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How state-business relations trumps market forces in determining commercial success

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Recent Overseas Development Institute (ODI) research shows that the relationship between government and large businesses is often more important in determining market outcomes than competition and market forces (Ellis and Singh, 2010).

Markets need to be disciplined through competition (and in some instances appropriate regulation) to work efficiently. The research confirmed this, by comparing outcomes in four very different markets – sugar, cement, beer and mobile telephony – across five countries – Bangladesh, Ghana, Kenya, Vietnam and Zambia. The analysis showed significant differences in the performance of each market across countries, caused by differences in both policy and private sector behaviour.

Markets characterised by more competition, with more players, more dynamic entry and exit and more intense rivalry for customers, tended to deliver better market outcomes, including lower prices, better access to services for consumers and improved international competitiveness. An increase in competition through new market entry often delivered significant and rapid benefits.

The cement industry provides a good example of the benefits of competition. In countries with many players, such as Bangladesh, which has 34 players, prices are much lower and there is more potential for exports and growth. In Zambia, which had only two cement producers in 2008, prices were as much as three times higher than in Bangladesh. But since the entry of a new cement plant in Zambia in 2009, prices have dropped by almost 10%, whereas prices in other countries have risen. Cement is an important input for construction and infrastructure development, which are often paid for out of the government budget and which underpin growth and industrialisation. Thus, its price and availability are important.

The impacts of competition are clear in other markets as well. For example in Kenya, mobile phone tariffs fell by as much as 50% following the introduction of two new entrants into the mobile phone market in 2008, which should make the use of mobile phones more affordable for many poor people.

Yet, despite the clear benefits of competition, the study identified various cases in which government has allowed monopolies or uncompetitive market conditions to persist. In some of the countries studied, competition authorities have investigated the competition problems identified but have been prevented from tackling them effectively.

What is often observed, especially in sectors dominated by large firms, is a very close relationship between business and government, such that government actors share in some way in the profits of those businesses. This may happen through state ownership, through ownership by individual politicians, through corrupt business deals, through corporate social responsibility initiatives e.g. building clinics or schools, through 'favours' such as selective price discounts or simply through high levels of taxation. This gives government a shared interest in the monopoly profits of these businesses, and means that government may continue to protect those businesses from competition, e.g. through barriers to imports or market entry.

Thus competition itself can become a bargaining chip in a power game between government and business, as these examples show:

- One company in sub-Saharan Africa claimed that they were asked by government to provide their product at discounted rates to a new foreign company in another industry that the government was trying to establish in the country. They claimed that, when they refused, their punishment was the government licensing of a new entrant to compete with them, thus undermining what had been a longstanding monopoly position.
- Sugar mills in some sub-Saharan African countries face frequent price intervention by government, which is determined to keep prices down for electoral reasons. This has sometimes caused them financial difficulties, resulting in underinvestment, which has reduced the efficiency of the mills and pushed up costs significantly. But in return, they have enjoyed significant protection from imports until now. Prices in such countries have become uncompetitively high though, which is bad

for poor consumers and which makes the sector very vulnerable to liberalisation, as neighbouring countries produce sugar much more cheaply.

This mutually beneficial relationship between government and business underpins the formation of a powerful economic elite, with vested interests in opposing pro-competition and pro-growth reforms, which has serious consequences for economic development more broadly. In this situation, it is the relationship between a business and the government that often seems to determine a company's commercial success in a country, rather than market forces, and this is likely to have significant economic costs.

The best way to tackle vested interests that oppose reform is to establish and facilitate coordination among other interest groups that stand to gain from reform. This includes consumers, both household (who can be mobilised through consumer groups) and industrial, who may gain considerably from lower priced inputs. It also includes potential new entrants to the market, who can make their voices heard through business associations.

If these groups can be mobilised to lobby effectively for reform, this can help offset the political pressure to maintain the status quo. Competition authorities can play an important role here, in coordinating such groups, publicising the costs of a lack of competition and providing evidence on the benefits of reform. Donors can also help support the development of constituencies for reform, by building the evidence base on the benefits of competition, working with civil society to develop a culture of competition and supporting the establishment of effective competition authorities.

Achieving a sound framework for competition is difficult, and beset by vested interests, but it is crucial to ensuring that markets work efficiently to deliver growth and development. The extent of competition is also crucial in determining the impact of globalisation on development, whereby large multinationals with considerable market power are entering small underdeveloped economies, which desperately need the products, investment capital and know-how that they bring but want to avoid the repatriation of excess profits and the unfair suppression of domestic business. Thus, sound competition policy is an important accompaniment to globalisation and liberalisation processes, to ensure that developing countries achieve the expected benefits.

Ellis, K. and Singh, R. (2010) 'Assessing the Economic Impact of Competition.' London: ODI. Downloadble from http://www.odi.org.uk/work/programmes/business-development/industry-competition-policy.asp