessary to achieve the regulatory goals. Modification or suppression of these regulations compels the firms affected to change their habits and expectations.
- *Regulation can replace competition policy.* In natural monopolies, regulation may try to control market power directly by setting prices (price caps) and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise in support of regulation, i.e. that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.
- *Regulation may substitute for competition law and policy.* Coordination and abuse in an industry may be prevented by regulation and regulators in the same way they are prevented by competition law and policy. As for example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. However, different regulators may apply different standards, and changes or differences in regulatory institutions may reveal that seemingly duplicate policies may have led to different practical outcomes.
- *Regulation can use competition institutions' methods.* Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Coordination may be necessary in order to ensure that these instruments work as intended in the context of competition law requirements.

Source: UNCTAD, *Model Law on Competition*, TD/RBP/CONF.5/7, September 2000.

21. The experiences of many countries show success in removing some of the severe restrictions on competition in regulated sectors, particularly in the professional services sector, through advocacy and competition enforcement. Anti-competitive practices include price-fixing agreements, untruthful advertising, quantitative restrictions on entry and disproportionate entrance requirements. However, despite significant progress through competitive advocacy and competition law enforcement reported by many countries, changes in the professional sector remain relatively slow and incremental, in part because the rents earned from anti-competitive practices can be large and the professional associations' lobby is strong and well organized.

22. In the airline industry, liberalization has highlighted the benefits of competition to consumers in general, but experience has shown that this competition is vulnerable to regulatory impediments and anti-competitive activity by existing airlines. Obtaining the full benefits of competition and competitiveness for consumers in this sector requires attention to both further regulatory reform and competition law enforcement. In particular, the promotion and protection of consumer welfare require attention to both competition and regulatory issues. In particular, effective competition which could enhance consumer welfare could be addressed through:

- (a) Further liberalization of regulatory constraints on competition at both the national and international levels;
- (b) Investment in and allocation of scarce airport capacity, including expansion of existing airports and ensuring entrants access to the available facilities;
- (c) Review of mergers and alliances and use of remedies to offset anti-competitive effects, as well as consideration of separation or divestiture in cases of dominance;
- (d) Control over predatory behaviour and other anti-competitive practices.

Issues for discussion

- (i) If there is a trade-off between competition and sector regulation objectives (for example, reducing the anti-competitive effect would also reduce the effectiveness of the regulation in protecting consumers), how should this be handled?
- (ii) Which sectors are affected by the potential conflicts between regulation and competition policy in safeguarding consumer welfare?
- (iii) What are the principal anti-competitive practices that harm consumers most in regulated sectors?

2.2 Effects of privatization of utilities on consumers

23. An important area that needs serious attention in developing countries is independent regulatory policies in the utility sector. This is especially important, as many countries, including developing countries, have in recent years gone ahead with privatization programmes, often converting State monopolies into private monopolies. Consequently, there is a serious need for sectoral regulators able to impose policies in defence of utility consumers, especially the poor.

24. Traditional public utility industries have a structure in which a non-competitive component of the industry is vertically integrated with a competitive component or activity. Such structures can arise in railways, postal services, telecommunications, electricity and many related industries. It is important that the separation of the two components of public utilities be considered before the privatization process begins in order to ensure that consumers' interest is protected. Also, it is important to place the control of the non-competitive component in the hands of a non-profit entity (usually a government body). Care should be taken, however, to ensure that incentives for efficient operation, maintenance and investment are upheld.

25. As public utilities are privatized there a number of issues related to consumer protection which should be considered:

- (a) Ensuring that goods and services are provided continuously and efficiently according to quality standards, and without a company abusing the dominant position it may have, with consequent harm to the consumer;
- (b) Monitoring and control of anti-competitive practices in the market place;
- (c) Facilitating low-income consumers' access to goods and services by putting in place the necessary safety nets;

- (d) Disseminating information on public goods and services available and their efficient use, and any safety risks;
- (e) Ensuring that the newly privatized entities fulfil their environmental responsibility, namely protecting diversity and the environment in general;
- (f) Ensuring that companies have civil responsibility for harm caused to consumers.

Issues for discussion

- (i) **Regulatory frameworks for privatized public utilities.** Is it necessary to have regulatory bodies, and, if so, what form should they take? At what point in the privatization process should these bodies be established? What should be the relationship between regulators, consumers and competition agencies?
- (ii) **Prices.** How can Governments ensure that privatized companies do not exploit consumers? Is it possible to ensure that consumers do not carry the burden of the losses that utilities may incur by their own inefficiency, and, if so, which policy measures are more appropriate?
- (iii) **Quality of goods and services and mode of delivery.** Which avenues can be explored for the consumer to be assured of quality goods and services and efficient delivery? How can Governments ensure that consumers have been provided with enough information about the good or service delivered?
- (iv) **Information dissemination and training.** Who is responsible for informing the consumer about the post-privatization arrangements, and his or her rights in that connection?

2.3 Competition and consumer access to financial services

26. As economic activities become more globalized through trade, investment and consumption, the challenge of securing access to finance on predictable and competitive terms accentuates the need to maintain a competitive and efficient financial sector.

27. At the international level, rapid and significant changes have occurred in recent years in the structure of financial services around the world, particularly in the developed world. Not only have markets become integrated across traditional product lines or within national borders, but also they have increasingly become global. Competition among financial institutions and between financial and non-financial institutions has become intense. Cross-border mergers and acquisitions in banking and insurance are now transforming the industry.⁶ These mergers and acquisitions are aimed at global restructuring or gaining and consolidating competitive edges. Such changes have been enhanced or, in many cases, initiated by deregulation, which has reduced the existing segmentation of financial services industries. The result is increased competition between and within financial centres on the basis of synergies of skills and infrastructure.

⁶ Described in *World Investment Report 2000: Cross-Border Mergers and Acquisitions and Development*, Part Two, pp. 99-157.

28. The situation is somewhat different in less developed economies. Given the relatively less developed financial sector in most developing countries and countries with economies in transition, and the fact that this sector constitutes a basic infrastructure of the economy, the public sector has traditionally played a large role in banking, securities and exchange, insurance and money markets, and in the postal system, which provides financial services especially in rural areas. The role of the public sector covers not only ownership and management but also prudential supervisory control. Market failure is an acute problem in this sector owing to asymmetries of information between contracting parties and moral hazards. Public policy aims at preventing systemic risk and providing safety nets such as deposit insurance.

29. In the past, competition policy was not a primary objective of regulation of the financial sector. However, as Governments have introduced deregulation and privatization into the sector so as to eliminate State-induced obstacles, there is a growing need for competition policy to address the anti-competitive practices of financial firms. Deregulation needs to be accompanied by appropriate prudential and transparent rules to prevent anti-competitive practices, and enhance competition and innovation in the financial services sector and promote consumer welfare. The major challenge for regulators, however, is that prudential concerns as well as the need to develop domestic financial industries have forced regulators to be generally cautious about introducing competition in the financial sector.

Issues for discussion

- (i) What are the implications of deregulations and technological innovations for the structure of financial markets? Will they enhance competition and consumer welfare?
- (ii) In view of the general trend towards privatization of State-owned financial institutions, is there a role for public policy, cooperatives and mutual institutions in enhancing competition, competitiveness and consumer welfare?

Chapter III

PUBLIC POLICY AND CAPACITY-BUILDING FOR RULE-MAKING AND ENFORCEMENT

3.1 The role of Governments, business and consumer representatives

30. Globalization and the rapid pace of technological innovation in services and consumer products make it difficult to anticipate all the potential consumer protection problems and their solutions. This requires continuous monitoring of consumer protection policies by local authorities. However, businesses also have a vested interest in helping to create and promote a safe environment for consumers. Self-regulatory efforts may offer some of the most promising avenues for consumer protection.

31. Business and consumer groups can work together to develop and implement voluntary self-regulatory codes that establish effective and enforceable consumer protection mechanisms. This could go a long way towards building consumer confidence and trust. Both governmental and non-governmental organizations can facilitate the development of voluntary self-regulatory consumer protection codes and initiatives by providing guidance for the basic elements of global consumer protection on-line. Also, Governments can assist by enforcing laws that support private sector efforts to protect consumers through self-regulatory codes.

32. Governments have recognized that internationally coordinated approaches may be needed in order to exchange information and establish a general understanding about how to address consumer protection in the context of borderless markets.⁷ In this respect, the challenge is how to strike the right balance between the desirability of social development and economic growth based on new network technologies, and the necessity to provide citizens with effective and consistent consumer protection. Many countries have begun to review existing consumer protection laws and practices to determine whether changes need to be made to accommodate the new challenges posed by global markets. These efforts should be part of a global framework for a cooperative effort between Governments, business, consumers and their representatives.

3.2 International cooperation

33. At the multilateral level, UNCTAD can play a role in this regard by bringing together government, business and consumer representatives to clarify specific policy and regulatory issues relating to consumer protection in the context of a globalizing world. The 1985 United Nations Guidelines for Consumer Protection, which have been extended to include provisions on sustainable consumption, define essential issues to be dealt with such as health and safety, access to goods and services, and measures for redress. They recognize two principal concerns: the imbalances that consumers face in economic terms, education levels and bargaining power, and the importance of just, equitable and sustainable economic and social development. The

⁷ See note 6.

Guidelines seek to further international cooperation in the area of consumer protection. They can assist in the identification of priorities and can serve as a model policy framework for developing countries. UNCTAD's Intergovernmental Group of Experts on Competition Law and Policy has provided an intergovernmental forum for international cooperation and interaction between Governments, business and consumer representatives on the issues of competition and the development dimension which oversees the implementation of the Set of Multilaterally Agreed Equitable Principles and Rules for Control of Restrictive Business Practices. The Expert Meeting on Consumer Interests, Competitiveness, Competition and Development is a distinct body from the Intergovernmental Group of Experts on Competition Law and Policy and aims at meeting the challenges posed by the evolving nature of the global economy and working to establish a safe and predictable global market place for consumers.

3.3 Follow-up work at the international level

34. International organizations, including the UN agencies, the Organisation for Economic Co-operation and Development, the World Trade Organization, the International Organization for Standardization, the Codex Alimentarius Commission and the European Union, are increasingly paying greater attention to consumer-related issues and rule-making. It is important to ensure that ongoing work in these areas does not lead to duplication and conflict. At present, there is no systematic understanding of how a coordinated approach to international consumer rule-making could work.

35. There is an urgent need to undertake a study examining how best to pursue a coordinated effort towards the implementation and enforcement of the United Nations Guidelines for Consumer Protection as well as international rules, with a view to developing a more predictable, systematic, efficient and effective approach to international consumer protection, and a coherent, rationalized approach to capacity-building for rule-making and enforcement of consumer protection measures. Such a study would also identify the steps involved in enforcing coherent international consumer protection measures.

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