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COMPETITION AND POVERTY REDUCTION

Background Note

-- Session I --

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COMPETITION AND POVERTY REDUCTION*

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1. Introduction

1. Poverty statistics have been uncharacteristically encouraging in recent years. The number of poor people declined in every major region between 2005 and 2008, according to the World Bank. (See Figure 1, first panel.) It was the first time that happened since the Bank began collecting data in 1981.

Figure 1. Population Living in Absolute Poverty, by Region, 2005 and 2008

2. Nevertheless, poverty reduction remains one of the most important challenges that governments face. The benchmark of US$1.25 per day identifies extreme poverty. If the benchmark is raised to just US$2.00 per day, then nearly 45 percent of the world’s people still live in poverty. (See Figure 1, second panel.) It is no exaggeration to say that “[a]bsolute poverty is a problem of massive dimensions.”

3. Governments are therefore looking in many policy areas, including competition policy, for answers that will help them to make more progress in reducing poverty. To assist in that effort, this session of the OECD’s 2013 Global Forum on Competition will explore the impact of competition on the poor. In this paper, we examine competition’s effect on the poor as both consumers (the demand side) and as small entrepreneurs or workers (the supply side). In both cases, the primary inquiry is whether competition alleviates poverty or not.

1.1 The Poor as Consumers of Essential Goods and Services

4. A country’s poorest people may not always be viewed primarily as consumers, but they necessarily consume things to live. Like everyone else, impoverished people need certain basic goods and services. Those include, for example, foods such as chicken, rice, beans and tortillas; financial services like money transfers and small loans; housing; fuel; and public infrastructure like urban mass transit systems. For the poor, the money spent on such things is a greater – and often far greater – share of their

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* This paper was written by Zsofia Tari and Jeremy West, OECD Competition Division.
income than it is for wealthier consumers. Therefore, when those essential goods and services cost more than they should, poor consumers suffer disproportionately. For them, higher prices might make essential items altogether unaffordable or might require the sacrifice of another item that is also greatly needed. On the other hand, lower prices for essential items have the potential to relieve poverty by putting previously unaffordable items (or greater quantities of items) within their reach. That is one reason why it is intuitively appealing to look toward competition policy as an agent for poverty reduction.

5. Higher prices have many possible causes, such as economy-wide inflation or supply failures. But when prices rise because essential goods or services providers merge with their rivals, use anti-competitive conduct to stifle them, or form a price-fixing cartel with them, protecting competition can lead to substantially lower prices. Other factors, such as overly restrictive or biased regulations, may also lead to unnecessarily low levels of competition and artificially high prices. Ironically, some government policies are motivated by pro-poor concerns but wind up doing more harm than good by harming competition. Some possible examples are implementing subsidies and import/export controls and mandating transportation services on infrequently-used routes. Competition authorities can identify such policies and advocate pro-competitive change as well as encourage competition considerations in pro-poor policymaking generally.

1.2 The Poor as Small Business Owners and Workers

6. Another way competition can make a positive difference is by helping the poor to earn more. If markets are open and competitive rather than closed and monopolistic or cartelised, one might intuitively expect there to be more opportunities for small, poor entrepreneurs and labourers. At a broader level, if more competitive markets translate into greater macroeconomic growth, and that growth boosts employment and wages, then competition might have economy-wide effects that help the poor, too.

7. Alternatively, one could argue that, in some circumstances, competition could take away poor people’s opportunities to succeed with small businesses or to find and keep jobs. Intense competition could lead employers to cut jobs or slash wages as part of an effort to become more efficient, for example. Innovations spurred by the pressure of competition sometimes make jobs obsolete. A market that once had room for small, inefficient entrants would tend to become more efficient as competition increases, possibly so much so that poor, start-up entrepreneurs with little capital would no longer have any chance of surviving if they entered. Even established employers sometimes go out of business when they can no longer compete with more efficient rivals, and when they go, jobs go with them – including jobs that were held by poor people.

8. How can these opposing forces be resolved? Is there evidence that greater competition actually does help entrepreneurs and workers in practice? If it does, are the benefits of competition collected mainly by large companies and wealthy people, or do the poor share in the rewards?

1.3 Other Considerations

9. Regardless of whether we are talking about helping the poor by lowering the prices they pay or by increasing the amounts they can earn, competition’s success in alleviating poverty depends not only on the quality of a country’s competition law and competition authority, but on several conditions. For example, if corruption and non-transparency are widespread within a government, greater competition may not lead to better results for those below the poverty line. It may also be difficult for a competition authority to intervene. In many countries, laws that could be used to fix competition problems are in place but they are not always adequately enforced. That could be, for instance, because the authority lacks the political power and influence to fight multinational corporations, which are often well connected to other parts of the government. We address those types of issues, as well.
Parts 2 and 3 of the paper set up the rest of the discussion by reviewing various ways to define poverty and by identifying its main causes. In Part 4, we quickly review what economic principles tell us about the likely effects on poverty of competition in essential goods and services markets. Then we explore some examples of how competition has actually affected poor consumers in real life. Part 5 focuses on competition’s theoretical and practical effects on the poor as entrepreneurs and wage earners/job seekers. Part 6 examines whether interventionist measures like price controls, import barriers, and subsidies might be better for the poor than competition. Part 7 addresses the issue of competition’s potentially mixed effects on poverty, given that both buyers and sellers are impoverished in some markets. Finally, Part 8 suggests some things that competition authorities can do to help reduce poverty.

2. Definitions of Poverty

While there is widespread agreement on the desirability of poverty reduction, defining poverty is more controversial. There is no objectively correct definition of poverty and most commentators accept that any definition must be understood in relation to specific political, economic or social contexts. For example, although poverty is a problem for both developing and developed countries, the official poverty line is usually higher in developed counties.

An article that appeared in The Economist in 2005 illustrates this point. The article compared the lives of an unemployed truck driver in the coal mining industry of the US’s Appalachia region and a doctor in the Democratic Republic of Congo. At US$521 and US$250-$600 per month, respectively, the incomes of the two men were roughly similar, but the American truck driver was considered desperately poor while the Congolese doctor was deemed to be very well-off. In the US, the median annual income in 2004 was $44,389. More often than not, even “impoverished” American families had at least one television in their home, their children usually attended school, and they typically did not have to grow their own food to survive. In contrast, the average annual income in Congo was US$673 and even basic utilities such as running water and electricity were rare.

Poverty can be defined by using three different concepts: income, basic needs and capability. Of these, the most commonly used concept is income, according to which a person is poor if her income is below a certain amount. The basic needs concept considers the material requirements for a minimally fulfilling life. These are normally understood to include factors such as basic health care and education. The capability perspective concentrates on basic needs such as adequate nutrition, clothing, and shelter, but also considers social aspects such as partaking in the life of a community.

For each of the above concepts there are two measurement methods: drawing an absolute poverty line or choosing a relative poverty threshold. Developing countries, where poverty tends to be a more widespread problem, usually use absolute poverty lines, whereas developed countries often prefer relative poverty measurements tailored to their inhabitants and their particular society’s standards.

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3 Ruth Lister, Poverty (Key Concepts), Polity Press (2004), Chapter 1.


2.1 Absolute Poverty Lines

15. An absolute poverty line is a level below which the minimum requirements for an adequate life are not being met. Absolute poverty lines are typically defined by either a state or an international organisation. For example, in 1990 the World Bank defined poverty as the inability to attain a minimum standard of living and established an international poverty line at US$1 per day to help track the global incidence of extreme poverty. The $1 per day standard was widely adopted.

16. To set that poverty line, the World Bank examined national poverty lines in low-income countries. The poverty lines were converted to a common currency to make it easier to compare them. The Bank used purchasing-power parity (PPP) exchange rates to take into account the variations in purchasing power of different currencies in domestic markets. Poverty lines varied between $275 and $360 per year in PPP terms, using 1985 commodities prices. Because these values are close to $1 per day, that benchmark prevailed as a popular poverty line. The advantage of using an absolute line and the PPP concept for defining poverty is that any two people with the same purchasing power over commodities are treated the same way, even if they live in different countries.

17. The $1 per day definition has drawn criticism for not reflecting the real cost of meeting basic requirements for a human being. However, almost one fifth of the total population in developing countries still lives below even that line.

2.2 Relative Poverty Thresholds

18. Relative poverty thresholds are based on comparisons to a median or average, and they tend to be used by the developed countries. Typically, relative poverty thresholds are set at 40-60 percent of the national median income. Relative poverty thresholds vary by country and they also change over time. The thresholds rise when the country becomes richer and fall when it becomes poorer. Unlike absolute lines, “relative lines do not claim to represent physiological minima and are instead (typically) set at a constant proportion of current mean income or consumption.” Because relative thresholds are always based on the population’s median or mean, poverty can never be eliminated under this definition (unless the distribution is fairly uniform).

19. Sociologist Peter Townsend uses a more subjective definition of relative poverty:

Individuals, families and groups in the population can be said to be in poverty when they lack the resources to obtain the type of diet, participate in the activities and have the living conditions and the amenities which are customary, or at least widely encouraged or approved in the societies to which they belong. Their resources are so seriously below those commanded by the average family that they are in effect excluded from the ordinary living patterns, customs, and activities.

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9 Ravallion, supra n.5 at 3.

20. The European Commission’s definition, adopted in 1975, is very similar to Townsend’s, but the social participation dimension is not explicitly mentioned: “The poor shall be taken to mean persons, families and groups of persons whose resources (material, cultural and social) are so limited to exclude them from the minimum acceptable way of life in the Member State in which they live.”\(^{11}\)

2.3 **The Holistic Approach**

21. Some approaches integrate the absolute and relative methods without setting an exact threshold. Most of the international organisations that have a part in alleviating poverty publish a general definition or explanation of poverty. These are usually holistic definitions that consider not only food scarcity but social and psychological aspects of poverty, as well.

22. The OECD does not endorse a specific definition of poverty, but in its Poverty Reduction Guidelines the Organisation’s Development Assistance Committee summarises poverty as follows:

> The concept of poverty includes different dimensions of deprivation. In general, it is the inability of people to meet economic, social and other standards of well-being. The multidimensionality of poverty is now widely accepted. It is based solidly on research that includes major participatory studies of what poor people mean by poverty. It covers measures of absolute poverty such as child and infant mortality rates, and relative poverty, as defined by the differing standards of each society.\(^{12}\)

23. According to the World Bank, “[p]overty is pronounced deprivation in wellbeing. . . . To be poor is to be hungry, to lack shelter and clothing, to be sick and not cared for, to be illiterate and not schooled. . . Poor people are particularly vulnerable to adverse events outside their control.”\(^{13}\) “The main focus is on whether households or individuals have enough resources to meet their needs. . . . Do they have enough food? Or shelter? Or health care? Or education?”\(^{14}\)

24. The United Nations (UN) Economic and Social Council has a similar definition that emphasises an inability to participate in a society:

> [P]overty is a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society. It means not having enough to feed and clothe a family, not having a school or clinic to go to, not having the land on which to grow one’s food or a job to earn one’s living, not having access to credit. It means insecurity, powerlessness and exclusion of individuals, households and communities. It means susceptibility to violence, and it often implies living in marginal or fragile environments, without access to clean water or sanitation.\(^{15}\)

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25. Nobel Prize-winning economist Amartya Sen used the holistic approach when defining poverty in his book *Development as Freedom*. Economic poverty, he says, deprives people of the freedom to satisfy hunger, obtain sufficient nutrition, remedy treatable illnesses, dress with dignity, live in acceptable housing, or have access to clean water and sanitation. The holistic approach is also reflected in some comments made by Andrew Mitchell, UK Secretary of State for International Development, in 2011. Discussing the progress that has been made in reducing poverty around the world, Mitchell refers not only to growth in per capita incomes but to non-monetary factors such as increased life expectancies and higher enrolment rates in secondary schools.

2.4 The Human Poverty and Multidimensional Poverty Indices

26. The Human Poverty Index (HPI) was developed by the UN to indicate the standard of living in a country. According to the UN, poverty means that the opportunities and choices that are most basic to human development are denied, so the HPI focuses on the deprivation of three basic elements of human life: longevity, knowledge and a decent living standard. Because poverty can have very different meanings in developed and developing countries, there are two different ways to calculate this index.

27. The index for developing countries takes into consideration the probability at birth of not surviving to the age of 40, the adult illiteracy rate, the fraction of the population without sustainable access to a decent water source, and the percentage of undernourished children. The index for developed countries sets the life expectancy at age 60 and considers the proportion of adults lacking functional literacy skills and the population below the income poverty line (50 percent of the median household’s income) as well as the long term (12 months or more) unemployment rate.

28. The UN replaced the HPI with a Multidimensional Poverty Index (MPI) in 2010. The three basic elements remain the same, but the MPI also uses ten indicators of critical “deprivations”, such as education, health, sanitation, assets and services (electricity, drinking water). Taken together, these indicators provide a fuller portrait of acute poverty than either simple income measures or the HPI. A household is identified as multidimensionally poor if it is deprived in some combination of indicator categories whose weighted sum exceeds 30 percent of all the types of deprivations that are tracked.

2.5 An Alternative Approach to Measuring Poverty

29. As we have seen, poverty can be defined in multiple ways, but a good definition should also correspond well with the population’s conception of poverty. A newer term, the “social subjective poverty line”, acknowledges that there is an income above which people tend to think they are not poor anymore and below which they usually think they are poor.

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30. Poor people sometimes believe that they cannot escape from poverty because of factors beyond their control that contribute to a lack of opportunities. Whether to have impoverished parents or not, for example, is obviously not a choice that a child can make, but if a child does have parents who are poor, that circumstance will certainly have an effect on the child’s opportunities. Recognising that fact, the World Bank developed an alternative index to measure how external factors affect one’s opportunities for having an acceptable life. The Human Opportunity Index (HOI)\(^{21}\) considers how personal circumstances (birthplace, wealth, race or gender) affect a child’s probability of access to basic goods and services. The HOI indicates how many opportunities (e.g. overall access to primary education, clean water, etc.) are available in a given country or region, and how equitably those opportunities are distributed between rich and poor people. With the numeric representation of differences in opportunities, it becomes possible to measure a society’s progress in moving toward universal access.

3. Why Poverty Persists

31. Determining why poverty is an ongoing problem is challenging because, among other reasons, perceptions of poverty tend to be different in rich countries from what they are in poor ones. While in some developed countries poverty is mostly viewed as a social problem, in developing countries it is often viewed as an economic one. Andre Béteille describes the complexity this way:

> It is undeniable that economic stagnation and backwardness make the removal of poverty very difficult, and this is particularly true when economic stagnation is accompanied by high population growth. But poverty, including absolute poverty, persists even in countries that are economically advanced and have little population growth, and this has led sociologists to be skeptical about the assumption of a simple relationship between poverty, inequality and economic backwardness.\(^{22}\)

32. It might seem intuitive that stagnant or low economic growth rates contribute to poverty, and that economic growth therefore must be an engine for lifting people out of poverty. It certainly may be, as China’s recent record shows. But a high GDP growth rate, especially in the short run, might also be accompanied by an increase in poverty rather than a decrease. Income distribution is just as relevant to poverty as economic growth is.

33. Among the root causes of poverty, some can be changed and some cannot. Immutable factors include a country’s geography and history, for example. Those things cannot be undone by government policies. Factors that are at least partially remediable – and are therefore more interesting from a policy standpoint – include overpopulation, skewed resource and income distributions, inadequate educational and employment opportunities, and environmental degradation.

34. The remediable causes of poverty can be further divided into general-economic, political/governance and psychological factors. These groupings are just an organisational convenience. As the cursory review below shows, the factors are highly interactive rather than neatly separated.


3.1 **General-economic Causes of Poverty**

3.1.1 **Malnutrition**

35. Poverty is almost synonymous with hunger. In the UN’s first Millennium Development Goal, being poor was essentially defined as not having enough to eat.\(^{23}\) But hunger is not the same as malnutrition. A malnourished person does not experience only discomfort, but an impairment in physical and mental abilities, either due to illness or fatigue.\(^{24}\)

36. The human body needs a certain number of calories to survive. When someone is very poor, the food they can afford may be barely enough to allow them to go through the motions of living and perhaps earn the meagre income that is used to buy that food. If people earn more, they can buy more food, build strength and work more. This simple biological fact can be depicted in an S-shaped curve representing the relationship between income today and income tomorrow. The very poor earn less than they need to be able to do significant work. That creates a poverty trap: the poor stay poor while others get richer, eat better, become stronger, and then find better paid jobs, so the income gap keeps increasing.\(^{25}\)

3.1.2 **Inadequate education**

37. Illiteracy and poor education are widespread among the world’s poor people. While almost all children have access to a primary level education due to recent global programs, 68 million children still do not attend elementary school.\(^{26}\) Some say that the main reason behind that number is that some children have to work to sustain their families and some parents see little reason for them to go to school when the employment opportunities are very limited anyway. That attitude is more common in rural areas. Yet Banerjee and Duflo report that the cause of absenteeism among poor schoolchildren does not seem to be driven by an obvious need at home, but rather by bad health or a simple unwillingness to be in school coupled with a lack of parental pressure to go.\(^{27}\)

38. Another problem is that some countries cannot afford to provide good schools, so even though an education is available it is not always a very good one.\(^{28}\) In developing and developed countries alike, meanwhile, people who cannot afford a college education may increasingly find themselves to be economically disadvantaged, particularly as employment opportunities in many economies continue to shift from being labour-intensive to knowledge-intensive.

39. Not everyone believes that improving formal education will necessarily reduce poverty. William Lewis, for example, has argued that while formal education may be necessary for social, political and philosophical development, workforces can be trained on the job to work at higher productivity levels. He

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\(^{27}\) Banerjee & Duflo, supra n.25 at 71-74.

\(^{28}\) Id. at 73-74.
pointed out that even though South Korea made a massive investment in public education, its workers achieved only 35 percent of the United States’ level of labour productivity.29

40. That, however, was in 2004. By 2011, South Korean labour productivity had grown to nearly 50 percent of the US level, meaning that labour productivity in South Korea grew faster than it did in the United States.30 While education may not have had anything to do with that, it might be the case that returns on an investment in education just take a while to show up.

3.1.3 Unemployment

41. The lack of employment opportunities has an obvious influence on poverty. “Historically, the link between unemployment and poverty is unmistakable.”31 Unemployment rates are currently high (varying between 5 and 20 percent) in developed countries.32 The situation is generally worse in developing countries (10 to 95 percent, but accurate data are often unavailable).33 In countries with large populations, a few percentage points of unemployment represent millions of people without jobs.

42. Of course, finding work does not automatically mean that a person’s financial situation will become adequate. Wages may be so low that people remain poor even when they are employed. In fact, there are more than six times as many working poor people in the world as there are unemployed poor people. That fact led Fields to observe that “[w]hat the developing countries have is an employment problem – that is poverty among those who work – rather than an unemployment problem.”34

3.1.4 Environmental degradation

43. The exploitation and deterioration of the environment (including bodies of water, forests, air and soil) can lead directly to poverty. The overpopulation and overuse of lands may cause shortages of food, clean water and building materials for shelters. In many developing countries a considerable percentage of the people subsist on agriculture, so they are dependent on lands and forests for their survival. Deforestation and the overuse of lands narrow the possibility for those people to feed themselves properly. Air and water pollution also contribute to health problems, which can limit a person’s ability to work and earn an income.

3.1.5 Economic trends

44. Inflation and certain changes in labour markets also contribute to deepening poverty. High inflation is a particularly punishing tax on the real incomes and savings of the poor.35 They tend not to use savings accounts, which (should) pay interest that rises with inflation, while the interest rates they pay to

34 Fields, supra n.2 at 253.
borrow money will surely climb. Very poor people already have to pay relatively high interest rates because regular commercial banks do not usually lend to them. So in the end they are likely to lose more than they gain by borrowing when inflation increases. Debt overhang (a condition in which a business, government, or family has so much debt that it cannot easily borrow more, even though new loans might be good investments that would more than pay for themselves) is another factor that causes and prolongs poverty.

45. Even when a family is not heavily indebted, economic trends can push them into poverty. For example, older workers who have held labour-intensive jobs most of their lives in developed countries are often jeopardised when manufacturing processes are outsourced to developing countries where the labour force is cheaper. While that shift can help to lift people in the developing countries out of poverty, when the older people who lost their jobs in the developed countries cannot be retrained, they may become unemployed and poor.

3.1.6 Single parenting

46. Single-parent families, usually women with children, tend to have a harder time escaping poverty than traditional families do. When both parents live with the children, the adults can allocate and share childcare and work duties. In contrast, poor single parents have to do everything themselves unless another relative is available to help, and they have no spouse to rely upon if they become unemployed. Illustrating the greater susceptibility of single parent families to poverty, the (absolute) poverty rate for mother-only families in the US was 43 percent in 2010, whereas the rate for two-parent families with children was 13 percent.36

47. Some developed countries have had a substantial decrease in the percentage of two-parent households during the past few decades. From 1970 to 2008, divorce rates increased in most OECD countries.37 In the US, for example, about 87 percent of children lived with both of their parents in 1970. By 2000, only 69 percent did. Part of the reason for that decline was an increase in the divorce rate, which more than doubled between 1960 and 1980. The rate levelled off in the 1980s and fell a bit in the 1990s, but in the meantime, the proportion of children born to unmarried parents had grown from five percent in the early 1960s to more than 33 percent in 2000.38

48. Across all OECD countries, 9.1 percent of households are single-parent households, out of which almost 85 percent are mothers with children.39 Single-parent households are three times more likely to be poor. The mean poverty rate in single parent families was 31 percent, compared with nine percent in two-parent families, in the mid 2000s in all OECD countries.40


40 All of the poverty rates in single-parent families in the OECD countries can be found in the OECD Factbook 2009, available at: www.oecd-ilibrary.org/docserver/download/3009011ec101.pdf?expires=1360225789&id=id&accname=guest&checksum=8B3638DC0C55FF5CD1FC5BC69BF6D8B3.
3.1.7 Sickness and disease

49. HIV/AIDS and other disease epidemics not only cause poverty but spread it, generating a far-reaching vicious circle. Even in the case of less serious illnesses, if a poor family has to borrow money for medicine or just for ordinary living supplies while a father or a mother is unable to work, the extra expenses and interruption to the flow of income can leave the family with no way to climb out of debt. Making matters worse, poor countries and people often lack the financial resources for preventative measures such as vaccinations, antiseptics, and educational programmes.

3.2 Political/Governance Aspects

50. Factors like corruption, rent-seeking elites, and a lack of respect for human rights also contribute to creating and perpetuating poverty. Weak institutions, laws, and courts, inefficient bureaucracies, a lack of social cohesion and insufficient political will to undertake reforms are all common features of bad governance and are inimical to sustainable development and poverty reduction. Moreover, political instability and unreliable institutions not only deter foreign investment but encumber national entrepreneurs who could be the basis for developing small and medium size enterprises.

51. Political violence from guerrilla groups can also contribute to poverty. In areas where such groups are serious threats, the steady risk of sudden expropriation reduces investment incentives and can force people into low productivity occupations, and thus into poverty. Political violence can also lead to huge displacements in which people are forced to abandon their land and jobs in order to escape from dangerous conditions. Rural people may wind up in cities, where their skills and educations may not match the demand for labour, so they have difficulty earning a living. When political violence has flared in Colombia, for example, the vast majority of displaced people have suffered from poverty.

52. Former World Bank President Paul Wolfowitz recently wrote that “[a]round the world, countries that are governed well, such as Brazil and Ghana, are making progress against poverty. Countries that are governed poorly are not reducing poverty [...]” Good governance, in the opinion of Wolfowitz and his co-authors, includes establishing written constitutions and laws, having free elections and universal voting rights, guaranteeing the right to free speech and association, protecting the judiciary’s independence, and holding public officials accountable for their actions. The authors also note that democratic societies have typically been better at reducing poverty than politically closed societies. Part of the reason is that when too much political power is held by too few people, a sense tends to develop among citizens that the economic game has been rigged to benefit the society’s elite class: “Where political power is concentrated, economic power tends to be concentrated as well, with the result that the enterprise and initiative that are essential for economic growth and job creation are stifled.”


44 Id.
In a new book, two professors place the blame for poverty squarely on political institutions. A lack of natural resources, a poor climate, a particular culture -- none of those factors are valid excuses for poverty, according to Acemoglu and Robinson. Until a country's political institutions are fixed, they assert, it cannot develop because economic institutions depend on political ones. The most common reason nations fail today is because they have extractive institutions -- which cement the power of those who benefit from the extraction -- instead of inclusive ones.

Extractive political institutions concentrate the power in the hands of a narrow elite and place few constraints on the exercise of this power, while inclusive political institutions [...] are those that allow and encourage participation by the great mass of people in economic activities that make the best use of their talents and skills and that enable individuals to make the choices they wish.

Through the analysis of the histories of both empires and countries, Acemoglu and Robinson conclude that development and prosperity can come about only when people know that if they work hard they will make money and get to keep it.

For development and prosperity, strong political institutions that share power -- like the institutions of democracy -- are crucial. They enable entrepreneurs to start businesses and to make long term strategic plans for how to grow and be productive so as to earn even more profit. Acemoglu’s and Robinson’s analysis shows, incidentally, that more productive countries have lower unemployment rates, which result in lower poverty rates.

Inclusive institutions also enable innovation, which is crucial to growth and poverty reduction. Innovation should not be held back because of special interests or protectionism, the authors argue. Historically, economies that supported the mechanisation of sectors like agriculture and manufacture prospered faster than those that mechanised more slowly due to concerns about the unemployment caused by industrialisation. Short term unemployment, though it can cause serious hardship, is therefore a sacrifice worth making. Economic growth and technical change are always accompanied by creative destruction. New technologies make existing skills and machines obsolete and this process obviously creates economic as well as political losers and winners on the market for a while. Often, however, the political elite stand in the way of development because they want to protect their power and incomes. That is why Acemoglu and Robinson conclude that egalitarian countries grow faster than elitist ones.

We take a closer look at the ways in which biased and misguided governance can contribute to poverty (partly by preventing competition from helping) throughout Parts 4.2.5, 5, and 6.

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46 Id. at 81.
47 Id. at 75.
48 Id. at 83-87.
3.3 Psychological Aspects – A Culture of Poverty

The idea of a culture of poverty is a theory about a psychological poverty trap. The theory holds that people who grow up in a poor family are socialised as poor people and that they do not view long term planning or saving money as realistic ways to escape poverty. Oscar Lewis describes them as being disconnected from the rest of society:

The people in the culture of poverty have a strong feeling of marginality, of helplessness, of dependency, of not belonging. They are like aliens in their own country, convinced that the existing institutions do not serve their interests and needs. Along with this feeling of powerlessness is a widespread feeling of inferiority, of personal unworthiness.… Usually, they have neither the knowledge, the vision nor the ideology to see the similarities between their problems and those of others like themselves elsewhere in the world. In other words, they are not class conscious, although they are very sensitive indeed to status distinctions. When the poor become class conscious or members of trade union organizations, or when they adopt an internationalist outlook on the world they are, in my view, no longer part of the culture of poverty although they may still be desperately poor.\(^{49}\)

Poverty has many different roots, and even if governments could eliminate all of the others they would still have to conquer the psychology of poverty, convincing poor people that it is worthwhile to save and spend the savings wisely.

4. Competition’s Effect on Poor Consumers of Essential Items, in Theory and in Practice

4.1 Theoretical Effects

60. From a standard microeconomic theory perspective, the effect of competition on poor consumers is straightforward: competition drives markets toward the equilibrium of supply and demand, eliminates inefficiency, and eventually results in prices that are equal to the most efficient firms’ marginal cost. If a market is less than perfectly competitive to begin with, then greater competition should bring about lower prices, higher output, better quality, and possibly more innovation. These results are generally to be expected in all markets, not just essential goods and services markets, and they benefit all consumers, including impoverished ones.

61. For example, if a rice cartel is dismantled by a competition authority’s intervention, we would expect poor consumers to benefit from lower prices and higher quantities in the rice market because the cartel members are no longer coordinating with each other to restrict their output and keep prices artificially high. Similarly, if a proposed 3 to 2 or 2 to 1 merger between two mobile phone service providers is blocked, we would probably expect the prices of mobile phone calls and text messages to remain lower than they would have been had the merger been permitted, because the two firms involved will have to continue competing. In the longer run, the competition that was preserved may also lead to more productivity growth – and thus relatively lower prices – as the firms vie with one another by innovating to cut costs and raise quality/service.

62. The poor can also benefit indirectly from greater competition. Suppose that a country has an anti-poverty programme in place, but that its procurement operations are generally plagued by bid-rigging. The contractors would be siphoning off money that would otherwise be used to fund the programme. The artificially high premiums charged by the big-riggers might mean, for example, that a supplemental nutrition program for poor children has to be cancelled due to lack of funds, or that only two new job training centres can be built instead of three. Ending the collusion and making the contractors compete again would lower costs, putting the savings back into the government’s budget.

63. Of course, a government programme does not necessarily have to be aimed specifically at fighting poverty for it to do so. For example, good roads can help people in many different socioeconomic groups, including rural farmers who need to receive farming implements and transport their crops to market. When bidding for road construction is rigged, though, fewer roads get built and repaired. Keeping the bidding process competitive will be very beneficial for the farmers, along with everyone else who relies on the roads.

64. Moreover, competition can have a kind of cleansing effect that eliminates the harm caused by corrupt and inefficient practices like nepotism and other forms of meritless favouritism. Businesses facing competitive constraints are less able to afford the habit of filling well-paid positions with poorly qualified relatives of executive officers or well-connected customers. Likewise, under competition, successful companies are those with the best products and prices, not those paying the biggest bribes or managed by people from favoured ethnic groups, etc.

65. A special case arises when competition problems exist at multiple levels in the chain of production. Suppose, for example, that in a particular country there are two wheat processors, who are protected from import competition by trade barriers and who allegedly collude by fixing the price at which they sell wheat flour to food manufacturers. Those manufacturers, in turn, sell to two large supermarket chains that share a duopoly. Suppose further that the two supermarket chains allegedly fix the price of wheat bread they sell to consumers. The national competition authority receives complaints about both price fixing arrangements, but it does not have the resources to pursue both matters simultaneously. Assuming that the authority’s objective is to achieve the best result for consumers, which case should be pursued first? Does it matter?
Some might argue that the authority should go after the supermarkets first because the retail bread market is logistically closer to consumers than the wholesale flour market. In particular, one hypothesis could be that because pass-through rates of supra-competitive pricing are less than 100 percent, a price reduction upstream can be expected to result in less benefit for consumers than a price reduction downstream. But does “closeness” to the consumer market really matter? In other words, if the competition authority succeeds in proving its price fixing case and the supermarkets no longer collude, will consumers see a greater reduction in the price of bread than they would have if the authority had successfully prosecuted the wheat processors for collusion instead?

Which case will yield the most savings for consumers on the price of wheat bread depends mainly on which stage in the chain of production has the bigger supra-competitive price mark-up and which case is easier to prove. The mark-ups depend on the elasticities of the cost and demand curves faced by the cartelists in their respective markets. There is simply no way to know in advance, as a matter of pure theory, which intervention by the competition authority will yield the biggest payoff for consumers. If the supra-competitive mark-ups in the flour and bread markets happened to be identical, and if both cartel cases really were equally easy to prove, then a retail market intervention would probably yield a larger benefit for consumers. Otherwise, that would not necessarily be true.

What is clear is that when there are competition problems at multiple stages in the chain of production, solving only one of them is unlikely to bring retail prices down to the competitive level. That may present a thorny public relations problem for competition authorities, especially in small or developing nations where essential goods frequently do have chains of production that are rife with multi-stage market power and/or anti-competitive conduct. Under these circumstances, consumers may not see a meaningful difference in prices until the competition problems at most or all of the levels are fixed. But the competition authority may be able to address only one problem at a time. That can create a frustrating, no-win situation for the authority. Either it loses its first case, which is an obvious public relations blow. Or it wins its first case but consumers do not see a significant difference in retail prices because competition problems remain at other levels of the production chain. So from the consumers’ perspective – and possibly from the average Minister’s perspective – the authority failed to make a difference.

The best approach that authorities can take in such situations is to base their decision about which stage of production to pursue first on a) where the highest supra-competitive price mark-up is occurring; b) which case is easiest to prove; and c) whether the authority would be able to solve competition problems in several product or geographic markets at once by intervening against certain firms, e.g. if the colluding firms at one particular link in the chain of production are also colluding in other markets, whereas the colluding firms at another link in the chain are not.

If we put theory aside, though, what is known about the actual effects that competition has had on poor consumers? We examine that question in the following section.

Another way to put the argument in favour of prioritising downstream interventions would be to contend that all the gains of an upstream intervention would be swallowed by the downstream cartel, so upstream actions are futile until the downstream problem is solved. But that would not be correct, either, because as marginal costs to retailers fall, their prices will also fall to some degree, regardless of the market structure. Then again, not all of the gains from an upstream intervention will get passed through, so it is possible that even if the mark-ups are bigger upstream than downstream, a downstream intervention might yield bigger benefits for consumers, all else being equal. However, in reality, all else will not be equal, and the answer to the question of which market to address first will depend mainly on which market has the highest mark-up and which case is easiest to prove.
4.2 Actual Effects

4.2.1 Competition problems affect consumers in both developing and developed countries

71. One way to establish that competition has actually helped poor consumers is to show that a lack of competition has harmed them. The competition community tends to accept as fundamental truths the ideas that wherever there are markets there is always a possibility that competition problems will occur, that such problems can indeed be found in virtually all market economies, and that they cause substantial harm to consumers. At times, however, officials from other policy domains and backgrounds, particularly in developing countries, have expressed scepticism about whether those ideas really hold true in their jurisdictions.\(^{51}\)

72. To help change that attitude, Simon Evenett, Julian Clark and Frédéric Jenny amassed databases of actual and alleged anti-competitive conduct in developing countries around the world.\(^{52}\) Their information shows not only that there is plenty of anti-competitive conduct in the developing world, but that much of it affects markets for essential goods and services. For instance, Peruvian poultry farms and their trade association have conspired to block entry and eliminate competitors. Likewise, 11 Peruvian wheat flour producers and their trade association formed a cartel to end a price war. Zambian poultry firms have demanded that their biggest customer stay out of the production market – and the customer complied.\(^{53}\) Cartels and boycotting agreements have been discovered and prosecuted in the baking, milling, sugar and milk industries in developing countries. Anti-competitive practices are endemic in public transportation markets such as bus and taxi services, on which many poor consumers depend. The cement industry, on which so much public infrastructure – including public housing – relies, is riddled with cartels and abuse of dominant positions.\(^{54}\) These problems are not specific to a small group of countries but rather are widespread throughout the developing world. (In fact, a closely related sector, construction, is perennially one of the most cartel-infested industries across the developed world, as well.\(^{55}\))

73. Years ago, the World Bank compiled a list of cartel prosecutions in developing countries. The cartels involved several kinds of essential goods and services, such as phone cards in Bulgaria, milk products in Estonia, citrus fruits in South Africa, and wheat in Chinese Taipei.\(^{56}\)

74. At a more detailed level, OECD peer reviews of developing countries reveal numerous instances of anti-competitive conduct in essential goods and services markets. In Argentina, for example, six cement

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\(^{51}\) See Frederic Jenny, “Cartels and Collusion in Developing Countries: Lessons from Empirical Evidence,” 29 World Competition 109, 109 (2006) (describing how competition issues were dropped from the Doha round of WTO discussions in part because a number of government officials believed that domestic anti-competitive practices were not prevalent in their counties, or that they did not impose a large cost on their economies).


\(^{53}\) This case is discussed in more detail in Part 5.2.2.2.


companies were alleged to have engaged in a nationwide market allocation scheme for a period of almost 20 years. A 1999 news article describing cartel activity in the sector sparked an investigation, which ultimately generated enough evidence to prove the conduct. The agreement was coordinated by the cement manufacturers’ business association. Its members exchanged detailed, company-specific, and current information on production, shipments and sales. Five of the six producers were fined a total of US$106 million.57

75. In 2008, the competition authority in Honduras opened an investigation of the cement market to determine whether an agreement existed between the country’s two cement producers to fix prices and share markets. The authority determined that the firms had colluded, given the regular communications between them that had taken place through the Cement Institute Foundation (Fundación Instituto del Cemento), their parallel behaviour in setting and changing prices, the fact that there were only two competitors in the market, and the lack of a rational explanation by the larger firm for the fact that it charged the same prices as its competitor despite having lower production costs. The Commission imposed a fine of L.51,896,000 (approximately US$2,730,000) on one firm and L.35,515,000 (approximately US$1,869,000) on the other.58

76. Another 2008 case in Honduras involved the sugar industry. The competition authority investigated whether the sector’s leading six firms were colluding. The evidence included the uniformity of price levels and price movements, despite variations in the firms’ costs. Several market characteristics facilitated collusion, including the lack of substitutes, a homogeneous product, and inelastic demand. In their defence, the investigated firms claimed that the Ministry of Industry and Trade invited them to regulate and agree upon sale prices to the wholesaler Central de Ingenios S.A. Nevertheless, in addition to imposing a fine on each of the firms ranging from L.6,514,306 (US$324,000) to L.20,204,899 (US$1,095,000), the Commission prohibited them from participating in meetings at the Ministry of Industry and Trade for the purpose of regulating market prices.59

77. A paper by Joseph Wilson of the Competition Commission of Pakistan describes several episodes of anti-competitive conduct that specifically harmed low-income consumers. One involved a savings program designed only for small account holders that was advertised by a bank industry trade association. The announcement mentioned a particular interest rate that would be paid by every bank offering that type of account. Wilson notes that the banking sector in Pakistan is highly concentrated, with the top five banks controlling 80 percent of the market. The spread between the interest rates for borrowing and saving in Pakistan is among the highest in the world, and Pakistani banks are the most profitable banks in the Asia-Pacific region. Jointly fixing the interest rate that would be paid to low-income savers obviously deprived them of the ability to benefit from competition and, by making saving less attractive, hindered efforts to alleviate poverty.60

59 Id. See United Nations, Implementing Competition-Related Provisions in Regional Trade Agreements: Is It Possible to Obtain Development Gains” (2007) for more examples.
4.2.2  A lack of competition harms poor consumers – and it does so disproportionately

78. Once we accept that significant anti-competitive conduct occurs in both developed and developing countries, we can implicitly argue that competition helps poor consumers everywhere by showing that a lack of competition harms them. There is evidence for that proposition. As Eleanor Fox observes, the data compiled by Evenett and Jenny leave no room for doubt that consumers in developing countries are harmed by elevated prices arising from cartels, mergers and monopolistic practices, and because some of the anti-competitive conduct affects essential goods and services, poor consumers suffer, too. Jenny describes the information in the databases as “stunning with respect to the scope and importance of anticompetitive practices revealed in developing countries.” Connecting this finding with poverty and how greater competition can alleviate it, he observes:

[A]nticompetitive practices such as price fixing in the retail sector or in the consumer goods sector clearly impose a large cost on consumers, and in particular the poorest consumers, by artificially increasing the price of basic necessities. If a sizeable portion of these goods is beset by competition problems and subject to overcharges of 10 to 15 percent, the problems of the poor will be compounded and their lives made worse. Thus, the fight against extortionary anticompetitive strategies should rightly be a part of pro-poor policies.

79. Separately, academics like John Connor have studied the impact of cartels on consumers. In one study, he found that during the period 1990 to 2007 Latin American consumers paid at least US$35 billion in overcharges due to price fixing by international cartels. Of course, that amount was paid by all consumers, not just the poor. Then again, the figure represents only the harm due to the cartels that were actually detected, and it ignores domestic cartels as well as effects in other parts of the world.

80. Moreover, some studies show that low levels of competition tend to harm poor consumers disproportionately. Creedy and Dixon, for example, have studied the relative burden of monopolies in certain commodities markets on Australian households from diverse income groups. The authors examined data from the Australian Household Expenditure Survey to see how the households spent money on products in 14 commodity groups such as food, non-alcoholic beverages, and housing costs. Creedy and Dixon were able to calculate the static loss of consumer surplus due to monopoly across the commodity and income groups. They found not only that there were welfare losses associated with monopoly power across all the income groups, but that the losses as a relative percentage of consumer surplus were higher for low-income households than for high-income households. In other words, the study showed that monopoly increases inequality among consumers. In fact, the data showed that the burden on the poorest ten percent of households was 46 percent higher than the burden on the richest ten percent. That finding did not change from market to market, leading Creedy and Dixon to conclude that regardless of the absolute size of the welfare loss due to monopoly, there may be a disproportionate impact on poorer consumers.

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61 Fox, supra n.54 at 226.
62 Jenny, supra n. 51 at 113 (2006).
63 Id. at 134 (2006).
66 A year later, Creedy and Dixon followed up with a study that examined the same issue but used a better method for measuring welfare and a concept of the lack of competition that was broader than the extreme case of a single seller. The main results and the authors’ conclusions were the same as in the earlier study, however. John Creedy & Robert Dixon, “The Distributional Effects of Monopoly,” 38 Australian Economic Papers 223 (1999).
81. Carlos Urzúa reached similar results in a study carried out for the OECD in 2008. Using data from Mexico’s National Survey of Income and Expenditure of Households, he studied the impact of market power on levels of household spending on staple products like tortillas, chicken, and milk. The data showed, as it did in Australia, that the relative negative effect of monopoly power is greatest among the poorest ten percent of households. In urban areas, those households suffer a relative welfare loss that is nearly 20 percent higher than that suffered by the wealthiest ten percent of households. This discrepancy is even more pronounced in rural areas, at nearly 23 percent.

82. Urzúa also created a map, reproduced below in Figure 2, which compares the welfare losses of each Mexican state relative to the state with the lowest loss, Baja California (in the upper northwest corner of the map). On the map, the red states (which look dark grey in black and white versions of this paper) have losses more than 2.5 times higher than Baja California’s loss, the orange states (medium grey) have losses that are 2 to 2.5 times higher, and the yellow states (light grey) have losses less than twice Baja California’s. It is easy to see that the southern states — many of which are among the poorest in Mexico — have the highest relative welfare losses.

Figure 2. Relative Social Welfare Loss Due to Monopoly Power in Mexico, by State


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83. Such findings appear to be consistent from country to country as well as from market to market. Hausman and Sidak obtained similar results when they studied the relative burden on poor consumers of the low level of competition in the US residential telecommunications market. They found that poor and less educated consumers pay more for long distance telephone calls than wealthier and better educated consumers, even after controlling for differences in levels of usage. Although the data available at the time was insufficient to prove it, the authors suspected that the discrepancy between what the two sets of consumers pay would shrink as a result of entry. 68

84. Given the especially heavy and negative effect of market power on poor consumers, these studies suggest that attacking cartels, abuses of dominant positions, and anti-competitive mergers in markets for essential goods would not only yield benefits to poor consumers, but that those benefits would be relatively strong.

4.2.3 A sample of cases showing that competition benefits poor consumers

85. Currently, there is not a large amount of publicly available data concerning the direct effect of competition in essential goods and services markets on poor consumers. This could be a fruitful area of study for competition authorities, who may be in the best position to examine the effects of their past interventions on consumers. At least some helpful information is available, though. This section of the paper focuses on two markets, banking and mobile telecommunications services, which provide clear illustrations of the benefits that competition can bring to poor consumers. Later, we will examine how competition in these same two sectors has helped poor entrepreneurs, as well.

4.2.3.1 Banking services

86. When he was Secretary-General of the United Nations, Kofi Annan observed that

[b]uilding inclusive financial sectors improves people’s lives, in particular those of the poor. A small loan, a savings account or an insurance policy can make a great difference to a low-income family. They enable people to invest in better nutrition, housing, health and education for their children. They ease the strain of coping with difficult times caused by crop failures, illness or death. They help people plan for the future. 69

87. Relatively few poor households in the world are connected to formal banking services (i.e. services provided by a regulated financial institution), though. A survey by Banerjee and Duflo, for example, found that in Panama and Peru less than one percent of poor households (defined as those living on less than US$2 per day) have savings accounts. Globally, more than 2.5 billion people do not have a formal bank account. 70 But poor people in general do manage to save money. Furthermore, many of them want to save money. One survey of urban adults in Brazil, for example, found that 64 percent of the respondents who did not have bank accounts were interested in having one. Yet poor people, whether they live in developing countries or not, tend to keep the extra cash they accumulate in unsecure places because formal savings accounts are either too expensive or unavailable at any price in their geographic area. 71


70 Department for International Development, supra n.17 at 13.

Consider, for example, that bank account maintenance fees cost formal sector workers in Rwanda three percent of the average monthly wage. In Singapore, those fees amount to only 0.05 percent of the average monthly wage. In fact, not only is the relative amount higher, the absolute amount is higher, too – much higher (US$4 per month in Africa, on average, versus about US$0.50 per month in South Asia). Asset concentration among banks is higher in Africa than in any other region. That may have something to do with the relatively high fees.\(^\text{72}\)

In any event, formal financial institutions typically do not go out of their way to serve the poor. It is a cruel irony that the relative cost of providing banking services to the poor is high, in large part, because the poor have so little money. With very low amounts at stake in each account, the profit available for banks in providing traditional savings accounts and loans to the poor is quickly eaten up by transaction costs. Another problem is that many of the poor live in thinly populated rural areas. The banks, being profit maximisers, seek economies of scale, so they are mainly interested in serving wealthier clients who live in large urban areas with dense populations. As a result, geographic distance, unsuitable terms and conditions, and unrealistic minimum balance and deposit size requirements all inhibit the poor from engaging in the formal banking industry even when the opportunity to do so is technically available to them.

 Nevertheless, and even though participation in the formal banking sector is still rare among poor customers, things are better than they used to be and a major reason for that is competition. For example, many Latin American financial markets were liberalised in the 1990s, allowing foreign banks into the region. The resulting increase in competition motivated banks to find progressively smaller-scale customers, which has helped some low-income families.\(^\text{73}\)

More competition would probably be even more helpful. Fortunately, the advance of technology is making that happen. More than one billion people own mobile phones but do not have a bank account.\(^\text{74}\) That fact created an enormous opportunity for mobile technology-based entrants to compete with the formal banks for the poor’s banking business. Not only did that happen, but the entrants have done it profitably.

Text messages sent and received by prepaid mobile phones have now emerged as a way for poor consumers to complete financial transactions while bypassing the formal banking infrastructure. For example, if the recipient of a money-bearing SMS does not have a bank account, the remitted sum can be converted into a pre-paid debit card that can then be used to make purchases. Or a line of consumer credit can be opened at a local retail outlet with password protection that works via SMS. Governments such as South Africa’s have advocated these systems, using them for many types of payments, including conditional transfers to low-income recipients. Text messages are not only faster than traditional financial transaction media like cheques, they are cheaper and more secure, too, both for the sender and the receiver.\(^\text{75}\)

M-PESA, which debuted in Kenya, is probably the best example of how successful mobile payment systems for the poor can be – both for the system operators and for the poor themselves.

\(^{72}\) World Bank, “Banking the Poor” (2009) at pp. 10, 29.


\(^{74}\) Department for International Development, supra n.17 at 14.

Safaricom Limited, a private telecoms company backed by Vodafone, introduced a mobile payment system called M-PESA in 2007. M-PESA is a low-cost, SMS-based, person-to-person money transfer service that requires neither senders nor recipients to have bank accounts. Senders can buy digital funds at any M-PESA agent and send electronic cash to any other mobile phone user in Kenya. Recipients redeem the SMS for conventional cash or else use their M-PESA-enabled phones as an electronic wallet. Phones are permitted to hold up to 100,000 Kenyan shillings (about 847€ at the current exchange rate). Within two years of M-PESA’s launch, its subscriber base exploded from about 100,000 to more than 7 million and during that time it moved approximately 130 billion Kenyan shillings (approximately US$1.5 billion). There are now at least 17 million registered M-PESA accounts in Kenya and more than 18,000 M-PESA agents.\footnote{76}{CCK Releases 2nd Quarter ICT Sector Statistics for 2011/2012,” Communications Commission of Kenya, (17 April 2012). Available at \url{http://www.cck.go.ke/news/2012/sector_statistics.html}.}

Moreover, M-PESA is a profitable endeavour. During its first two years, M-PESA generated £50 million of Safaricom’s £150 million in profits.\footnote{77}{“Private Sector Has Potential to Aid Development, but Beware the Pitfalls,” The Guardian (UK) Poverty Matters Blog (11 July 2011), available at: \url{www.guardian.co.uk/global-development/poverty-matters/2011/jul/11/private-sector-aid-potential-and-pitfalls}.}

In contrast, Kenya has only 750 traditional bank branches and three million formal bank accounts.\footnote{78}{Department for International Development, supra n.17 at 14.}

Good ideas tend to spread, and mobile banking services have done so. After its success in Kenya, M-PESA was implemented in Afghanistan, Tanzania, and South Africa. In Pakistan, a mobile payment service called easypaisa grew so quickly that within two years it had more customers than all the banks in Pakistan combined.\footnote{79}{Luis Tejerina, César Bouillón & Edgardo Demaestri (eds.), Financial Services and Poverty Reduction in Latin America and the Caribbean, Inter-American Development Bank (2006) at vii.}

Mobile payment technology has also given poor consumers a fast and safe alternative to traditional and considerably more expensive international remittance services like Western Union’s. Remittances – loosely defined as payments sent home by a family member who is working abroad – have grown tremendously over the years. The IDB estimated that 2006 inflows to Latin America and the Caribbean from remittances amounted to more than US$60 billion per year, which was more than three percent of the region’s GDP at the time.\footnote{80}{United Nations, supra n.69 at 39, available at: \url{www.uncdf.org/sites/default/files/Download/bluebook_0.pdf}.}

Remittances usually go to low-income recipients and are primarily used to finance consumption, so they are indeed an essential service for many poor people. Because relatively few of the senders or beneficiaries of remittances have formal bank accounts, they have historically relied heavily on money transfer services like Western Union, which has many locations around the world but is quite costly, having claimed as much as 20 percent of the amount transferred in the late 1990s.\footnote{81}{United Nations, supra n.69 at 39, available at: \url{www.uncdf.org/sites/default/files/Download/bluebook_0.pdf}.}

The ability to send and receive payments on a cheap, prepaid mobile phone via text message negates Western Union’s old-economy advantage of having many physical locations while undercutting its price. Once again, competition brought about by technology was the key to breaking that market open and reducing prices.

The success of these innovative payment systems shows that greater competition can help to extend financial services to the poor, and thanks to superior technology it can also be profitable. Seizing on that theme in a 2007 article, the IDB’s President, Luis Alberto Moreno, urged financial institutions not...
to sit on the sidelines but to join in the process of coming up with innovative and profitable ways to serve impoverished customers:

It is time for financial institutions to accelerate the development of innovative mechanisms and new programs to reach the microfinance, remittance, and other underserved markets. If . . . financial institutions exploit this opportunity, we will have taken a major step toward improving the lives and possibilities of the majority of the region’s inhabitants. From the standpoint of financial institutions, such moves represent an opportunity to open up a potentially enormous and profitable market.81

4.2.3.2 Mobile telecommunications services

98. We have just discussed how competition from mobile telecommunications firms has helped poor consumers in the context of banking and payments services. But as everyone knows, mobile phones also provide a means of communicating by voice and text messaging, and smartphones can provide internet access. These features have been very useful to impoverished consumers, and competition has made them more accessible.

99. In contrast to formal banking services, access to mobile telecommunications services has spread to poor populations around the world with great speed. The number of mobile subscriptions in Africa increased from fewer than 25 million in 2001 to almost 650 million in 2012, making Africa the fastest growing region in the world for mobile phone services. Two-thirds of African adults now have access to information and communication technologies, and today Africa has more mobile subscribers than either the United States or the European Union.82 Although Asia already has a huge mobile subscriber base, it is still growing at an impressive rate. A 2011 UN report notes that the number of mobile telephone subscriptions in the Asia-Pacific region more than doubled during the previous five years, rising from around one billion to 2.5 billion. Even in the rural areas of East Asia, 83 per cent of people now have a mobile phone.83 In Latin America, meanwhile, mobile phone subscriptions have overtaken fixed line subscriptions as the preferred method of communication. As of 2009, more than 88 percent of the population in Latin America had a mobile subscription, while fixed line penetration was below 20 percent.84

100. Much of the growth in mobile phone subscriptions among poor consumers is due to competitive deals that target low-income consumers. Pay-as-you-go deals are often cheaper than installing a fixed line, especially in rural areas where fixed line service may not even be offered at any price. Before the introduction of mobile phones, telephone service had simply been out of reach for many poor people – an unavailable or unaffordable luxury. But mobile phones have come to be viewed as essential goods, even for many of the poor. Furthermore, mobile phone services have made broadband internet access possible

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81 Moreno, supra n.73 at 89.
for many of the world’s poor people, especially in difficult-to-reach areas where there is no DSL or cable coverage. It is therefore hard to deny that in this case, at least, competition has benefited the poor, and once again the catalyst was technological development.

101. Many empirical studies by the World Bank of entry by mobile telephony service providers show that the more competitive their markets were, the more these providers succeeded in penetrating the potential customer base. Competition, in other words, helped to bring phone service to more people than the absence of competition did.85

102. One comparative study of competition in the mobile telecommunications markets in five countries showed that greater competition drives the introduction of new services, brings those services to more people, and lowers prices. A competitive environment also strengthens incentives to offer services that meet the needs of poor customers, including price and product promotions designed specifically for them. Some of the services that competition helps to bring about have additional development benefits, too, such as money transfer services. A noteworthy example in the study is Kenya, which until recently had a concentrated mobile telecommunications market with relatively high prices. When two new service providers entered in 2008-2009, though, the additional competition they brought caused tariffs to fall by as much 50 percent.86

4.2.4 An arguable example of competition harming poor consumers

103. Although competition has certainly reduced poverty in many essential goods and services markets, one cannot realistically claim that competition has served the poor well in each and every instance throughout history. An extreme example occurred in Bolivia’s microcredit market and is described in a report issued by the United Nations.87 After the hyperinflation crisis of the mid-1980s and the strong structural adjustment policies that followed, small-scale enterprise grew dramatically as employment in traditional mining and state enterprises declined. That shift provided a golden opportunity for microfinance to serve this emerging market. The early microcredit organisations worked with banking authorities and donors to transform into banks and non-bank financial intermediaries.

104. Problems arose in the late 1990s, however, when Bolivian consumer credit companies also began to enter the microcredit market. Because these credit companies did not understand how to analyse a client’s ability to pay very well, they simply relied on the fact that an applicant for credit had borrowed or had a current loan from a microfinance institution as proof of creditworthiness. Clients then took advantage of the multitude of lenders, often maintaining two or more loans at a time and borrowing more than they could handle. Some of them were late making their payments or “bicycled” their loans. That is, they used the proceeds of one loan to pay off another.

105. The increase in excessively risky lending coincided with the arrival of a major recession and soon borrowers found themselves with unmanageable levels of debt. Heightened social unrest in Bolivia followed, with mass protests over the prices of basic utilities like water and electricity. The microfinance institutions’ relations with clients worsened, too, as they struggled to get their clients to pay.

In that tense atmosphere, two borrower associations formed out of people’s growing desperation. Both of them worked on the same principle: for a fixed membership fee of roughly US$8.50, they promised debt relief through borrower revolts. Their appeal was powerful and their memberships swelled. With municipal elections approaching, political parties were attracted to this cause because it enjoyed so much popular support.

Subsequently, the debtors’ associations threw their own leaders in jail. In one association, the leaders had illegally collected debt service payments owed to the microlenders and used them to make their own loans. After a few months, the associations resurfaced with new leaders and new demands. In addition to debt forgiveness, they wanted prohibitions against certain collection practices, extended grace periods, longer loan terms, and annual interest rates of two per cent. Their tactics escalated, too. In the most extreme example, demonstrators carrying dynamite took over the Superintendency of Banks in July 2001, holding employees hostage and threatening to blow up the building.

It is not really fair to blame competition for the result in this case, though. Competition did not cause the credit companies to do a poor job of analysing creditworthiness; it merely encouraged them to enter the market. They failed to make wise lending choices and all of the participants in the market suffered because of it. One could just as well blame inadequate banking regulation for the predicament in which the debtors found themselves, as more prudent lending policies would have prevented them from becoming so mired in obligations.

4.2.5 Other conditions may prevent competition from helping poor consumers

Even assuming that a country’s competition authority is adequately vested with financial resources, professional expertise, and investigative and remedial powers, competition still depends on a number of other framework conditions and policies to thrive and function properly. The conditions include the effective rule of law, a reasonably transparent and corruption-free government, adequately staffed and funded courts and police forces, a liberalised trade regime, the absence of anti-competitive regulation, and a certain degree of macroeconomic stability. The absence of any one of those conditions can undermine competition’s ability to work – and therefore undermine its ability to help poor consumers.

4.2.5.1 Undue influence: close relationships between firms and government officials

The recent work of Karen Ellis and Rohit Singh highlights this problem in the context of developing countries (though it can certainly arise in developed countries, too). Ellis notes that one of competition’s virtues is that it can balance the power between businesses and the government. Where competition is weak, however, that balance may tilt in a dominant firm’s favour and enable it to convince politicians to help prevent competition from emerging in a market. The typical results are sustained supra-competitive prices, persistently inferior quality, and/or stifled innovation, all of which harm consumers, including the poor.

Ellis elaborates, noting that large multinational firms with substantial market power are often well connected with government officials, particularly in underdeveloped countries, and that such firms may have considerable influence over governments for a variety of reasons. A nation may badly need a company’s products, investment capital, and know-how, for example. But a class of economic elites can arise when well-connected politicians and business people join forces to extract the economic rents in a market at the expense of the rest of society. Public works projects may be steered toward favoured

contractors even if other firms submit more competitive bids. Alternatively, potential entrants might be willing to compete in a market but they can be deterred with tools like import/export barriers, regulations that make it difficult and expensive to acquire business permits, or preferential tax rates for incumbents. Regardless of the particular strategy chosen, the intention and the effect is to stop competition from functioning, thereby enabling incumbent firms to keep their prices higher and their quality lower. Furthermore, in one way or another, the government officials in these extractive alliances will take a share of the profits. The relationship may involve full or partial state ownership of the business, or some degree of ownership by politicians or their families, for instance.

112. Notably, it is not only large multinational firms that can affect competition by influencing governments. Khemani points out that in many developing countries it is normal for major corporations to be family-owned or controlled by a small group of powerful investors. These corporations and families may control multiple companies in a pyramid ownership structure or one that has interlocking directorates. Such closely held or family groups may have a strong effect not only on particular markets but on the general economy, too, which can translate into an outsized influence on the government. Fox agrees that excessively snug relationships between businesses and governments are a serious problem in developing countries, noting that markets there “are pock-marked by state intervention and control. Whether the intervention is through state measures, state-owned enterprises, or enterprises licensed or privileged by the state, these enterprises are likely to run on principles of privilege, preference, and cronyism.”

113. Ellis’s and Singh’s field work reveals many examples of this type of close relationship between powerful firms and the governments of developing countries. In fact, the fortunes of those firms are frequently determined by the strength of that relationship rather than the crucible of market competition. Some of them enjoy the government’s protection and largesse for a while, but they are replaced by new favourites if they do something to fall out of favour. For instance, Ellis mentions a company that was asked by one government to provide its product at discounted rates to a new foreign company in another industry. The government wanted to help that company to get established within its borders. The first company refused and claimed that the government punished it by licensing a new entrant to compete with it, thereby eroding what had been a safe and mature monopoly position. “Thus competition itself becomes a bargaining chip in a power game between government and business[.]”

4.2.5.2 An example: trade protectionism in the Zambian sugar market

114. A superb example of governments getting in the way of competition in an essential goods market is provided by Ellis’s and Singh’s study of the refined sugar industry in several countries. Sugar is part of the staple diet in most countries and is also a source of income for many people in rural areas. Consequently, some governments are heavily involved in the sugar industry, including governments in Bangladesh, Kenya and Viet Nam. In various ways, those governments support, operate, protect, or


90 Fox, supra n.54 at 229-230; see also Mark Dutz & R. Shyam Khemani, Competition Law & Policy: Challenges in South Asia 11 (2007), quoted in Fox, supra n.54 at 213 n.6 (summing up the problem of overly snug relationships between influential big businesses and governments, which are often accompanied by “inflexible, inefficient industrial and financial market structures [and] have adverse implications . . . for fostering effective competition . . . and for the persistence of an anti-competitive nexus mutually supporting vested interests between incumbent firms and government, with some of the earned rents used to entrench market power by buying government favoritism.”).

91 Ellis, supra n.88 at 2.
control the business of sugar in their respective countries. While the motives for that involvement, such as promoting rural development and job creation, may have been benign, the state-led sugar industries in those countries perform poorly. They use obsolete technology and inefficient farming methods that result in comparatively low productivity. The sugar industries in all three countries are struggling to survive against competition from privately produced and imported sugar. The approach of direct intervention by governments is close to failure. But that conclusion is just part of the context for a more surprising finding.

115. Continuing to set up their key point, Ellis and Singh note that in contrast to the first three countries, Zambia has a sugar industry that is led by the private sector. It produces the highest amounts of sugar per hectare of the five countries they studied. Indeed, Zambia’s output per hectare is three times higher than Viet Nam’s, the second most efficient country in the group, and its cost of production is one of the lowest in the world (US$169 per ton vs. the world average cost of US$263 per ton). The Zambian sugar industry is very profitable, internationally competitive, and is expanding to take advantage of new export opportunities. These results imply that private sector incentives and management expertise are superior to those of governments, at least in the sugar industry.

116. Significant reforms are needed to improve the performance of the sugar industries in Bangladesh, Kenya and Viet Nam. Because reforms could put some existing sugar mills out of business, however, local interests would make this politically unpopular and thus difficult to accomplish even though it would be in the best interests of consumers and the country as a whole.

117. And what is the surprising part of the Ellis and Singh study? Given Zambia’s substantially superior productivity, one would expect Zambian consumers to pay much less for sugar than consumers in the less efficient countries. But Zambian consumers actually pay significantly more for sugar than consumers in every other country in the study:

Figure 3. 2008 Retail Spot Market Prices for Sugar, in US$/kg

![Image of bar chart showing retail spot market prices for sugar in different countries, with Zambia having the highest price at 1.2 times the world average, and Bangladesh having the lowest at 0.57 times the world average.]


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92 Karen Ellis & Rohit Singh, “The Economic Impact of Competition,” Overseas Development Institute Project Briefing no. 42 (July 2010); Ellis & Singh, supra n.86 at 88.

93 The fifth country was Ghana.

94 Ellis & Singh, supra n.92; Ellis & Singh, supra n.86 at 13.
118. Sugar prices are not only higher in Zambia than in other countries, they are well above the price at which Zambian sugar sells on international markets. That is at least partially due to the monopolistic structure of the industry in Zambia, where one large, multinational firm has 93 percent of the market and is protected from foreign competition by non-tariff import barriers. Sugar importers wishing to do business in Zambia must acquire permits in a process that Ellis and Singh describe as “bureaucratic and non-transparent... with the Ministry of Agriculture, the Ministry of Health, and the Ministry of Commerce all having to clear the import of sugar”. The Zambian Competition Commission has investigated but was unable to fix the problem. Ellis and Singh tersely observe that “the government may have vested interests in the industry’s profitability.”

119. On the other hand, where genuine market competition does manage to take root in spite of a cosy relationship between an incumbent and a government – say, due to a breakthrough innovation that enables a new firm to enter the market in spite of the barriers put in place to protect the incumbent – it may result in the favoured incumbent being outperformed. That, in turn, can break down the anti-competitive alliances formed by economic elites, combat cronyism, and reduce the profitability of corruption. Competition has the ability to do a variety of great things – if it is allowed to flourish.

4.2.5.3 Another example: anti-competitive zoning regulations in Mexico City

120. Mexico’s submission to the 2012 Latin American Competition Forum contains another good example of how government policies can interfere with competition’s ability to reduce poverty. The Assembly of Representatives of Mexico City approved a zoning standard that restricted the ability of large-scale supermarkets to operate in impoverished areas of the city. The CFC argues that the standard has both an anti-competitive purpose and a harmful effect on consumers. Specifically, the regulation is designed to protect owners of small, established, less efficient and more expensive convenience stores from potential entrants. It also harms poor consumers who would have saved time and money and had more choices if the more efficient, larger supermarkets had been allowed to enter the areas where they live.

121. Mexico’s submission acknowledges that zoning regulations can have legitimate purposes, such as protecting residents from negative externalities that might occur if businesses were allowed to operate wherever they pleased. But when zoning regulations are implemented for the purpose of protecting businesses from competitive pressure, they lack legitimacy. Mexico City is not the only place where zoning regulations are used to protect small local stores from more efficient potential entrants. Brusick and Evenett point out that the same type of problem exists in Indonesia, for example.

4.2.5.4 Benevolent motives for interfering with competition

122. A complicating factor is that the motives of the government officials involved in “partnerships” with protected businesses are not always rooted in corruption. They may be benevolent. In fact, their motive may be precisely to reduce poverty. Thus government officials might demand, in exchange for helping to block competition, that a protected incumbent provide a certain number of jobs or that it provide...

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95 Ellis & Singh, supra n.92; Ellis & Singh, supra n.86 at 14, 17-18.
health or education services for employees and their families. Or the goal might be to diversify the economy, foster regional integration, or pursue some other legitimate goal that happens to be something other than the traditional objectives of competition policy in developed countries, i.e. maximising efficiency and consumer welfare. Alternatively, officials might ask a company to give the government a discount on public procurement projects. They might also simply have their eyes on the greatly-needed tax revenue that a company generates, which will be even more substantial if it earns heavy profits due to a low level of competition.

123. Similarly, it has not been uncommon for privatisation programs to result in the sale of state-owned monopolies to the highest bidder, with the understanding that there will be little or no real regulatory oversight in the future, so as to maximise the sale’s proceeds for the state. But this means that a public monopoly is transformed into a private monopoly, with consumers ultimately paying for the premium received by the government on the sale of the enterprise. Even if the sale is accompanied by the creation of a regulatory authority that is charged with preventing the now-private monopoly from abusing its dominant position, a well-documented problem with regulatory agencies (whether they are in developed or developing countries) is that they are vulnerable to being captured by the industries they are supposed to control.

124. A major problem with these types of benevolently motivated arrangements is that consumers are paying for the profits that drive the deals, and in essential goods and services markets, it is the poor consumers who are most heavily affected. In any event, Ellis’s and Singh’s evidence suggests that the risk that these kinds of influence-peddling partnerships will be misused for rent-seeking purposes is substantial.

4.2.5.5 The difficult problem of very small, local monopolies

125. Sometimes geography and population size stand in the way of competition’s ability to help poor consumers. A village might have such a small population that it can support only one business – e.g. a single village grocer or general store. If the next village or town is far away and residents cannot afford transportation, they will be unable to shop elsewhere. Competition under such circumstances is tightly constrained by geographic and scale-related barriers, so the village stores in such places can charge supra-competitive prices and consumers will persistently suffer. Furthermore, if anti-competitive conduct occurs in these small, remote villages, competition authorities are unlikely to have the resources to investigate such low-stakes matters, given their other responsibilities. Does that mean governments can do nothing to encourage competition in small, isolated communities?

126. Not necessarily. While many villages simply do not have the necessary size to support more than one local competitor in a given product or service market, and investigations of small-town anti-competitive conduct may be out of the question, governments can try other approaches. Supporting the development of internet infrastructure is one of them. E-commerce is ideal for bringing competition to places where it has never existed before. And though it may seem unrealistic to expect e-commerce to flourish in some poor areas, a) e-commerce has been very successful in boosting competition in many places where citizens have internet access, whether they live in small towns or not; and b) the advent of increasingly cheap mobile phones that can connect to the internet has made the idea of poor people living in small towns and surfing the web more realistic than ever before.

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99 Brusick & Evenett, supra n.98 at 276.
100 Id. at 281.
101 Ellis, supra n.91.
The Internet has provided consumers with a powerful tool for searching for and buying goods and services. Benefits have included increased competition and lower prices, more choice in products and services, and the convenience of shopping for goods and services . . . anywhere and at any time."102 Furthermore, even though it was issued more than three years ago, a joint report for the OECD and World Bank already noted that "many millions of poor people are engaging in tasks normally associated with the Internet such as information retrieval, payments and remote computing using relatively simple mobiles."103 Mobile phone usage has grown quickly all over the world, and is continuing to do so in the developed world. (See Figure 4.)

Figure 4. Mobile Phone Penetration in Developed and Developing Countries (2000-2010)104

However, more internet infrastructure and more mobile phone usage will not stimulate competition from e-commerce if shipping costs are prohibitive or if consumers believe that their orders are unlikely to reach them anytime soon, if at all. For e-commerce to become a realistic alternative in small villages, postal services have to reach them regularly. And those services have to be affordable, reasonably quick, and very trustworthy. Although internet access is spreading in Mexico, for example, e-commerce has hardly blossomed. Part of the reason for that is the poor quality of the postal service.105 If


104 This chart appears in “Mobile Services in Poor Countries: Not Just Talk,” The Economist (27 January 2011), available at www.economist.com/node/18008202.

105 See, e.g., “On Mexican Time,” The Economist (23 March 2006) (noting that Mexicans tend to avoid using Sepomex, the state-owned postal service, for important mail, delivering it by hand themselves or relying on private carriers instead), available at www.economist.com/node/5664823; “¿Cuál Es el Destino del Correo en México? La Experiencia Internacional Sugiye Uno: Servir al Comercio Electrónico,” Sin Embargo (9 October 2012) (urging that Sepomex should be made into a reliable distribution platform for e-commerce,
governments wish to take advantage of the formidable competition and growth that e-commerce can create, they must take steps not only to improve internet access, but to make their postal services affordable and reliable.

129. Even with adequate internet access and postal services, though, e-commerce cannot improve competition in all essential goods markets. One would not want to buy fresh milk or meat through the internet and have it delivered by post, for example. Private delivery services exist for e-grocery businesses in the well-populated areas of many OECD countries, but deliveries to tiny, remote villages would be very expensive. Nevertheless, essential goods like clothing and non-perishable foods are more suitable for postal delivery.

130. Another option, of course, is to invest in improving roads and public transportation. If travelling to other towns to shop becomes more feasible, poor consumers can avoid having to buy from their monopolistic village store. Where very small and remote communities are concerned, however, it may be prohibitively expensive for governments to improve roads and transportation.

4.2.5.6 Some of competition’s effect on poor consumers depends on the poor themselves

131. Another type of practical problem that may get in the way of competition’s ability to reduce poverty is simply that poor consumers might not take advantage of what competition has to offer them. This problem can occur, for example, if the poor are less informed or more easily manipulated than other consumers. As an illustration, consider that the study of the US residential telecommunications market by Hausman and Sidak, mentioned earlier, could also be interpreted in a different way. The fact that wealthier and better educated consumers were able to obtain lower prices than poor consumers could be viewed as suggesting that there must have been some competition in the market. Therefore, it implies that the problem for the poor and undereducated group might not have been a lack of competition so much as an inability or a disinclination to capitalise on that competition. If that is correct, then this is another reason why making markets more competitive will not necessarily be enough to help the poor. They may need help with learning how to be better buyers, how to compare complicated offers, or – if they are being intentionally deceived – they will need the help of a consumer protection agency.

132. Indeed, the deception problem figured prominently in the collapse of the US real estate market bubble that triggered the 2008 global financial crisis. So-called predatory lenders were competing so fiercely with one another that they had begun to market loans to poor homebuyers with very high risk profiles. In their eagerness to finalise more and more loans, the lenders engaged in deceptive practices that

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106 According to the management consulting firm McKinsey, the Internet has generated as much economic growth in the past 15 years as the Industrial Revolution did in 50 years. McKinsey studied the correlation between Internet maturity and growth in per capita GDP, concluding that “an increase in Internet maturity similar to the one experienced in mature countries over the past 15 years creates an increase in real GDP per capita of [US$500] on average during this period. It took the Industrial Revolution of the 19th century 50 years to achieve the same results.” McKinsey Global Institute, “Internet Matters: The Net’s Sweeping Impact on Growth, Jobs, and Prosperity” (May 2011), Executive Summary at 3.

enticed poor customers to accept the loans even though the lenders knew the financial terms were so onerous and the customers’ ability to pay so weak that the likelihood of default was high. When they were ultimately unable to keep up with their mortgage payments, many borrowers lost what little savings they had, sliding deeper into poverty or moving below the poverty line for the first time.\footnote{E.g., James Pulliam, “Good Cop, Bad Cop: Market Competitors, UDAP Consumer Protection Laws, and the U.S. Mortgage Crisis,” 43 Loyola of Los Angeles Law Review 1251 (2010); Timothy Johnston, “Mortgage Marketing Practices and the U.S. Credit Crisis,” 13 Academy of Marketing Studies Journal (2009).}

133. The University of Michigan Professor Aneel Karnani bristles at what he perceives as a fashionable assumption that poor people are rational, well-informed and willing participants in free market economies. He contends that this romanticisation of the poor leads to an over-reliance on unfettered, market-based approaches to poverty alleviation, which in turn allows governments and corporations to deny poor people the legal and regulatory protections they need.\footnote{Aneel Karnani, “Romanticizing the Poor,” 7 Stanford Social Innovation Review 38 (2009).} Karnani, to be perfectly clear on this point, is \textit{not} saying that the poor are incapable of making rational choices. Neither is he advocating heavy-handed government interventions, tightly regulated markets, or the old-fashioned notion that government officials should take all important choices out of the poor’s hands in a paternalistic fashion. But he does believe that governments should impose some limits on free markets to help prevent the exploitation of the poor. He also points out that even when the poor avoid deceptive sellers and take advantage of the lower prices made possible by competitive markets, they often decide to spend the money they save on things that do not reduce their poverty in the long term.

134. In fact, he argues, poor consumers often make decisions that appear to be against their self-interest. For example, suppose that competition lowers prices in some essential goods market. One might assume that this result will at least marginally reduce poverty, but that could be a mistake. Whether lower prices will actually reduce poverty depends on what poor consumers do with the money they save due to the lower prices. As any person might do, the poor could choose to spend it on a “vice” product like alcohol or tobacco. In the case of the poor, though, making that choice might mean that they or their children continue to be malnourished, that their leaky roof does not get patched, or that their broken-down bicycle – which might be needed for getting to and from a job – continues to be out of service. In addition, too much alcohol or tobacco can damage people’s health and keep them out of work. Seen in that light, it is possible that greater competition could harm the poor precisely because it can reduce prices on essential goods.

135. From a policy standpoint, this is an inconvenient fact. Malnutrition (for example) can trap people in a condition of poverty. But if it is true that by eating more, the poor could start doing more work and thus get out of that poverty trap, then they should eat as much as they can. Yet, that is not necessarily what they do. A typical poor household could spend up to 30 percent more on food than it actually does if it completely cut out expenditures on alcohol, tobacco and festivals. Likewise, when very poor people get a chance to spend a little bit more on food they typically do not maximise their intake of calories. Instead, they just tend to buy better-tasting, more expensive calories.\footnote{Banerjee & Duflo, supra n.25 at 22-40.}

136. Karnani’s point is, essentially, that while policymakers need to adopt measures to reduce poverty, including promoting competition, they should also acknowledge that “the poor lack the education, information, and other economic, cultural, and social capital that would allow them to take advantage of – and shield themselves against – the vagaries of the free market.”\footnote{Karnani, supra n.109 at 40.} While that description is too stark (the poor certainly do not always lack information, for instance), there is some support for his argument.
137. He also notes that the economists Banerjee and Duflo found that because the poor typically do not have bank accounts, they are more likely to spend any available cash on impulse purchases.\[^{112}\] Furthermore, the hardships that poor people are more likely to face, such as hunger and violence, often lead them to do whatever they can to ease their suffering in the short term rather than focusing on advancing their long term economic prospects. Karnani points to research showing that the less income people have, the more likely they are to try to draw some comfort from smoking, drinking alcohol to excess, eating unhealthy diets, and splurging on ceremonies and festivals.\[^{113}\] Notably, he presents this in a sympathetic rather than a sanctimonious manner, citing Banerjee’s and Duflo’s observation that “Perhaps at some level this [escapism] is emotionally wise. Thinking about the economic problems of life must make it harder to avoid confronting the sheer inadequacy of the standard of living.”\[^{114}\]

138. We cannot expect too much of competition alone, in other words. Many other factors can get in the way of reducing poverty. But competition can at least give poor consumers more resources so that they have a better chance to help themselves.

5. **Competition’s Effect on Poor Small Business Owners and Workers, in Theory and in Practice**

5.1 **Theoretical Effects**

139. In principle, competition should also be able to help the poor in their capacity as small entrepreneurs, wage earners and job seekers. That is not to say that competition will always help the supply side poor, but it certainly can happen. Competitive markets force firms, over time, to allocate society’s resources toward activities where they will be most productive and profitable. That process eliminates some firms from the market, but it also enables the survivors to compete better, which will increase macroeconomic growth.

140. Greater macroeconomic growth, in turn, can help to boost employment. Macroeconomic growth due to more competition could boost wages, too, as output rises. Higher real wages should raise standards of living and thus reduce poverty. Likewise, insofar as greater rivalry encourages innovation, competition can help to create new product markets and businesses, which will present new opportunities for the poor to earn more money. So, if these macro-level effects do happen, we would expect to find empirical support for a causal chain leading from greater competition to greater growth and innovation to higher incomes for the poor.\[^{115}\]

141. At the microeconomic level, competition law enforcement could help the poor to earn more by carrying out the usual agenda of blocking anti-competitive mergers, breaking up cartels, and stopping the abuse of dominant positions. For example, a poor entrepreneur might want to start a business in


\[^{114}\] Karnani, supra n.109 at 41.

\[^{115}\] One has to bear in mind, though, that when poverty is defined with relative thresholds, macroeconomic growth will not reduce the number of people living in official poverty unless the growth is skewed in favour of the poor.
competition with a large, established firm, and he or she might even have an idea for how to be a more efficient competitor. If the incumbent is dominant and is blocking small entrants with some type of anti-competitive conduct, competition law enforcement could help. Similarly, a cartel might have the same interest in keeping disruptive entrants out that a single dominant firm has. In both cases, once the competition problem is removed, industry output should increase. That means the demand for labour could increase, too, which means more jobs and/or higher pay.

142. Anti-competitive mergers also cause market power problems that have the potential to harm poor entrepreneurs. A frequent complaint in both developing and developed countries, for instance, is that consolidation among large supermarket chains and their international distribution systems creates monopsony power that is used against small farmers, resulting in artificially low prices for their produce.\(^\text{116}\) A sound merger review system would block transactions that cause a substantial decline in the intensity of competition.

143. Furthermore, other factors such as overly restrictive regulations may make it unnecessarily difficult for new businesses to compete, thereby taking away opportunities for poor people to find work and/or earn more. Making competition stronger by advocating for the reform of such regulations can give those opportunities back.

144. Comparing the two basic ways in which the poor can earn a living – either as self-employed small business owners or as wage earners who work for someone else – which group stands to benefit more from increases in competition? In other words, if competition authorities wanted to prioritise poverty reduction, would it make more sense for them to focus on creating and protecting opportunities for small entrepreneurs, or on protecting competition in markets with firms that employ a lot of poor people? That is the sort of question that can keep an econometrician busy for a long time.

145. For one thing, the percentages of poor people that earn wages as opposed to running their own businesses vary from country to country and sector to sector. In Peru, for example, 69 percent of poor (living on less than US$2 per day) urban households run a non-agricultural business. That figure is between 47 and 52 percent in Indonesia, Nicaragua, and Pakistan. In developed countries, even if we use official national poverty lines instead of the US$2 per day benchmark, the figure would be far lower. In rural areas around the world, the share of poor (living on less than US$1 per day) households that are self-employed in agriculture varies widely, too, ranging from 25 to 98 percent. In Mexico and South Africa, though, very few poor people are self-employed in agriculture. Complicating matters is the fact that many poor households derive income from multiple sources. Sometimes small business owners also work for someone else to earn a second income. For example, using the US$2 per day benchmark, 47 percent of poor urban households in Cote d’Ivoire and Indonesia have more than one type of income. The figure is 24 percent in Mexico, 36 percent in Pakistan, and 20.5 percent in Peru.\(^\text{117}\)

146. Then there is the difficulty of estimating the effects that competition has on things like innovation and per capita GDP growth,\(^\text{118}\) the degree to which improvements in those things actually filter down to poor people and make them better off, and the extent to which the poor benefit as entrepreneurs as opposed to wage earners. An additional difficulty is the need for data on how interventions by competition

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\(^{116}\) See Brusick & Evenett, supra n.98 at 290-91 (noting complaints of this nature in Thailand, Peru, France and Indonesia). Note that anti-competitive mergers among supermarket chains can also be expected to harm poor consumers because the resulting increase in market power tends to lead to higher retail prices.

\(^{117}\) All of the statistics in this paragraph are from Banerjee & Duflo, supra n.112 at 151-52.

\(^{118}\) The Competition Committee currently is engaged in a stream of work aimed at evaluating the impact of competition enforcement activities on GDP and jobs.
authorities affect the poor microeconomically, again discerning between effects that help small entrepreneurs and effects that help wage earners.

147. At least one person has an intuitive idea about the answer, though. Arneel Karnani argues that the poor-as-entrepreneurs are romanticised by outsiders just as much as the poor-as-consumers are. There is a tendency among governments and aid organisations, he contends, to generalise the poor as talented, creative entrepreneurs who just need a bit of help with a loan or some skills training before deftly steering their little businesses toward profitability. Karnani wants to disillusion everyone who has that notion. He points out that most microcredit clients are not entrepreneurs by choice. If they could find a job with reasonable wages they would happily take it. Furthermore, there is little evidence that the poor are particularly good entrepreneurs. That should not come as a surprise, he says, because “[m]ost people do not have the skills, vision, creativity, and persistence to be an entrepreneur. Even in developed countries with high levels of education and access to financial services, about 90 percent of the labor force is employees, not entrepreneurs.”

148. Banerjee and Duflo are in full agreement. The reason so many poor people are self-employed is that being an entrepreneur is often easier for them than finding a job offer:

You buy some fruits and vegetables or some plastic toys at the wholesalers and start selling them on the street; you make some extra dosa mix and sell the dosas in front of your house; you collect cow dung and dry it to sell it as a fuel; you attend to one cow and collect the milk. These types of activities are exactly those in which the poor are involved.

It is important not to romanticize these penniless entrepreneurs. Given that they have no money, borrowing is risky, and no one wants to lend to them, the businesses they run are inevitably extremely small, to the point where there are clearly unrealized economies of scale. Moreover, given that so many of these firms have more family labor available to them than they can use, they do very little to create jobs for others. Of course, this pattern makes it harder for anyone to find a job and hence reinforces the proliferation of petty entrepreneurs.

149. Karnani therefore argues that the best way to alleviate poverty is to raise the real incomes of poor people by giving them more opportunities to be steadily employed with reasonable wages. To do that, he says, governments should focus on creating and growing private enterprises in labour-intensive industries with policies that support deregulation, better infrastructure for transportation, and more robust capital markets. Although he does not mention competition policy, one can infer that Karnani would advise competition authorities to worry more about protecting competition in sectors with large (and potentially large) payrolls than in sectors with lots of small-time entrepreneurs.

150. What about the possibility that more competition actually damages the earning prospects of poor people? One can easily imagine scenarios in which that might happen. Fierce competition on the supply side of labour markets, for example, tends to drive wages down. In product and service markets, intense competition sometimes drives employers to cut costs by, among other things, eliminating jobs or cutting wages. Businesses eventually exit markets entirely when more efficient rivals enter and compete with them, causing near-term job losses. Small farmers, for instance, tend to have a very difficult time competing with large-scale agribusinesses. Competition-driven innovation might also turn out to be harmful to poor entrepreneurs and labourers, at least in the short term. New technologies can eliminate jobs by making older technologies obsolete and by driving small entrepreneurs and old-technology businesses out of markets.

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119 Karnani, supra n.109.
120 Banerjee & Duflo, supra n.112 at 162.
151. Considering the theoretical effects on real wages for poor, unskilled workers of an increase in foreign competition due to greater international trade only adds to the uncertainty of how competition affects the poor. There are at least eight kinds of potentially significant ways in which international trade can affect poor, unskilled workers, and the net effect is indeterminate.\textsuperscript{121} For example, more foreign competition might cause old, inefficient domestic firms to exit and new, more efficient domestic firms to enter. Or existing firms might allocate their resources more efficiently. Either one of those effects could cause wages to rise where productivity increases.

152. Alternatively, if domestic firms react to more foreign competition by outsourcing to smaller businesses or individuals in the informal sector, the average wage of people who used to work in the formal sector might decline. Then again, the workers might wind up with higher incomes despite the decrease in hourly wages if they work more hours in informal sector jobs.

153. Even if the net effect of competition on growth, employment, and wages turns out to be positive overall, it is one thing to say that competition drives those beneficial results in general. It is another to say that it reduces poverty in particular. The poor need \textit{inclusive} growth – growth that gives \textit{them} more entrepreneurial opportunities, more jobs, and higher incomes.

154. Whether or not they get it will depend on a great many things. For example, one should not necessarily expect the effect of growth on poor people in developing countries to be the same as it is on poor people in developed countries. Nearly 60 years ago, the economist Simon Kuznets hypothesised that as a country develops economically, it will trace out an inverted-U shaped curve if income per capita is on the horizontal axis and income inequality is on the vertical axis. That is to say, Kuznets predicted that the poor initially would not receive a proportionate share of income growth, but if the growth continued, inequality would eventually fall.\textsuperscript{122}

\textbf{Figure 5. The Kuznets Curve.}

\begin{figure}[h]
\centering
\includegraphics[width=0.5\textwidth]{kuznets_curve.png}
\end{figure}


\textsuperscript{122} Simon Kuznets, “Economic Growth and Income Inequality,” 45 American Economic Review 1 (1955). The curve could exist because, initially, those who already had money within an economy would suddenly have more good opportunities to invest profitably. The poor, however, would be flocking to cities in search of manufacturing jobs, thus keeping wages down. Kuznets believed that once a certain level of average income was achieved, democratisation would occur, the country could afford to be more of a welfare state, and the benefits of growth would filter down to everyone in society.
Kuznets’s particular theory was not necessarily correct. In fact, his hypothesis has been liberally criticised over the years. But the larger point is that context probably matters, so general macroeconomic growth may not automatically translate into poverty reduction.

Getting back to competition, we need to know whether there is evidence – in any setting – that more competition actually does help poor entrepreneurs and workers in practice. Or do the benefits of competition mainly accrue to big businesses and wealthy people?

Moreover, competition may sometimes help the poor as consumers but harm those same people as small business owners or wage earners. Suppose that a decline in competition at some level in the chain of production caused a general rise in food prices. Poor farmers who sell some of their output might be made better off as sellers while simultaneously being made worse off as consumers (with respect to the food they consume that is not self-supplied). What is known about the net change in welfare for the poor in the presence of these mixed effects?

In the next section of the paper, we take a look at what is known about the answers to those questions.

### 5.2 Actual Effects

As was the case with competition and poor consumers, there is not much publicly available data on the direct effect of competition on poor small business owners and workers. This, too, could be a fruitful area of study for competition authorities, as they may be in the best position to examine the effects of their past interventions on poor people’s opportunities for earning a better living. There is some helpful information, though, both at the macro (general economy) level and the micro (market-specific) levels.

#### 5.2.1 Actual macroeconomic effects of competition on poverty

At the macro level, we are interested in whether there is a causal chain leading from greater competition to greater GNP growth to poverty reduction. Although the question is by no means settled, there are indications that competition boosts GNP growth, including innovation-driven growth. There is also some evidence that GNP growth alleviates poverty.

### 5.2.1.1 The link between competition and GNP growth

The effect of competitive markets on macroeconomic growth is a major topic itself. A comprehensive review of that literature would be unwieldy in a paper that focuses on the effects of competition on the poor. But a sample can adequately make the case simply that there is evidence that competition drives economy-wide growth.

- In 2003, the World Bank published a report which found that economies with competitive domestic markets tend not only to have higher levels of income, but higher income growth rates,
as well. The report further noted, incidentally, that those same economies tend to have lower poverty rates.

- In 2007, the OECD Secretariat issued a report on the relationship between competition policy and macroeconomic performance. The report surveyed the theoretical and empirical literature and found that policies that enable competitive market forces can raise output per capita by encouraging investment, improving productivity and increasing employment. It used the experiences of certain OECD countries to show how pro-competition reforms create resilient, adaptable economies that grow faster and create more jobs. It also reviewed empirical, long-term evidence showing that eliminating anti-competitive regulation correlates with faster productivity growth because competition speeds the adoption of new technologies.

- Other OECD research has focused on the question of how pro-competitive policies and regulations affect performance and found an empirical connection between strong competition in goods and services markets and better productivity and employment outcomes.

- The UK’s Office of National Statistics issued a report in 2007 that identified five main factors in raising productivity (which is generally believed to contribute to GNP growth). One factor was competition and another, innovation, is intertwined with competition (see Part 5.2.3.2. below on “The importance of innovation and innovation policy”).

- William Lewis of McKinsey & Company compiled a book’s worth of anecdotal examples to make his case that undistorted product market competition is the key factor in determining productivity, which in turn drives prosperity. Lewis and his colleagues spent 12 years studying why some nations remain poor, even after receiving substantial international assistance, while others prosper. Repeatedly, the McKinsey team found evidence that the economies of poorer countries were being slowed down by government policies that interfered with competition. Economic progress, they concluded, depends on increasing productivity, and that cannot happen when policies prevent more efficient companies from replacing less efficient ones.

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128 Lewis, supra n.29.
A typical problem was that poor countries often protected their domestic firms from foreign competition, even when the foreign companies were more productive. But if they worked for a more productive company, local workers could earn higher wages and local consumers could enjoy lower prices.

5.2.1.2 The link between GNP growth and poverty reduction

162. Turning to the link between general economic growth and poverty reduction, many sources express little doubt that a causal relationship exists. For example, a 2011 report by the UK’s Department for International Development does not merely state that economic growth reduces poverty; it says there is plenty of evidence that economic growth is the primary driver of poverty reduction.\(^\text{129}\) The report cites, among other things, an interesting empirical paper by Kraay, who studied changes in poverty in a sample of developing countries during the 1980s and 1990s.\(^\text{130}\) Kraay found that nearly all of the variation in long run changes in poverty is driven by growth in average incomes. That is an important result not only because it shows that there is a strong connection between per capita GNP growth and poverty reduction; it also suggests that the positive effects of greater competition on per capita GNP will be shared by the poor.

163. Earlier empirical work by Kraay and Dollar, incidentally, found that in a panel of 92 developed and developing countries, growth in the incomes of the poor matched growth in average incomes at a rate of roughly one to one.\(^\text{131}\) That finding contradicts the Kuznets curve hypothesis. A rising tide, it seems, really does lift all boats, and it does so at a uniform rate. The central message of Kraay’s work for governments interested in reducing poverty is that they should adopt policies that promote broad-based growth in their economies. The central message for competition authorities wishing to show that they can help in the fight against poverty, meanwhile, is that if they can demonstrate that their work boosts overall GNP growth, then that is as good as showing that their work reduces poverty.

164. Yet it is hard to square Kraay’s results with today’s reality in many countries. The gap between rich and poor has been growing, not shrinking, in over three-quarters of OECD countries, for example.\(^\text{132}\) That fact might be less worrisome if more poor people were escaping from absolute poverty than entering it, despite the fact that their incomes are not growing as fast as rich people’s incomes. But even after decades of generally positive macroeconomic growth, many countries still have about the same fraction of absolutely poor people that they have had for 30 years or more.

165. The situation in the US exemplifies how poverty can persist, or even increase, despite generally positive growth over long periods.\(^\text{133}\) The US’s annual GNP growth rate has been positive far more often than it was negative during the past 50 years. Yet the official poverty rate has remained essentially flat since 1966, fluctuating between 11 and 15 percent. In fact, lately it has been at the high end of that range. In 2010 the US poverty rate was 15.1 percent, representing 46.2 million people. That was the largest

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129 Department for International Development, supra n.17 at 6.
133 The US is an especially helpful example because it is one of the few developed countries that uses an absolute poverty line rather than a relative one.
number of Americans officially living in poverty in the entire prior period of 52 years for which poverty estimates had been published.\textsuperscript{134, 135}

166. What is going on? While the recent uptick in poverty can be at least partially blamed on the 2008 global financial crisis, that cannot be the only factor at work. If it were, there should have been a meaningful and lasting decline in the poverty rate prior to 2008, during all those years of growth. The answer may have something to do with how income, income growth, and wealth are distributed in the US. Income inequality in the US has been rising steadily since the mid-1970s, when the Gini coefficient was 0.30. In the late 2000s, it was 0.37.\textsuperscript{136} Income growth has also been skewing rather steadily in favour of wealthier Americans. During the period 1993-2000, the mean portion of total annual real income growth captured by the wealthiest one percent of Americans was 45 percent. In the 2009 to 2010 period, 93 percent of real income growth went to the wealthiest one percent while the remaining seven percent went to the other 99 percent of the population.\textsuperscript{137} Today, a single American family – the Waltons, whose patriarch founded Wal-Mart – owns more wealth than the bottom 40 percent of US citizens.\textsuperscript{138}

167. The “Kraay effect” of average GNP growth on poverty, therefore, is not immutable. It seems that it can be undermined by an income distribution that is significantly skewed and/or becoming more so.\textsuperscript{139}

\begin{thebibliography}{99}
\item[] The US is unusual in that its official poverty measurements are based on pre-tax income and do not include the value of non-cash government support (such as public housing, food subsidies, etc.). But starting in 2011, the Census Bureau began to calculate a Supplemental Poverty Measure (SPM) that takes taxes (and tax credits) and non-cash support into account. In 2011, at 16.1%, the SPM poverty rate was higher than the official rate of 15.0% and represented 49.7 million people. In fact, the SPM rate was higher than the official rate in all three of the years for which the SPM has been calculated (2009-2011) and the SPM rate grew in both 2010 and 2011. Kathleen Short, US Census Bureau, “The Supplemental Poverty Measure: Examining the Incidence and Depth of Poverty in the U.S. Taking Account of Taxes and Transfers in 2011” at pp. 10, 16 (December 11, 2012), available at www.census.gov/hhes/povmeas/methodology/supplemental/research/aea2013.kshort.pdf.
\item[] The Gini coefficient measures how much the income distribution among individuals or households in an economy deviates from a perfectly equal distribution. A value of zero represents perfect equality, while 1 indicates perfect inequality. The Gini coefficient figures are for the US’s working age population (ages 18-65) and take into account taxes and transfers. OECD StatExtracts, available at http://stats.oecd.org/Index.aspx?QueryId=26068.
\item[] For further support on this point, see Ferreira, supra n.123 at 435-36 (showing that the growth elasticity of poverty reduction falls with inequality, i.e. the greater inequality is, the weaker the effect of growth on poverty reduction).
\end{thebibliography}
Figure 6 shows the levels of income inequality, represented by the Gini coefficient, in countries around the world as of 2009. Countries with low Gini coefficients, represented by the dark blue end of the colour spectrum, have the lowest degree of income inequality. Poor citizens in these countries have relatively more to gain from macroeconomic growth. Countries with high Gini coefficients, represented by the dark red end of the spectrum, have the highest degrees of income inequality. Poor citizens in these countries have relatively less to gain from macroeconomic growth.

Figure 6. Income Distributions around the World in 2009.


Figure 7 shows the recent relationship between income and income inequality in a sample of 74 countries. Although the axes are essentially the same as those used to depict the Kuznets curve, this is a different chart because it shows a snapshot of the situation in many different countries, rather than what happens over time in one country. There does not appear to be a very strong relationship between income and income inequality from one country to the next. Countries with relatively low incomes exhibit a broad range of income inequality, as do countries with relatively high incomes.

14 of the 74 countries are OECD members. All of the Gini data are from the World Bank (http://data.worldbank.org/indicator/SL.POV.GINI), except for seven values that are from the CIA World Factbook (https://www.cia.gov/library/publications/the-world-factbook/fields/2172.html). Recent Gini data are unavailable for many countries. Therefore, the graph includes only those countries for which data are available during the period 2007-2009. The GDP per capita data are from the database of the United Nations Statistical Division (http://unstats.un.org/unsd/snaama/dnllist.asp) and are also from the period 2007-2009. The Gini and GDP data are from the same year for each country. For better visualisation, we used the common logarithm of the GDP.
What all this means for competition authorities wishing to make a contribution to poverty reduction – especially those in countries with high Gini coefficients – is that it probably is not enough to rely only on the positive effect that competition has on GNP growth. They will need to target sectors in which the poor earn, or could potentially earn, their livings. The latter will vary substantially from country to country and depend on whether one is talking about the rural poor or the urban poor, but some obvious candidates are farming and farming implements, crop processing and distribution, and industries with high demand for unskilled labour. Other candidates include industries that facilitate small entrepreneurial activity, particularly banking services and mobile telecommunications (see Part 5.2.2.2. for more discussion of those).

5.2.2 Actual microeconomic effects of competition on poverty

5.2.2.1 A lack of competition harms poor entrepreneurs and workers

Earlier, we discussed evidence that competition problems exist in developing as well as developed countries and how those problems have harmed poor consumers. What about the effects on poor entrepreneurs and poor wage earners?

Source: OECD, with data from the World Bank, the United Nations, and the CIA World Factbook.

To help reduce poverty on the demand side, competition authorities would need to target sectors in which the poor spend most of their money, i.e. essential goods and services.
172. In a recent article, Frederic Jenny explored the harmful effects of export cartels in primary product markets. Focusing on potash, a key ingredient in fertilisers, Jenny found substantial overall economic harm. Although he does not attempt to estimate the harm done specifically to poor farmers, he does include estimates of total harm done to certain developing countries that import potash. It stands to reason that a significant component of that harm must fall on the shoulders of poor farmers who buy fertilisers, as well as on the governments that subsidise the price of fertilisers.

173. For example, Jenny notes that India and China are some of the world’s largest consumers of potash. India imports all the potash it uses, while China imports about 60 percent of its demand. Jenny estimates that, between 2011 and 2020, China will pay an average overcharge of about US$900 million per year due to the cartelisation of the potash export market. India’s situation is even worse, as Jenny forecasts that it will pay an average overcharge of US$1.17 billion per year. He observes that if India continues its annual potash subsidy of US$1.5 billion, between 80 and 100 percent of that subsidy will serve only to pay for the monopoly rent that the potash cartelists are collecting. We can infer that even though poor Indian farmers are not paying for the surcharge directly, they are still being harmed by it. The government’s subsidy money could have been used to help poor farmers in other ways if it were not being used to enrich the potash cartel. Or it could have been used to help other poor Indian citizens. Summing up the harm, Jenny calls it “a huge cost for importing countries [that] may have dramatic consequences in developing countries struggling to feed their rapidly increasing populations.”

174. For additional examples showing that the lack of competition causes harm to small entrepreneurs, we refer again to Professor Jenny’s compilation of cases from around the developing world. It includes instances of market concentration and price fixing agreements among agricultural products traders. Those two things have a monopsonistic effect on small farmers that reduces their incomes below the level they would be under competitive conditions. This problem is known to harm, for example, coffee growers in Kenya and Latin America, cotton, tea and tobacco growers in Malawi, and milk processors in Chile. Cartels also raise the input prices that farmers pay, as in the potash example above. But Jenny found allegations of cartel formation in fertiliser markets for Kenyan tea growers, as well. In addition, he describes vertical restraints in the beer sectors of Kenya, Zambia and South Africa that impede growth opportunities for small retailers.

5.2.2.2 Three industries in which competition has benefited poor entrepreneurs and workers

Banking services

175. We noted in the discussion on the consumer side of poverty that relatively few poor people in the world are connected to formal banking services. That is true not only with respect to services like savings accounts, but with regard to loans, too – including business loans for small entrepreneurs. An IDB survey, for instance, found that only 3.3 percent of the poor population in Latin America and the Caribbean has access to formal or semiformal credit. Studies by both the European Bank of Reconstruction and Development and the Pacific Economic Cooperation Council have found that the inability to obtain loans

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143 Id. at 116.
144 Jenny, supra n. 51.
145 Id.
is a major obstacle for SMEs in developing and transition economies.\footnote{146} Even in the US, more than 40 million people have no access to financial services.\footnote{147}

176. Yet loans are vital for small entrepreneurs wishing to start and expand businesses. Small businesses, in turn, are vital to employment, which is critical for poverty reduction. In developing countries, small businesses are responsible for nearly 50 percent of all employment.\footnote{148} If medium enterprises are included, the figure goes significantly higher. For example, SMEs in South Asia account for over 70 percent of total employment.\footnote{149} In Latin America, 98 percent of all businesses are micro, small, or medium size enterprises. They generate 40 to 50 percent of GDP and account for 40 to 60 percent of employment, depending on the country. Furthermore, 70 percent of the region’s poorest people either own or work for a microenterprise. As Luis Moreno, the President of the Inter-American Development Bank (IDB) has said, “[t]his suggests that we have a significant opportunity to reduce poverty in the region by making financial services more inclusive.”\footnote{150}

177. Moreover, in a 2007 study, Thorsten Beck and two colleagues found that greater financial development (i.e. better-functioning, growing capital markets) not only boosts the incomes of the poor, but that it does so disproportionately.\footnote{151} Consequently, improved access to capital reduces income inequality, as well. In particular, the authors showed that about 40 percent of the long run effect of financial development on the income growth of the poorest 20 percent of the population is due to less income inequality. The other 60 percent is the result of financial development’s effect on aggregate economic growth. Just to nail the point home, the authors emphasise that financial development reduces the percentage of a given population that is living in extreme poverty (defined as less than US$1 per day).\footnote{152} Making improvements in the availability and quality of financial services is therefore an important means of reducing poverty.

178. Formal financial institutions usually do not try very hard to win the business of poor entrepreneurs. Impoverished small business owners therefore tend to obtain loans, if at all, from informal sources like unregulated moneylenders.\footnote{153} Credit from informal sources, however, is expensive relative to


\footnote{147}{Moreno, supra n.73 at 86.}

\footnote{148}{Department for International Development, supra n.17 at 13.}

\footnote{149}{Syed Quader & Mohammed Abdullah, “Constraints to SMEs: A Rotated Factor Analysis Approach,” Munich Personal RePEc Archive Paper No. 26135, at p.5 (October 2010), available at http://mpra.ub.uni-muenchen.de/26135/.}

\footnote{150}{Moreno, supra n.73 at 85.}


\footnote{152}{Id.}

\footnote{153}{Abhijit Banerjee & Esther Dufo, “The Economic Lives of the Poor,” 21 Journal of Economic Perspectives 141, 155-56 (2007); Moreno, supra n.73 at 85-86; Tejerina, Bouillon & Demaestri, supra n.79 at vii; Loïc Sadoulet, “Savings and Deposit Services for the Poor,” in Luis Tejerina, César Bouillon & Edgardo Demaestri (eds.), Financial Services and Poverty Reduction in Latin America and the Caribbean, Inter-American Development Bank (2006).}
what banks charge, and the cost of financing has a powerful influence on how much a business can grow. Informal credit, being unregulated, also involves making insecure transactions, so it is riskier than formal credit. More competition might bring greater access to formal loans and lower interest rates.

179. In fact, there already is some evidence that greater competition has improved access to, as well as the terms of, banking services in some parts of the world. First, the United Nations has reported that microcredit interest rates fall quickly in areas where competition in the market increases. Second, IDB President Moreno has pointed out that when financial markets in Latin America were liberalised and foreign banks entered in the 1990s, competition started to thrive. The result was that banks began to look for smaller and smaller sized customers. “This development was highly effective in deepening access to financial services.” What is more, competition not only helped to shrink the spreads between savings and loan interest rates, but the banking sector boomed in some countries, such as Colombia. Third, the World Bank has found that the degree of competition in the banking sector is positively correlated with access to financial services for enterprises, especially in poor countries and countries with underdeveloped financial and institutional infrastructures. In particular, competition in those types of countries is associated with more loans to the private sector with lower collateral requirements.

180. However, Jenny found evidence that competition in many developing countries’ banking sectors is weak due to anti-competitive conduct and mergers. The absence of competition has allowed the spread between borrowing and lending rates to be greater than it would otherwise be. “This hinders the prospect for economic development of firms that are too small to have easy access to international capital markets.”

181. Likewise, Khemani notes that in most developing and transition market economies, insufficient competition is responsible for restricting access to capital for new and small businesses. “[D]omestic bankers in many countries have successfully resisted introduction of competition and entry by new domestic and foreign banks.” He points out that even amid a major financial crisis, big conglomerates in East Asia were able to dilute reforms and delay their implementation. As in developed economies, lenders and investors naturally believe that their capital will be safer with established, proven businesses. But whereas small and new entrepreneurs in economies with well developed capital markets can find competitive lenders and investors who seek risk (though they expect a premium for it), small entrepreneurs in countries with poorly developed capital markets are likely to find no funding at all, or else dauntingly high interest rates. Eventually, that problem can lead to a lopsided market structure in which a few big conglomerates tower over the economy while a multitude of small businesses fight for survival. These observations confirm that an opportunity exists in the banking sector for more competition to help reduce poverty.

155 United Nations, supra n.69 at 103.
156 Moreno, supra n.73 at 87.
157 World Bank, supra n.72 at 60.
158 Jenny, supra n. 51 at 123.
159 Khemani, supra n.89 at 61-62.
Mobile telecommunications services

There is strong evidence from across the world of the various development benefits associated with mobile phone services, including significant reductions in the cost of doing business, and improvements in connectivity which make it easier for businesses to link up with suppliers, existing customers, and potential new customers. This improves the investment climate, catalyses private sector development, and stimulates growth. Thus a well-performing and competitive mobiles sector, with low prices and wide coverage, can have significant knock-on benefits for the economy as a whole.160

182. And do any of those good things wind up helping small, poor entrepreneurs and wage-earners? Or do they only help large businesses and well-to-do people? The history of the Indian fisheries sector shows how small primary goods producers can benefit from the entry and development of competitive mobile telecoms services.

183. Between 1997 and 2001, mobile phone service began to appear in Kerala, an Indian state with a large fishing industry. Robert Jensen’s analysis shows that when fishermen and wholesalers there started to use mobile phones, the resulting improvement in access to market information enabled them to greatly reduce variations in fish prices and totally eliminate waste. Consequently, both the fishermen’s and consumers’ welfare increased.161 Because fishing is so vital to the economy in Kerala, those increases were felt by many, many people. Over one million people are directly employed in the fisheries sector in Kerala, and more than 70 percent of adults there eat fish at least once per day.

184. Prior to the entry of mobile service operators, fishermen at sea had no way of knowing what the current prices were at any of the various markets along the coast. Furthermore, they usually had to choose just one market per day to go to because of both high transportation costs (the markets were, on average, about 15 kilometres apart) and the limited number of hours that the markets were open. Storage was very costly, so most fishermen simply sold their catch in their own local market. That meant that quantities in a given market were heavily dependent on the amount of fish that happened to be caught nearby. Consequently, prices tended to vary greatly from market to market, and while boats docked at some markets were dumping their catches for lack of interested buyers, buyers at other markets were going home empty-handed because there were not enough boats there. If the fishermen could have known where the best prices were while they were still at sea, they could have earned substantially more for their catches and sold all they had. And when the supplies increased, consumers in those markets would have saved money as prices declined.162 Simply put, the market was hugely inefficient.

185. But by 2001, more than 60 percent of the fishing boats in Kerala, as well as most of the fish wholesalers and retailers there, had mobile phones. Jensen conducted a microlevel survey and found that both price dispersion and waste declined markedly because the availability of market information was so much better. The boats were systematically heading toward the markets where they could get the best price for their catches. Jensen also found that the fishermen’s profits increased by an average of eight

160 Ellis & Singh, supra n.86 at 74.
162 Id. at 881-82.
percent and consumer prices dropped by four percent. While those gains might not seem huge, they were permanent improvements rather than one-off bonuses.

186. Not only fishermen, but producers and consumers of other perishable primary goods (e.g. milk, eggs, fruits and vegetables) throughout the developing world are increasingly benefiting from mobile technology in the same ways that Kerala’s fishermen and consumers have benefited. These are gains that would never have happened without the competition and innovation from mobile telecoms companies.

187. Note that the Kerala example shows competition working at two different levels. Upstream, competition between mobile companies and other communications providers resulted in innovation, entry and affordable services. That, in turn, allowed more competition downstream in the fish wholesale markets, where imperfect information had been preventing competition among wholesale buyers as well as among fishermen. Once that imperfection was corrected, the waste and non-competitive pricing that had been the norm was eliminated, resulting in welfare gains for both fishermen and consumers.

The poultry sector in Zambia

188. In describing the recent history of the poultry sector in Zambia, Thulasoni Kaira provides another example of how competition can create more opportunities for small entrepreneurs. Poverty is widespread in Zambia, with 64 percent of the population living on less than US$1.25 per day. Zambia’s poultry sector, however, has been a success story. Its output rose from 16 million birds in 2000 to 26 million in 2007, and it is one of the country’s biggest employers. Competition law enforcement has been instrumental in the industry’s growth.

189. In 1999, the country’s largest day-old chick supplier, Hybrid, agreed to sell one of its farms and a processing plant to Galaunia Holdings, its largest customer. The sale was conditioned on an exclusive dealing agreement requiring Galaunia to buy day-old chicks only from Hybrid, and on Galaunia’s promises not to raise any poultry on the acquired farm and not to enter the chicken hatchery business. For its part, Hybrid promised not to set up a poultry processing plant in competition with the one that Galaunia acquired. Hybrid had only one serious competitor at the time (Tamba Chicks) and was considered dominant by Zambia’s Competition Commission, while Galaunia was the largest single buyer of day-old chicks – four times larger than its nearest competitor.

190. The arrangement between the two companies not only led to higher prices for day-old chicks, it prevented Tamba Chicks from selling to the largest chick buyer. As a result, Tamba began to have problems paying its bills. Sensing an opportunity, Hybrid arranged a loan for Tamba but forced it to give Hybrid the right to buy Tamba first if Tamba ever wanted to sell its business, which it eventually did. The Commission nullified all of those agreements as violations of the Competition and Fair Trading Act. When Hybrid nevertheless made a bid for Tamba, the Commission blocked it. Instead, a new entrant

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Specifically, Jensen found that the mean coefficient of variation of the price across markets in Kerala dropped from 60 to 70% to 15% and under. Waste, which had averaged 5 to 8% of each catch, was totally eliminated after mobile phones appeared. Id. at 883.

Id. at 881 & n.2, 920.


As of 2006, the last year for which data are available. CIA World Factbook, available at https://www.cia.gov/library/publications/the-world-factbook/geos/za.html.

Kaira, supra n.165 at 161.
acquired Tamba and not only remained in operation but outcompeted Hybrid, gaining a market share of 50 percent versus Hybrid’s 40.

191. That competition has been crucial downstream. As noted above, the industry grew substantially after 2000. Eventually, more than ten significant firms were competing with Galaunia, with new firms entering at the rate of nearly one every year. Kaira notes that increasing demand has spurred large chicken producers, struggling to fulfil orders, to sign contracts with small-scale farmers. The result has been exceptional growth for both the formal and informal chicken farmers.168

5.2.3 Other conditions affect competition’s ability to help poor entrepreneurs and workers

We have noted that the proper functioning of competition policy, and its degree of success in helping poor consumers, depends not only on the quality of a country’s competition authority and its competition law, but on other framework conditions, as well. The rule of law must be respected, for example. Government must be reasonably transparent and free of corruption. Courts and police forces have to function well. The trade regime cannot be too protectionist. And there needs to be some political and macroeconomic stability. Those and other framework conditions also affect competition policy’s ability to help poor entrepreneurs and poor wage earners.

5.2.3.1 Undue influence: close relationships between firms and government officials

192. Just as corrupt, symbiotic relationships between powerful businesses and government officials can harm poor consumers, they can harm poor entrepreneurs. The incumbent-protecting tactics mentioned in Part 4.2.5.1, after all, are designed and implemented with the specific purpose of keeping potential competitors out of markets. When those potential entrants are poor entrepreneurs, they suffer because the competitive process is not working and therefore not giving them opportunities they would otherwise have. If public procurement officials direct contracts to favoured, established businesses, for instance, instead of selecting a winner through a legitimate, competitive bidding process, governments miss out on an obvious opportunity to encourage less established entrepreneurs and fight income inequality. If the newcomers could have operated more efficiently than the protected incumbent, then the governments also miss out on a chance to save money. Furthermore, to the extent that the protected incumbent inflates its prices, output will be reduced, which also hurts employment.

193. Entry deterring strategies that use burdensome regulations, such as those requiring frivolous permits, expensive application fees, or extensive paperwork, can be especially effective against small, poor entrepreneurs. That is largely because they have fewer resources than larger, more established firms, so meeting the requirements drains a larger proportion of a small business’s budget and attention. As an example, consider that in Uganda, prospective entrepreneurs must face 18 different procedures that take nearly a month and more than 90 percent of per capita annual income to complete before they can legally go into business. In the UK, by comparison, starting a business involves six procedures that take 13 days and less than one percent of average annual income to complete.169 Studies show that cumbersome regulations for starting a business are correlated with corruption.170

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168 Kaira, supra n.165 at 161-66.
169 Department for International Development, supra n.17 at 18.
Evidence that regulations have a substantial restraining effect on small entrepreneurs is provided by a study carried out by Suresh Moktan in Bhutan. He interviewed and received questionnaire responses from 168 micro and small enterprise owners and managers about the factors that impede their growth. The results indicated that the most significant constraints were restrictive government regulations, inadequate access to capital, and poor infrastructure. A survey of SMEs carried out in Bangladesh reached similar results, finding that burdensome regulatory restraints were second only to high lending rates in constraining SME growth. The authors found that

> [w]hile SMEs in Bangladesh may not be deliberately discriminated against by legal or administrative regulations, they do remain susceptible to unequal treatment due to dissimilarity in economic capacities, transition phases, resource potential, location reasons, lack of well-disposed connections, and so forth. Such biases result in the distortion of a competitive environment for business in which the major brunt is often confronted by fragile micro and cottage enterprises, which then could lead to the proliferation of informal business.

Operating their businesses informally, i.e. without complying with the laws, interferes with the ability of small enterprises to grow, hire more people, and compete effectively with the bigger, more established, formal firms. Such businesses are therefore in a no-win situation to some extent: either they operate legally and remain constrained by regulations that are much more burdensome on them than on larger businesses, or they operate illegally and remain constrained by the need to stay “under the radar” of law enforcement. Competition authorities can do a great deal to boost competition and improve the fortunes of small, poor entrepreneurs by identifying unnecessarily anti-competitive regulations and advocating their removal or revision.

To assist governments with the task of reducing unnecessary regulation, the OECD has developed a Competition Assessment Toolkit. The Toolkit provides a general methodology for identifying unnecessary State-imposed restraints and developing alternative, less restrictive policies that still achieve government objectives. Designed for use by officials at all levels of government, and requiring no specialised training in economics or competition policy, the Toolkit consists of a series of simple questions to screen for laws and regulations that have the potential to unnecessarily restrain competition. In particular, the Toolkit facilitates the evaluation of draft new laws and regulations, for example, through regulatory impact assessment programmes; the evaluation of existing laws and regulation, whether in the economy as a whole or in specific sectors; and can assist government bodies engaged in development and review of policies, such as ministries that develop laws or the competition authority in its evaluation of competitive impacts of regulations.

The importance of innovation and innovation policy

One framework condition that has the potential to strengthen competition’s poverty-fighting effects is innovation policy. Innovation is responsible for most of the increase in material standards of living that has taken place since the industrial revolution. New and improved products, services, and manufacturing processes are the main engines of economic growth. In fact, it is widely believed that innovation’s dynamic effect on consumer welfare far outweighs the static effects on which competition policy often focuses. Yet competition itself can be a key driver of innovation, so there can be – at least in

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172 Quader & Abdullah, supra n.149.
173 See www.oecd.org/daf/competition/competitionassessmenttoolkit.htm
174 OECD, Going for Growth (2006) at 56.
principle – a chain of causation connecting competition to innovation, innovation to growth, and growth to poverty reduction.

198. This part of the paper briefly discusses the first link – the one in which competition drives innovation. The existence of that relationship remains controversial. While some scholars firmly believe that competition leads to more innovation, others have argued that the most innovative companies are the ones that face little or no competition. This is an old debate among economists, and it still fuels a great deal of theoretical and empirical work. The question of how, exactly, competition affects innovation seems to have no universal solution. Instead, the answer requires a host of conditions, exceptions, and caveats. What seems certain, at least, is that competition is capable of both promoting and deterring innovation. On the one hand, strong competition can encourage companies to innovate so as to keep up with, get ahead of, or remain ahead of their competitors. On the other hand, some degree of market power may stimulate innovation by making it easier to recover costs and earn profits. Policymakers are left with the complex task of creating an environment in which the rewards for innovation are sufficient to encourage it, but where there are also competitive pressures that encourage firms to create, use and circulate innovations. Finding the optimal degree of competition is further complicated by the fact that innovation processes vary considerably across industry sectors and types of inventions.\textsuperscript{175}

199. If it is possible to tease one central, reasonably well-accepted finding from the empirical literature in this area, it would probably be the idea that there is an inverted U-shape relationship between market concentration and research and development ("R&D") intensity when the former is plotted on the horizontal axis and the latter on the vertical axis. In other words, there is growing support for the proposition that concentration and R&D intensity generally have a positive relationship at low levels of concentration, with R&D activity reaching a peak at a moderate level of concentration, after which the relationship becomes negative and R&D intensity shrinks as concentration continues to rise. To the extent that market concentration is a good reflection of the degree of competition, and that R&D intensity is a good reflection of innovation, the message here is that the most fertile environment for innovation is a market with a moderate amount of competition.\textsuperscript{176}

200. An important nuance – particularly in the context of competition policy and small entrepreneurs – which is revealed by empirical studies concerns the difference between the kinds of innovation that large incumbents typically pursue and what smaller challengers typically attempt. The former group tends to focus on developing inventions that build on or extend the status quo technology, whereas smaller firms and entrants are more likely to concentrate on disruptive innovation that can alter the nature of the market. Because new technologies that change the elements necessary for success may reconfigure the state of competition, they are often welcomed as a strategic opportunity by marginal competitors while being treated as a threat by the leading firms. That is often true even if the leading firms are the ones who created the new technology. In those cases, the incumbent simply shelves the technology, having patented it, kept its existence secret, or taken other measure to prevent competitors from using it. Consequently, breakthrough or disruptive inventions are often brought to market by small start-up firms. The implication for competition enforcers is that innovation is most likely to thrive in market environments that support a variety of firm sizes and feature low barriers to entry for innovative entrants.\textsuperscript{177}

\textsuperscript{176} Id. at 46.
\textsuperscript{177} Id. at 51.
201. A key conclusion that follows from the inverted U-shape hypothesis and the greater inclination of small, entrepreneurial start-up firms to come up with breakthrough innovations is the need to implement effective competition law enforcement. The inverted U-shape suggests that, in general, moderate amounts of concentration create the kind of market environments that are most conducive to competition. Most competition enforcement occurs in relatively concentrated markets; that is, markets that tend to have significant potential for greater competition and therefore increased innovation. Accordingly, by performing their usual enforcement duties well and deterring established firms from using restrictive trade practices to thwarting potential entrants, competition authorities will protect opportunities for innovation and growth.

202. Of course, competition enforcement does not exist in a policy vacuum. Competition’s ability to bring about growth-inducing and potentially poverty-reducing innovation is affected by other elements of a country’s overall policy approach to innovation. Education, tax, trade, and intellectual property policies, for example, will all have substantial influences on the nature and amount of innovation that occurs. If a country encourages innovation with a group of sound, innovation-friendly framework conditions, competition law enforcement and policy will be more likely to encourage creative entrepreneurs to invest in bringing their ideas to the marketplace.

203. The OECD recently published a major study on policies that promote innovation. The OECD Innovation Strategy is the culmination of a three-year, multidisciplinary and multi-stakeholder effort. It provides analysis and policy guidance on a broad range of issues from education and training policies, to policies that provide business environments and infrastructures that are conducive to innovation, to policies that foster the creation and diffusion of knowledge. It can support government efforts to develop effective innovation strategies and to achieve economic and social objectives. It advocates an approach which takes into account the interplay of different policy domains and brings them together through supportive mechanisms for governance at the local, regional, national and international levels.

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Box 1. Two Recent Examples of Innovation Helping the Poor†

1. A Solar Powered Lighting and Charging System. Last April, a company called Azuri Technologies (UK) introduced a solar-powered light and charging system to the residents of Kokete, Kenya. Like many other Kenyan villages, Kokete is not on an electricity grid. People who live there had to buy paraffin for lamps if they wanted to work or study after dark. They also had to spend hours travelling to and from the nearest charging station if they wanted to use mobile phones to communicate. Those conditions created a poverty trap for people living in Kokete: They could not afford to build power lines to their homes, and the lack of power kept them poor.

Azuri’s solar charger, called Indigo, is dismantling the trap. It converts and stores enough solar power to run two LED lights and a phone charger for eight hours each day. Schoolchildren are now able to continue their studies after dusk. Parents save money on paraffin and can communicate more often with people outside of Kokete. And no one has to breathe paraffin fumes anymore.

How can poor villagers afford Indigo units, and how can Azuri turn a profit? They do it with a business model similar to the one mobile service providers pioneered for millions of low-income people. Customers do not buy Indigo units up front. Instead, they buy pay-as-you-go scratch cards, which they consume as they need power, just like prepaid mobile phone customers use scratch cards to pay for mobile talk time. Indigo users validate their scratch cards via SMS from a mobile phone. They then receive a one-off passcode, enter it on the Indigo’s keypad, and the unit starts to operate for a fixed period (typically a week). After a while of using the scratch cards, customers own their Indigo unit and can enjoy free power. Some people in Kokete are already planning to use bigger Azuri systems to start businesses – an option that the company calls “pay as you grow.”

There are still more than one billion people in the world who have no access to electricity today. The market for Indigo, and its potential to help reduce poverty, is therefore very large. This example illustrates how an innovation can help the poor as consumers and as entrepreneurs simultaneously. It also illustrates how innovation can take the form not only of a new product, but of a new business model that spills over into other markets.

2. A Fresh Milk Chiller. Milk is an important source of protein in India, where much of the population is vegetarian. In fact, India is the largest producer and consumer of milk in the world. Most of that milk is produced by small dairy farmers, who typically own four or five cows. The farmers bring buckets of fresh milk twice a day to collection centres, where trucks whisk it to the nearest chilling station before it spoils. But the electricity supply is not always steady and the refrigerators are not always reliable, so a huge amount of milk – 30 percent – is lost due to spoilage.

An entrepreneur named Sam White went to India in 2007 to talk to dairies there about a solar powered refrigeration device his partner Sorin Grama was developing. Solar powered refrigeration was not steady enough for the milk business, White kept hearing. Dairies need a more reliable system, but the conventional refrigeration firms were not providing anything. So Grama designed a chiller with a thermal cell similar to a rechargeable battery; it draws power from the grid at night when it is readily available, stores it, and then the cell goes on stand-by during the day. Farmers pour their milk into the chiller during the day. If power from the grid goes off, the thermal cell instantly steps in and keeps the milk cold. Farmers who buy White and Grama’s chillers, called Prometheus Power Systems, no longer need expensive diesel generators, which were necessary for backing up older generation chillers. The farmers not only save money on generators, they earn more because more of their milk stays fresh.

†Both examples are described in TIME magazine (17 September, 2012), pp. 40-42.

5.2.3.3 The importance of effective laws and courts

204. In a new book, Professors Robert Cooter and Hans-Bernd Schäfer argue that effective laws and legal institutions are instrumental in the fight against poverty. Conversely, they say, when laws and legal
institutions are missing or ineffective, innovation – and thus poverty alleviation – will be inhibited.179 Sound laws as well as an efficient court system are necessary for key investments to be made and for inefficient firms to exit in a timely, smooth fashion, but not all countries have such laws and courts in place yet.

205. Whether in Silicon Valley or in developing countries, well-drafted contract, property, and business organisation laws are necessary for inventors, creditors and partners to have enough confidence in each other to launch an innovative business venture. The innovator has to be able to trust the financier with an idea, and the financier has to be able to trust the innovator with the money. But governments cannot simply pass good laws and then expect magical things to start happening immediately, the authors note. It takes time for laws to evolve into solid institutions that adequately protect venture investments and profits.

206. The poorest countries in the world tend to have weak capital markets, so entrepreneurs often turn to friends and relatives for capital. Cooter and Schäfer show that, historically, when societies start from a condition of lawlessness and then implement secure property rights, there can be a growth spurt that is based mainly on “relational” finance, i.e. borrowing from family members. Being rather limited in most cases, family financing arrangements tend to keep business ventures small and local. No modern countries have become wealthy by relying only on relational finance.

207. Instead, countries have to expand their citizens’ financing opportunities with private finance systems, such as commercial bank loans. To do that, countries need laws that effectively control behaviour, not just wishful, idealistically worded laws that do not actually bind people to behave responsibly. Laws are as effective as the sanctions that support them, the authors explain. People need to believe that failing to obey laws will make them worse off than complying. Once they believe that, financing and all the innovation and growth that comes with it can proceed. This is really not a new idea. The World Bank, for instance, made the same point in a 2009 publication called Banking the Poor.180

208. The point here is that competition can create incentives and opportunities for small entrepreneurs to bring their ideas to markets, but without a reliable legal system in place, the business transactions that are necessary to turn ideas into actual market entry will be less likely to occur.

6. Are “Pro-Poor” Government Interventions Better than Competition?

209. Whether the stated motive is to fight poverty, stabilise prices, help domestic businesses grow, or something else, governments are sometimes tempted to interfere directly in markets rather than entrust them to the forces of competition. The interventions may take the form of imposing price controls or trade barriers, granting subsidies, or setting up government-owned businesses to serve “poor” markets, to name a few examples. Even when well-intended, though, interventionist policies usually are not superior long term alternatives to liberalised, competitive markets. As one speaker noted at last year’s Global Forum on Competition, interventions like price controls might initially improve the lives of poor consumers who have difficulty affording necessities, but the strategy is ultimately likely to backfire because it interferes with the signalling effect that prices have on market participants.181


180 See World Bank, supra n.72 at 58-59 (noting that the degree to which creditors can credibly enforce contracts plays an important role in reducing credit risks for banks, which affects the ease of access to finance).

210. Price caps, for example, usually reduce the incomes of farmers and therefore tend to reduce their incentives to produce more food, which is exactly what would have helped poor consumers. A viable strategy to stabilise and reduce food prices must somehow involve finding a way to increase agricultural production, not decrease it. Another problem is that price caps do not only reduce prices for poor consumers, they reduce prices for all consumers – even those who can afford higher prices. Price caps therefore divert resources toward people who do not actually need help. Furthermore, price caps may result in shortages due to the reduced incentive to produce more of the item. It does little good to keep an item’s price lower if the item is not actually available for purchase. Subsidies for agricultural inputs and outputs are similarly distortive and inefficient because the lion’s share of the aid winds up going to large farmers who are least in need of assistance.

211. Even worse, these interventions have a snowball effect that makes them more and more costly to maintain. Suppose a government decides to subsidise the price of bread. That will encourage more consumption, as intended, but the greater demand will also put upward pressure on the price of bread, meaning that the government will have to spend even more on subsidies to keep the effective price constant.

212. That is exactly what happened in Mexico when the government subsidised the price of tortillas, which account for more than half the daily calories and protein of the poor in that country. The tortilla subsidy became more and more of a financial burden on the government. In 1994, it was projected to cost US$1billion per year within two years unless the subsidy was limited. It was, gradually, and the costs came down. Price controls, which had also been in effect, were gradually lifted and then removed altogether in 1999.

213. Granted, when people are starving, letting retail food prices remain too high for them to afford is an unacceptable short run outcome. But over time, the signals that high prices send to both consumers and producers are vital for positive change, and some types of “pro-poor” market interference (e.g. price controls) can cause shortages, which do not help starving people, either. One way or another, shortages will cause rationing until production is increased or alternative products are found and consumed. A high price is one type of rationing mechanism. It has some efficiency benefits compared to the alternatives, but we may not like the distributional effects of how it does its job, i.e. it cuts out the poor. So we might prefer to use price controls together with enforced rationing instead, especially in the short term. If a government simply controls prices but lets people buy as much as they want at those prices, the rationing will be achieved when shops run out of the item in question at some point during the day. New costs will appear in the form of long queues. Sometimes an intermediate solution appears, as when shopkeepers do the rationing, allowing people to buy only a certain amount of bread, etc. But one way or another, a good in short supply must be rationed.

214. In sum, high prices tell consumers that certain products are relatively expensive to produce, motivating them to find cheaper alternatives. At the same time, high prices tell producers that they should invest in increasing production. These responses will jointly move the market toward a new equilibrium with more food and lower prices. If prices are held artificially low, though, consumers and producers will respond differently and the result will eventually be shortages.


215. Some countries have laws that require agricultural products to be sold to marketing boards that are governed by grower representatives or that set prices for staple foods. These laws implicitly centralise the determination of prices and quantities with mandatory, state-sanctioned frameworks that would be illegal if undertaken by private businesses on their own. There is a danger that such arrangements are subject to capture by the larger growers.

216. At a general level it is partially understandable why countries sometimes decide to put open competition on hold in agricultural markets. In many developing countries, property rights remain uncertain, agricultural industries may not yet be part of the taxation system, and rural populations may not yet be able to fully participate in education or have access to medical and other basic services. So there may simply be other urgent priorities. Carefully sequencing the order of market reforms is important. But waiting to implement a competition law, to let markets work with minimal interference from the State, and to develop a culture of competition has real costs, too. The sooner competition is allowed to work, the sooner its benefits will accrue.

7. Mixed Effects on Poverty

217. Some essential goods are both consumed and produced by poor people. When the poor are on both the demand and supply sides of a market, competition can have mixed effects on poverty. For example, greater competition in the market for corn might move poor consumers’ welfare in one direction while moving poor farmers’ welfare in the opposite direction. Imagine that there is an increase in competition in the corn market that results in lower wholesale prices. Poor consumers who buy corn-based products may benefit. But those lower prices may also reduce the incomes of poor farmers who grow corn. Alternatively, an increase in wholesale corn prices would make the farmers better off, but it might harm consumers. Farmers who supply part of their own demand for corn and buy the rest would experience simultaneous and opposing welfare effects from price changes in the corn market.

218. Does this mean that whenever there are poor people on both the demand and supply sides of a market, the overall effect of competition on poverty is indeterminate? Is it therefore impossible to claim that competition policy can help to reduce poverty in such markets?

219. The answer to both of those questions seems to be no, at least with respect to most staple food markets. (Staple foods are highly relevant, since in many countries poor people not only grow and sell these products but also spend the majority of their income on them.) Ivanic and Martin studied the impact on poverty of higher staple food prices in nine low-income countries. Although the effects varied by commodity and by country, net poverty increased much more frequently and substantially than it declined. One can infer that lower food prices – a generally expected consequence of greater competition – would reduce net poverty more frequently and more substantially than they would increase it.


187 Ivanic & Martin, supra n.186. at 1-2. The staple products in the study included wheat, rice, maize, sugar, and poultry.
220. In fact, one can further infer that Ivanic and Martin’s results would be stronger in cases where the lower prices are caused specifically by greater competition. The reason is that poor farmers often do not enjoy much of the benefit of higher food prices anyway. That means they have less to lose when prices decline, so the consumer welfare gains will be offset by a smaller amount. As the 2012 GFC clarified, where market power exists on the supply side of staple food markets, it is usually in the form of either a large agribusiness that pays poor people wages to work the company’s farmland or a large firm acting as a middleman between a large number of small, poor farmers on one side and small shops that distribute the goods on the other. The large firms in the middle have most of the leverage, so they extract most of the available profit.

221. This hourglass shape represents a common situation in wheat, rice, poultry, coffee, and many other markets:

![Figure 8. Common Bottlenecks in Agriculture](image)

Source: OECD

222. Higher or lower food prices in these markets will not alter the incomes of the poor on the supply side very much. Consequently, most of the welfare effects of lower staple food prices caused by greater competition will be felt by poor consumers, who will benefit, rather than by poor farmers.

8. What Can Competition Authorities Do to Help Reduce Poverty?

223. First and foremost, they can continue to do their jobs. That means enforcing competition laws, working to improve them as needed, lobbying for more resources where appropriate, and – critically – using advocacy to create a culture of competition in their economies.

224. That culture should extend beyond the private sector to encompass the public sector, too. “The competition agency can play an important role in calling attention to anti-competitive and unproductive state measures and their costs to society. It should probably be the nation’s ‘strongest public voice on promoting competition and articulating the competition perspective.’” Because so many different policies affect competition, part of the authority’s attention should be focused on considering how policies

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188 Taylor & Petr, supra n.185 at 15.
189 Fox, supra n.54 at 233 (quoting Mark Dutz & R. Shyam Khemani, Competition Law & Policy: Challenges in South Asia 28 (2007)).
that are largely or wholly formed in other parts of the government – like trade policy, industrial policy, state ownership, regulation, investment promotion, and anti-corruption – affect competition. When the effects are harmful (or expected to be harmful), the competition authority should let its concerns be known.

225. In particular, competition authorities can explain to their colleagues in other parts of the government the distortive harm that interventionist policies like subsidies and price controls can cause. If the government is contemplating taking over the supply of some essential good or service – unless there is clear evidence that the government's intervention is critical (e.g. there are insufficient transport options for moving food where it is desperately needed) – the authority can point out that governments are not better at running businesses than the private sector and that their intervention may only wind up causing shortages and deterring private firms from entering and solving the problem.

226. Likewise, competition authorities may find it useful to remind government agencies that promote subsidies, tariffs or import quotas that market exit is a normal, healthy, and necessary part of the competitive process. Propping up inefficient, unviable firms distorts that process and can lead to wasted government expenditures, product shortages, or higher prices. In addition, it can lead to lost opportunities for small, domestic entrepreneurs who might otherwise be able to enter, compete, and earn a better living.

227. People sometimes argue in favour of subsidies and trade protectionism by saying that letting companies fold is cruel or unjust. It is unavoidable that jobs will be lost when firms close down, so there are very real human costs whenever a business fails. But competition creates winners as well as losers. Furthermore, artificially keeping inefficient firms alive interferes with economic growth, which is a necessary ingredient for poverty reduction. Governments wishing to help people who lose their jobs when subsidies are cut would do better to put the money saved into creating or improving social safety nets. Beneficial programs for displaced workers who are impoverished or in danger of falling into poverty include temporary income support, vocational training, and job placement services to help people make the transition from one line of work to another where there are better employment prospects.

228. It is not only subsidies and trade policies that can retard efficient exit, though. Sound bankruptcy laws and an efficient court system are also necessary for smooth market exit to occur, but not all countries have such bankruptcy laws and courts in place yet. Where appropriate, a competition authority could advocate the necessary measures to correct any deficiency in that regard.

229. Moreover, competition authorities can work to persuade regulatory bodies to take the competition effects of their policies into account and to eliminate unnecessarily anti-competitive regulations. One way to do so is to implement a process for impact assessment that examines the competition implications of regulations. The OECD’s Competition Assessment Toolkit was specifically designed to help governments to do that.\(^\text{190}\)

230. Of course, competition officials offering advice in some of these circumstances will be doing so in rather sensitive political contexts, so they will have to strike a careful balance between sound competition policy advice and ensuring that they do not come across as uncaring or out of touch with the reality of what impoverished citizens are going through. Indeed, competition officials can emphasise that a primary reason for offering their advice is the welfare of those citizens.

231. But what can be done in situations where those things are not adequate?

\(^{190}\) See [www.oecd.org/daf/competition/competitionassessmen toolkit.htm](http://www.oecd.org/daf/competition/competitionassessmenttoolkit.htm)
232. One such situation can occur when there are cosy relationships between influential firms and government officials. Strong vested interests will fight hard to prevent pro-competitive changes from taking place. To overcome them, Ellis and Singh suggest that competition authorities consider aiding or even setting up interest groups that would benefit from pro-competitive reforms. Such groups could include consumers (both household and commercial) who would gain from lower prices, as well as recent and potential entrants who have been restricted by current policies but remain interested in participating in a market. Both consumer groups and business associations might already exist, so the agency might need only to support them rather than establish them. That support could include coordinating the groups’ efforts, publicising the problems at issue and providing evidence that pro-competitive reforms would help consumers. With the authority’s help, such groups might succeed in counterbalancing the political forces that maintain the status quo.191

233. Brusick and Evenett note that such endeavours will probably be quite challenging, but that amassing large groups of interested individuals and businesses is the right approach:

[I]njecting the discipline of competition and limiting the exercise of market power into economies where vested interests have strong links to policy makers is unlikely to be easy in developing countries (and in industrialized countries for that matter). . . . Proponents of such measures ought to marshal a wide base of support within society and not solely focus on the important technocratic details that these measures entail.192

9. Conclusion

234. For competition to benefit the poor, a good competition law is not enough. A good competition authority is not enough, either. A culture of competition has to take root in a country, not only among sellers and buyers, but among courts, politicians, and government agencies. Competition needs a supportive policy environment and adequate framework conditions to work properly. There has to be a genuine market economy in which governments take the competitive effects of legislation and regulations into account. Not least of all, local realities have to be acknowledged, not only in terms of institutional capabilities but with regard to the skills and vulnerabilities of the poor population.

235. To understand the actual effects of competition on poor consumers, small business owners, and workers more thoroughly, more empirical research is needed. The welfare of poor people before and after the level of competition changes in markets – whether because of an intervention by the competition authority, normal entry or exit, or something else – has to be systematically analysed over time, in several countries and in several product/service markets. This would be a fruitful area of study for academics, competition authorities, or international organisations.

236. At this point, although there is evidence that competition is beneficial for macroeconomic growth, it does not seem clear that macroeconomic growth is necessarily inclusive; the poor can be left behind and the struggle against poverty can stagnate, depending on the severity of income inequality in a country. Therefore, if competition want to reduce poverty, they are likely to have the greatest effect when focusing on markets in which poor people spend most of their income (essential goods and services), on markets that facilitate small entrepreneurs’ success (banking and communications services), and on labour-intensive sectors that employ the poor.

191 Ellis, supra n.88 at 2; Ellis & Singh, supra n.86.
192 Brusick & Evenett, supra n.98 at 294.