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*Sri Lanka**

– Apsara Thurairetnam[1†]

A beautiful island in the Indian Ocean, Sri Lanka is a country of about 19.4 million people with an area of 65,610 square km. Like many other countries in its neighbourhood, it got its Independence in 1948 after about four centuries of foreign subjugation by the Portuguese, then the Dutch and finally by the British. Known as Ceylon at its Independence, it changed its name to Sri Lanka in 1972. Modern Sri Lankan history has witnessed various violent movements against its own people.

Economy

There have been two armed insurrections in the 1970's and 1980's, as well as a bloody civil war that lasted well over two decades till 2001. One study has estimated that between 1983 and 1999 Sri Lanka's total war expenditure amounted to approximately two years of annual GDP, which in turn has been a large setback to the country's economic growth[2].

In spite of these difficulties Sri Lanka has made important gains in terms of human development, in the areas of health and education, as shown in the country profile. However, it is estimated that one in five households live below the poverty line, and Sri Lanka still remains a developing country that is internationally classified as being in the lower middle-income category.

PROFILE	
Population:	19.4 million*
GDP (Current US$):	20.1 billion*
Per Capita Income: (Current US$)	930 (Atlas method)*** 3,778 (at PPP.)**
Surface Area:	65.61 thousand sq. km
Life Expectancy:	74.0 years**
Literacy (%):	90.4 (of ages 15 and above)**
HDI Rank:	93*

Sources:
- World Development Indicators Database, World Bank, 2005
- Human Development Report Statistics, UNDP, 2005

(*) For the year 2004
(**) For the year 2003

Competition Evolution and Environment

From the mid 1950's to the late 1970's, the state played a dominant role in economic and social activities in Sri Lanka. In 1977, the Sri Lankan economy was liberalised, moving away from a state interventionist economic policy towards one based more on market processes. From this period up to the present, successive governments have been sustaining and promoting this policy, though various pro-poor and anti-market policies were still endorsed from time to time. The privatisation of SoEs has also been very much a part of this liberalisation agenda, particularly after 1987.

However, in reality, the reform process in Sri Lanka has so far not been very successful. Issues of bad governance as well an ineffective policy framework have not provided sufficient incentives for private investment, growth and employment to take place. Effective regulation in the form of competition policy and law has not been well enforced; and this has resulted in the price and access issues of goods and services being poorly addressed.

Furthermore, the privatisation process has been conflicting with competition principles, as governments placed more importance on maximising revenue through the granting of monopoly power than on increasing consumer welfare and sector efficiency in the long run. The ineffectiveness of this regulatory framework has been largely attributed to the short term outlook of successive governments, who

* Original paper submitted in November 2004. Revised in January 2006
1 The views expressed in this paper are those of the author and do not necessarily represent those of the Institute of Policy Studies.
2 This study conducted by the Institute of Policy Studies (IPS), includes both the direct and indirect costs of the war during this period. Direct costs are those, which are immediately attributable to the conflict, such as the destruction to life and property, military expenditures incurred by the parties in conflict and refugee care. Indirect costs are those which are a by product of the conflict, and includes capital flight, loss of foreign aid to the country, shortfall in tourist inflows, and emigration of skilled labour.

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have often let *ad hoc* policy measures linked to the electoral cycle permeate the policy making process in Sri Lanka.

Competition Law and Institutions

Competition law was introduced into Sri Lanka with the enactment of the Fair Trading Commission Act (FTCA). No 1 of 1987 This Act provided for the establishment of the Fair Trading Commission (FTC), a quasi-judicial body under the Minister of Commerce and Consumer Affairs (hereinafter referred to as 'the Minister').

The FTC held wide-ranging powers for the control of monopolies, M&As, and anticompetitive practices. It was also entrusted with price control power that enabled it to fix prices or set out a price structure.

Additional powers of the FTC included the authority to examine the price structure of a good at the request of any agency; and investigation of prices referred to it by the Minister. However, the price-control powers of the FTC had been curtailed to a great extent by the Industrial Promotions Act (IPA) No 40 of 1990.

Box 30.1: Price Control Orders

Several reported cases in Sri Lanka deal with orders made under the Control of Prices Act No. 29 of 1950. Some of the decisions are indicative of the underlying legal principles applied by the Sri Lankan courts in interpreting provisions and orders relating to price control.

In the case of Ummar vs. Rambukuwella (1943), the trader was charged with selling mutton along with offal, such as suet or kidneys, where there was a price control order fixing the price of mutton. The Court held that suet is either mutton or offal and if it is mutton there was no violation of the price control order as the trader had charged the prescribed price for mutton. On the other hand, if suet is offal, the trader had still not violated the price control orders, as there was no prescribed price for offal. If the customer demanded the replacement of suet and the trader refused to do so, then the prosecution might have succeeded. The court added that in any event the customer had a civil remedy.

The trader was acquitted on the grounds that the prosecution had failed to establish the charge, which was that the trader had sold one and a half pounds of mutton including half a pound of offal in contravention of the price control order. However, the judge stated that he came to this conclusion regretfully as he had no doubt in his mind that the trader's intention was to evade the spirit of the Law.

Source: Jayasuriya, D.C (2004*), Consumer Affairs Authority Act*

The FTCA 1987 took a behavioural as opposed to structural approach, as monopolies, mergers, and anticompetitive practices were considered illegal only if they were contrary to the public interest.

Specifically, a monopoly was deemed to exist in relation to the supply of any goods only if it was of a prescribed percentage of all goods supplied in Sri Lanka, by one and the same person, or to one and the same person. The prescribed percentage was an arbitrary cut off point determined by the Minister in consultation with the FTC, and generally varied between 40 to 50 percent.

While holding monopoly power, a firm was also required to pass a second test determining whether its actions were contrary to the public interest, before being declared to have violated the competition law. However, as there was no specific definition in the law as to what constituted the 'public interest',[3] this provision has been used as a justification for non-intervention where there was anticompetitive behaviour and vice versa. The lack of guidelines to interpret the elements of the public interest test is a major limitation of the FTCA, which is heightened by the lack of case law.

The FTCA's scope of application has also been limited by the 'prescribed percentage' test under the provision on monopolies. One example relates to the cable market in which ACL Cables' buyout of Kelani Cables, giving the former the control of over 70 percent of the Sri Lanka national market, but in which the FTC was unable to initiate an investigation, as cables were not a 'prescribed item'.

As stipulated by the FTCA, the FTC was also empowered to strike down any proposed merger that gave the acquirer the control of or dominance in a market, and which operated against the public interest. The law's provisions also required that all M&As be notified in writing to the FTC at least thirty days prior to the proposed acquisition. However, in practice, non-compliance with the pre-merger notification was very common in Sri Lanka.

Furthermore, although the FTC had powers commensurate to a District Court to conduct investigations, it did not initiate merger inquiries in some cases even when being given notification by the relevant parties, as reflected in the Glaxo-Welcome SmithKline Beecham (GSK) merger. Although Glaxo Welcome referred this case to the FTC, the Commissioners held the view that extra-territorial jurisdiction (since the GSK merger was an international one) did not fall within the purview of the authority, and thus did not take any action.

3 This common public interest test was very broad, and the FTC had the power to take into account 'all matters that appeared relevant'. Under this definition of "public interest" special consideration was given to safeguarding consumer and producer interests, maintaining a balanced distribution of industrial activity, and promoting effective competition in the domestic market as well as export markets.

The concept of the ‘effects doctrine’ had little significance on this decision made by the FTC, and there was no legal provision for it under the Law.

Anticompetitive Business Practices

As regards anticompetitive practices, the FTCA had defined such practices to include instances where a person, in the course of business, pursued a course of conduct that had the effect of restricting, distorting or preventing competition in connection with the production, supply or acquisition of goods or the supply or securing of services (Section 14).

The major drawback of this provision was the lack of demarcation between different types of anticompetitive conduct, such as price discrimination, exclusive dealing, predatory pricing etc. The broadness of this definition often led to failure by the FTC to capture strategic market behaviour by firms that were potentially anticompetitive (see box 30.1)

The members of the FTC were appointed by the Minister, and held office for a three-year term with no provision for reappointment. However, the selection process and structure of the FTC could not guarantee its independence. Under the provisions of the law, the Minister was empowered to remove any member of the commission without providing any reasons. Furthermore, it was a decision that could not be challenged in a court of law. This left much room for political influence and undermined the ability of the FTC to function in a transparent and independent manner.

The FTC was also empowered to take extensive remedies for any violations of the FTCA. However, such penalties have often failed to have a deterrent effect, and not enabled the FTC to gain legitimacy as a competition authority that actively pursued cases that contravened the law. One reason for this was that the FTC’s powers had been curtailed to a great extent by its inability to make binding interim orders, and also by extensive delays in court proceedings in Sri Lanka.

Consumer Affairs Authority Act

In the early 2000s, the Government of Sri Lanka decided to go for a unified law to deal with competition regulation and consumer protection issues. Accordingly, the Consumer Affairs Authority Act (CAA Act) was passed in January 2003. This Act repealed the three main legislative instruments on competition and consumer protection, which were the FTCA, the Consumer Protection Act 1979, and the Control of Prices Act 1950[4], and incorporated several sections from each one of them, with slight modifications in some instances.

The CAA Act 2003 provides for the establishment of a Consumer Affairs Authority (Authority) and a Consumer Affairs Council (Council). In contrast to the previous FTC, investigative and adjudicative powers have been kept separate in these two bodies. The reasoning behind this is that a body, which is engaged in search, seizure and investigation, cannot perform judicial functions in a fair and impartial manner, hence the need for the separation of powers.

Box 30.2: Unfair Trade Practices and Abuse of a Dominant Position

Ceylon Oxygen Ltd (COL) held approximately 80 percent market share in the production and distribution of oxygen gas and related products from its inception in 1936 until 1993. Industrial Gases (Pvt) Ltd (IGL) commenced operations in this market in December 1993. In 1994, IGL objected to the behavior of COL on the grounds of unfair trade practices that were detrimental to IGL.

It was alleged that in the aftermath of IGL’s entry into the market, COL had resorted to predatory pricing tactics, which were evidenced by a reduction in the deposit fee on oxygen cylinders from LKR 8,500 to LKR 3,000. In addition, there was a decrease in the maintenance charges from LKR 75, to a range of LKR 55 to LKR 35 after IGL’s entry.

Further, allegations were made of discriminatory discounts and exclusive dealing, whereby COL had entered into written agreements with its bulk purchasers that made it compulsory for them to purchase their total requirements from COL for an agreed time period. It was also established that substantial discounts were given on different types of gases and cylinder charges.

On this matter, the FTC identified three courses of conduct that would constitute anticompetitive practices, namely predatory pricing, discriminatory rebates, and exclusive dealing. However, the Court of Appeal held that the FTC did not have the jurisdiction to investigate such practices under Section 11 of the FTCA, and therefore, did not recognise such conduct as ‘restricting, distorting or preventing competition’ within the meaning of Section 14.

Source: CUTS (2002), *Towards a New Competition Law in Sri Lanka.*

4 See Box 30.1

Therefore, under the CAA Act, it is stipulated that the functions of the Authority should be the control or elimination of restrictive trade agreements, investigation of anticompetitive practices, and promotion of effective competition between traders and manufacturers, and consumer protection. In contrast, the Council performs the adjudicatory duty of making determinations once the Authority has concluded its investigations on prices or anticompetitive practices.

However, while there have been some improvements in the current legislation from previous laws, certain vital provisions have not been addressed under the new Act. In terms of some legislative provisions, the CAA Act is even weaker and more undefined than the previous competition and consumer protection laws.

One weakness in the statutory provisions is that the term 'unfair trade practices' has been left undefined in the new Act, as in the previous FTCA. Another deficiency is that legislative provisions, which deal with monopolies and mergers, have been completely omitted from the Act.

The rationale given for this approach is that there are provisions in other statutes that can deal with monopolies and anticompetitive practices, and there is therefore no need to for such a provision to be provided under the CAA Act, as it may become a deterrent to private investment. This dilution was perhaps carried out under pressure of the US, in negotiations on a possible US-Sri Lanka free trade agreement.

It is now left to the judiciary to interpret the few provisions under the Act to give effect to the legislative intent when dealing with monopolies, mergers and unfair trade practices.

The CAA Act, in its current form, resembles a consumer protection law rather than a competition law, and the lack of clear statutory provisions and guiding principles has meant that effective implementation of competition law in Sri Lanka has become much more difficult.

The current CAA Act, which replaced the FTCA, however, has tried to address some of the problems encountered by the previous competition regime. The CAA Authority consists of one Chairman, three full-time members and part-time members to make up a body of not less than ten people. As in the previous FTC, all members of the Authority are appointed by the Minister, with no provision for reappointment.

The Council, however, consists of one member each from the fields of commercial law, business and economics, who are appointed by the Minster for a three-year period. As in the previous FTCA, provisions under the new legislation give the Minster the authority to remove the Chairman or any other member for misconduct, or physical or mental incapacity. However, a distinctive provision under the new law is that judicial review on the removal of a Chairman or full time member is allowed.

Unlike the FTC, the CAA Authority has its own sources of funding. The Authority is authorised to earn its revenue from the sale of forfeited goods, fines imposed by the Commission for offences committed under the Act, as well fees earned from enterprises that register with the Authority. The separate funding arrangements of the Authority are likely to increase its independence and transparency, and it is more likely to gain legitimacy in the eyes of firms and consumers.

Regulatory Framework

The first sector specific regulatory institution in Sri Lanka was the National Transport Commission (NTC), which was established in the mid 1980's together with the liberalisation of the bus transport system in Sri Lanka. However, since then the NTC has largely remained a dormant entity.

The other sector specific regulatory authority in Sri Lanka is the Telecom Regulatory Commission (TRC), which was established in 1996 under the Sri Lanka Telecommunications Act (SLTA). The SLTA outlined several public interest considerations that were required to be pursued by the TRC in carrying out its functions. These included providing a reliable and efficient telecommunications service nationally; protecting the interest of consumers with regard to the charge, quality and variety of telecom services; promoting effective competition between telecom operators; and promoting the rapid and sustained development of domestic and international telecom facilities in Sri Lanka.

To this end, the TRC was equipped with powers to hold investigations and make determinations in disputes between customers and operators. The TRC could also recommend the issuing of telecom licenses to the Minister of Telecommunications and Information Technology, although these could be rejected at his/her discretion. Furthermore, the TRC also had the mandate to determine tariffs in consultation with the Telecom Minister.

Despite these powers, there have been instances of significant regulatory failures in this sector. This was largely due to the privatisation strategy of the Government, which aimed at providing exclusivity provisions in agreements with investors, when divesting public sector enterprises. Although this maximised revenue for the Government, it also allowed political agents to pursue their own interests and favour their protégés at the expense of the public.

Over time, this created huge opportunities for rent extraction by politicians, which became institutionalised in the reform process. Inevitably, the regulatory structures became very weak, as investors were obviously willing to pay more for public entities if rent extraction could be continued in the future unhindered by regulations.

This was the situation with the privatisation process in the telecom sector where the TRC was required to 'maintain' the international monopoly conferred on the dominant incumbent operator – Sri Lanka Telecom (SLT). This particular concession contributed to several instances of abuse of dominant position by the SLT, such as the refusal to implement the closed numbering plan drawn up by the TRC and the blocking of calls originating from competitors. Various other anticompetitive behaviours with respect to interconnection and legal disputes over the use of enhanced voice services by other operators for international calls were also undertaken by the SLT, without any intervention by the regulatory authority.

Other utilities, such as electricity, ports, and water were without regulators for a long time. In 2001, however, the Government undertook to implement far-reaching reforms in the utilities sector, with the creation of a multi sector regulatory agency. This was known as the Public Utilities Commission of Sri Lanka (PUCSL), and included the water and electricity sectors at the initial stage.

The rationale for this multi sector approach was that economic regulation of the utilities industries had similar features, such as long-term investment, a large public owned element with contractual limits on competition, and the need to provide services of acceptable quality to consumers at the lowest possible prices.

Moreover, a multi sector agency was also considered to be a move towards a more effective, independent and accountable regulatory authority. Due to the reasons explained earlier, sector specific regulatory agencies in Sri Lanka have been riddled with problems, with large-scale rent extraction becoming rampant. Thus it was thought that a multi sector body reporting to a central agency, i.e. the legislature or the President's or Prime Minister's office, instead of a line ministry, would be less susceptible to political pressure.

Although the PUCSL has been set up, it is still to become operational, and at present plays only an advisory role to the government. In the future there are likely to be difficulties with regard to the division of labour between the line ministries and the multi sector authority. Therefore, it would be necessary to clearly define the responsibilities of the PUCSL, so that the sector approach to reform does not continue to prevail.

Another difficulty that continues to exist is the exclusion of certain sectors, such as LPG from the PUCSL. This is again due to the government's strategy of maximising revenue through granting of monopoly power, as a means of attracting private investment. Due to this, incumbent operators, such as the Ceylon Petroleum Corporation, continue to be shielded from the purview of regulatory principles.

Consumer Protection

Consumer protection legislation in Sri Lanka was brought in with the passage of the Consumer Protection Act No 1 of 1979 (CPA). The CPA provided for the setting up of the Department of Internal Trade (DIT) within the Ministry of Commerce and Consumer Affairs to regulate internal trade, and establish fair trading practices. The task of consumer protection was solely under the authority of the DIT, and for this purpose it was vested with wide ranging powers.

One provision allowed the DIT[5] to set the standards to which manufactures or traders had to conform, regarding

Box 30.3: Proof of Weight in Tins

Conflicting views have been expressed on the admissibility of statements in the labels on tins as proof of weight. In Piyadasa vs. Yapatilake (1968), the accused was convicted for selling a tin of 14 ounces of Milk Maid Condensed Milk in excess of the maximum retail price fixed by the price control order.

The accused was ordered to pay a fine of 1,500 Sri Lankan rupees and face imprisonment for one month. In the appeal, it was contended on behalf of the accused that there was no evidence, apart from the label on the tin, which the prosecution had submitted as evidence, that the tin in question in fact contained 14 ounces of condensed milk. In view of this, the Court held that it was incumbent on the prosecution to prove that the quantity of Milk Maid condensed milk sold by the accused was 14 ounces, and the accused was acquitted.

Within a month a similar case arose for consideration in the courts. However, the Chief Justice referring to the previous judgment stated that he could not accept the position that the statement on the label of the tin constituted hearsay evidence. The Courts held that if it is the seller's case that the weight of the tin was different, the burden also lies with him to prove the actual weight. The previous judgment, it was submitted, fails to consider the purpose served by labels, which are affixed by manufacturers and on whose representations traders rely on for purposes of sale.

Source: Jayasuriya, D.C (2004), *Consumer Affairs Authority Act*

5 Under section 8 (2)

the manufacture or sale of any article. Any person who bought goods that were not compatible with the given standards was entitled to lodge a complaint with the Commissioner of Internal Trade (CIT), and obtain compensation from the trader or manufacturer concerned.

Other powers vested with the DIT included the authority to enter into written agreements with manufacturers or traders, setting out the maximum price, the quantity sold, and the conditions of sale; the issuing of directions with respect to the labelling, pricing and packaging of any good; and the regulation of traders with regard to the display of price lists, warnings, directions and other important information required for the use of any good (see box 30.3).

As mentioned before, the CPA, however, has recently been replaced with a new law, CAA Act, which combines both competition regulation and consumer protection provisions. From the consumer protection perspective, however, the law is not an improvement, as it does not provide for the establishment of Small Claims or Tribunals for consumers.

As the court procedures in Sri Lanka is costly and time consuming, many are reluctant to bring proceedings against manufacturers and traders, unless it is for a substantial claim. The lack of a speedy and inexpensive procedure for the disposal of small consumer claims makes consumer protection a difficult task.

A further drawback of the CAA Act is that the Minister has the power to prescribe any good or service, as a 'specified good or service' if he or she feels that it is 'essential to the life of the community' (Section 18). Under this provision, manufacturers and traders cannot increase the retail or wholesale price of such specified goods unless written approval is obtained from the Authority.

At present six items being, cement, liquefied petroleum gas, milk powder, wheat flour mosquito coils, and matchboxes, have been notified as specified goods. The CAA Act, however, does not set out the guidelines for the determination of such goods as specified items, and one wonders about the basis for the selection of mosquito coils and match boxes as being 'essential to the life of the community'.

Compared to the earlier regime, however, the current CAA Act has some improvements with regard to the financial assistance to consumer groups and information provided to the public. In the past, many consumer organisations and advocacy groups were unable to perform due to the want of funds. Hence, the provision that permits the Authority to allocate a proportion of its funds for 'the assistance, promotion, and encouragement of consumer organisations and the administration and development of these organisations' is beneficial.

The Authority is also required to keep consumers informed about the quality, standards and price of goods and services, and promote the exchange of information on market conditions and consumer affairs with other institutions.

Concluding Observations and Future Scenario

At present, Sri Lanka does have legal and institutional framework for a competition regime; however, effective enforcement and monitoring mechanisms capable of delivering the goals and objectives of competition law have been lacking. There is also no competition culture in the economy among policy makers, firms and consumers, which can promote competition as being an integral part of the industrialisation and privatisation process.

The newly enacted CAA Act, while containing some laudable provisions, has not really been a serious effort to provide for comprehensive coverage of matters related to competition and consumer protection. Most notable in this is the significant 'hole' in the legislation in relation to monopolies and mergers. Furthermore, although the Consumer Affairs Authority holds considerable powers in respect of price control compared to its predecessor, the legislation is silent as to the consultative process that must precede the determination of such prices. This can greatly undermine the Authority's transparency and fairness in conducting its affairs. While the objective of the Government should be to infuse a better 'competition culture' into the economy, the new CAA Act is a step back in many ways.

The Sri Lankan Government's approach to competition policy has also not been accompanied by a clear-cut economic policy framework, as a result of which competition concerns still tend to be dealt with in an *ad hoc* manner in response to sectoral needs. In the future, this issue would need to be addressed in order to formulate a comprehensive and effective competition policy framework for the Sri Lankan economy.

Suggested Readings

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