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EFFECTIVENESS AND POTENTIAL IMPACT OF COMPETITION POLICY AND LAW AND REGULATION TO THE ECONOMY

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1.0 INTRODUCTION

1.1 Preamble

The evolution of economic theories on competition can be divided into four stages:

i. **the origins of competition**: the dynamic concept of competition in classical economic literature and the static concept of competition in price theory, followed by the development of models of imperfect competition and monopolistic competition; late 1770s -

ii. **the structure-conduct-performance** paradigm (Harvard School of Industrial Organisation 1940s);

iii. **the 'antitrust revolution' of the Chicago School** and the related theory of contestable markets, and

iv. **the new industrial economics**, making use of game theory and transaction cost analysis.

1.1.1 The Origins of Competition

The roots of the concept of 'competition' are as old as economic science, if the latter starts with the famous book *The Wealth of Nations* (1776). Even before that time the merits of and problems with competition often submerged in economic writings. Smith, by anticipating the welfare theorems with his 'invisible hand' theory, generalised competition to a force driving economies to the very best outcomes that are feasible. The most frequently quoted passage in the book is:

> *"He [specifically each individual] generally, indeed neither intends to promote the public interest, nor knows how much he is promoting it… [He] intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention".*

According to classical economics, healthy competition signifies both reciprocal rivalry and the absence of government restrictions, such as the exclusive privileges which characterised the mercantilist period. Government intervention in general certainly would not improve upon the results of the competitive process although Smith himself was a believer of keeping entry into the market open. Competition was hailed as a process but limited government intervention sometimes would be necessary to allow for the process to work.

Neoclassical economists continued to believe in the healthy effects of competition but somewhat shifted the interest from competition as a process to competition as a situation (as one later would say, a market structure). The necessary conditions to achieve a perfectly competitive outcome are:

(i) the rivals must act independently or non-cooperatively

(ii) the number of rivals, potential as well as present, must be sufficient;

(iii) the economic decision makers must possess knowledge of the market opportunities;

(iv) there must be freedom to act on this knowledge; and

(v) sufficient time must elapse for resources to flow in the directions desired by their owners with no restrictions on the magnitude of these flows.

A perfectly competitive market now was defined as a set of properties such as supply and demand exercised by a very large number of actors, free entry and exit, homogeneous products being traded on the market and zero search or transaction costs. The outcome of such a market is an efficient one in that no other outcome can achieve the same level of welfare for society. Yet it relies on many conditions which are unachievable, such as very large numbers of suppliers (in the presence of scale economies), no search costs (difficult to maintain in the few cases one has very many suppliers) and so on.

The model of perfect competition therefore has to be seen as a yardstick against which other market structures are to be judged. In all instances in which this set of properties are not met, a case of market failure is seen to exist. For a long time, the mere existence of such market failures were seen to be sufficient reasons for government policies, such as antitrust laws or the creation of public utilities.

Nowadays, this viewpoint has changed. A market failure is a necessary condition for government intervention, but not a sufficient one. The cost of government failures, for instance due to government officials and regulators being captured by private and social interest groups has to fall short of the costs due to market failures. In general, antitrust policy, due to its distance *vis-à-vis* redistributive issues, and due to its permanent and 'generic' character is not an area of government intervention where one expects a lot of capture a priori.

1.1.2 The Structure, Conduct, Performance Paradigm (S-C-P Paradigm)

Technology and tastes constitute market structure. The number of suppliers as those who have access to a certain technology is specified and the consumers who have different tastes can make their choice over different brands. Still this allows for many different outcomes unless a particular structure entails a certain type of conduct. This is what the S-C-P paradigm tried to achieve: a general theory that mapped common elements in the market structure of any industry into a performance indicator of that sector.

S-C-P paradigm was developed by Edward S. Mason (1949a) at Harvard University in the late 1930s and early 1940s. The paradigm implies that market results (the success of an industry in producing benefits for consumers, employment, stable prices, technological advancement and so on) in an industry are dependent on the conduct of sellers and buyers (as regards decision variables like advertising, R&D, and so on). Conduct, as mentioned, is determined by the structure of the relevant market. The structure of an industry depends on basic conditions, such as technology and preference structure. Government policy (antitrust policy, regulation, taxes, and so on) may affect the basic conditions, and hence the structure, conduct and performance of an industry.

Concerning static performance (profits and consumer surplus), three major measures of market performance are used:

(1) The rate of return, which is based upon profits earned per dollar of investment;

(2) The price-cost margin, which should be based upon the difference between price and marginal cost, and is related to the Lerner index of monopoly power; and

(3) Tobin's q, which is the ratio of the market value of a firm to its value based upon the replacement cost of its assets. Bain (in his publication) argues that profits are higher in industries with high concentration and high barriers to entry.

Regarding market shares, some studies have made clear that substantial market shares are not evidence prima facie for the presence of market power. On the contrary, it seems to be the case that the resulting larger market shares are the result of superior efficiency, as predicted by a Cournot model with cost asymmetries.

1.1.3 The Chicago School (1950s)

The problem of tie-in-sales was analysed by Bowman (1957). Predatory pricing was investigated by McGee (1958), while another hot issue overwhelmed with misconceptions, namely vertical price fixing, was the topic of a paper by one of Chicago's leading scholars in microeconomics, industrial organisation and law and economics, Telser (1960).

The Chicago approach to competition policy is not merely the result of the rejection of government intervention in the economy, although the opposite view often occurs. On the contrary, the economist Aaron Director (1950s) reached his conclusions by *analysing* competition problems through price theory. Director sought an explanation for practices observed in real markets which tallied with the maximisation of profits, utility and welfare. Of course, if firms can engage in actions which are anti-competitive *and* profitable, they will do so. But already in 1964, Stigler showed that it was often more profitable to stay out of cartels than to form them. This conclusion, however, has been both confirmed (see Salant, Switzer and Reynolds, 1983), and rejected (see Deneckere and Davidson, 1984), indicating that one has to carefully investigate the nature of the interactions that takes place in industry. In the Chicago tradition, concentration mostly will be the result of *efficiency*, hence if antitrust authorities interfere with an existing market structure, they are likely to cause inefficiencies, and reduce rather than enhance welfare.

One of the most important attacks on the S-C-P doctrine of conducting antitrust policies was given again by Stigler when investigating the role of barriers to entry. Often the Harvard tradition argued that fixed costs were seen to lead to scale economies on the one hand, but also to barriers to entry on the other. Stigler defines a barrier to entry as 'a cost of producing (at some or every rate of output) that must be borne by a firm which seeks to enter the industry but is not borne by firms already in the industry'. Barriers to entry are present only if the costs for firms entering the market turn out to be higher than the costs for the existing firms. If, for example, it costs $10,000,000 to build the smallest possible efficient factory having an economic life of ten years, then the annual costs for a new entrant will be only $1,000,000. The existing firms will be confronted with the same annual costs, at least if it is assumed that they also intend to replace their factories. Accordingly, there is no cost disadvantage for the new entrant (see Posner, 1979; Spence, 1980, or Schmalensee, 1983) for initial ideas regarding the importance of sunk rather than fixed costs. These ideas were the fundamentals of what later on became the contestable market defence.

In the theory of contestable markets, the fact that the market structure is concentrated says nothing, of itself, about the degree of efficiency. Even with a high degree of concentration, allocative efficiency is not excluded because potential entrants exercise a controlling discipline. Perfect contestability produces a similar outcome to perfect competition: prices are equal to marginal costs, as required by the welfare theorems, but without having a substantial number of competitors in the industry. The players necessary to guarantee this result are found outside the industry.

1.1.4 The New Industrial Economics: Game Theory and Transaction Cost Analysis (early 90s)

Game theory offers a rigorous analytical framework - like price theory – to analyse the competition of firms. Game theory requires being explicit on the set of players (firms), on their strategies, and on the advantages these strategies can bring to them (payoffs). It offers solution concepts that take into account firstmover advantages and credible commitments that firms can take. By the fact that pure price theory does not offer much room for search and transaction costs phenomena. Nonetheless, transaction cost theory has a longstanding tradition in the law and economics of antitrust (see Williamson, 1975, 1979). The central idea in transaction cost economics is that the market is not entirely free in the sense that certain operations (transactions) are not entirely costless. As such, the transaction cost approach superimposes frictions upon microeconomic price theory. Seen in this light, transaction cost analysis is more a complement to than a substitute for price theory. The point of departure in Williamson's analysis is not the subject matter of the sale/purchase transaction (goods or services) but the transaction or transfer system itself. The transaction is an exchange between two or more individuals whereby they transfer 'property rights' (that is, rights to dispose of scarce resources, which may be limited not only by other individuals' ownership rights but also by rules of legal liability and the provisions of competition law). Transactions differ perceptibly so far as costs are concerned and these differences in transaction costs influence the choice of the right organisational form or 'governance structure'. The transaction cost approach is thus concerned with the costs which are necessary to maintain the economic system. To put it briefly: markets and firms are regarded as alternative instruments for implementing transactions (see Williamson, 1985, 1986).

Indeed, whether a transaction to acquire a good or service is carried out over the market or within the firm depends on the relative efficiency of these two institutions. A hierarchical form of organisation may be superior to a market-based solution. The relative efficiency of the two forms is determined on the one hand by the costs of entering into and carrying out agreements in a market, and on the other hand by the characteristics of the individuals who are affected by the transaction.

Transactions differ from each other in a number of respects: the uncertainty to which the transactions are exposed, the frequency with which the transactions are repeated (once, occasionally, regularly) and the extent to which transactions must be supported by transaction-specific investments ('asset specificity'). By asset specificity Williamson (1985) means the extent to which suppliers and customers must make specific investments in order to be able to carry out the transactions.

Transaction-specific investments bind the supplier and the customer closely together. If the supplier cannot readily exploit his specific investments elsewhere and the purchaser, because of his specific investments, cannot readily place his order elsewhere, the supplier and the purchaser are bound to each other for a substantial period of time. This leads to situations in which market participants are very much dependent upon each other.

Transaction cost economics has important implications for antitrust policy. Certain market structures might be the result of transaction cost efficiencies, not the strive for market power. A welfare-maximising anti-trust law then must take into account these efficiency aspects. In the context of the control of concentrations it is necessary to consider what transaction cost savings will be prevented by a merger prohibition and whether these (possible substantial) costs are compensated by the anticipated advantages of more intensive competition. Vertical integration or vertical restraints can be the result of complex negotiations aiming at the reduction of transaction costs.

1.1.5 The New Empirical Industrial Organisation and the Bounds Approach

The new empirical industrial organisation has tried to resolve the problem of indeterminacy in the new industrial economics, by leaving it open as to what kind of conduct prevails in an industry. The general idea is that industry structural elements can be measured and modelled, hence one starts from theoretical models of a sector. As such, conduct which is much harder to know *ex ante* is left open to be determined empirically.

The divergence of industries necessarily calls for sector-specific models. Usually the fundamental ingredients are specifications of supply and demand, modified and augmented with industry-specific features. Estimation based on time series analysis allows the identification of market power, that is to separate the effects of cost changes from mark ups. The new empirical industrial organisation is a great leap forward for antitrust practitioners, as it allows the simulation of the effects of mergers and the detection of collusive behaviour.

1.2 Competition Concepts

Competition policy, refers to those government measures that directly affect the behaviour of enterprises and the structure of industry. An appropriate competition policy includes the following:

i. Micro- economic policies that enhance competition in local and national markets, such as trade liberalisation policy, relaxed foreign investment and ownership requirements, economic deregulation and privatisation; and

ii. Competition law (also referred to as anti-trust, anti-monopoly law or restrictive business legislation in some countries) designed to prevent anti-competitive business practices by firms and unnecessary government interventions in market place.

The type of market structure is one of the basic concepts for competition analysis. Market structure is important in that it affects market outcomes through its impact on the motivations, opportunities and decisions of economic actors participating in the market. Industry structure is categorized on the basis of market structure variables which are believed to determine the extent and characteristics of competition. Those variables which have received the most attention are number of buyers and sellers, extent of product substitutability, costs, ease of entry and exit, and the extent of mutual interdependence. In the traditional framework, these structural variables are distilled into the following taxonomy of market structures:

- Perfect Competition: many sellers of a standardized product,
- Monopolistic Competition: many sellers of a differentiated product,
- Oligopoly: few sellers of a standardized or a differentiated product, and
- Monopoly: a single seller of a product for which there is no close substitute.

Contestability of markets is another important aspect of competition and it entails freedom of entry and exit of market. Free entry does not imply that entry costs absolutely nothing, or that it is easy, but rather that the entrant has no relative disadvantages compared with participants who are already active in the market. Any impediment to exist by definition increases the riskiness and hence the real cost of opening for business.

A potential entrant will hastate long before embarking on an enterprise form which it will be difficult to withdraw if his entry proves to have been a mistake. Availability of a pool of potential entrants, is another aspect as being able to respond quickly to an entry opportunity. It is their threat that disciplines incumbent and forces them to serve customers sufficiently. Lastly, Sluggishness in response of incumbent, particularly the pricing responses to entry.

If some costs are sunk, it implies the incumbent has already paid for them, and will have written them off instantaneously as they are worth nothing if the activity is stopped. Potential entrants find it appropriate to judge the profitability of market entry on the basis of the post entry competition (which will determine the profitability) and the costs they still have to sink. If competition is hard, profits will be too low to cover these costs, and potential entry will never discipline the incumbents for it will not occur. Implicitly, the contestable market model by assuming zero sunk costs therefore assumes that investments can be redeployed in another activity (complete lack of asset specificity), or resold on a second-hand market that is not prone to failures (Akerlof, 1970, and Van Cayseele, 1993).

1.3 Economic Premises for Competition Policy Law

The premises for operations of competition policy and law are market-based economy. Tanzania economy since 1967 operated under centrally planned economy and hence there were no conditions for competition policy application. This resulted into highly market concentration in some market. The economic reforms that started in the mid-80s led to trade liberalisation measures including privatisation of state owned enterprises and consequently the dissolution of the Price Commission[1] in 1993, the competition policy and law was introduced. Subsequently, the Government enacted, the Trade Practices Act of 1994.

The premises can also be traced from the goals of implementing competition law. There is recognition of influence of economics on competition. It seems fair to say that American Antitrust law has been influenced by a constantly increasing and ever more penetrating use of economic theory, whereas the influence of economics on European competition law has remained rather modest. At present there are remarkable differences between American and European law with respect to the treatment of some hot issues in antitrust, such as predatory pricing and merger control. These differences may be attributed to at least two reasons. The main goal of European competition law (Articles 85-86 EC Treaty and Regulation 4064/89) has always been the promotion of market integration. A similar goal is absent in American Antitrust law, since the latter rules came into being when a common market was already established. It was mainly political necessity, rather than economic theory, that made an active competition policy necessary in the eyes of the authors of the EC Treaty. The elimination of market compartmentalisation caused by restrictions on competition was necessary in order to achieve the central objective of integrating national markets.

Consequently, the view of the Chicago School that productive and allocative efficiency are the only objectives which may be taken into account in interpreting and applying antitrust law could not get a firm basis in Europe. To a large extent, European competition law is at the same stage of development as American antitrust law was in the 1960s (Bergh, 1996). However, there are some signs of a greater willingness by the European Union to make use of economic theory (for example, with respect to the analysis of vertical restraints).

[1] The Price Commission established by Act of Parliament in 1973.

2.0 TANZANIA COMPETITION POLICY AND LAW

2.1 Background

Competition Policy and Law is new to Tanzania. Tanzania has been under a centrally planned economy from 1967 to 1986 when the new policy based on the market economy was formally adopted. From 1986 the Government of Tanzanian embarked on a policy and legislation program whose main object was to liberalize the economy.

Some of the most important Acts passed by Parliament during this time were:-

- The Cooperative Societies Act, 1991
- The Loans and Advances Realization Trust Act, 1991
- The Banking and Financial Institutions Act, 1991
- The Foreign Exchange Act 1992
- The Public Corporations Act 1992 (As amended)
- The Crop Boards (Miscellaneous Amendments) Act, 1993
- The Investment Promotion Act, 1997.

However, the total effect of these Acts was to reduce direct government involvement in business, remove monopoly requirements in most of government sponsored corporations, protect private investments and create enabling environment for private firms' participation in the economy.

Meanwhile, through The Public Corporations Act, 1992, as amended, the Presidential Parastatal Sector Reform Commission (PSRC) was established and charged with the task of privatizing 400 plus parastatal organizations which had had monopoly in their respective economic spheres. By 1997 PSRC had privatized most of the parastatals and were embarking on the utilities and infrastructure parastatals. These are natural monopolies.

As a continuing process of adaptation of economy to a market based one, the Government in 1993 repealed the Price Control Act of 1973 and come up with the Fair Trade Practices Act No. 4 of 1994 that later on changed to the Fair Competition Act, 2003. the changes were prompted by the fact that the Act was too comprehensive in certain parts and weak or vague in others. There was need to establish a body that was independent, that could exercise transparency, accountability and impartiality.

The salient attributes of the Fair Competition Act, 2003 are :

i. The implementing institutions of the Act are the Competition Commission and the Fair Competition Tribunal

ii. Competition Commission is led by a Director General under a Commission headed by a chair and whose members are part time and come from the public.

iii. The Competition Act covers all firms and persons engaged in business except where:

   a. An agreement relates to remuneration, conditions of employment, hours of work or working conditions of employees.

   b. An agreement provides for compliance with or the application of standards of dimension, design or performance prepared or approved by the Tanzania Bureau of Standards or any other association, institution or body prescribed by regulations.

   c. An agreement relates to exports of goods or services outside Tanzania and if the particulars of the agreement are filed with the Commission within 21 days after it is made.

   d. An agreement is to comply with the obligations of the Republic with the government of another country.

iv. The Act provides for appeals against decisions by the Commission to the Fair Competition Tribunal.

v. While the main Act deals with competition in the economy, it also contains provisions for regulating fair business practices and consumer protection in the economy. In particular it deals with misleading and deceptive conduct, unfair business practices, unconscionable conduct, implied conditions in consumer contracts, manufacturers' obligations, product safety and product information, and product recall. However the adjudication of all these direct consumer protection related issues is neither dealt by the Commission nor the Tribunal. It is dealt by the normal courts.

vi. The Act allows for the co-existence with economic multi-sector regulatory laws.

vii. The crucial attributes of competition laws of; accountability, independence, due process and transparency are clearly spelt out in the Act.

viii. The need to raise consumers' organizational capacity and awareness has been taken into account by making provision for the establishment of a National Consumer Advocacy Council.

ix. Given the need of encouraging small and medium enterprises to grow, their merger and acquisition requirements have been allowed for by establishing a threshold provision below which mergers and acquisitions of small and medium enterprises can take place without notifying the Commission.

x. The Act provides room for anti-competitive conduct and actions under certain conditions. This allows for developmental and environmental requirements of a country to be taken into account, if need be.

xi. The Act provides for action against anti-competitive action or conduct from foreign companies or foreign persons that may affect the economy.

xii. The Act also emphasizes the role of advocacy in competition policy and law.

The competition and regulatory framework is governed at the moment on the basis of the following Acts;

- The Fair Competition Act, 2003 (FCA);
- The Energy and Water Utilities Regulatory Authority Act, 2001 (EWURA Act);
- The Surface and Marine Transport Regulatory Act, 2001 (SUMATRA Act);
- Tanzania Civil Aviation Regulatory Authority Act, 2003 (TCAA Act);
- The Tanzania Communications Regulatory Authority Act, 2003 (TCRA Act).

2.2 Performance

Since the introduction of the economic reforms, many programs have been undertaken towards developing a markets led economy. The legal framework for protecting and promoting competition is sufficient as evidenced by the wide mandate contained in the functions of the Fair Competition Commission. Here below are some of the status of development in relation to competition promotion.

2.2.1 Sectoral Issues

Following the decision by the Government to liberalize the economy in 1986, most of the economic activities have been opened up for competition. However, the market in Tanzania has some basic disadvantages which include:

i. The economy is still highly regulated especially at sectoral level. For example, There is still a large presence of marketing boards for most of the commercial crops. The sugar industry is regulated by a board that registers sugar cane growers, issues licenses or permits for export and import of sugar and monitors the basis or method of pricing, selling and purchases of sugarcane. The Government has privatized the Kilombero Sugar Company Ltd. which is the largest of the four sugar factories in Tanzania. Under the terms of the share sale agreement, the investor is protected by being exempted from payment of import duties. The exemption granted to the investor is a *barrier to entry* and poses anti-competitive behaviour to existing firms.

The structure of the tobacco industry is made up of many small scale growers who number about 40,000 (FIAS, 2002), grouped under more than 2,000 primary co-operative societies. The tobacco sector suffers from significant barriers to entry due to limitation of contestability in the market.

ii. Impact of economic regulation on the economy: Economic and technical regulation exists on natural monopolies of water and electricity services and other service sectors of communication and transport.

iii. The industries are highly concentrated.

iv. Transportation network is not highly developed and therefore transport costs are relatively high.

v. Business information network is not well developed.

The major sectors with public restraints to competition include the sugar industry, fixed line telephone system, commercial crops for which minimum prices are fixed by crop authorities, e.g. coffee, cotton, cashew and tobacco. There are sectors which are under legal monopoly such include utilities namely: water supply and sewerage services and electricity.

2.2.2 Institutional Development

The two implementing institutions for competition have been set up, the Fair Competition Commission and the Fair Competition Tribunal. Commission and Tribunal was inaugurated in December, 2005. Currently the recruitment for staff for the two institutions is ongoing. SUMATRA is in place and EWURA is on progress.

2.2.3 Competition Regulation

The broad objective of the Competition Act is to promote efficiency in the economy and enhance the welfare of the people of Tanzania as a whole.

Specific objectives of FCA are:-

(1) To increase efficiency in the production, distribution and supply of goods and services;
(2) To promote innovation;
(3) Maximize the efficient allocation of resources
(4) Protect the consumers

The Substantive Rules of FCA for regulation of competition are the following:-

- Horizontal Agreements: A *per se* prohibition is introduced under Section 9 (1) to horizontal agreements that seriously affect competition. These are:-
  - (i) Price fixing between competitors
  - (ii) A collective boycott by competitors
  - (iii) Output restriction between competitors
  - (iv) Collusive bidding or tendering

  Section 12 of the Act provides for exemption for an agreement upon application by a party to that agreement, which may be granted either unconditionally or subject to such conditions as the Commission sees fit. The conditions for consideration of the exemption under the Act for a restrictive agreement are based on: contribution to efficiency in production or distribution, promotion of technical or economic progress, contribution to greater efficiency in the allocation of resources and protection of environment. In addition, the agreement should not prevent, restrain or distort competition no more than is reasonably necessary to attain the benefits; and the benefits to the public resulting from the agreement should outweigh the detriments caused by preventing, restraining or distorting competition.

- Vertical agreements: Vertical arrangements are subject to rule of reason. There is no separate provision in the Act that provides for vertical restraints. It is however presumed that vertical agreements will have anti-competitive effect under abuse of market power.

- Misuse of Market Power: The Act under section 10 prohibits a conduct by a person in the market with dominant position if the object, effect or likely effect of such conduct is to appreciably prevent, restrict or distort competition. However if exemption is granted under S.12, the conduct of making or giving effect to that agreement is not prohibited during the period of exemption.

  Dominance in the Act is defined in terms of market power and market share. A firm has to be tested both in terms of market power and market share for dominance according to the Act. Therefore the power of a firm to control prices over time, or to reduce competition, or to behave to an appreciable extent independently of its competitors, customers or suppliers should be associated with the market share. This is attributed to a share exceeding 35 per cent of the relevant market.

- Mergers: A merger is prohibited if it creates or strengthens a position of dominance in a market. A merger may be approved or disapproved based on benefits to the public in one or more ways of the following conditions:-
  - (i) contributing to greater efficiency in production or distribution
  - (ii) promoting technical or economic progress;
  - (iii) contributing to greater efficiency in the allocation of resources; or
  - (iv) protecting the environment

- Consumer Protection Issues: While the main body of the Act deals with competition, the rest of the provisions deal with consumer protection. This includes misleading and deceptive conduct, unfair business practices, unconscionable conduct, implied conditions in consumer contracts, manufacturers' obligations, product safety and product information, and product recall.

2.3 The Way Forward

Recruitment and Enforcement: The process that has been started with the institutions to be expedited to operationalise the much awaited tasks.

Advocacy: following the fact the general level of understanding of the benefits of competition in Tanzania is low, due to the fact that the concept of competition policy and law has been recently introduced, raises the need to advocate more for the competition policy and law. The task should involve different government institutions and creation of awareness to the public.

Capacity building: the newly formed institutions need capacity building in terms of training, working equipment and tools.

3.0 POTENTIAL IMPACT OF COMPETITION POLICY AND LAW

Markets and firms are indeed institutional forms, and their existence and survival are explained out of economic efficiency. The use of one mode or the other for a particular type of transaction directly follows from the relative costs of operating over one system or the other. As such, the laws which regulate and interfere with these institutions will also be judged in the long run by economic efficiency. If legal rules make it more difficult to operate over a particular institution (for instance competition policies which forbid vertically integrated firms), that institution will lose appeal and vanish, together with the law that regulated it (Cayseele, 1999).

In the light of the relationship between market structure, market conduct and market results, competition law became an instrument for generating optimal outcomes by directly influencing market structure (merger control). If prices increase as a result of market concentration, then mergers must be closely scrutinized. In the 1968 Merger Guidelines of the American Department of Justice it was stated that an analysis of market structure was fully adequate for showing that the effect of a merger, as spelled out in Section 7 of the Clayton Act, 'may be substantially to lessen competition, or to tend to create a monopoly' (US Department of Justice, 1968). The Department announced that its merger policy would focus on market structure 'because the conduct of the individual firms in a market tends to be controlled by the structure of that market'.

3.1 A Review of Competition Benefits

Different government policies affect competition and hence consumer welfare. Although a competition law may be quite narrow in its scope, competition policy is much more broad and comprehensive in its scope and tries to bring harmony in all government policies that encourage, or adversely affect competition and consumer welfare.

A well designed and implemented competition policy promotes economic growth by ensuring better allocation of resources. A study carried out for Australian economy (CUTS, 2005) estimates the expected benefits from a package of competition – promoting and deregulation reforms to incur an annual gain in GDP of about 5.5% or A$ 23bilion where consumers would gain by almost A$ 9bilion besides having an increase in real wages, employment and government revenue.

3.1.1 Overall Implications and Impact of Competition Policy

The role of protecting the interests of consumers

This is the basic role of competition policy. An effective legislative and policy framework is required to protect consumers and industrial users from anti-competitive practices that raise prices and reduce output (WTO, 2004).

Less mature markets are often more, than less, vulnerable to anti-competitive practices. The reasons include: (i) high "natural" entry barriers due to inadequate business infrastructure, including distribution channels, and (sometimes) intrusive regulatory regimes; (ii) substantial asymmetries of information in both product and credit markets; and (iii) a greater proportion of local (non-tradable) market. In these circumstances, consumers in developing countries have a particular compelling need to be protected against cartels, monopoly abuses and the creation of new monopolies through mergers.

The role to global trade

The links between competition policy and the effectiveness of international agreements to liberalize trade have long been thought to be important (Bagwell & Staiger, 2003). This thinking was evident in the original Charter of the ITO (Chapter V), in which extensive rules governing restrictive business practices were included. However, this comprehensive set of rules died with the ITO and GATT rules that apply specifically to restrictive business practices are far more limited. The primary rule governing restrictive business practices in GATT applies only to import monopolies, and is contained in Article II, paragraph 4, which states in part:

> *"If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this agreement , such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule, …"*

In effect the intended purpose of this rule is to secure the integrity of market –access commitments against the subsequent exploitation of (import) monopoly power.

More recently, the links between trade and competition policy have received renewed attention. For example, these links have been emphasised in discussions within the WTO, where a working group on the interaction between trade and competition policy has been given the task of evaluating them. Therefore, there is an increasing role of competition policy in addressing the impact of international anti-competitive practices, notably, cartels on developing countries (WTO, 2004). For example, in the 1990s, extensive evidence surfaced that international cartels are alive and flourishing in the globalizing economic environment.

The role as an agent of trade (economic) policy

Competition Policy and Law has a broader significance as an aspect of economic policy (WTO, 2004). Apart from the direct significance of anti-competitive practices for the welfare of citizens in developing countries, as Osakwe (2001) emphasizes, in many cases, failures of trade liberalization to generate sustained development and growth can be traced to a failure to introduce complementary domestic policy reforms.

More specifically, a failure to implement competition policy and related regulatory reforms can prevent countries from the potential gains from external liberalization, by inhibiting an appropriate supply response. For example countries may not be well-poised to take advantage of the potential benefits of trade liberalization in expanding incomes and opportunities unless they simultaneously take steps to reduce costs and enhance the efficiency of infrastructure sector such as telecommunications and transportation; eliminate artificial restrictions in entry, exit and pricing in industries where they exist; and otherwise establish and strengthen incentives for innovation, the creation of efficient management structures and productivity improvement.

Furthermore, a transparent and effective implementation of a competition policy can be an important factor both in enhancing the attractiveness of an economy to foreign investment, and in maximizing the benefits of such investments.

Contributing to the wider regulatory reform agenda

The advocacy function of competition agency which include public education activities, studies and research undertaken to document the need to market –opening measures, formal appearance before legislative committees or other government bodies in public proceedings, or behind the scenes lobbying within government.

In relation to anti-competitive agreements (cartels)

Adam Smith remarked in a famous passage in the Wealth of Nations:

> *"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise price. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary (Spencer, 1974)"*

According to Adam Smith, competition among businessmen is not a "natural" form of behaviour; given the opportunity, businessmen would prefer to seek ways of avoiding competition if they could strengthen their market positions by doing so.

Investigations conducted by the U.S. Department of Justice, the EC, the Canadian Competition Bureau and other jurisdictions' authorities (WTO, 2004) revealed the existence of major cartels in the following industries (to cite a few); graphite electrodes (an essential input to steel mini-mill production), bromine (a flame retardant and fumigant), citric acid (a major industrial food additive), lysine (an agricultural feed additive), seamless steel pipes (an input to oil production) and vitamins (WTO, 2004).

The costs of such cartels to the world economy have been in the magnitude of multi-billions of dollars annually. WTO noted that many examples of international cartels involve firms headquartered in developed world with substantial exports to developing countries (WTO, 2004)[2]. Looked at 16 cartelised products, further noted:

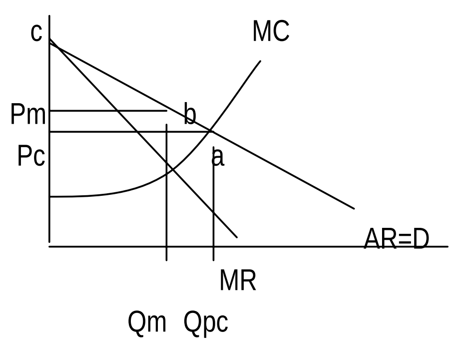
> *"Examining these sixteen products-which were cartelised at some point during the 1990s and for which we were able to obtain reasonably reliable data the total value of such cartel-affected imports to developing countries was USD 81.1 billion. This made up 6.7 percent of all imports to developing countries. It is equal to 1.2 percent of their combined GDP" (WTO, 2004).*

The price impact of cartels supplying the above mentioned products appeared to have been in the range of 20 to 30 percent on average-implying a total overpayment by developing countries for their imports of something in the order of USD 10 to 24 billion annually (WTO, 2004).

Consumers' Surplus

Consumers' surplus is a measure of consumer welfare and is defined as the excess of social valuation of product over the price actually paid. It is measured by the area of a triangle (Pc- c-a) below a demand curve and above the observed price as shown in figure 2.3 below.

Figure 3.1: Consumer surplus under perfect competition



Source: Sloman, 2004

Under Perfect Competition the industry will produce an output of Qpc at price Pc, where MC = P (=AR): i.e. at point *a*. Consumers' total benefit is given by the area under the demand curve. The reason for this is that each point on the demand curve shows how much the last consumer is prepared to pay (i.e.

[2] The report further gives reference to Levenstein and Suslow (2001)

the benefit to the marginal consumer). The area under the demand curve (D) thus shows the total of all these marginal benefits from zero consumption to the current level, therefore total benefit. Consumers' total expenditure is Pc *X* Qpc. The Consumer surplus is the difference between total benefit and total expenditure, in other words between the price and the demand curve. Pm and Qm are monopolistic price and quantity respectively. It is also important to note that profits are maximised when MR= MC.

Consumers' surplus is a widely used measure of consumer welfare because it only requires information on the demand curve (prices and quantities). However, there is considerable debate over the degree to which it corresponds to more theoretically appealing measures of consumer welfare. In general, consumers' surplus is more useful the lower is the income elasticity of demand.

Consumer welfare

Consumer welfare refers to the individual benefits derived from the consumption of goods and services. In theory, individual welfare is defined by an individual's own assessment of his/her satisfaction, given prices and income. Exact measurement of consumer welfare therefore requires information about individual preferences. In practice, applied welfare economics uses the notion of *consumer surplus* to measure consumer welfare, which has been presented above.

3.2 Some Empirical Studies on Effectiveness of Competition

3.2.1 Economic Welfare Analysis

Total surplus (total economic surplus) or social welfare/economic efficiency (Hausman, 1999).

TS = CS + PS

Where,
TS = Total Surplus
CS = Consumer Surplus
PS = Producer Surplus

Consumer Surplus is the aggregate amount of by which consumers' valuation of a good – the amount they are willing to pay – exceeds the price they must pay for the good;

Producer Surplus which is the amount the producer receives in excess of what he must receive to be willing to continue producing the good in question.

The aggregate of consumer and producer surplus is total surplus – the amount which society's valuation of a good exceeds the good's cost.

When the price of good rises, consumer surplus declines for two reasons (Hausman, 1999):

- Some consumers cut back their purchases of the good, so less quantity is demanded. Although those consumers may purchase substitute goods, overall welfare still declines by the degree to which substitute goods yield less consumer satisfaction.

- Consumers who continue to purchase the product receive less surplus than before the price increase.

When prices rise due to inclusion of a regulatory surcharge or a tax, producer surplus also decreases as less output is sold. The net welfare reduction resulting from a price increase is referred to as "deadweight loss"

3.2.2 Market Concentration and Prices

A study on the effects of Market Concentration, Mergers, Hospital Costs and Prices (Connor, 1998) in USA, indicated a shift away from non-price competition toward price competition in health care markets; that this shift was fueled by increased market penetration by price-sensitive buyers. The horizontal hospital mergers produced average cost savings of approximately 5%, which were generally passed on to consumers as lower prices; and that some evidence that post-merger price reductions were smaller in less-competitive markets.

Antitrust advocated were concerned that increased concentration in hospital markets can give the remaining hospitals oligopoly power, reduce competition, and result in increased consumer prices. That the mergers in already –concentrated markets have heightened potential for collusive pricing.

3.3 Tanzania Case

The Fair Competition Commission has administrative taken up some cases since 1998, such include in the areas of: Mergers and acquisitions, Advise to Communication Authority on Cell Phone Operators, Brewery Industry, Drinking water, Textile industry, Petroleum industry operators and supermarkets. The outcomes have been positive in most areas.

4.0 CONCLUSION AND RECOMMENDATIONS

Tanzania is very new in competition and economic regulation. The Tanzania Competition law has been designed so as to create a implementation institutions that have autonomy, transparency, accountability in order to be credible to stakeholders. More benefits to consumers and operators will be achieved as relevant organizations become more vibrant.

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