

# Competition Watch

in Key Growth Sectors of Nepalese Economy

Arpita Nepal, Pramod Rijal & Sarita Sapkota



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# Preface

As a part of its efforts to raise economic agenda in Nepal, Samriddhi Foundation is committed to an annual analysis of growth constraints of Nepal along with exploring policy options. This process termed as the 'Nepal Economic Growth Agenda (NEGA)' is an annual effort to identify short term as well as long term policy bottlenecks that hinder Nepal's economic growth. This research paper 'Competition Watch in Key Growth Sectors of Nepalese Economy' prepared as a follow up to the NEGA 2012 is one of the six cross-cutting issues covered under NEGA 2013.

NEGA 2012 identified and discussed policy constraints in five growth sectors of Nepal viz. Agriculture, Education, Hydropower, Transport, Infrastructure, and Tourism. Building on this research, NEGA 2013 focuses on identifying and discussing cross-cutting issues that affect the growth of all five sectors and also makes recommendations to address these issues. The goal of these analysis and papers is to facilitate the creation of a competitive and conducive business environment for Nepal, thereby leading to economic growth and prosperity.

The six different issues studied under NEGA 2013 are industrial relations, contract enforcement, anti-competitive practices, foreign direct investment, public enterprises, and regulatory environment for businesses. Each research paper has been prepared in consultation with individuals and groups who are experts or are involved in the particular field.

The six issues studied under NEGA 2013 have been presented as individual research papers that will be combined and presented as NEGA 2013 towards the end of 2013. This research paper on anti-competitive practices was prepared by the team of Ms. Arpita Nepal, Ms. Sarita Sapkota and Mr. Pramod Rijal.

Anti-competitive practices fall under the jurisdiction of Anti-trust law worldwide. In Nepal, Competition policy and Competition promotion act are

relatively new endeavors. However, the markets of Nepal are rigged with various forms of anti-competitive practices. From outright cartels and syndicates to more subtle form of 'associations' and much more implicit government sanctioned monopolies all plague the Nepali market. Any attempt at outlining anti-competitive practices requires a clear definition and understanding of practices that reduce competition with a market. One of the major challenges faced during the course of this paper is the lack of any clear definition that outlines anti-competitive behavior. Therefore, the authors had to rely on theoretical definitions and observed activities of various associations.

This paper is an attempt to outline anti-competitive activities in its' various forms and to outline major causes and institutional weaknesses that have led to such behavior in Nepali markets. It delves into the five sectors identified during NEGA, 2012 and looks at the anti-competitive behavior found in these sectors of the economy. While Hydropower sector is filled with government regulatory burden curbing competition, Public Transportation sector of Nepal is filled with cartels formed by private companies. There are both kinds of anti-competitive behavior in education, tourism and agriculture. Among all the sectors analyzed, agriculture sector was found to be the most competitive in comparison to the rest of the sectors. Yet, there are structural problems that still inhibit growth in this sector.

Improving competition is just one way of promoting growth in these sectors of the economy. A competitive environment comes with a major benefit of protecting consumers (who are already a vulnerable group with limited purchasing power). Therefore, addressing anti-competitive behavior becomes even more essential in a developing economy like Nepal.

A new approach that this paper has taken is to include anti-competitive behavior of the government while analyzing such behavior of private players. This paper concludes with several broader recommendations to improve the environment of competition and several sector specific recommendations to improve competition within each of the sectors analyzed.

## Abbreviations and Acronyms

AICL	Agriculture Inputs Company Limited
APMC	Agriculture Produce Marketing Committee
APP	Agriculture Perspective Plan
CAAN	Civil Aviation Authority of Nepal
CDO	Chief District Officer
CPMP Act	Competition Promotion and Market Protection Act
DDC	District Development Committee
DoED	Department of Electricity Development
GoN	Government of Nepal
H.E.P.	Hydro electric project
IPP	Independent Power Producers
FNNCI	Federation of Nepalese Chambers of Commerce and Industry
FNNTTE	Federation of Nepalese National Transport Entrepreneurs
MoCS	Ministry of Commerce and Supplies
NAC	Nepal Airlines Corporation
NATA	Nepal Association of Tours and Travel Agents
NDRI	National Research Development Institute
NEA	Nepal Electricity Authority
NEGA	Nepal Economic Growth Agenda
NOC	Nepal Oil Corporation
NT	Nepal Telecom
PIL	Public Interest Litigation
PPA	Power Purchase Agreement
SoE	State Owned Enterprise
TIA	Tribhuvan International Airport
WFP	World Food Programme

*The Nepali year is based on the Bikram Sambat Calendar and is approximately 57 years ahead of the Gregogrian calendar (2062/1/1=2005/4/14)*



# 1. Introduction

There are many empirical studies and theoretical perspectives explaining the importance of competition for economic growth (Reis and Farole, 2010). Competition drives firms to become more productive and efficient in producing goods and services and creates incentives for innovation. Competition also increases consumer choice, protects against vested interests, and provides a level playing field for different market players (Rodriguez-Clare, 2005; Harrison, Rodriguez-Clare, 2009; Kerf, Nato and Geradin, 2005).

In Nepal, discussion about competition began with the liberalization measures and restoration of democracy in the nineties. The current legislative framework for competition is encapsulated in five acts. They are: the Industrial Enterprises Act, 1992 which ended the “license raj” and eased the process of establishing industries; the Foreign Investment and Technology Transfer Act, 1992, which opened foreign investment in all sectors except cottage industries, ammunition, explosives and gunpowder, industries related to radioactive materials, and the currency and coinage business; The Black Marketing and Certain other Social Offenses and Punishment Act, 1975 ; The Consumer Protection Act, 1997; and the Competition Promotion and Market Protection Act, 2063 (2007).

The liberalization of the market and decreasing number of state owned enterprises has created more space for competition in Nepal during the last 20 years. Transfer of the government owned monopoly Nepal Telecom to being a company and opening up the sector led to success in increasing mobile technology penetration phenomenally. This

stands as the flagship example of recent liberalization<sup>1</sup>. However, there is still a long way to go in terms of liberalizing the economy. Government of Nepal (GoN) continues to have monopoly control over supplying basic goods and services such as petroleum products (petrol, diesel, cooking gas, kerosene) and certain aspects of electricity. These areas are plagued by shortages. There are excessive losses and continual malpractices within the organizations. Simultaneously, the business sector has developed and sustained anti-competitive behavior through cartels, price fixing, creating barriers to entry and other unlawful collusion in a number of sectors.

With this context this paper focuses on the status of competition in five key areas of the Nepalese economy and attempts to explain what factors foster anti-competitive practices in these areas. The five areas are discussed in the Nepal Economic Growth Agenda (NEGA) Report 2012<sup>2</sup>. NEGA conducted detailed studies on five important growth sectors and discussed the roles they could play in furthering economic growth in Nepal. Those sectors are Agriculture, Education, Hydropower, Transport Infrastructure and Tourism.

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1 Until 2004, when Nepal Telecom (NT) formerly known as Nepal Telecommunication Corporation (NTC) was the only state owned telecommunication company of Nepal, it used to take several years to install landline phones at people's home, not mention the exorbitant prices and the fact that telecommunication was viewed as a luxury as only selected 'rich' people could afford it. Now, even those in the lowest income bracket in the country are able to enjoy the services of a cell phone and can have access to it in no time.

2 Available at [samriddhi.org](http://samriddhi.org) (<http://samriddhi.org/page.php?id=36>)

## 2. What are Anti-Competitive Practices?

The Competition Promotion and Market Protection Act, 2007 of Nepal explains Anti-Competitive Practices in its second chapter and includes the following activities as anti-competitive:

- Making anti-competitive agreements including that of prices, control of production, distribution and sale, market allocation, applying syndicate systems in transportation or distribution of goods or services etc.
- Abuse of dominant position
- Merger or amalgamation with intent to control competition
- Bid Rigging
- Exclusive dealing
- Tied Selling
- Misleading advertisement

The paper discusses cartels, abuse of dominance, and anti-competitive mergers as well as government policies, provisions and activities that foster and promote anti-competitive practices. Government entities that produce similar effects as private-sector anti-competitive practices are also considered. More emphasis is placed on anti-competitive agreements, such as cartels, and state barriers to entry, exit, and operation, abuse of dominance than to anti-competitive mergers due to their relative prevalence within Nepal (Refer to Explanation of Key Terms list for full definition of the terms used in the paper).





## 3. Competition in Selected Growth Sectors

During the research for NEGA, one important issue that crosscut the five sectors and inhibited their growth was anti-competitive practices. Following section discusses the sectoral anti-competitive practices.

### Hydropower

Hydropower, Nepal's major source of power was considered a natural monopoly from a policy angle before the nineties; however, as the demand for electricity grew consistently, it provided space for economies of scale and there were innovations in cost effective technology to generate hydropower. These two major developments of expanded market and cheaper cost of production provided space for private sector participation. Although the private sector entered the hydropower industry following the enactment of the Hydropower Policy and Act in 1992, the sector has not been able to grow as expected. The shortages are apparent from the acute energy crisis that currently prevails in Nepal. In this context, the dual role of the Nepal Electricity Authority (NEA) as a regulator as well as a market player has negatively affected competition in the hydropower sector.

Electricity supply can be divided into four segments: generation, transmission, distribution and retail supply. Among these, generation and retail supply by nature are areas which can have several competing bodies while transmission and distribution demonstrate nature of a monopoly owing to economic inefficiency of building competing transmission lines. In Nepal's case, 70 percent of electricity is generated by the public sector and

30 percent is generated by licensed Independent Power Producers (IPPs) (NEA, 2011). NEA is the regulatory authority, which holds a monopoly over transmission and distribution of retail supply. It is the only purchaser of power generated by private producers (with the exception of few micro hydro powers which sell directly to consumers in very small amounts). Production by IPPs became legal in 1992. Prior to 1992, NEA was the sole authority involved in production. The nature of competition or lack of it in the hydropower sector can explain many of the challenges that plague the sector currently which have been examined as follows<sup>3</sup>:

a) Barriers to entry:

i. Ad hoc licensing: The Hydropower Development Policy, 2001 has made a provision of issuing four kinds of licenses - survey, generation, transmission and distribution, where Department of Electricity Development (DoED) is the responsible authority. The survey license of a hydropower project up to a maximum capacity of 10 MW is issued within 60 days and the licenses of all other types are issued within 120 days of the submission of all the details. If the application for generation license is not made, the ownership of the survey report is devolved on the government. For power generation, a hydropower project of more than 10 MW catering to the internal market, license is issued on a competitive basis through invitation of proposals. In case of hydropower projects of more than 100 MW with explicit purpose of exporting, license is issued through invitation of proposals or through negotiation with the applicant. So far, the Department of Electricity Development (DoED) issued licenses to 188 companies in the category of 1-25 MW with combined generation capacity of 1,178.55 MW. Among them, the license validity of 165 companies has expired in 2011 and that of remaining 23 will expire in 2013. Many such licenses were issued in the year 2008 without adequate study. Studies reveal that majority of license holders have inadequate financial and technical knowhow essential for the construction of a hydropower project. They

3 For more details on the challenges in Nepal's hydropower sector, see "Investment Prospects and Challenges of Hydropower Development in Nepal" published by Samriddhi Foundation, 2012

hold licenses not for generating electricity but to sell them to potential developers at higher prices. As a result, real developers have not been able to acquire license for the project. They have been forced to buy licenses from the ‘pseudo’ entrepreneurs at higher price (DoED, 2012). Similarly, in category of 25-100 MW, licenses for 51 different projects were issued out of which license validity of 33 companies has already expired and that of remaining 18 projects will expire in 2012. In this period, only six projects have gone into construction phase (DoED, 2012). This clearly shows us that there was a fault in the way these licenses were issued. Realizing this fact, the Government of Nepal made an amendment in Electricity Regulations, 1993 in October 2012. It was mainly done to discourage license holders who have not shown genuine interest in developing hydropower projects.

The new amendment has classified survey license into six different categories. One million Nepalese rupees have been fixed as license fee per annum for hydropower projects of 1 MW-5MW. A million rupees is respectively increased in each class of hydropower projects with different capacities such as more than 5MW-10MW, 10MW-25MW, 25MW-100MW, and 100MW-500MW and higher than 500MW<sup>4</sup>. It is not necessary that all projects will turn out to be feasible for construction after the survey and considering there is no income during the survey phase itself, it gets even more difficult for potential power developers. NEA has not clarified the basis for the cost calculation of the fees for survey contracts.

The nature of licensing process so far has been rather arbitrary and not yielded desired outcomes as the paragraphs above demonstrate. Licensing in itself is a barrier to entry and depends upon the discretionary power of the regulatory agency in the absence of pre-defined and clear selection criteria.

ii. **Non-availability of Transmission lines:** Transmission lines, generally considered a natural monopoly, have been under the NEA. However, NEA, which is “politically and bureaucratically stymied in

<sup>4</sup> As per the second amendment of Electricity Regulations, 1993 in October, 2012. Retrieved from <http://doed.gov.np/download/Licence-Fee-2069-6-15.pdf>

corporate planning and implementation (Niti Foundation, 2011)” has not been able to construct transmission lines as per the demand. Currently, lack of adequate transmission lines and insufficient capacity of existing and planned cross-border transmission lines are major constraints in distribution of generated power (Dhungel & Rijal, 2013). Construction of many projects have been delayed due to lack of transmission lines where examples include the Maya Khola H.E.P (14.9 MW), Solu H.E.P (23.5 MW), Tallow Solu H.E.P. (82 MW) and Mewa Khola H.E.P. (50 MW), among many. Hence, in a time of severe energy crisis, lack of adequate transmission lines and the bureaucratic discretion in terms of how and where transmission lines are built stands as a deterrent to entry for new players. Even if a new project is licensed and is built, there is no guarantee that they will be able to transmit the energy that has been produced.

iii. Additionally, the process and time required in issues related to land acquisition, environmental clearances and other licensing requirements create direct impact on entry.

#### b) Abuse of dominant position:

i. NEA as a monopsony: In all hydropower projects where power is distributed through the national grid, generators must sign a Power Purchasing Agreement (PPA) before the construction and all independent power producers singularly sell to NEA. Total capacity exchanged between the private power producers and NEA has reached 1,186.702 MW during the study phase (DoED, 2012). NEA offers flat rate for the projects up to 25 MW. Previously, the rate was NRs. 4 and NRs. 7 per unit in rainy and summer seasons respectively. NEA raised the PPA rates by 20% meaning the producers will be paid NRs. 4.80 per unit in rainy season and NRs. 8.40 in dry season. As a result, NEA signed a PPA worth 714.77 MW during the 2010/11 year at the increased rates. This is almost double the total capacity of the Power Purchase Agreement (PPA) signed in the past. For projects above 25MW NEA is provisioned to conduct individual PPAs with respective producers. NEA as the single buyer wields a considerable power in these agreements and this kind of individual agreement also create

plenty of room for rent seeking. This in general creates an unfair playing field amongst market players.

Similarly, the new price agreement is still inadequate to entice new investment where the cost of production is often higher than the return that NEA is offering. Further, the price for consumers to purchase electricity has remained constant for over a decade. Electricity is highly subsidized and this price discrepancy is responsible for the huge losses experienced by the NEA. The latest price adjustments for suppliers occurred in September 17, 2001 and in 2012. The cost of production due to higher inflation rate has forced the NEA to buy electricity at a costlier price from the developers, while selling it at a low price to consumers. Due to the losses, there are delay in payments to IPPs by NEA, additionally discouraging more investment and new entry.

ii. **Discriminatory practices:** NEA's practice of building transmission lines (over which it has monopoly) gives us a prime example of discriminatory practices. The history of transmission lines built clearly demonstrates that NEA gives priority of building transmission lines over those projects where it is either involved fully or has a share in power generation. This implies that in order to be able to sell one's power, some sort of NEA involvement has to be sought (NEGA, 2012).

Similarly, NEA being a public enterprise can access long term low cost loans with about 4 to 5 percentage interest rates subsidized by the government while independent power producers have to go via commercial banks which provide only short term loans<sup>5</sup> with interest rates ranging from 12 to 14 percentage. This clearly increases the cost of production of private producers who are expected to compete with NEA.

The PPAs conducted for NEA owned or projects with NEA shares are higher than PPAs for independent producers. This is another instance where NEA clearly demonstrates discriminatory practices (NEGA, 2012).

5 Although refinancing is available, it is only given for a six months period subject to approval by the central bank. For a long gestation period project like hydropower, this serves as a severe constraint for private producers.

## Transport

Services in the road transport sector of Nepal are entirely run by the private sector. The state has had negligible participation as a service provider. The state had intervened in the market in 1961/62 with a cooperative public transportation company called Sajha Yatayat<sup>6</sup>, which halted services in 2002 due to politicization and overstaffing. The company is now under new management and was established as a cooperative in 2011 with an executive board elected from the general body members (Kharel, 2013).

One of the most prominent forms of anti-competitive practices in the current Nepalese market is prevailing syndicate in the road transportation sector. This includes syndicate in public buses, taxis and other modes of public transportation and goods carriers. The syndicate operates in the form of transport associations where transport entrepreneurs are members. These associations serve a number of functions which include cooperative functions among transport entrepreneurs as well as those which inhibit competition<sup>7</sup>.

Transport entrepreneurs are largely small scale entrepreneurs who own one to two buses typically. People who have returned from working abroad come back with some savings. These people generally buy one bus and join the association. An association has about 60 to 70 members.

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6 Sajha Yatayat Company website: <http://www.sajhayatayat.com.np/article-history> (accessed on 12/10/2012)

7 Interviews with transport entrepreneurs who have been in the business for very long have revealed that the first association of transport entrepreneurs was the Purvanchal Motor Association established in 1974 under the leadership of Min Bahadur Suwar. After this, there were a series of associations that opened up across the country – Prithvi Highway Syndicate opened in Pokhara, Arniko Yatayat in Kathmandu, Seti Mahakali in the Western region, Paschim Nepal in Butwal and Narayani Yatayat in Hetauda. Later in 1982, all these associations joined hands and lobbied with the government to form first ever national federation under the name Federation of Nepalese National Transport Entrepreneurs (FNANTE) Association registered on August 23, 1982 under the National Direction Act, 2018 (2061)

## Lawful Cooperation vs. Unlawful Collusion

Formally registered as associations of transport entrepreneurs on several categories such as type of transportation, geographical area, route and other basis, these associations perform cooperative and collusive functions. Some are explained below.

### a) Cooperative Functions

Some of the cooperative functions these associations perform are directed towards:

i. **Declining average costs:** The public transportation sector of Nepal seems to incur several fixed costs. Chief among these is the insurance administration cost. A transport entrepreneur during the paper expressed, 'Insurance claim process is the most cumbersome in Nepal. As an individual entrepreneur, I had to have a staff team fully dedicated to claiming insurance. Given the road conditions in Nepal, accidents are frequent and I would spend about 25% of my income just on claiming insurance. The association brings down the cost for me. Once I joined the association, all the insurance handling including filing for claims and the administrative process was taken care of by the association.' Besides insurance, other fixed costs include advertising and ticketing services, which are pooled by the respective associations, and the association takes care of setting up and staffing these facilities. Similarly, other costs include monitoring on-board staff, repairs and maintenance workshops for the vehicles, parking spaces and uploading and downloading zones. All these fixed costs would be burdensome for entrepreneurs with single or less number of vehicles but are significantly lowered once the entrepreneurs pool their resources into the association. Declining average costs also support economies of scale argument i.e. there are economies of scale out of coordinating buses amongst various entrepreneurs through the association. For a minimal fee per trip called 'trip fee' the association takes care of most needs including insurance handling, ticketing, staff monitoring and even maintenance of the vehicle in some cases.

ii. **Collective bargaining in an uncertain environment:** It is important to analyze the environment that existed during the formation of these cartels and during its turbulent history. Nepal has had a very turbulent political history mired by revolutions and civil wars. It is difficult to contemplate a smooth functioning business in such an environment. The grouping and re-grouping of the cartel association coincides with major political changes and turbulence. When the first association was registered in 1975 and the national federation in 1982, Nepal was undergoing a major change from a direct monarchy to a multiparty democracy. By 1982, the disgruntlement with the direct monarchy was high and there were hints of another revolution brewing (Upreti, 1983). Similarly, the federation split and later rejoined during 1995/96 which was also the time when the civil war with the Maoist rebels broke out. In 2006, once the Maoists came to the peace process (BBC, 2012) the national federation also regrouped and formed its current structure. The coinciding of these events indicates that there may be another story of collective bargaining here as similarly argued by Grief, Milogram and Weingast (1994) concerning medieval merchants of Europe. The political uncertainty with left leaning forces in Nepal playing a major role meant that property rights were never secure and the rulers could act as perpetrators at any point of time. Therefore, the association acts as a collective bargaining forum for the entrepreneurs and also negotiates with the rulers to establish protection for individual entrepreneurs. The entrepreneurs individually would not be able to bargain. This is especially true for small-business entrepreneurs, and given that most of Nepal's transport entrepreneurs operate independently or with a small fleet. The Federation of Nepalese National Transport Entrepreneurs (FNANTE) currently boasts of being able to shut down the country. It is an umbrella organization of all the various associations including not just public transport entrepreneurs but also entrepreneurs of several other forms of public transit such as taxi owners, entrepreneurs of goods transportation and cargos. This has strengthened the position of FNANTE as a major force even in political negotiations. Transport entrepreneurs can certainly wield power over policies, and collective bargaining is not limited to maintaining relations with the political parties. It is useful to have the association to deal with the police administration (traffic police particularly), bureaucracy (tax



filing, registration, license renewal issues) and labor unions (drivers' and conductors unions). According to Sheth and Parvatiyar (1992), business alliance formation is a factor of two features – uncertainty and trust among the competitors. They describe a cartel as a form of business alliance that would form when external uncertainties are low and the trust level between competitors is low as well. Given their description of trust and uncertainty, the public transport syndicates in Nepal fall more under their definition of a collaborative enterprise (external uncertainty is high but the competitors trust each other).

However, besides the cooperative aspect in helping ensure returns, there is a collusive component in several activities conducted by the syndicate, which has become problematic. Sapkota (2012) explains “it is because of the syndicates—who argue that the main rationale for imposing monopoly is to check fall in profits due to excess supply of vehicles and to regulate the market—that passengers have no choice of road transport services.”

## b) Collusive Functions

As opposed to the cooperative functions explained above, the associations' functions also lead to collusive activities that inhibit competition. “The number of vehicles that ply on highways, and inter and intra district roads are dictated by syndicates, which in the veil of transport associations, try to impose monopoly power over transport fares, quality and frequency of service. Following repeated requests from the private sector and realizing the cost of anticompetitive practices and distortions created by syndicates/cartels, the government officially banned them several years ago (Sapkota, 2012)”. During the interviews conducted for this particular study, transport entrepreneurs have expressed that their return of investment have climbed from 20% to 50% after joining the transport cartel.

Some of such specific anti-competitive practices that arise out of the cartel are discussed as follows:

a) Barriers to entry:

i. **Route Permit:** Any private transporter will have to become a member of the syndicate before being able to operate. Road permits from the government are only provided on recommendation of the transportation syndicate (United Nations World Food Programme [WFP] & Nepal Development Research Institute [NDRI], 2008) although the law stipulates that anyone applying for a road permit should get one. This has created barriers to entry for new entrepreneurs and has affected the cost of transportation, which eventually affects the cost of other goods and services. In comparison, the cost of transportation from Shanghai (China) to Tatopani (border town in Nepal), a distance of almost 2500 km, is equal to the cost of transportation from Tatopani to Kathmandu, a distance of 114 km (Ibid.).

Route Permit for Public Vehicles to ply in Kathmandu Valley: Entry barriers also exist in form of getting route permits to run vehicles for public transportation in Kathmandu Valley. The barriers to entry have created an unfavorable situation where in 2006 (BS 2063), the Bagmati Zone Transport Management Committee had decided to not provide Route Permit for new vehicles in Kathmandu Valley (Gyanwali, 2011). Without the consent of syndicates, no one is allowed to add new vehicles in any route. This is happening even if entrepreneurs legally pay all the required fees to the government (Sapkota, 2012). According to Transport Management Office's small/large vehicle's statistics, there are more than 40 local routes where public transportation permissions are issued. In those routes, different associations allow only those vehicles under their membership to ply and conditions for otherwise do not exist (Gyanwali, 2011). In this situation, the associations hold monopoly and hence hold the power to ask any amount for money for 'allowing' vehicles to enter service given the route permit scenario. "The dealings for such permits via the association revolve around a minimum of NRs. 400,000-500,000 and transport offices still do not provide route permits without recommendations from the associations. The fact of such dealings is apparent from the start of dozens of new public

transportation services by minibuses in areas outside the Ringroad in the past year despite the halt in new registration” (Ibid.).

In this scenario, public transportation in Kathmandu valley is fraught with issues of overcrowding, harassment of women, reckless driving and unhygienic environment. With vehicle shortages, people are forced to travel standing, squatting and crushed in a crowd. The Public Transport Quality Survey revealed that current public transport service is unreliable and undependable on different aspects: frequency of service, availability of service during anti-social time, and level of comfort<sup>8</sup> due to overcrowding and recklessness in driving. 67.3% passengers find public transportation unhygienic and ill maintained and 12.4% finding it very unhygienic and ill maintained (Udas, 2012). These stats also help explain the current quality of public transportation in Kathmandu Valley (Public Transport Quality Survey, 2012). The possibility of public transportation developing better facilities seems distant given such high barriers to entry.

ii. Quotas – the case of Taxis in Kathmandu Valley: As per the Department of Transport Management, there are currently 8,000 taxis registered in Kathmandu Valley. The government had stopped registration of new taxis in Kathmandu valley since May 30, 2000 citing reasons such as the number of taxis being more in proportion compared to the population in the valley and the capacity of the roads (Shrestha, 2013). However, despite the population rise and expansion of road facilities in the valley in the past twelve years, the halt continues. Many entrepreneurs also claim that this halt persists under the perpetual pressure from the taxi entrepreneurs association. In this situation, more than one and half decade old 800 cc Maruti Taxis are still being sold at an average of NRs. 1,000,000<sup>9</sup> where prices for buying the old number plates alone are as high as NRs. 500,000 minimum (Shrestha, 2013; Karobar, 2012). The taxis are small, 8 Around 34.2% passengers feel uncomfortable with seating space in public transportation and 6.1% feel very uncomfortable; majority about 61.7% of female respondents were uncomfortable with space in public transport as it's overcrowded and 69.1% agreed that the most of the public transport drivers practice reckless driving making travel uncomfortable. (Udas, 2012)

9 The same Maruti vehicle in that condition as a private car would be bought and sold for around NRs. 500,000.

often not too clean and in old condition. However, since the prices of taxis are kept high through this restriction, the cost is borne by the consumers eventually who pay high price for low quality services. Many places outside Kathmandu Valley have better facilitated 1000 cc vehicles (such as Alto, Santro etc.) for a taxi compared to old 800 cc Maruti Cars in Kathmandu (Shrestha, 2013). Many taxis have broken meters, and tampering with them is an open secret. For this reason, many passengers negotiate a price before entering the taxi. Application had been given at the Transport Management Division to reopen registration (Ibid.). However, the government plans to study the current condition of Nepalese roads, population and arrive at a conclusion about the 'right' number of taxis Kathmandu Valley needs and would be able to handle. In the past, the Taxi Entrepreneurs' Association has implemented tools such as strikes and blockades on the streets of Kathmandu for days presenting demands on issues related to fares, registration, regulations and other matters to the government.

**b) Barriers to expansion:**

i. When the Nepal Association of Tour and Travel Agents' (NATA) Pokhara Chapter initiated a tourist bus (well facilitated luxurious bus) service in between Pokhara and Chitwan for Nepalese, the Prithivi Highway Bus Entrepreneurs Committee created an obstruction, demanding the luxurious bus service should be limited to the tourists (Karobar, 2012a). Such incidents happen along all highways and intra and inter districts roads (Sapkota, 2012). At times, entrepreneurs have to pay up as much as the cost of vehicle itself to add an additional vehicle to a particular route.

**c) Barriers to full scale operation:**

i. Although vehicles are mainly operated on an individual basis, the "Dial system" predominates as Associations or Syndicates manage routes on behalf of owners. The "Dial System" requires vehicles to stand in queue and wait for their time to operate as decided by the Association (Maunder, Pearce, et al., 1999). The transport associations also decide the queue for the vehicles in majority of the cases as part of their 'management'. At

end of 2010, the umbrella organization of the cargo vehicles' (dhuwani) entrepreneurs association made a formal decision allowing the vehicles under its membership to operate on different days on odd-even<sup>10</sup> license plate number basis which was implemented in many places in the country such as Nepalgunj, Dhangadi, Birgunj, Bhairahawa, Itahari, Biratnagar etc. This increased the cost of transportation of goods by 20 percent and consequently increased the costs of goods being transported (Khatiwada, 2010). After the introduction of the odd-even number queue, there were shortages of trucks and the price of transporting goods from Birgunj to Kathmandu increased from NRs. 19,500 to NRs. 22,000 - NRs. 25,000 (Yadav, 2011). The trend persisted as of January 2013 for goods carriers in Birgunj, Butwal and other places where tokens were given for even numbered carriers to provide services for three days a week and odd numbered carriers for the other three days in a week (Karoobar, 2013). Besides the odd-even basis other forms of queues are also introduced and established by several such associations across the county in bus service and other modes of transportation.

#### d) Price fixing:

i. Transport entrepreneurs are free to fix freight charges for transportation of goods, but it is in practice determined by the Transport Entrepreneurs Association. Therefore the price is artificially high. Such price fixing on the top of entry barrier through syndication has resulted in high cost of logistic services (Karnikar, 2010). This is not only the case for goods transport but for passenger transport as well, including fares for buses, micro-buses and other vehicles for public transportation. The government allegedly sets the fare based on a 'scientific' process, and consultations with the transport entrepreneurs. However, in practice, the revision of 'scientific' government fares is done by the associations and the decision of the associations is applicable to all members. "In Dailekh, a remote district in the Mid-West of Nepal, the truck and tractor entrepreneurs' association fixed the cost of transportation at NRs 3,000 per ton from Surkhet (nearest

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10 Odd-even number basis implies plying only odd numbered license plates on a particular stipulated day and alternating it with even numbered license plates.

regional market at a distance of 70 km). Traders in Dailekh reported that if they were allowed to transport their goods outside the syndicate it would only cost about NRs.1,250 per ton” (WFP & NDRI, 2008).

## Agriculture

Agriculture plays a critical role in the Nepalese economy as this sector still contributes more than one third to Nepal’s GDP, and more than two-thirds of its population depends on it for employment and livelihood (Economic Survey, 2011/12). Compared to the industrial and service sector, it is the least productive sector. Despite the prioritization of agriculture development in all periodic plans of the government, agriculture still remains a subsistence phenomenon where 85 percent of total agriculture output is used for self-consumption (Nepal Economic Recovery Assessment, 2008). Hence, the sector remains in dire need of commercialization.

At both the production and marketing level, there is no literature suggesting anti-competitive practices in agriculture sector of Nepal, neither from the market side nor the government. In terms of Agricultural marketing, compared to neighboring India, where APMC (Agriculture Produce Marketing Committees), state bodies established under the Agricultural Produce Marketing Acts “have been statutorily vested with the power to regulate both the creation of markets as well as the entities that can participate in such markets for agricultural produce (Gujral, Joshi & R. V., 2011)”, buying and selling of agricultural products in Nepal is not regulated.

However, despite a relatively free environment in agriculture production and marketing, Nepal’s goals of commercialization of agriculture remain far-fetched. This suggests that the problem remains elsewhere. The Nepal Economic Growth Agenda (2012) which studied five key sectors (including Agriculture) in outlining the key challenges, puts problems related to infrastructure (lack of agriculture connectivity roads) inputs, especially fertilizers, seeds, agro-chemicals and supplements

as a challenge in improving the scenario of subsistence farming through increased productivity and commercialization of agriculture.

Despite the emphasis laid on commercialization during every periodic planning not much has been achieved. From a competition perspective, commercialization of agriculture is also affected by:

#### a) Barriers to entry

i. The land holding and ceiling in Nepal needs to be re-examined as it impedes commercialization of agriculture thereby rendering commercialization non-competitive. The provision of land ceiling limits the competitiveness that can be gained through specialization and commercialization. However, owing to the policy focus on providing land rights and land redistribution, Nepal has never been able to pass land policies that would allow mechanization and large scale farming. These act as barriers to entry for private entrepreneurs willing to invest in agriculture but are restrained by land ceilings and land use policies. Recently, there has been a move towards promoting commercialization through the provision of contract farming. However, since the legal provisions have not been put in place, we are yet to see the impact of contract farming on competition in agriculture.

ii. Status of competition, i.e. lack of it thereof in Nepalese market, in fuel supply has also been affecting the agriculture sector. Frequent shortage in fuel supply, which is much needed to the farmers for agricultural equipment such as tractor has also remained a constraint. Besides this, the unavailability of fuel supply seriously impedes the competitiveness of agricultural products that need to be transported to the market. Irregular fuel supply increases the cost of agricultural products thereby making them more expensive in comparison to imported products.

#### b) Abuse of dominant position

i. Agriculture Input Corporation Limited (AICL) as the corporation

in charge of providing inputs to farmers receives subsidies to grant to farmers. It purchases fertilizers at a higher cost and provides it at a subsidized price to farmers. Owing to these subsidies, although private parties are allowed to open fertilizers plants, there are not many private firms in this business. The private sector complains that they cannot compete with subsidized fertilizers. This kind of subsidy removes ground for a competitively supplied fertilizer resulting in acute shortages or substandard materials destroying crops due to farmer's reliance on black market to fulfill the fertilizer demand.

## Education

Education has been widely dominated by the public sector in Nepal. The number of students enrolled in public schools in primary, lower secondary and higher secondary level are 5,449,736 whereas 1,062,694 are enrolled in community schools (which generally receive assistance, including some funding, from the government). On the other hand, 951,363 students are enrolled in the private schools (Federation of Nepalese Chambers of Commerce and Industry [FNCCI], 2011). The quality of education provided in public schools and private schools differs greatly. For example, based on the 2004 SLC results, compared to an average pass rate of 85 percent for private schools, the pass rate of public schools was only 38 percent. Similarly, while an overwhelming majority of private schools had pass rates in the 80–100 percent range, less than 7 percent of the public schools had as high pass rates (Thapa, 2011). In this year's SLC result, students from private schools had an 80 percent pass rate while students from public schools had about a 30 percent pass rate (Sharma, 2013).

One of the factors that has led to private schools performing better than public schools is increased competition in the private education system. Many private schools are centered in urban areas and owing to the large number of schools, competition is high. Generally, these private schools are competing with each other on fees, services and other facilities. There are reportedly around 2,500 schools in the Kathmandu Valley alone,



of which 70 percent are private. Additionally private education supplies nearly 100% of all lower level education within the valley (Adhikari, 2013). Unfortunately, recent developments in regulating education poses a serious threat to competition in this sector:

### a) Barrier to entry

i. Following an increase in private school student enrollment, the district education offices have decided to reject registration of new schools in the new academic session (Republica, Jan 20, 2013). This may come under the veil of maintaining standards or regulating prices. However, as basic law of demand and supply imply, this practice will only increase prices for the students in the long run. The debate regarding education has been an ideological one in Nepal. While left factions create a hue and cry over commercialization of education, it cannot be denied that the quality of education has improved since the introduction of private education. It has also encompassed a wider range of students from high income levels to very low income levels. This unfortunate change in regulation is also due to the confusion in our policy approach of treating education. While private education requires education to be treated as any other commodity, our policy and political rhetoric is ripe with perceptions of education as a higher call of voluntary service. This response from the government, albeit a temporary one (as said to be only for the next academic year), creates an entry barrier for upcoming private schools and is anti-competitive behavior from the government.

ii. **Standards:** Government of Nepal (GoN) recently passed the Private and Boarding School Directive 2013. This directive regulates the size of the classroom and other infrastructural facilities of the school. There are a lot of low cost private schools who do not meet these standards but are serving low income families. This directive if implemented will end up in mergers creating bigger schools but effectively limiting competition by reducing the number of schools and creating a barrier to entry for low cost schools which may not necessarily meet the standard (Jha, 2013). Similarly,

recently GoN introduced limits to advertising money that can be spent by private schools. This is yet another measure that removes information availability from potential parents and promotes a non-competitive environment (The Himalayan Times, June 18 2013).

## b) Tied Selling

i. Another anti-competitive practice in the sector is tied selling. ,“In most private schools, students are required to purchase textbooks sold by the schools in exorbitant prices without having any other option. These books are mostly bought from foreign publishing houses and photocopied. Uniforms are a part of the deal, and students have to go to particular stores to have their uniforms tailored (SAWTEE, 2005)”. This is a tied selling practice that has increased the parents’ ire resulting in a demand for regulating private schools. Students are often forced to buy stationary, uniform and books from specified stores thereby increasing the price of goods.

## Tourism

Widely recognized as one of the sectors with high growth potential and having a comparative advantage for Nepal, the tourism industry has helped the country maintain a positive balance of payment despite a huge trade deficit. With an average spending per visitor per day of US\$ 65.3 (National Planning Commission, 2011), tourism indeed plays a vital role in sustenance and advancement of Nepalese economy. In general, the sector is highly competitive in providing a wide range of services and products to tourists and laws and policies also recognize the role of private sector in the growth of the sector.

Despite this potential, Nepal’s flag carrier, Nepal Airline Corporation (previously Royal Nepal Airlines Corporation), has been hampering the possible growth of the tourism sector according to the Nepal Economic

Growth Agenda (NEGA). With a total of 1600 staff members<sup>11</sup>, the airline's current fleet includes two Boeings and five Twin Otters<sup>12</sup> and operates in six international destinations (specifically Delhi, Bangkok, Hong Kong, and Kuala Lumpur, Dubai and Doha<sup>13</sup>). Established in 1958, the state carrier faced competition from Indian Airlines, Singapore Airlines and Lufthansa in the mid-1980s. However, the domestic market for aviation was liberalized only in 1992. In the nineties and early 2000, the Nepal Airlines Corporation (NAC) faced a number of high profile corruption cases. Due to political interference, the airline's performance faltered (International Directory of Company Histories, 2001). In March 2013, the airlines shut down its regional office in Delhi. It had not been able to operate a single flight in 18 months (Acharya, 2013).

The Tourism Policy-2009 has recognized the issue of the performance of the flag carrier and has appealed for restructuring and reforming the corporation within the framework of a public private partnership, which no doubt would be a major landmark for tourism sector of Nepal. However, it is yet to be implemented. There are two regulatory hurdles that act as barrier to entry in the Nepalese civil aviation sector:

### a) Barriers to entry

i. Foreign operators not allowed in domestic aviation: After the liberalization of the domestic aviation in 1992, many private airlines started operations and gradually came up with better service compared to NAC. However, foreign airlines are still prohibited in domestic routes. It is necessary to invite world class airline companies if we expect world class service in domestic market (Wadhwa, 2005).

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11 Federation of Nepalese Chambers of Commerce of Commerce & Industry [FNCCI] Associate Members' Directory. [http://www.fncci.org/members/page1.php?op=pageload&file=search\\_result&type=am&am\\_catid=47](http://www.fncci.org/members/page1.php?op=pageload&file=search_result&type=am&am_catid=47). Retrieved 4/18/2013

12 <http://www.ch-aviation.ch/portal/aircraft/quick?phrase=Nepal+Airlines>. Retrieved 4/18/2013

13 Nepal Airlines Corporation, Corporate Overview. <http://www.nepalairlines.com.np/?section=corporate&action=browse>. Retrieved 4/18/2013

ii. The Civil Aviation Authority of Nepal (CAAN) which has a vision of “making air services an effective vehicle of high economic growth through wide scale tourism promotion and accessibility,” is largely a regulatory body, but is also a service provider for ground handling. According to existing policies, CAAN has the right to charge ground handling fees from airlines operating out of Tribhuvan International Airport (TIA). Currently NAC charges a fee on behalf of CAAN and provides a royalty of about 10 percent. Many airline companies such as Pakistan Airlines, Thai Airways and Air India have their own ground handling services. The remaining airlines, which do not have their own ground handling service, are said to be unsatisfied with the service provided by NAC and hint towards the need to introduce other service providers on a competitive basis. The airlines that do not want to operate ground handling themselves have to rely on the bad quality service provided by NAC. This has led to several airlines cancelling their operations from Nepal altogether. Similarly, renowned airlines such as Luftahansa, Singapore Airlines and Aeroflot, which had been operating in Nepal in the past, have pulled out citing high operational costs in Tribhuvan International Airport. The expensive ground handling charges resulting from Nepal Airlines Corporation’s monopoly on ground handling has increased the cost for international airlines operating Nepal substantially. Indeed, these international airlines cited expensive landing, parking and ground handling fees, among other complaints.

## 4. What Fosters These Anti-Competitive Practices?

Traditional microeconomics describes cartels as inherently unstable organization pointing out game theory strategies that demonstrate better pay-offs for cheating (Rubinfeld & Pyndick, 1998). However, many studies use cartel duration as an indication of its success or failure (Fear, 2006; Grossman; Levenstein and Suslow in Grossman 2004). The public transport syndicate in Nepal has been around since 1982, enduring in one of few forms, and it can be seen as a durable endeavor. However, there is a persisting dichotomy such that during this period the cartel at the central level has been fraught with breaks in agreement and separation, while at the regional level where these cartels mostly function, cartel associations have been quite persistent and individual entrepreneurs rarely break away from these groups

As seen in the sectors mentioned above, besides collusive business practices, government monopolies which disallow competition have also held consumers captive. Some factors that help sustain such anti-competitive practices are discussed below.

**Government backing: implicit enforcement collaboration with administrative and police agencies**

Following Public Interest Litigation (PIL) filed by consumer forum activists, the Supreme Court of Nepal had declared the practice of syndicate illegal and called on the government to take necessary punitive action (The Himalayan Times, 2011). However, the syndicate system is still very much

in practice today and garners its support ‘unofficially’ from the government bureaucracy, police administration and politicians alike.

The syndicates have devised efficient enforcement mechanisms in collaboration with the existing bureaucracy, political clout and police agencies. Tilton (in Grossman, 2004) argues that cartel enforcement is stronger when government policy is to implicitly support cartels, using Japan as a historical example. Grossman (2004) explains that when the expected cost of punishment is greater than the expected benefit from cheating, cartels sustain. In Nepal, the government fixes the price of public transport. The FNNTTE, with its threat of general shutdowns due to strikes, has a powerful price lobby with the government. Even if we assume that the price is exogenous (since it is only initially fixed by the government), the cartel still uses a queue system to control supply. The buses that do not run on queue face multiple problems from traffic police. Entrepreneurs who cheat find that the police, insurance and administration become less cooperative, even if the cartel resorts to violence or vandalizes the property of the cheater.

## Feeble Rule of Law environment and use of violence

Collusive practices, even when illegal by law, sustain due to the feeble rule of law environment like in Nepal. As mentioned earlier, when transport syndicates use force and violence, the local authorities and police focus on temporarily pacifying the situation rather than subjecting it to legal code.

Violence is a mechanism to sustain collusive business practices. If a sufficiently strong syndicate does not “approve” of activities or behavior in the market, violence can be an effective regulator. Vandalizing and physical abuse is not uncommon among Nepal’s transportation entrepreneurs. A national daily from January 28, 2011 reports:<sup>14</sup>

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14 Ojha, K & Khatiwada, Y (Jan 28, 2011). Syndicate hatau: Sarkar (In Nepali). <http://www.ekantipur.com/nep/2067/10/14/full-story/324213.html>

“Last month the entrepreneurs from Kavre vandalized a bus from Sindhuli for not obeying the syndicate rule. Similar incident had taken place in Gorkha where one association vandalized the vehicle of another association for plying its vehicles without permission. However, rather than stopping the syndicate, the local government showed lack of responsibility by leaving it up to the transport entrepreneurs federation to solve the issue.”

There have been cases of violence between two or more rival syndicates, usually due to turf wars where each syndicate claims sole rights to a given area. One example of two associations having such a dispute over the BP Highway and resorting to violence and vandalizing was reported in a national daily in 2012, January 01. The two associations attacked each other's property and erected blockades with the threat of force on the highway (Basnet, 2012).

Use of force or threat is predominantly used to 'settle' several types of disputes in Nepal. Given this feeble Rule of Law environment, transport cartels' method of enforcement is no exception.

## Legal and Institutional weaknesses

Anti-trust legislation is new to Nepal. A Competition Act has been formulated and adopted; yet implementation of competition law is still weak. An important aspect of anti-trust legislation is the definition of cartels and how to measure cartel behavior; these tasks still remain in the Nepalese context. Although the Herfindahl-Hirschman index, based on industry concentration and market share the measurement standard in the United States, is used in anti-trust legislation, the lack of data on market concentration would be a major challenge in using a similar measure in cases like Nepal. At the same time, it is also important to identify sources and causes behind collusive behavior. If the fixed cost faced by industries is based on regulatory and political environment, then policy reforms of these constraints may be more effective.

The Competition Promotion and Market Protection (CPMP) Act has provisioned for a board responsible for implementing the act. The board consists of 11 members from different groups of stakeholders and is under the chairpersonship of the Secretary of MoCS. The board is entrusted with investigating, monitoring, observing and taking other necessary measures to restrain anti-competitive practices. However, since the board constitutes of ex-officio members, carrying out the functions of the board does not necessarily gain priority as each member has several other duties and responsibilities. Therefore, the board remains in a non-functioning state. The Act also has a provision to designate any officer employee of Nepal Government as the Market Protection Officer for the purpose of investigation and to file the cases against anti-competitive activities under the Act. This shows that the current CPMP act lacks institutional back up for implementation. The CPMP Board has not received a single case filed under the CPMP Act in five years of existence. No case has therefore tested the adequacy of competition law and the legitimacy and capability of the relevant authorities.

## Government sustained anti-competitive practices

In Nepal, the government defines anti-competition in law and legislation as private sector monopolies or collusive behavior between firms that damages competition and therefore consequently deprives the consumers of the potential benefit of competition. However, state monopolies of State Owned Enterprises ( s), monopolies perpetuated from direct and indirect support of the state (indirect meaning obliging the private sector's rent seeking behavior), restrictive laws and provisions that create barriers to entry for new players (e.g. license raj) all create similar anti-competitive effects but are not discussed as much.

The transport sector's anti-competitive behavior stems from the private sector and is fostered by implicit backing from the government along with feeble rule of law implementation. However, in different aspects of the mentioned sectors such as agriculture and hydropower, state monopolies have contributed to the dismal performance of the sector. Similarly, in



the education sector, as presented above, government initiatives to better 'regulate' have resulted in anti-competitive behavior.

Most often, when it comes to State Owned Enterprises and their monopolies, the argument is that the particular good or service being supplied is a 'public good.' However, 'many goods that are allegedly impossible to provide on markets have been, or at present, provided through market mechanisms-from lighthouses to education to policing to transportation-which suggests that the common invocation of alleged publicness is unjustified, or at least overstated' (Palmer, 2009). Even in the Nepalese experience, the examples of the liberalization of telecommunications, aviation and other sectors has demonstrated that the dismantling of state monopolies results in the service being accessible and affordable to general population. Thus, there seems to be a market solution to the non-excludability exception of certain 'public goods' as well.



## 5. Recommendations

Based on the cross sectoral and general analysis presented above, we can deduce that making Nepal a competitive market is no small feat. Violations with regards to competitive environment are prevalent both in the private sector as well as in the government sector. Similarly, institutions to oversee a competitive environment are weak. Above all, the law and order situation in the country as a whole complicates this scenario further. Given such a regime, following are some recommendations that can help Nepal move forward in the right direction of reform. These recommendations have been categorized in two levels: Overall recommendations and Sectoral recommendations. However, this kind of reforms would only bring about marginal changes and an overall reform strategy needs to be developed aligned with sectoral policies of the government.

### Overall Recommendations

1) Dis-incentivizing implicit support of non-competitive behavior in law enforcement and bureaucracy: While the legal framework of Nepal may not support anti-competitive behavior especially from the private sector, the continuity of anti-competitive behavior implies a tolerance of these behaviors from the rule enforcement agencies. These kinds of behaviors are primarily apparent in transportation and education sector. The transport owners association seem to wield a disproportionate amount of power over the bureaucratic agency that is supposed to oversee its' operations. One aspect of reform in transportation sector could be simply to remove any kind of permit or license requirements to operate public transportation. This would dis-incentivize the bureaucracy in siding with any particular parties. Similar removal of licensing and permit

requirements can benefit the private education sector as well. This kind of system reform will provide no space for bureaucracy or law enforcement agencies to side with any particular sides (particularly, big schools that lobby for higher standards such that low cost private schools are not able to compete any more). These kinds of reform on the other hand can expect a lot of resistance from the bureaucracy as well as law enforcement agencies as these reforms are bound to make many of the staffs in these agencies redundant. To top it all, removing systemic requirements as such also minimizes rent-seeking opportunities for regulatory agencies. This could be another factor for resistance. Therefore, in order to dis-incentivize implicit support of non-competitive behavior, a thorough discussion with all stakeholders involved would be a good starting process. Any reform that includes extensive discussion will come with ownership. These discussions can also function as benefits negotiations between the various stakeholders. The ultimate policy reform would be one in which none of the stakeholder feel alienated or forced to compromise all by themselves.

2) Improving 'Rule of Law': Nepal needs a better 'Rule of Law' environment. However, in case of ensuring competition, it has become urgent to punish perpetrators and enforce certain security structures to protect private property. Some steps have already been initiated in this direction with the introduction on an 'Industrial protection security Unit' under the Armed Police Force in Nepal. While positive steps such as these have to be applauded, there is room for much more reform. Improving 'Rule of Law' in all aspects may be a challenging task overall. However, in terms of ensuring commercial security, one of the primary intervention areas is also increasing the presence and access of commercial benches in Nepal. Many start-ups victimized by established cartels are wary of entering a legal battle over the existing court structures as the cost of administering justice is high in Nepal. Going to court implies generations of legal battles as the precedence of property disputes in Nepal have adequately demonstrated. Therefore, as suggested by Connelly, Krishnan & Giri, 2013, one of the primary concerns of ensuring a competitive environment in Nepal is ensuring contract enforcement. For this, the commercial justice administration system needs an overhaul. Similarly, units within the police

force trained on commercial disputes and proliferation of private arbitrators and mediators can help temporarily alleviate some of the pressures felt by the lack of rule of law. Despite all these options, however, there is no alternative to strengthening the overall rule of law environment in Nepal.

3) Legal and Institutional reform: The Competition Promotion and Market Protection Board provided by the Competition Promotion and Market Protection (CPMP) Act constituting ex-officio members could be more functioning in dealing with anti-competitive practices that involve mergers between big firms aimed at creating a monopoly. However, as demonstrated in the paper above, in issues such as transport syndicates, the problem is sustained at local levels and is spread throughout the country. Therefore, entities overseeing anti-competitive practices should exist at the local level. Adding to the responsibilities of Chief District Officers (CDOs) at the local level might not be an effective method considering the fact that CDOs are responsible for implementing more than 50 acts currently, and also perform other administrative functions. Devolution of certain levels of authority to local entities such as the District Development Committee (DDC) and further capacitating them to oversee anti-competitive practices is important. Similarly, although Nepal does have CPMP Act, not a single case has been filed as per this act. This demonstrates that there is a need to revisit the act itself and analyze its' shortcomings. While the act currently may be of international standard, what Nepal needs is localized solutions to its unique problems. Therefore, the institutions provided by this act as well as the wording of the act itself are in need of severe revision. This deficiency is clearly demonstrated by the definition of anti-competitive practices as mentioned in the act. The definition of the terminology is not clear. At the same time, the definition is in conflict with the policy stand of GoN on several issues including hydropower and education to name a few of the sectors analyzed by this paper.

4) Acknowledging and dealing with government sustained anti-competitive practices: Anti-competition legislation so far only addresses anti-competitive practices sustained by market players. In Nepal, however, there is no recognition of the fact that the government is a primary

market player with active public enterprises that are equipped with special privileges. In addition, many such agencies have dual and conflicting roles – that of a market player and a regulatory agency in that field. NEA and CAAN are only two such examples mentioned in this paper. This kind of duality of roles provides these agencies an unfair advantage thereby removing a level playing field for private market players. In addition, wherever the government has a public enterprise, it seems government policy has been highly favorable to public enterprises and rather discriminatory to private parties in these areas – fertilizers for agriculture is a case in point. This is only one aspect of government sustained anti-competitive practices. As the analysis above presents, one of the primary reasons for sustained anti-competitive practices in the market is government backing. Similarly, policies such as licensing, subsidies naturally result in the destruction of a level playing field by favoring some while discriminating against others. Our understanding of anti-competitive practices is yet to address this key area of intervention by the government. Unless these kinds of activities by the government is also brought under the purview of anti-trust legislation and government is treated the same way as private market actors when it deems necessary to enter the market, we cannot envision fair market practices and reap benefits of a competitive environment. A lot of such activities of the government fall under deregulation and therefore, anti-competitive practices reform also needs to address deregulation to a larger extent. This requires a policy reorientation and recognition of government sustained anti-competitive practices as a primary step towards reform.

## Sectoral recommendations

1) **Hydropower:** Some immediate reforms to improve competition within the hydropower sector are outlined as follows:

- **Unbundling NEA:** In sectors that are considered natural monopolies, unbundling the functions of the monopoly organization can bring more efficiency. In the hydropower sector efforts, to enable competition in a natural monopoly

structure would have to begin with separating generation, transmission, distribution and retail supply. Unbundling the services will improve competition, although transmission and distribution may still be considered monopolistic and relatively more difficult to liberalize. Recent technological development has made unbundling electricity supply services a possibility, but it is till a long process and should be approached in phases.

- Competition within transmission: An alternative is the introduction of wheeling charge system. Under this system, NEA would still construct the transmission lines, but it would charge a certain amount from those IPPs and use that service to directly sell to certain consumers (industries such as cement, iron, steel etc.) according to their requirements. This would open up a path to introduce multiple buyers and a competitive price system which will diversify the dependence Independent Power Producers hence on NEA, hence encouraging more generation.
- Licensing: The overall licensing process within NEA needs an overhaul. Licensing is already a form of anti-competitive practice. However, if it is a necessity, then there are several established ways to enforce competition within the licensing process. A survey license does not guarantee generation. Therefore, bidding for generation may be a better idea. However, the government can conduct survey and feasibility studies with contractual agreement with private parties. These feasibility study findings can then be sold to power producers through competitive bidding. If the survey licensing trend is to be continued then the costs have to be rationalized and depend upon a model that explains assumptions made clearly. An arbitrarily decided system will only end up discouraging investment further.

- Introducing multi-buyer system: If the power producers are able to negotiate with private entities and other parties to sell electricity then they should be allowed to do so. This would break NEA's monopsony as well as relieve the system and the need to build transmission lines and/or enter into PPAs that may not be beneficial for the agency. This would not only introduce competition within the buyers' market but can also help in developing more hydropower projects as one of the major challenges faced by power producers currently is the inability to sell at a price that they deem fit.

2) Transportation: Following are some marginal reform measures to improve competition in the public transportation sector:

- Local law enforcement and administration: Since syndicates sustain due to feeble enforcement of rule of law (given the use of violence), use of local administration and law enforcement should be strengthened along with decentralization. While the kind of decentralization mentioned above is likely to help in making prompt and more informed decisions at the local level, in order for it to be effective, ability to effectively mobilize law enforcement agencies such as the police is important. Addressing anti-competitive issues such as transport syndicate could start at the local level where at the initial phase, a transport route could be chosen for reform on the basis of possibility of implementation and relatively least resistance. This phase could be the piloting phase which would provide some valuable learning in real time implementation of existing laws and provide a direction in going about dealing with large scale issues.
- Clarify definition of syndicate and cartel activities: Within the transport sector, as our analysis suggest there are many



collaborative functions of the association. Therefore, any legislation targeting transportation cartels and syndicates should clearly define activities that fall under syndicate and activities that are cooperative functions of an association. This kind of clarity in legal definition will remove legal loop holes and help law enforcement agencies as well.

- Removing approval and route permit system: Cartel sustenance in Nepal is also backed by the system requiring approval and route permits to function. Removal of this kind of system can also be helpful in curbing the discretionary power of the bureaucracy as well as removing rent seeking opportunities. This would be an improvement in the competitive environment.
- Removal of quotas: As in the case of taxi operators within Kathmandu valley, it is important to get rid of quotas. Quotas as an anti-competitive system automatically raise prices through the dial system. This is a major barrier to entry and to any kind of innovation happening within this sector as the state of the age old taxis and tampered meter within Kathmandu valley clearly demonstrate.
- Removal of price – controls: Price controls as an economic policy only create shortages, rent-seeking opportunities and more often than not, benefit an already privileged group. It is abundantly clear from price controls in our fuel sector that such policies are not only economically inefficient but also hamper entrepreneurial innovation. Therefore, GoN needs to seriously reconsider its policy of price-controls within the public transport sector as well. Instead, in order to help the most vulnerable population, direct cash subsidies may prove to be more efficient. Therefore, a detailed cost-benefit analysis of price controls needs to be undertaken and this kind of policy

should be phased out to improve competitiveness within the public transportation sector.

3) **Agriculture:** Following are some recommendations to improve competition within the agriculture sector in Nepal:

- Contract farming: While Nepal's land reform process is an overhaul that requires a lot of political consensus building, contract farming is one way to address land fragmentation and unavailability of land for commercial agriculture purpose. If contract farming is legislated then entrepreneurs with large scale farming ideas can finally make headway into commercializing agriculture in Nepal.
- Fuel supply: Fuel is an essential component in the agricultural process. It helps in ensuring produce reaches consumers from farms. While doing so, competitive transportation and fuel supply will bring down the cost of transportation thereby making Nepali produce more competitive. Therefore, opening up fuel supply indirectly accrues a lot of benefit to Nepali agriculture due to its' heavy reliance on land transport for market access.
- Benefits for farmers not AICL: Since a large proportion of Nepali population is reliant on subsistence farming and fertilizers is always a key input, GoN has been subsidizing AICL. This has distorted the market in such a way that there is no longer a space for private fertilizer producers to compete in the market. Therefore, in order to effectively reach its objective of helping farmers in need while also retaining a competitive market in input supply, the GoN can provide direct cash subsidies to farmers for fertilizer purchase rather than subsidizing an inefficient institution and institutional supply mechanism.

4) Education: Following are some recommendations to improve competition within the private education sector:

- Policy clarity: It has become essential for GoN to clarify its policy perspective regarding private education. While public rhetoric on private education spouts a negative perception of commercializing education, our policy perspective presents a confused picture. In some policy documents, education is treated as a service and large a responsibility of the government while other policy documents encourage commoditizing education. In such a policy environment, it is difficult to promote any kind of competitive practices in education. Therefore, the first step in terms of education policy is to have a policy clarity of whether education is a voluntary service or a tradable service.
- Removing Standards: GoN especially has to make efforts towards removing standards for schools. As our analysis suggest, these standards have only managed to take low cost schools (that were providing quality education to low-income groups) out of business. The standards also have clearly implied a double standards in terms of GoN policy as the standards are used for punishing private schools while the same standards are not monitored in government schools. This has made competitive environment in education sector worse off. Therefore, one major reform in this area is to re-analyze the impact of standards and remove ones that are hampering competition.

5) Tourism: Following are some recommendations based on our analysis for the tourism sector in order to improve the competitive environment in this sector:

- Unbundling CAAN: As in the hydropower sector, CAAN also functions with a dual authority – i.e. it is the regulatory agency for civil aviation while is also a market player in terms of ground handling and management of the only international airport of Nepal. In order to improve one of the first impressions of our nation when tourists enter, it has become imperative to introduce competition in the ground handling and management of Tribhuwan International Airport. Therefore, unbundling CAAN into a regulatory agency that is separate from its function of ground handling and managing TIA has become imperative. Many international airlines in the past have cited bad management of TIA as a primary reason for canceling their services in Nepal.
- Opening up the domestic sector: In the name of promoting domestic investment, Nepal has not allowed any foreign investment in the domestic air transportation. In order to promote tourism and introduce a competitive environment, another reform area is to open up domestic air travel to foreign investment. This could potentially boost quality of airplanes and service while, also encourage tourism as tourists will be better able to trust internationally recognized aviation operators. This would also provide competition for our domestic operators to provide better services.

## 6. Conclusion

**A**nti-trust legislation is a relative concept and needs to be adapted to differing situations. One size fits all policy would definitely be redundant as our current legislation and its inactiveness clearly demonstrates. At the same time, if competition is so important to a fair and functioning market economy then any government that announces its' dedication to a market economy should also review its policy stance to scrutinize anti-competitive practices sustained by government policy and actions.

In order to protect flailing and meager investments, Nepal is in an urgent need of a reform process that addresses security concerns and ensures a competitive environment for the investors. Protecting competition in all sectors is especially important in a developing economy like Nepal because of the protection that competition provides to consumers. Nepali consumers do not have high purchasing power and their consumption (largely spent on essentials) needs safeguarding. This is where a well-rounded competition regime has a role to play. In addition, in light of rent-seeking tendencies a competitive regime also ensures effectiveness by minimizing these rent-seeking opportunities. The need of the hour is a localized competition policy that encompasses sectoral policy differences and streamlines competition within the larger economy of Nepal.



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## Glossary of Terms

Horizontal Anti-competitive Practice: One firm making collusive arrangements with another on the same level, such as a distributor with a distributor or producers with producers. Examples include: cartels, market sharing, and bid rigging.

Vertical Anti-competitive Practice: When a firm conducts restrictive business practices with another at different level such as manufacturer with wholesalers, it is considered vertical anti-competitive conduct. Examples include: price discrimination, exclusive dealing, resale price maintenance, etc.

Unilateral Anti-competitive Conduct: It occurs when a firm enjoying a certain degree of market power engages in restrictive business practices on its own. Examples include predatory pricing (dumping) and tied selling.

Cartels: Cartels are anti-competitive agreements between similar firms, usually to fix prices, to rig competitive tendering process, to divide up markets, or to limit production. It is mostly possible in an oligopolistic market structure where interdependence between firms is high, and defecting results in a high cost or low reward. Some specific cartel activities are:

*Price Fixing*: Competitors in a cartel directly agree on a set price for a good or service or 'indirectly' skew prices by offering the same discounts or credit items.

*Bid Rigging*: Suppliers or service providers collude for a specific firm to win at an auction. One firm is designated to 'win' and the colluding firms refrain from bidding, withdraw their bids, or submit bids with

high prices or unacceptable terms. Winning firms reciprocate by colluding for the other firms to win in future bids

*Market Sharing:* Competitors allocate markets based on geographical areas or type of consumers and maintain monopolies in those divided areas.

*Production Control:* Competitors control the production goods or services or their supply in the market to increase profits.

Abuse of Dominance: A dominant market player is defined in terms of its market share. The Competition Promotion and Market Protection Act, 2007 of Nepal defines a dominant firm as the one with at least forty percent or more of the annual production or distribution of such goods or services. The Singaporean Competition Act, in contrast, defines market dominance as a firm having a market share of sixty percent or more (Competition Promotion and Market Protection [CPMP] Act 2007; Competition Commission Singapore, 2012). Being a dominant firm, however, cannot be taken in itself as anti-competitive. It is only considered anti-competitive when the firm in the dominant position is abusive with its power; for example if it uses its position to reduce customer bargaining power or if it bars new firms from entry into the market. This, in general, is done through:

*Exclusive Dealing:* In this type of practice a manufacturer does not allow more than one firm to take its distributorship in a particular territory. When another distributor with same level of experience, network and capacity applies for the distributorship, it will be denied the opportunity. It prevents an efficient distributor from passing on the benefits of its efficiency to the consumers.

*Predatory Pricing:* Under this practice, a firm sells below its cost of production in order to make the market unprofitable for its competitors and drive them out of the market. When competitors are driven out of the market, the firm is then capable of increasing

the price or committing other anti-competitive acts of abuse.

*Tied-selling:* Tied-selling means combining the sale of fast moving items with the slow moving commodities (which are available in abundance) during a time of short supply. In this, the seller possesses some form of market power whether due to the nature of goods or other factors.

*Refusal to Supply:* The dominant firm withholds key products or services essential to other businesses.

*Price Discrimination:* Consumers are discriminated by their willingness and ability to pay. For example, transport service providers charge lower prices for students, airlines charge different fares according to class, or telecommunication companies charge a lower tariff during off-peak hours.

*Resale Price Maintenance:* The manufacturer fixes a minimum price to be charged by the wholesaler to retailer. Resale price maintenance is considered anti-competitive behavior because it restricts the ability of the distributor to pass on comparative advantages in efficiency its efficiency to the consumers.

Mergers Limiting Competition: The Competition Promotion and Market Protection Act, 2007 of Nepal restrict mergers with the 'intent' to maintain or achieve monopoly. The Act considers any merger resulting in more than forty percent of total market production or distribution of a good or service within Nepal as being made with 'intent' to control competition (CPMP Act, 2007). The definition varies by country.





## Annexes

### Annex 1: List of people consulted for 'Competition Watch in Key Growth Sectors of Nepalese Economy'

S.N.	Name	Designation	Organization
1	Mr. Prateek Pradhan	Editor	Karobar Daily
2	Mr. Apurba Khatiwada	Expert, Competition Practices	
3	Dr. Sandip Shah	Former President	IPPAN
4	Mr. Birendra Bahadur Deoja	Former Secretary	GoN
5	Mr. Sunil Sharma	Manager	Nepal Tourism Board
6	Mr. K.P. Pandey	Deputy Director	FNCCI
7	Mr. Padmendra Shrestha		Niti Foundation
8	Mr. Dolanath Khanal	General Secretary	FNNTTE
9	Dr. Dev Bhatta Shakya		NEAT
10	Mr. Sumit Baral		Nepal Investment Climate Reform
11	Mr. Kashinath Poudel	Senior Officer	Civil Aviation Authority
12	Mr. Sunil Mool	Senior Officer	Civil Aviation Authority
13	Dr. Subarna D. Shrestha	President	IPPAN
14	Ms. Cynara Manandhar		Niti Foundation
15	Mr. Suyash Poudel		FNNTTE
16	Mr. Shankar Man Sing		CNI
17	Mr. Rajendra Baniya	Secretary	PABSON



## Samriddhi, The Prosperity Foundation an introduction

Samriddhi, The Prosperity Foundation is an independent policy institute based in Kathmandu, Nepal. It works with a vision of creating a free and prosperous Nepal.

Initiated in 2007, it formally started its operations in 2008. The specific areas on which the organization works are:

- i. Entrepreneurship development
- ii. Improving business environment
- iii. Economic policy reform
- iv. Promoting discourse on democratic values

Centered on these four core areas, Samriddhi works with a three-pronged approach—Research and Publication, Education and Training, and Advocacy and Public Outreach.

Samriddhi conducts several educational programs on public policy and entrepreneurship. It is dedicated to researching Nepal's economic realities and publishing alternative ideas to resolve Nepal's economic problems. Samriddhi is also known for creating a discourse on contemporary political economic issues through discussions, interaction programs, and several advocacy and outreach activities. With successful programs like “Last Thursdays with an entrepreneur” and “Policy Talkies”, it also holds regular interaction programs bringing together entrepreneurs, politicians, business people, bureaucrats, experts, journalists, and other groups and individuals making an impact in the policy discourse. It also hosts the secretariat of the ‘Campaign for a Livable Nepal’, popularly known as ‘Gari Khana Deu’.

One of Samriddhi's award winning programs is a five day residential workshop on economics and entrepreneurship named Arthalya, which intends to create a wave of entrepreneurship and greater participation among young people in the current policy regime.

Samriddhi is also committed towards developing a resource center on political economic issues in Nepal called Political Economic Resource Center (PERC) currently housed at Samriddhi office. It also undertakes localization of international publications to enrich the political economy discourse of Nepal. Samriddhi was the recipient of the Dorian & Antony Fisher Venture Grant Award in 2009, the Templeton Freedom Award in 2011 and the CIPE Global Leading Practice Award in 2012.

*(For more information on the organization and its programs, please visit [www.samriddhi.org](http://www.samriddhi.org))*

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  - ii. उद्यमशीलता विकासमा बजारको भूमिका
  - iii. बजारका गुणहरू
  - iv. Role of Rule of Law in Enterprise Building
  - v. Role of Government in Enterprise Building (Vol. I)
  - vi. Role of Government in Enterprise Building (Vol. II)
05. Economic Growth and The Private Sector of Nepal
06. दासत्वको बाटो (Nepali Translation of “The Road to Serfdom”)
07. Nepal Economic Growth Agenda (NEGA), Report 2012
08. Critical Constrains to Economic Growth of Nepal
09. Investment Prospects and Challenges for Hydropower Development in Nepal
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16. Industrial Relations An Institutional Analysis
17. Doing Business in Nepal: Ground Realities
18. Analysis of the Performance of the Public Enterprises

*All the publications are available in Samriddhi, The Prosperity Foundation and major bookstores in the country.*

'Competition Watch in Key Growth Sectors of Nepalese Economy' is one amongst six research paper series prepared for the Nepal Economic Growth Agenda (NEGA), 2013. NEGA is an annual constraints analysis performed by Samriddhi Foundation to identify, deliberate and offer policy alternatives to existing policy bottlenecks that hinder Nepal's economic growth.

After NEGA 2012 identified five growth sectors of the Nepalese economy viz. agriculture, education, tourism, hydropower and infrastructure, NEGA 2013 focuses on researching cross-cutting issues that affect growth in all these sectors and hinders Nepal's economic growth process. The cross-cutting issues covered by NEGA 2013 are industrial relations, contract enforcement, anti-competitive practices, foreign direct investment, public enterprises and regulatory environment for businesses.

This study on anti-competitive practices prevalent in key growth sectors of the Nepalese economy uses a slightly different approach. It not only includes anti-competitive practices by the private sector but also takes a look at government policy, regulations and actions that have promoted anti-competitive behavior. It also delves into the weak institutions that result in anti-competitive behavior. This study offers an overall recommendation for improving the environment of competition in the Nepalese economy and also in various growth sectors of the economy specifically.



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