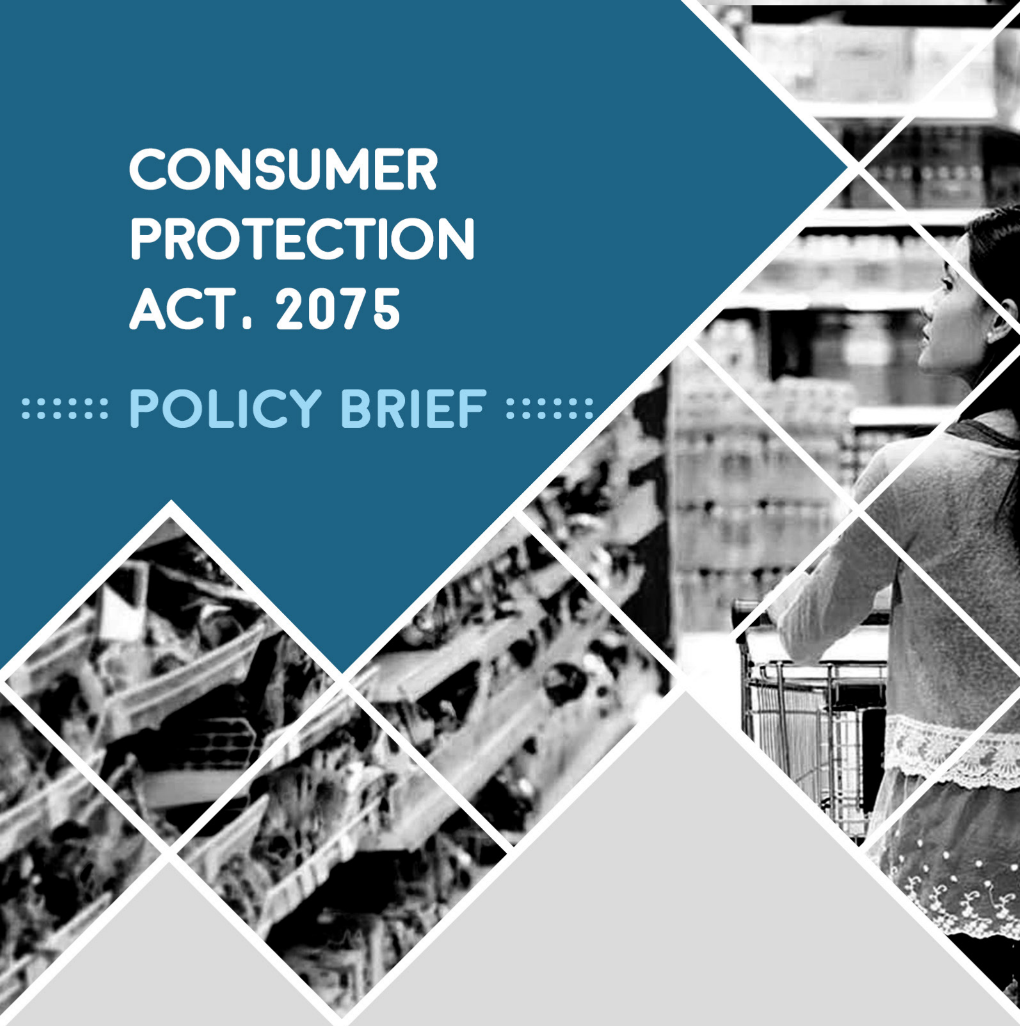
CONSUMER PROTECTION ACT, 2075

POLICY BRIEF



SAMRIDDHI FOUNDATION

Consumer Protection Act, 2075

::::: Policy Brief :::::

A Review of Consumer Protection Act, 2075

Given the changed political and administrative architecture of the nation, the Government of Nepal is incessantly working to draft and amend laws to ensure their coherence with the Constitution. For the same, the Ministry of Industry, Commerce and Supplies has introduced Consumer Protection Act, 2075 with amendments to the Act endorsed in 2054. The Act intends to uphold consumers' right to quality goods and services and provide ways to mitigate any grievances they might have regarding the same.

Introduction

Legislations for consumer protection regulate the terms of transactions between producers and consumers in the economy and thus have an important bearing on overall social and economic development. While it is imperative to create a conducive environment where producers can freely engage in productive activities and create employment opportunities for the masses and create wealth in general, it is also equally important to uphold the consumers' Constitutional right to quality goods and services. Adhering to this very principle, the Act has tried to incorporate many aspects of consumer protection like protection from hazardous goods and services; promotion and protection of consumers' economic interest; their access to adequate information; education; effective redressal mechanisms; and formation of independent consumer groups.

However, while enacting legislations, due regard should also be given to ensuring that they do not become barriers to private entrepreneurship because private entrepreneurs drive the engine of growth and create wealth in the economy. Consumer protection laws that hamper entrepreneurial activities can have serious negative repercussions for the economy. Thus, legislators should take into account the myriad of costs and benefits of any proposed provisions while drafting such legislations.

At the same time, legislators should also ensure that laws are simple enough for the consumers of the law – the entrepreneurs, investors and the general public—to understand and follow. Any vagueness in the law will diminish clarity and predictability, and subject the law to discretionary interpretations of administrators. When that happens, there is no guaranteeing that the best interest of either consumers or producers or even both will be treated with the highest regard that it requires. For example, in this 33-page Act, there are 41 instances of "as prescribed (elsewhere)." This means that people will have to refer to 41 other places to understand this law completely. Moreover, even when they do, the interpretations of these clauses could be different according to the people interpreting them. This raises doubts over future policy environment which is very crucial to any investor or entrepreneur's decision. This is likely to affect the investment climate of the nation at large.

1. Price Regulation

Section	Subsection	Clause	
4	1		The Government of Nepal shall regulate the supplies, price, quality, measurement, label, advertisement of the goods and services regularly in order to protect the rights of the consumers
4	2	H	To make necessary provision to maintain uniformity in the price in general, by managing wholesale or retail business.
19	2		The maximum price of essential food and other goods or services shall also have to be fixed in the list pursuant to sub-section (1) The maximum price of essential food and other goods or services shall also have to be fixed in the list pursuant to sub-section (1).
19	3		While selling the goods or service pursuant to sub-section (1), the seller shall not sell, or cause to be sold, the same in a price higher than that referred to in sub-section (2).
21	1		The agency as prescribed shall prepare the standards relating to determination of price of goods or services as prescribed.

21	2		While preparing standards relating to price determination pursuant to sub-section (1), profit amount to be taken by the seller also shall have to be accepted as basis in such a way that production cost of the goods, transport expenses, custom, tax, charge paid by the importer pursuant to law shall not be more than the percentage fixed while selling.

Price controls, even though are legislated with best of intentions, are nonetheless liable to negative ramifications. It is important to fathom that such interventions from the government can never overcome the economic forces of supply and demand. Since supply and demand shift constantly in response to tastes and costs, but government prices change only after a lengthy political process, government prices will effectively never be an equilibrium price. This means that the government price will either be too high or too low. Prices levied with the intention of protecting consumers, always tend to be lower than the market derived prices.

If prices are held below the natural levels, the entrepreneurs cannot earn desired level of profit, making the sector less lucrative. This can affect both the existing entrepreneurs and new entrants in the industry. The existing entrepreneurs will have fewer incentive to innovate and grow. Thus, they start pulling out resources like talent, capital and investment from the industry and seek for opportunities elsewhere to gain better returns. In the long run, price controls will also reduce new entry and investment. Price controls thus lead to reduction in the amount of trade and investment in the economy. This not only distorts competition, but also limits innovation in the industry. Section 4, sub-section 2, clause H and section 21, subsection 2 are more likely to cause such repercussions.

In the long run, price controls can thus work against the benefit of consumers.

Firstly, price controls make the entrepreneurs reluctant to engage themselves in costly rationing. An example of how price control works against the benefit of consumers can be seen each time the Nepal Oil Corporation (NOC) reduces prices. Prices come down on one hand, but the suppliers invariably create an artificial shortage in the short run. In the case of essential goods, examples of other countries, especially India, demonstrates that price controls have occasionally reduced supplies of some essential food items and increased uncertainty about future supplies, thus creating rationing and pushing up food prices.

Secondly, reduction in number of operating firms, competition and innovation leads to fewer consumer choices. Moreover, since the firms cannot compete on the basis of price, they start compromising on the quality of goods and services. The availability of only limited choice and reduction in quality of goods and services results in loss of consumer welfare.

Limiting competition and innovation is the most damaging for the economy and society, as it not only distorts a well-functioning market, but also harms the potential future market of the product.

Thus, price control levied with the motive of protecting consumers, despite its appeal, are not the most popular instruments as it distorts allocation of resources in the market. It will in turn lead to problems like surge in prices, shortages, rationing, deterioration of product quality and potentially black markets. Such price setting can incentivize informal markets, where the seller do not have to comply with the government set standards and prices.

Recommendation

The government should have greater faith in the disciplining effects of competitive market and the ability of consumers to take rational decisions. Through innovation, the private sector who are able to operate freely in the economy can find several successful methods to reduce the price paid by the buyers. The government, for greater benefit of the economy and society, should thus remove the mentioned clauses from the Act.

Implementation of clauses, whereby the government can provide the consumers greater access to market information regarding competing firms can serve the intended purpose. Providing consumer education through greater information access and counselling, could ensure that those goods and services most wanted by consumers would be provided to them at affordable prices. When all the market forces, with proper access to information comes into play, direct intervention and other patronizing approach by the state on behalf of the consumers, can be regarded as unnecessary.

2. Profit Margin Fixation

Section	Subsection	Clause	
17	1		No one shall sell, distribute or transport or hinder the sale and distribution of any goods by taking profit higher than that prescribed and over the cost invested in the production, import, transport, hoarding or sale and distribution of that goods.

Profit Margin Fixation is one of the popular methods of controlling prices. Such regulations are usually adopted with the intention to correct market failures. Government intervention which focus on enhancing consumer welfare through allocation of resources at reduced price is said to be beneficial only in the short run. However, in the long run such policies have adverse effect on the economy as these have series of unintended consequences.

Profit margin fixation largely affects the entrepreneurial sphere of an economy. Entrepreneurs, innovators and investors usually view such policies which allow the government agencies to fix profit margin as per their discretion as impediments. When an individual is denied the access to his/her expected level of return from the investment, the sector often becomes unattractive. Such policies thus, not only makes the investment environment unfavorable, but also hinders entrepreneurship and innovation in the sector.

In fact, strict regulations which does not allow the industries to make high level of profit, disincentivizes the existing entrepreneurs to continue their operation. It is natural for individuals to seek for more profit or profitable sectors to invest in. It can have two negative ramifications:

Only large companies with massive economies of scale remain in the market. In the long run this not only disrupts the supply of the product, but also hinders the level of competition in the market. The reduced supply will either result in surge in product prices or decrease in product quality.

Businessmen will engage themselves in fraudulent business practices and continue the supply of the product. For example, in 2017 Department of Supply Management and Protection of Consumer Interest conducted raid and sealed nine branded shops in Durbarmarg, after finding they were selling their products with steep profit margins. The shops were accused guilty because of the policy that no trader in Nepal can sell goods with the profit margin exceeding 20 percent. However, this policy seemed unfair for the entrepreneurs as the margin did not incorporate the rent, salary of employees, bank interest and other expenses that the business had to incur. Thus, they reluctantly agreed to have conducted bad business practices like under invoicing of goods to invade custom duty, which made it seem like the products were sold at very high margin.
In such scenarios, the consumers will be the final victims of increased price and reduced quality in the absence of competition. In a market economy, these back lags would be corrected through competition.

Way Forward
Removal of such clauses from the act would be more beneficial to the consumers, entrepreneurs and the economy.

3. Supply Regulation

Section	Subsection	Clause	
4	2	A	To implement the policy relating to quality, price determination and supply system of goods or services.
	2	F	To fix the maximum quantity of the storage of the goods in any special circumstance, or at any particular place, for the period prescribed.
		G	To receive foods from the producers at the prescribed price and sell them to the general people with determining certain quantity of such foods in case there is a shortage of any foods produced within Nepal.

Supply regulations are usually adapted by government agencies to overcome potential market failures which might lead to unavailability of goods and services in the market. However, some form of supply regulations might lead to problems like opaque prices, queues, and distortionary behavior that negatively affect both the demand and supply sides.

Strict regulations on supply of goods and services by imposing maximum limit of stock that sellers can keep, distorts the market mechanism. In such scenario, willing suppliers will not be able to sell the products to the willing buyers. Given that such strict policies distort a well-functioning market, where the demand is high and the supply limited, both buyers and sellers will be reluctant to trade in black markets. It is important to comprehend that when buyers are deprived of accessing goods through formal channels, it does not reduce the consumption of such goods. Instead they consume the goods and services from black markets and are often willing to pay higher price for the same good. Moreover, as consumers are willing to pay higher prices in the black markets, the suppliers will benefit more from creating artificial shortages. The gap between demand and supply of the product acts as an incentive for the people to engage in behaviors that promote black markets, artificial shortages and rationing. The scenario is likely to be worst in cases of emergency/special situations. On one hand black markets are already a serious threat to economic growth as they are illegal markets where economic activities are not recorded, and its taxes not paid. On the other hand, the difficulty in availability of goods and increase in prices has an adverse effect on consumer welfare.

With the implementation of Section 4, subsection 2, clause G, the entrepreneurs cannot earn the rightful amount of profit benefitted from variations in market conditions. On the contrary, the firms need to solely bear the risks associated with the same. Additionally, the cause mentions "to receive foods from the producers at the prescribed price…", which again is very arbitrary and gives discretion to government agencies to fix buying price. In Nepal, Nepal Food Corporation (NFC) has been purchasing food grains from the market and selling them in various districts since its establishment. However, the demand for food grains is very high in rural areas of Nepal and the assistance provided by NFC is insufficient to protect poor people in deficit areas from rising food grain prices. Thus, advancement in agricultural sector through policies that incentivizes private sector to foster, compete and innovate is the need of the hour for Nepal to solve the food crisis.

These unfair practices, disincentivize the private enterprises to invest further in the sector, hampering technological innovations, which could improve the market trends in favor of consumers. These impediment to entrepreneurship can thus be counterproductive.

Supply regulation also disrupts the level of competition in the market. The regulation of price, quality and supply leaves the entrepreneurs with no grounds based on which they can compete. This is a huge impediment for existing firms to continue their operation and new firms to enter the industry. Moreover, due to such consequences, only a few firms will benefit, whereas the welfare of new entrepreneurs, consumers and the economy is adversely affected.

Lastly, the effort of government to maintain supply of essential good is commendable, however, it is a costly initiative. It not only is highly labor intensive and costly, but also acts as a hindrance for market forces to come into play.

Way Forward

Reforms that involve deregulation of such restrictive policies through incorporating policies that reinforce fair competition among suppliers would be very beneficial to the economy. Encouraging entrepreneurship through such reforms will most likely make the goods more easily accessible and affordable.

4. Quality Regulation

Section	Subsection	Clause	
4	1		The Government of Nepal shall regulate the supplies, price, quality, measurement, label, advertisement of the goods and services regularly in order to protect the rights of the consumers
16	2	Q	Bad business practice – selling without fulfilling the structure, measurement or standard if any, prescribed for selling or providing any goods or service selling without fulfilling the structure, measurement or standard if any, prescribed for selling or providing any goods or service
18		A	No one shall do or cause to be done any of the following acts, regarding any goods or services: producing, selling or importing sub-standard goods knowingly.
33	3		While carrying out inspection, investigation or search pursuant to subsection (2), if it seems unsafe, affected goods or goods having no quality are being produced or sold and distributed, or service provided or activities are contrary to this Act and the rules framed under this Act, the Inspection Officer may impose restriction on producing or selling and distribution of such goods or providing services for prescribed period by taking samples of such goods as prescribed.

35	1		If the goods are not found to have the quality as prescribed while testing the samples of such goods forwarded to the laboratory for testing pursuant to Section 34, such goods shall be confiscated and shall, as required, be destroyed as prescribed.
35	2		When the goods are confiscated and destroyed pursuant to subsection (1), the producer, importer or seller shall have to bear the expenses for confiscating or destroying such goods.

Laws regarding quality control are drafted with the intention of protecting consumers against low quality products. However, in a low-income country like Nepal, such legislations for product standards on all goods and services without proper cost benefit analysis could have negative impact on consumer welfare and economic competitiveness.

The act fails to define what goods having no quality ascribes to. Section 16, subsection 2 clause q mentions "… selling without fulfilling the structure, measurement or standard if any, prescribed for selling or providing...". The term 'prescribed" makes the clause arbitrary, which might generate skepticism among producers.

The main objective of consumer protection law is to safeguard the interest of the consumers. Thus, while drafting such legislations, due regard should be given to the purchasing power of consumers, and their choice regarding the desired level of service, quality and technology to be used.
According to the 2018 economic survey of Nepal, 21.6% of the population live in absolute poverty. Moreover, 40% of the

total population in Nepal belong to the poor or low-income category, whereas, only 10% are categorized as rich. Majority (40%) population of Nepal are subject to only 12% of the total income of the country, whereas the richest 10% earn 35%.

It is apparent that the people belonging to low or lower middle-income group have lower purchasing power. As depicted by the above figures, this group accounts for majority of population in Nepal. It can thus be interpreted that, due to unaffordability of high-quality goods and services, majority of consumers in Nepal have lower expectations of product quality. These consumers with low purchasing power tend to make conscious compromise and settle for low priced products. Consequently, the demand for low quality products becomes high in Nepal. Majority of the producers in order to meet the demand of the local market thus engage in producing such goods and services. When the law demands for stringent product standards, whereas the locals demand low-priced goods and services, any rational producer would choose to serve the local demand. These producers thus, instead of improving the standard choose to operate in informal economy. In informal economy, there is no obligation to conform to either domestic or international regulations and standards and thus they can supply the goods demanded by the local market. The consumers who cannot afford goods and services that meet the legislated standard will be compelled to consume the products from informal economy. Where consumers are forced through lack of choice to use the informal market for basic goods, they are denied their rights to safety, information, redress and a healthy environment. Many consumer organizations urge people not to engage in practices that fuel the informal market as this will only expose them to further suffering.

Complying with the business legislation becomes expensive to the entrepreneurs, discouraging them to enter into the formal market. When the new entrants in the formal sector is limited, the competition in the industry is adversely affected. Lack of capacity and resources will make it more difficult for small producers to upgrade their production processes to meet the standard. Thus, only large firms or multinational companies who have capacity to meet the domestic and international standards can operate in the formal economy. The smaller and medium-sized firms (SMEs) and smallholdings can get caught in a cycle of underdevelopment, whereby the lack of valuable market access without conforming to standards serves to prevent their future development. Nepal should give immense priority to prevent this, as more than 80% of Nepalese entrepreneurs are engaged in SMEs. In the context of widespread poverty, serious policy issues emerge if these measures lock small producers out of the more dynamic markets, leaving them to supply only the less lucrative local and informal markets.

Recommendation

Effective implementation of Section (7) subsection (1) clause (d) & (e), Section (16) subsection (2) clause (a), (c), (i), (k), (l) & (m), ensures the consumption of only those products that do not damage or harm the consumers.

While the additional clauses regarding quality control might be rendered unnecessary, there might still be cases where determining the quality is imperative. Thus, there should be an attempt to clarify the clauses which can be interpreted arbitrarily. Additionally, incorporating a clause which mentions the need to conduct proper cost benefit analysis prior to imposing such regulation is imperative.

5. Consumer Protection Council

The consumer protection council of Nepal comprises of 15 members. The minister of industry and commerce heads the council and 12 other members are the chief officers of different ministries. While the council is very important to oversee the safety of consumers, the mentioned structure poses concern over its effectiveness and efficiency.

It is important to comprehend that the structure of council members constitutes of ministers and top-level officials. Since they are already burdened with the task of supervising their concerned departments, consumer protection will never be their top most priority. Moreover, conducting meetings among these members will be a tedious task, majorly due to time commitment issues.

The council is government centered and lacks representation from various stakeholders. This increases the risk of uninformed decision making. The process of formulating regulations and policies will be centralized, such that, it might be relevant to only a specific party whilst ignoring the repercussions on the greater half of the economy. There can be instances where regulations and policies will be introduced by focusing more on interventionist approach while completely disregarding the market signals. Such policies can derive good results in the short run, however, in the long run they can have bizzare consequences. The fact that the amended Act has increased the members from ministries in the council poses threat of similar instances in the future.

Recommendation

The council should be diversified and should incorporate different stakeholders from sectors like human resource, economics, advertising, media, education, standard and testing committee, multinational as well as local level entrepreneurs, members from other consumer protection committees. One of the ways to do this is to put advisors from different sphere of the economy to present a true picture of the market and the consequences that various policies can result in. The broader committee can perhaps advise the government on imperative issues whilst giving ample respect to economy, market and competition.

6. Inspection Mechanism

Section	Subsection	Clause	
31	1		The Department may carry out casual inspection for the protection of the rights, interests of the consumers.
33	1		If there is reasonable ground to believe that the unsafe goods having adverse effect or sub-standard goods are being produced or sold, or services have been provided, or any acts are being done contrary to this Act and the rules framed under this Act, the Inspection Officer may, by entering into such a place at any time as necessary, inspect, inquire or search, arrest the person who commits such act and hold such a person in detention for seven days with the permission of the case trying authority.

The above-mentioned clause of the Act creates skepticism among entrepreneurs as it portrays arbitrariness in the matter of inspection. The act has failed to define casual inspection.

The Act provides the monitoring officers wide discretionary powers when carrying their general duty. Exercising the power granted, these officers can conduct unannounced inspections of firms in order to ensure their adherence to stipulated regulations. While such surprise investigations give a true picture of the daily operations and practice of the firm, it generally is considered to be an impediment by entrepreneurs. Frequent and unannounced inspection make the business environment unfavorable and thus, it adversely affects the entrepreneurial environment of the nation. Numerous surveys, studies and anecdotes confirm that businesses tend to suffer from the inspection systems in the hands of myriad inspectors from different agencies and levels of government. The uncertainty of inspections and unpredictability of its outcome poses greater threat to entrepreneurs and thus they often refrain from making investments. This scenario is more relevant for micro, small and medium-sized enterprises (MSMEs). For these firms, an inspection not only takes time and resources from the senior members of the firm, but also increases risks of future costs and vulnerability in front of state authorities.

Moreover, such practices often promote corruption. The monitoring officers become more susceptible to taking bribes from the firms in order to mark them as clean. Given that, the entrepreneurs face additional monetary hurdle. This not only has serious effects on entrepreneurship, but also is a loophole through which bad business practitioners remain in the market. Through Section 33 – Duty, responsibility and rights of monitoring officer, the government provides certain powers to the officers. The amendment to this section aims to increase the powers given to these monitoring officers. The sub-section and clauses of the section have vague clauses that can be interpreted in many ways. With the increase in the authority of the officers and the inclusion of imprecise clauses, the cynicism among entrepreneurs are likely to increase. If the individuals are charged guilty for minor wrongdoings or false charges, the business is likely to incur serious loss due to the inability to operate throughout the inspection phase. The business is also likely to incur loss due to the incredulity that is likely to be created among consumers toward the brand.

For example, in 2017 Department of Supply Management and Protection of Consumer Interest conducted raid and sealed nine branded shops in Durbarmarg. The ministry began its legal proceedings after 20 days and allowed the shops to reopen. While the intention of the government was to protect the rights of consumers against fraudulent business practices, the government failed to comprehend the right of businessmen. Firstly, the businessmen could not operate for 20 days even though proper inspection from the legal authorities were not carried out and chances of these shops not being guilty persisted. Secondly, the trust of many consumers regarding these brands were severely affected even though their documents and paper works had not yet been reviewed by the government.

Recommendation

The Act should bind the power of the monitoring officer and mention the clause in more well-defined and precise language, such that it doesn't sound vague. The clause should clearly mention that the monitoring officer can arrest the person only when charged guilty after inspection. As per international norms, in the case of inspections conducted by surprise, the procedural transparency and the control of inspectors' discretion should be tighter. Inspection services should spend as much effort in providing information and compliance services to businesses as in carrying out surprise inspections and penalizing noncompliance.

In Hariyana, enterprises are inspected only when credible and verifiable complaint of violation is filed in writing and approved by the higher authorities. This measure intends to avoid harassment of the entrepreneurs by restricting the discretion and arbitrariness in the matter of inspection.

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, Educational and Training, 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.
(more information at www.samriddhi.org)