

## Business syndicates: Real or imaginary?

Friday, Oct 10, 2008

By *Dr. Ahsan H. Mansur*

WHENEVER prices go up, we hear complaints about business syndicates manipulating the market and getting away with unreasonable profits. Newspaper reports, TV talk shows, and seminars frequently point the finger at the collusive operations of such syndicates, and blame them for any adverse price movements in the domestic market. This piece aims to ascertain whether there is any merit in this charge. Business syndications are possible if trade is controlled by a few large business houses, which generally have connections with the ruling regime. In the past, when imports and exports were controlled through licenses and permits and allocation of foreign exchange to the authorised traders, selected business houses could have enjoyed some degree of control over the market. The worst example of such business syndication was during the British time, with exclusive rights for trade on important products given only to a limited number of British companies. During Pakistan time, and the early years of Bangladesh, some degree of market power was enjoyed by some companies (public and private) through access to a limited number of licenses for imports and to foreign currency through foreign exchange control. The current, more liberal, trade and exchange regimes in Bangladesh certainly do not allow

continuation of such preferential or discriminatory practices. During the 1990s, Bangladesh abandoned multiple currency practice in favour of the unified exchange rate regime and removed restrictions on all current account transactions.

A few years back, Bangladesh also adopted a floating exchange rate regime with rates determined in the interbank market, with unrestricted access for all engaged in external current account transactions (including commodity trade).

With the liberalisation of trade regimes, except for a few products prohibited for health, religious, and security reasons, all other products can be imported by the private sector, subject to payment of applicable duties and taxes.

As a result, along with the volume of imports, the number of importers in Bangladesh has increased to tens of thousands. In addition to normal growth in imports, whenever prices go up or down in the international market, we see these importers asking for additional import letters of credit.

What was our experience when we were hit by price shocks last year? Let's take the case of rice. Which group imported most rice into Bangladesh in the aftermath of the floods and Sidr? Certainly, until the world prices were lower than the prices in Bangladesh, it was the private sector.

Land ports with India suddenly became active, with thousands of trucks with sacks full of rice lined up across the border. Ships loaded with rice docked at Chittagong port in large numbers. Even the border crossings with Myanmar became busy trading points. Hundreds of traders placed orders for rice from West Bengal, and the volume of rice imports reached record levels.

Is it conceivable that thousands of traders could have acted as some kind of a syndicate? If they had, why would the volume of imports surge to record levels within a very short time? Conventional collusive

behaviour would

imply that, since rice demand is very inelastic, traders would try to limit imports to a minimum level

collectively in order to maximise profit through higher prices.

The sharp increase in letters of credit opened for importing rice and wheat (1312.5% in dollar terms in 2007/08),

and edible oil and oil seeds (539.7% over the same period) certainly goes against the syndication hypothesis.

Could thousands of traders and rice millers ever act like a syndicate? Garment exporters are a good example in

this regard. Almost all garment exporters are members of the Bangladesh Garment Manufacturers and Exporters

Association (BGMEA), and it is considered to be the most powerful and best organised trade body in

Bangladesh.

But, could it limit competition among numerous manufacturers who out-bid fellow exporters and sign contracts

accepting very low unit prices, which the BGMEA considers harmful for overall health of the sector? In spite of

numerous decisions taken by the BGMEA, unit values of Bangladeshi exports continued to decline, even for

products for which Bangladesh is considered to be the most important sourcing country.

When there are thousands of players, the decisions taken at the apex body are not going to be followed in a

competitive environment without financial and other sanctions for the violators.

The factories will undercut each other if there is scope for doing so without suffering losses. If BGMEA could

not enforce a relatively minor decision, why would anybody believe that somehow thousands of importers could

have become organised in an invisible manner to follow the orders of the so called "rice syndicate."

The hypothesis that syndicates rule the markets in Bangladesh is also negated by the recent declining price trend

in most primary essential products. If the syndicates had such market manipulation capacity

why would they allow the price of palm oil to fall from Tk. 105 per kg a few months ago to less than Tk. 70 per kg now? Why would the so-called syndicate members incur losses of hundreds of crores of taka due to the collapse of palm oil prices in the international market if they had such control over the market in Bangladesh? The same applies to soybean, wheat and onion, albeit to a lesser degree. Now that the prices of most commodities are coming down we do not hear about syndicates, as if they have disappeared in a magical way.

The perception of syndication originates from two factors, and the tendency to blame some groups for the miseries caused by price hikes. If world prices go up, domestic prices go up almost instantaneously, since traders use replacement costs of products in setting their current prices. On the other hand, if international prices decline, the traders do not have any incentive to cut the prices on existing stock and take a loss. The traders who have unsold inventories will minimise losses by charging at least their cost price by slowing down imports.

At the same time, those importers who do not have large inventories would like to order in large volumes at lower world prices, and have them delivered within the shortest possible time in order to take advantage of the price gaps between the domestic and the world markets. The gap will certainly disappear as soon as new shipments arrive in the country. In Bangladesh, given the proximity of Singapore and India, the price differential may last only a few weeks. The windfall profits that the traders get at the time of price spike in the world market gives the impression that they manipulate prices. The instantaneous price adjustment on products already in stock, and bought at lower prices, gives the impression of market manipulation. The traders, however, see this as the means to replace the stock being sold with new ones at

the prevailing market prices. This behaviour, although rational, leads to sharply higher profits, and may not be ethical.

However, that is a completely different issue and has nothing to do with market manipulation through syndication.

Ahsan Mansur is a former Division Chief, IMF.