STUDY OF MONOPOLIES AND COMPETITON POLICY IN ZIMBABWE

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Final Report

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Acronyms

AG	Attorney General
CPI	Consumer Price Index
CR4	Four Firm Concentration Ratio
CSO	Central Statistics Office
DoJ	Department of Justice (US)
ERS	Export Retention Scheme
ESAP	Economic Structural Adjustment Programme
GDP	Gross Domestic Product
GNP	Gross National Product
GOZ	Government of Zimbabwe
HHI	Hirschman-Herfindahl Index
IMF	International Monetary Fund
IPC	Implementing Policy Change
ISIC	International Standard Industrial Classification
OGIL	Open General Import License
PCM	Price-Cost Margin
PE	Public Enterprise
RBP	Restrictive Business Practice
SME	Small and Medium Scale Enterprise
SITC	Standard International Trade Classification

UDI	Unilateral Declaration of Independence
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
ZANU	Zimbabwe African National Union
ZIC	Zimbabwe Investment Centre
ZUPCO	Zimbabwe United Passenger Company

PREFACE

This report is submitted to the Inter-Ministerial Committee on the Monopolies Commission, Government of Zimbabwe, by a team of consultants funded by the Implementing Policy Change project, a USAID project.

The consulting team is comprised of: Mr. Anthony Davis, Competition Specialist/Team Leader (Abt Associates); Dr. Clive Gray, Restrictive Business Practices Regulation Specialist (Harvard Institute for International Development); Dr. David Gordon, Political Economist (Abt Associates); Mr. William Kovacic, Legal/Judicial Specialist (George Mason University School of Law); Dr. Eugenia West, Business Economist (consultant); Mr. David Hatendi, Zimbabwe Economics Specialist (Merchant Bank of Central Africa); and, Mr. Andrew Chataika, Zimbabwe Economics Specialist (Merchant Bank of Central Africa).

The consulting team is greatly appreciative of the guidance provided by the Inter-Ministerial Committee, and the assistance received from the many groups contacted in Zimbabwe and from the USAID mission in Zimbabwe. Any errors or omissions in the report are the sole responsibility of the consulting team.

STUDY OF MONOPOLIES AND COMPETITION POLICY IN ZIMBABWE

EXECUTIVE SUMMARY

1.0 Objectives of the Study

The objectives of the study were to:

- Assess and analyze industrial concentration, restrictive business practices (RBPs) and regulation in Zimbabwe, and the impact of ESAP (Economic Structural Adjustment Programme) on RBPs and their regulation.

- Identify and analyze worldwide experiences with regulating RBPs, especially within the context of simultaneously introducing structural adjustment programs, so as to draw implications for Zimbabwe.

- Recommend policy actions and institutional, legislative and procedural options to regulate market power and RBPs in Zimbabwe.

The scope of the study included assessment of:

- A wide range of restrictive business practices, irrespective of whether these were undertaken by monopolists or by firms in unconcentrated industries.

- Commercial, services and financial sectors in addition to the manufacturing sector, which was the main focus of the study.

- Parastatal monopolies (statutory and non-statutory) and enterprises of mixed private-public ownership, in addition to private firms.

2.0 Conduct of the Study

The study was conducted by a team of seven specialists: a competition specialist/Team Leader; an RBP regulation specialist; a judicial/legal specialist; a political economist; a business economist; and, two Zimbabwe economists.

The study was carried out between January and March 1992. Meetings were held in Zimbabwe during the month of February with members of government, the private sector and academia. In addition, selected interviews on competition policy and RBP regulation were conducted in the United States, the United Kingdom and Switzerland. A literature search was also conducted to facilitate the team drawing upon the competition policy experience of other countries.

3.0 Main Findings and Conclusions

The main findings and conclusions of the study are presented below.

3.1 Degree of Competition in the Economy

There is a growing concern on the part of both government and the business community that there is a lack of competition in Zimbabwe domestically and that its industries are internationally uncompetitive. Four factors when taken in concert tend to support these concerns: (i) the existence of high levels of concentration in most industrial sub-sectors; (ii) the low level of investment and the consequent lack of change in the industrial and corporate structure over an extended period; (iii) the lagging growth of exports; and, (iv) the continuing loss of skilled personnel, especially to other countries in the region.

The degree of competition in the economy is largely a function of the level of concentration in and barriers to entry in a given sub-sector. The manufacturing sector in Zimbabwe is highly concentrated.

- Of the 7,000 plus items produced in Zimbabwe, half of these items are produced by only one producer. Approximately 80% of all items are produced by three firms or less.

- Analysis of the four firm concentration ratio -- CR4 (which is the proportion of output originating from the four largest enterprises), reveals that of the 57 industrial sectors at the four-digit industrial classification level (ISIC) in 1989/90:

    - 45 industrial sectors, or nearly 80% of all sectors, have concentration ratios equal to or in excess of 75%, a level which is considered highly concentrated or oligopolistic.

    - 12 industrial sectors, or over a fifth of all sectors, have concentration ratios of 100%, indicating that there are four firms or less in the entire industry.

    - Only 7 sectors have concentration ratios less than 50%.

- Analysis using the Herfindahl index, a more precise and increasingly preferred measure of concentration, further indicates the high degree of concentration.

    - Pure competition is denoted by an Herfindahl of 0 and a pure monopoly by 10,000. Industrialized nations consider industries with indices above 1,800 as being highly concentrated and likely to be uncompetitive, and industries with indices of 1,000 or above as fairly concentrated and potentially uncompetitive.

    - In Zimbabwe, of the 57 industrial sectors, 46 have indices above 1,800, and 49 above 1,000. Five industries are pure monopolies with a Herfindahl index value of 10,000.

- These results using both the CR4 ratio and the Herfindahl index may in fact understate the degree of concentration given that the industrial data at the 4-digit level is a fairly aggregate measure.

- In addition, many major industrial groups have close relations with each other, either through direct equity holdings or through cross-directorships, indicating further concentration of ownership and/or control.

Several non-manufacturing sectors are also highly concentrated in Zimbabwe, such as urban passenger transport and banking.

A large number of commercial and services sectors are dominated by parastatals, which have the sole right to provide a given good or service, or are placed in a "privileged" position. For example, purchase and sale of cotton, purchase and importation of grains, marketing of most minerals, and broadcasting are all monopolies run by parastatals.

There have been significant <u>barriers to entry</u> in Zimbabwe in the past. These have served to increase or maintain high levels of industrial concentration, preclude entry by other firms, and have furthered the creation of uncompetitive market structures which serve to increase prices and restrain output to the detriment of consumers. These barriers have taken many forms.

- <u>Government-erected barriers to entry</u> have been particularly significant. These have included an extensive system of price controls, strict labor market regulations, foreign exchange controls and trade policy, and direct ownership of sectors of the economy through public enterprises.

- <u>Industry structure</u> barriers such as limited supplies of raw materials, economies of scale and scope, and product differentiation and brand loyalty. Existence of many of these barriers was facilitated either by government regulations, and/or the smallness of the Zimbabwean domestic market combined with high levels of protection and insularity.

- <u>Business practices</u>, such as price fixing, collusive tendering, tied sales, and allocation of market and customers, which have acted as barriers to entry.

While the combination of a high degree of industrial concentration and high barriers to entry does not automatically lead to abuse of market power by monopolists and oligopolists, the scope for exercising such power exists. There is some evidence and good reason to believe that RBPs are extensive in Zimbabwe.

<u>Restrictive business practices</u> by their very nature are difficult to prove without extensive industry specific analysis, and with the major reforms contemplated under ESAP, the usefulness of assessing past experience with RBPs is doubtful. Nonetheless, there is evidence to infer that RBPs are pervasive in Zimbabwe in both concentrated and unconcentrated industries.

- The high level of industrial concentration itself implies that the scope for RBPs is extensive. In other countries, industries with Herfindahl indices greater than 1,800 are considered to have a strong likelihood that RBPs are present. In Zimbabwe, more than 80% of industries exceed the 1,800 threshold.

- RBPs are reported to be pervasive by many groups in Zimbabwe -- government, private companies, and industry associations. This conclusion is based on: (a) interviews with over 50 different groups in Zimbabwe conducted during February 1992; and, (b) six researched cases studies on selected industries in tradeable and non-tradeable sectors.

  - The most pervasive RBPs include price fixing/collusion, collusive tendering, tied sales, discriminatory professional practices, and area restriction. These occur irrespective of whether a given industry is concentrated or not, and are not highly correlated with concentration.

  - Many of these RBPs are reactions to, and were exercised because of, the highly controlled environment that has faced Zimbabwean industry. For example, price collusion was fostered in part by the need to apply for price control modifications, and tied sales are made possible largely because of the scarcity of such commodities such as cooking oil, sugar and rice.

- However, firms in industries of higher concentration do not necessarily command higher margins. The correlation of Price-Cost Margins (PCMs) to either the Herfindahl index or CR4 concentration ratio is not significant in Zimbabwe.

  - The absence of any relationship between market power and profitability is most likely due to the impact of government price controls on a wide range of final and intermediate manufactured products, which has prevented enterprises from reaping high profits as a result of their high levels of market power.

- Industry entry and exit rates for manufacturing sectors (at the 4-digit level) over the period 1970/71 through 1989/90 have largely been stagnant, suggesting that the number of firms operating in the given subsector has not changed significantly over time. This tends to indicate that incumbent firms enjoy and/or have erected barriers to entry.

  - However, available entry/exit data does not permit analysis of whether it is the same firms which remain in a given subsector over time, nor whether the sector has low levels of profitability and thus potential new entrant's interest was dampened.

3.2 Government Regulation and Control of RBPs and Abuses of Market Power

Although few explicit regulations exist to control RBPs or abuse of market power, the government has pursued policies in the past which limited firms' ability to benefit from their market power.

- No laws currently exist which serve to control RBPs in Zimbabwe. Up until 1989, there were some general provisions countering certain forms of horizontal price fixing and conditional selling (tying) arrangements, but these are largely no longer in effect and were never widely enforced.

- The government has pursued four policies in the past which, among other objectives, have served to limit abuse of market power:

  - The first, and most important, was extensive price controls. Prices for "essential" products were determined directly by the Cabinet; those for "strategic" products were determined by the Ministry of Industry and Commerce; while prices for remaining consumer goods were determined on a cost-plus basis.

  - The second was intervention by the government to fix wages and salaries and limit the ability of firms to release workers. This policy had both "redistribution of rents" and anti-inflationary aims. In the early years of independence, it led to sharp wage rises that could not be easily passed on, due to price controls.

  - The third was the informal use of the foreign exchange allocation mechanism as leverage to keep firms from getting out of line. The lack of transparency and automaticity in the allocation of foreign exchange has been an important instrument of government influence over the business community.

  - Finally, the government sought ownership in the industrial sector in part as a way to "counter" the influence of private sector monopolies and oligopolies, as well as to reduce South African influence in the corporate sector. While there are only a few public monopolies in the productive sectors, there is extensive government equity participation, including large shares in some of the leading industrial conglomerates. However, government ownership by no means guarantees that monopoly rents will not be sought by the government entity.

The government's past efforts at intervention in response to the monopoly and oligopoly situation substantially achieved its aims, but did so at great costs.

- On the positive side, monopoly profits have been effectively limited, and the evidence of foreign-owned firms repatriating excessive profits is almost nil. Wage differentials diminished. At the same time, inflation was limited and some price stability and predictability achieved. There is no question that government achieved substantial influence over the business environment.

- On the negative side, in general, the pattern of regulation erected high barriers to entry, which served to freeze the existing industrial and corporate structure. Price controls and labor regulations, in particular, increased the risks that potential new entrants faced. The foreign exchange allocation system and industrial licensing system both deterred new entrants and gave a powerful incentive for existing firms to engage in collusion and other restrictive business practices. The growing barriers to entry reinforced the already existing incentives for firms to concentrate on the domestic market, while limiting the pressure on firms to maintain and improve the quality of their goods. Incentives for new investment were limited. Finally, the substantial public equity in large conglomerates, perversely, created a governmental stake in the maintenance of the status quo.

3.3 The Effects of ESAP on Competition

The ESAP, as envisaged, will substantially alleviate the RBP and abuse of market power situation in Zimbabwe. However, important instruments for regulation, particularly price control, will be lost. Four major elements of the ESAP are intended to liberalize the economy and substantially improve the competitive environment: (i) trade liberalization; (ii) price decontrol; (iii) domestic deregulation; and, (iv) parastatal reform and privatization.

- Trade Liberalization. The lowering of trade barriers, removal of exchange controls and reductions in restrictions on foreign investment will allow the discipline of international competition to be exerted, provide greater export market opportunities and expand the relevant market for domestic firms, and widen consumer choice.

- Price Decontrol. The removal of price controls will mean the loss of an important instrument of government control over RBPs, but will allow prices to be set by market forces. In the absence of other externalities, this will improve efficiency in the allocation of resources to the benefit of producers and consumers alike.

- Domestic Deregulation. The reduction in the level of domestic regulation of business (e.g., labor laws, investment regulations, licensing) and the streamlining of procedures will reduce the cost of doing business, increase business confidence and lower risk, and enhance market entry of new firms.

- Parastatal Reform and Privatization. Increasing the size and the role of the private sector through privatization and encouraging parastatals to operate more commercially will increase the degree of competition in the economy overall, and decrease market imperfections and the level of direct and indirect subsidization.

The structural adjustment program will thus create an entirely new environment for government's efforts to regulate monopolies and oligopolies.

3.4 The Need for Explicit Competition Policy

Specific RBP policy and regulation is still likely to be needed in addition to ESAP reforms, in order to guide the transition to market forces, provide a code of conduct, and alter market structure where required.

- Even in a post-ESAP period, certain monopolies and RBPs are likely to persist and will require some form of regulation and control. While government-created regulations that accentuate concentration and the scope for RBPs can be removed, some monopolies will still remain due to economies of scale or other aspects of industry structure or technology. It is the experience of most countries that these so called "natural" monopolies require regulation. Utilities and telecommunications are typically in this category. Industry specific regulatory bodies are usually set up to counter abuse of market power by these entities.
    - RBPs will still exist because it is the natural tendency of most companies to engage in, where permitted, some collusion or other form of restrictive business practice. Economies such as the Germany, the United States and Canada, have relatively open trade systems and market-based economies, yet still felt the need to create stringent and complex RBP-related regulation and enforcement regimes.
- Some regulation and advocacy role is required to ensure that the competition enhancing aspects of ESAP come into full force in a coherent and coordinated fashion.
    - Domestic deregulation elements of ESAP particularly need better specification and implementation so as to lower entry barriers and enhance competition. Equally essential will be full implementation of plans to expand the export retention scheme and OGIL, provide export incentives, and reform and privatize public enterprises.
- RBP regulation is also required to guard against RBPs and other abuses of market power during the transitionary period while ESAP is being implemented.
    - For example, as price decontrols advance ahead of trade liberalization, domestic incumbents will have the scope for price gouging in the interim, as effective foreign competition may be slow to materialize, either because it takes time for foreign firms to set up domestic operations which can compete effectively, or because the sharp devaluation of the Zimbabwean dollar has made imported goods less competitive on the domestic market.

It is in this context that the government has decided to look at alternative mechanisms for monopoly and oligopoly regulation, and at the general issue of competition policy.

3.5 Key Dimensions of Competition Policy

Implementation of an effective competition policy in concert with the ESAP will be needed to create a competitive industrial structure.

The main focus of competition policy is to: (a) ensure that reforms in government policy and regulations that positively affect competition and competitiveness are well designed and fully implemented; (b) provide a code of conduct for businesses which establishes the "rules of the game" by which private exchange through market forces should occur; and, (c) alter market structure through appropriate monopoly and mergers and acquisitions regulations, in situations where the economic benefits outweigh the costs. In the context of ESAP, implementation of such a competition policy will: (a) improve productivity; (b) promote innovation; (c) facilitate new entries; (d) stimulate export performance; and, (e) enhance consumer sovereignty.

The explicit goals addressed by competition policy varies by country, and depends on the overall objectives of government and the nature and structure of the economy. In the case of Zimbabwe, the competition policy goals might, at a minimum, include the following.

1. Protect consumer welfare.

2. Promote economic efficiency and international competitiveness.

3. Expand the base of entrepreneurship.

The focus should be to enhance the degree of competition in domestic markets and the competitiveness of Zimbabwean producers vis-a-vis the world market. As a result, Zimbabwe should adopt a policy that strives to achieve the following objectives.

- Enhance competition among domestic producers in a given branch, to oblige some or all of them to reduce unit costs, offer their products to domestic consumers at lower prices, and in the process, become more competitive on the world market, both in exporting and competing with imports.

- Enhance competition among domestic producers in their purchase of domestic inputs, to oblige them to offer "fair" prices to local suppliers.

- Allow, in branches where efficiencies are attainable through economies of scale which outweigh those attainable via competition among multiple producers, one or more of these to attain sufficient size to exploit such economies, even if the number of viable producers is thereby reduced.

- Facilitate the formation of producing and trading units of sufficient economic power to absorb the overhead costs of breaking into new markets, including both export markets and domestic markets hitherto dominated by imports.

- Prevent large producers from abusing their market power to destroy or hamper the growth of efficient smaller enterprises.

The primary means for achieving these goals and objectives are to:

1. Lower barriers to entry; and.
2. Reduce restrictive business practices.

Restrictive business practices and barriers to entry emanate from three principal sources.

1. Policy, regulatory and institutional environment.
2. Anti-competition business behavior.
3. Market size and structure, and the nature of technology.

The extent to which government can exercise control over the remedial actions required in each of these areas decreases as one moves down the list.

- While not easy to put in place, it is fully within government's control to change the policies, regulations and institutional arrangements which have served in the past to limit competition.

- The behavior of businesses can be regulated, but creating and operating an effective competition system to accomplish this is not an easy task and will take time to develop. Even in its mature stages, the competition system will be unable to detect all occurrences of restrictive practices or to enforce restrictions on all offenses that are brought to its attention.

- Economies of scale change very little over time and will remain a barrier to entry, particularly in an economy as small as Zimbabwe's. The economic benefits of breaking up companies in industries which are subject to economies of scale are minimal, and should not be undertaken lightly.

3.6 Principles of Competition Policy

Experience in countries around the world and a preliminary review of the situation in Zimbabwe, suggests that a number of key principles and guidelines should be considered while formulating competition policy.

- The purpose of competition policy is to protect the process of competition not individual competitors. Emphasis should be placed on reducing all entry barriers and restrictive business practices irrespective of which groups they affect.

- Parastatals and other government entities should be subject to the same set of competition policies and regulations as private companies. This is particularly important in Zimbabwe where: (a) the government owns or controls a high share of productive capacity; and, (b) a main objective of ESAP is increased reliance on market forces. The transition to greater reliance on market forces is almost meaningless if the majority of the market is not subject to these forces, and the private sector is dealt with in a discriminatory fashion.

- It is the abuse of market power or dominant position which reduces the degree of competition, not high market share or being a monopolist or oligopolist, per se. Just because a monopoly or oligopoly exists does not mean that harm is being done to the economy. In fact, in the case of economies of scale, the economic benefits may far outweigh any costs.

- An open trade system is not a substitute for competition policy, because: (a) not all goods are inherently tradeable; and, (b) introduction of foreign competition may reduce the degree of concentration, but does not necessarily limit the scope for collusion or other RBPs.

- The forces of competition should be allowed to "drive" inefficient, uneconomic entities out of business. Much of the benefit of an open, competitive economy is the increased pressure on producers to become efficient. This will accelerate the modernization of Zimbabwe's industrial base and enhance its international competitiveness. Government should encourage such modernization, and not subsidize or protect inefficient producers.

- Transparency and impartiality in the competition system is a pre-requisite for its success. It is essential for the business community to have confidence in the competition system, and perceive it as a facilitator of the competitive process, not a hinderance to efficient business operations. Generating such credibility is particularly important in the early years of developing the competition system.

- A successful competition policy will rely just as much on effectively performing pro-competition and advocacy functions of the system, as the elements which combat RBPs and uncompetitive actions. In this manner, the full competition impacts of ESAP will materialize.

3.7 Means for Implementing Competition Policy

The instruments and action areas required to build and operate a competition system include the following.

1. Creation and/or strengthening of institutions charged with executing both the pro-competition advocacy and the "prohibition" functions of the competition system.

2. Enactment of legislation to: (a) create laws governing RBP and abuse of market power offenses; (b) legally constitute the institution(s) charged with executing competition policy; and, (c) provide the requisite institution(s) with the legal power to enforce the laws governing RBPs.

3. Development of procedures to guide the "day to day" operations of the institutions and/or legislation which make up the competition system.

4. Provision of the training and technical assistance required to develop and sustain the institutional, legislative and procedural elements of the system.

In designing a competition system, it is important to note the following from the outset.

- A competition system is not and should not be static. It should evolve over time, as required.
  - A prudent path to take may involve adopting in the first instance a few simple laws and strengthening an existing institution, and as experience is gained and more resources become available, a more robust set of institutions and laws can be contemplated.
  - It takes many years to establish a fully developed competition system. Creating a competition system takes time, cannot not be adopted wholesale from another country and must be tailored to the specifics of the country in question. This requires a large element of "learning by doing".
- There are risks and costs associated with either selecting an inappropriate competition system or poorly implementing an apparently appropriate one. Government must be committed to providing resources, ensuring the transparency of procedures, and maintaining independence from the influence of special interests. A competition system which is either poorly equipped technically and/or which is not independent from special interests may do more economic damage than good. A poorly designed and/or implemented system may also undermine ESAP reforms and erode confidence that the reforms will lead to reliance on market forces.
- Creation of a full-fledged Monopolies Commission is not a pre-requisite for establishing an effective competition system, and in Zimbabwe's case may be one of the least desirable courses of action in the nearer term. A wide range of options exist for developing an effective competition system.

3.8 Institutional Options

Several types of institutions can be envisaged under the broad category of a competition system.

1. Institution(s) charged with "prohibition" functions such as combatting RBPs (largely those exerted by businesses) and taking action to change market structure (monopolies, mergers and acquisitions).

2. Institution(s) which perform a pro-competition advocacy function, particularly to address actions of government which have, inadvertently or otherwise, led to a reduction of competition and competitiveness.

3. Institution(s) created with the explicit role of protecting consumer interests, such as a Consumer Protection Agency.

4. Institution(s) charged with assisting groups judged to be disadvantaged vis-a-vis competition, and worthy of special assistance.

Five main models for executing the "prohibition" function, are as follows:

1. Do nothing (no new laws, no new institutions) other than fully implement ESAP reforms.

2. Create new competition laws, with enforcement conducted through private cause of action, but no public enforcement apparatus being created.

3. New competition laws and public enforcement through an RBP Division of the Attorney General's Office.

4. New competition laws with public enforcement by means of a Competition Commission resident within an existing Ministry.

5. New competition laws with public enforcement by means of an independent Competition Commission.

Model 3, perhaps combined with provisions to allow private cause of action in addition to public enforcement, is the IPC Team's recommended model.

- The ESAP-only model is insufficient, as argued above, because RBPs are likely even after a full and successful implementation of ESAP -- worldwide experience supports this conclusion.

- The legal basis and procedures for creating private cause of action as a means for enforcing RBP laws is limited -- thus, Model 2 would be difficult to implement and insufficient.

- Models 4 and 5 are pre-mature given in that they are resource-intensive, and the extent and nature of the competition problems in a post-ESAP period are still not known with precision.

An institution with a pro-competition advocacy function should, under any circumstance, be created as a matter of priority. An institution charged specifically with a consumer protection function, as important as it is, may best be put in place at a later date, particularly given resource constraints. Assisting small, black entrepreneurs to become competitive is a priority of government, and new institutions and mechanisms are needed. However, removing barriers to entry overall, irrespective of which groups they affect, should be a first priority.

3.9 Legal Dimensions of Competition Policy

Choices regarding the legal complexion of a competition system are not independent of the institutional model(s) chosen. However, existence of a strong legal system can serve to limit the extent to which new institutions need to be created. The legislative component of a competition system can include three broad functions:

1. Create laws governing RBP and abuse of market power offenses.

2. Legally constitute the institution(s) charged with executing competition policy.

3. Provide the requisite institution(s) with the legal power to enforce the laws governing RBPs and abuses of market power.

While there are numerous issues related to the legal elements of the range of competition systems presented above, four issue areas particularly need to be addressed.

1. Scope of Law. Which groups should be subject to the law? What set of specific RBP and market structure laws are to be enacted? How many RBP and market structure areas are to addressed? Which laws are to be treated on a per se basis versus rule of reason? How should the number of laws enacted and their treatment change over time?

2. Means of Enforcement. Which entity or entities will have the right of enforcement of legal statutes? What set of remedies and penalties will be available? Should any competition-related offenses be considered criminal actions? How will treatment vary between civil versus criminal proceedings?

3. Legal Recourse and Rights of Appeal. What recourse and on what basis will parties have the right to appeal legal decisions? What procedures and which institutions should be involved?

4. Legal Constitution of Entities. Which entities should be legally constituted to perform the various functions of a competition system? What alternatives exist for creating such institutions and what are the implications?

4.0 Recommended Next Steps

Reforms in addition to those in ESAP will be required to enhance domestic competition and international competitiveness and to address RBPs. A strategy for moving forward needs to be developed in the context of resource constraints and the practicalities of an implementation process.

- The implementation of ESAP reforms is proceeding behind original schedule. Owing to a variety of reasons (most prominently, the food crisis occasioned by the lengthy drought), it is conceivable that some key ingredients of ESAP, particularly aspects of domestic deregulation and public enterprise restructuring and privatization, may not be in place for several years. This means that there necessarily will be a substantial lag before ESAP-generated forces of competition fully come to bear upon the economy and create robust, self-correcting market forces to promote efficiency and dissolve impediments to entry and expansion by new enterprises.

- Experience in numerous other countries, both developed and less developed, indicates that firms will continue to attempt to engage in certain forms of RBPs -- notably, horizontal price-fixing and collusive tendering -- even if ESAP were fully implemented today. In short, though ESAP could go a great ways toward diminishing the frequency and seriousness of RBPs, they are very likely to remain. This will call for further public policy response.

- Zimbabwe faces stringent resource constraints. Establishment of new competition policy, institutions and legislation will tax these limited resources further. The imperative to reduce civil service employment levels will make public officials wary about committing substantial resources to the creation of a new government entity. At least for the coming few years, the development of a new competition system is likely to take place under conditions of austerity.

- There is a strong sense within the government and within important segments of the private sector that, notwithstanding resource constraints and the press of other national business (such as implementing ESAP and combatting the drought), it is important to proceed in the near term with the development of a new competition system.

Given the above objectives and constraints, a strategy for establishing an appropriate competition regime should proceed in phases that take into account resource limitations and time lags associated with putting the necessary foundations for authority in place. Past experience in Zimbabwe suggests that building effective institutions and enacting appropriate legislation will be a deliberate and lengthy process. The following framework is proposed as one way to achieve the government's aims, as it implements ESAP and copes with resource limitations.

4.1 Immediate Steps

The first area that needs to be addressed is development of an overall competition policy. This should set out goals and objectives, provide an overall strategy for installing an appropriate competition system, and guide the further development of the institutional and legislative means for executing the strategy. A competition policy statement should be produced as early as possible by government. It should be widely disseminated, forming the base of a business code of conduct.

Secondly, institutional and legal components need to be put in place. Two broad functions should be addressed: (i) pro-competition advocacy to promote competition; and, (ii) an enforcement capacity to address restrictive business practices. The IPC Team recommends that the institutional means for executing these two functions be kept separate. A Competition Council should be created to perform the pro-advocacy function. In the first instance, the Attorney General's office should be enhanced institutionally to enforce prohibitions against RBPs.

- The early tasks of the Competition Council are to reduce barriers to entry, particularly those which result from government action, create a "level playing field," and stimulate domestic competition. It should act as an advocate for competition, and address itself to government, business and society at large. One of its main roles should be to help ensure that competition aspects of ESAP are appropriately specified and are well implemented.

- The enhanced Attorney General's office in the early phase should focus on combatting restrictive business practices. It should enforce a limited set of simple statutes covering the most obviously detrimental RBPs and try them on a per se basis.

Creation of the Competition Council and enhancement of the AG's office will require action in three areas: (i) institution building and strengthening; (ii) legislation; and, (iii) training.

- The Competition Council needs to be created as an institution and appropriately staffed, and the AG's office will need new staff to perform the specific RBP-related functions.

- Legislation will be required to put in place statutes covering the initial set of most evidently abusive RBPs for treatment on a per se basis, as well as to legally institute the Competition Council and to give the AG's office enforcement powers related to RBPs.

- Training will be needed in several areas. Economics and legal staff at both the Competition Council and enhanced AG's office will need training in monopolies, competition and RBP related areas, as will judges in the high courts and to a lesser extent in the Supreme Court.

In the longer term, depending on the success of the initial strategy recommended above and the overall success of ESAP, the competition system will probably evolve. For example, the AG's office might progressively enforce more complex statutes addressing an expanded set of RBPs and try cases increasingly on a rule of reason basis. Progression to this level would depend on the success of the early efforts in combatting RBPs and would only be possible as a result of the increased experience of the AG's office, private sector and government in RBP issues and the growing body of legal cases from which to draw precedence.

4.2 Specific Action Plan

The following action program, with ten key steps divided into three phases, should be undertaken to implement the initial phase of the strategy recommended above.

- Phase I would occur in the first 6 months of the program. The four key steps are to:

    1. Develop an overall competition policy to guide further evaluation of institutional, legislative and procedural options.

    2. Design a Competition Council, to perform a pro-competition advocacy function and ensure that the full competition effects of ESAP materialize.

    3. Draft legislation covering an initial, limited set of most evidently abusive RBPs for treatment on a "per se" basis.

    4. Assess training needs in monopolies and competition related areas for the Competition Council, enhanced Attorney General's office, and the court system (High and Supreme).

- Phase II should be executed between months 6 and 12, and include the following four key action items.

    5. Start the training activities, as identified in action item 4 above.

    6. Create, staff and begin the operation of the Competition Council, as designed in action item 2 above.

    7. Submit RBP legislation, as drafted in item 3 above, to Parliament for consideration and approval.

    8. Conduct institutional strengthening design of the enhanced Attorney General's office, so it has the capacity to investigate and try RBP cases.

- Phase III should be started by about the 12th month, assuming Phase I and II are on schedule, and should include two main action items.

    9. Enact the legislation covering an initial, limited list of RBP abuses, as approved in item 7 above.

    10. Create and staff the enhanced Attorney General's office, as designed in item 8 above.

CHAPTER 1

INTRODUCTION

1.1 Political-Economic Background

In 1965, the white minority government of Ian Smith and the Rhodesian Front unilaterally declared its independence from the British Crown. Fifteen years later, after the imposition of international economic sanctions and a bitter war of national liberation, the Rhodesian regime was forced to the negotiating table. During internationally-sponsored talks, a democratic political framework was agreed upon by all parties. Elections were subsequently held, and, in April of 1980, Zimbabwe gained its independence under an African nationalist regime dominated by the Zimbabwe African National Union (ZANU). Robert G. Mugabe, leader of ZANU, became the prime minister of the newly-independent state.

At independence in 1980, the new state of Zimbabwe inherited one of the most advanced and diversified economies in all of Africa. The backbone of the economy was the commercial farming and livestock sector, made up of some 6,000 European farmers and ranchers, that produced a wide range of crops and livestock products for both local consumption and for the export market. While agriculture contributed only about 12% of GDP (reflecting the relatively advanced structure of Zimbabwe's economy), it provided employment to nearly 300,000 workers, produced over one-quarter of all exports, and enabled the country to maintain food self-sufficiency.

The new state of Zimbabwe also inherited a diversified mining sector, including asbestos, chrome, coal copper, gold, nickel, iron, and silver. Mining contributed some 8 or 9 % of GDP, and was also an important source of both employment and exports. It was in the extent and diversity of the manufacturing sector, however, that Zimbabwe differed the most from other African countries. At the time of independence, industry provided nearly one-quarter of GDP, while employing some 160,000 workers. The industrial sector was in itself highly diversified, with strong sub-sectors in foodstuffs, chemicals, and metal products among others. In all, some 7,000 different products were produced.

At independence, Zimbabwe's diversified productive base was supported by a relatively advanced financial system, including commercial banks, merchant banks, insurance companies, and a stock exchange. Zimbabwe also inherited a well developed infrastructure including an inter-urban road network, rail lines tieing the country into the extensive central and southern African rail network, and an electrical power grid mainly generated by the Kariba Dam, which limited the country's dependence upon imported petroleum.

But, if newly-independent Zimbabwe inherited an advanced and diverse economic structure, it was, at the same time, a country marked by an extraordinary degree of racial inequality. In 1980, the white population (which at its peak had comprised only 5% of total population) of a little over 200,000 owned nearly one-half of all agricultural land and completely dominated the commercial and industrial sectors. The whites had utilized their control of all existing governmental institutions to direct them to intervene in favor of white interests. While the whites constantly expressed their belief in capitalism, and developed an especially virulent aversion to anything that smelled of "communism", one trenchant observer has described the set of privileges and protections that the Rhodesian government guaranteed them as amounting in reality to a "socialism-for-the-whites."

After the transition to majority rule, the new government of Zimbabwe articulated an approach to economic development and economic policy issues that was shaped by five quite disparate politico-economic themes.

- The first was the need to respond its mass political base by improving the living conditions of, and opportunities for, the nation's black majority.

- The second was the desire to implement ZANU's ideological program, that is, to diminish foreign influence over the economy and to initiate the transformation of Zimbabwe into a socialist economy.

- The third was the realization that the existing economic structure would provide the resources for any radical initiatives, and thus must be sustained.

- The fourth was the commitment to honor its international obligations, especially those involving land ownership and white political representation, undertaken at the Lancaster House peace negotiations.

- The fifth was the belief that gaining control over the existing state structures and, indeed, strengthening the role of the state, was critical for responding to the regime's mass base and for creating a counter-balance to white and foreign influence in the economy.

The evolution of economic policy and, indeed, of economic outcomes in the 1980s reflected the complex interplay of these five themes. In general, the government had tremendous difficulty in reconciling these themes. The conflicting nature of the themes slowed down the policy-making and policy-implementation processes and led to the oft-expressed belief that, in Zimbabwe, no issue was ever "closed". The top political leadership attempted to manage the conflicts among policy themes by appearing to be all things to all people. While this played a useful role in the early years of independence, over time it satisfied no one and led to a general decline in credibility.

Of the five themes, the most straight-forward and the one over which the new government had the most direct control was the takeover and the strengthening of the state structures. It is not surprising, then, that the Africanization of the state and the expansion of many of its various organs progressed at a very rapid rate. Nor is it surprising that the already extensive interventionist role of government in the economy was further strengthened. This was the outcome of the interaction between themes one, two, three and five. Expanding public employment was one of the easiest ways for government to respond to its mass base. While the government sought to control foreign influence and initiate a shift to socialism, they shied away from any aggressive moves towards nationalization, fearing a sudden exodus of white capital and skills. Rather, government viewed the deepening of the regulatory environment as an instrument for achieving their nationalist and socialist goals.

Thus, for a number of reasons, the state sector grew rapidly after independence. Total budgetary expenditures rose from 33 % of GDP at independence (already a substantial figure) to 48 % of GDP in 1990. Interestingly, the expansion of the state in Zimbabwe did not bring with it the "exit" of economic activity into the parallel economy that occurred in so many other African states. That the parallel economy has remained so peripheral in Zimbabwe is a sign of the continuing high level of state influence over economic outcomes. The state's influence over actual economic outcomes may be greater in Zimbabwe than in any other African nation.

The primary way in which the regime responded to its mass base was through the public provision of social services, which expanded rapidly during the 1980s. Primary school enrollments doubled to over 2 million, while secondary school enrollments grew nearly ten-fold. Medical care was extended to millions who formerly had no access to modern treatment. As a result, infant mortality declined sharply and life expectancy has increased. The regime also moved to increase wages and protect workers from being fired, initiated a substantial land redistribution program, and began to aggressively promote expanded maize production on the communal lands through a combination of price incentives and the provision of inputs and extension services.

While the government eschewed policies that immediately threatened the existing economic base, they did little to encourage investment that would expand and deepen that base. Over time, this lack of investment, in and of itself, threatens the economic base. The government's ambivalence about the foreign role in the economy led, in practice, to the creation of barriers to new foreign investment. The Foreign Investment Committee received no clear mandate from government to encourage foreign investment; and so it didn't. The government's very cautious external borrowing policies also limited new domestic investment. Partially driven by a very strong desire to avoid recourse to the IMF and the World Bank, Zimbabwe limited its external borrowing and avoided debt rescheduling. As a result, the availability of foreign exchange to revitalize the country's industrial base was extremely limited. In addition, domestic investors were wary that the government would some day begin to act more decisively on its socialist rhetoric. The outcome of these factors was a very low level of private investment in Zimbabwe for virtually all of the 1980s. By 1987, private sector investment had dropped to only 8 % of GDP. This was despite a quite robust (20 %) rate of domestic savings.

The low level of private investment in the economy was the primary cause of stagnant economic growth throughout the 1980s. Over the course of the decade, economic growth barely matched the population growth rate, meaning that in per capita terms there was virtually no improvement. Since most public investment was in the social sectors (and in taking over certain assets whose South African ownership were deemed politically inappropriate), the large rise in public spending did not translate into sustainable economic growth.

In the late 1980s, the political and economic costs of low levels of economic growth began to accumulate. Unemployment became a major problem. Of the 200,000 young people leaving school each year, only 70,000 are able to find employment in the formal sector. Since the government's strategy on addressing racial inequalities had been based upon "redistribution from growth," it was not surprising that the lack of dynamic growth was generating new political pressures to move much more swiftly and decisively in addressing the continuing very high levels of racial inequality in ownership and control of resources in the country. These pressures have taken two main forms: (i) that the government should move rapidly to shift land ownership from whites to black Africans (whites, who comprise a little more than one percent of the population, still own some 30% of the country's total agricultural land); and, (ii) that government should be pro-active in promoting the growth of black businesses.

On the economic front, the import strangulation has taken an increasing toll on the country's capital stock. Domestic fiscal imbalances also increased. The low level of economic growth meant that the expansion of government spending could only occur through a combination of high levels of taxation and an increasing volume of deficit spending. Government revenues increased from 25 % of GDP at independence to 37 % of GDP by the end of the decade. Despite this, the government had to resort to extensive deficit financing. The fiscal deficit was in excess of 10 % of GDP for most of the decade. As a result, inflationary pressures in the economy were growing, despite government's efforts to suppress inflation through price controls. By the end of the decade, the fiscal situation had become, in and of itself, a constraint to private sector investment.

The low levels of economic growth and the growing external and domestic imbalances interacted with broader changes in the international and regional environment (the collapse of communism in Eastern Europe and the dramatic changes in South Africa) to lead to a major re-thinking of economic strategy by the Zimbabwe government. There was a marked shift away from the prior commitment to creation of a socialist economy, and greater interest in promoting the private sector. The government began to consider what had formerly been unthinkable, an internationally-supported economic reform program. At the same time, there was continued concern on the part of government that the benefits from such a change in policy not simply accrue to the existing business sector who, behind a comfortably protected economic environment, were already earning substantial profits. Thus, at the same time as structural adjustment was put on the government's agenda, so was monopoly and competition policy.

1.2 The Competition Problem in Zimbabwe

The growing concern, on the part of both government and the business community, with the lack of competition in Zimbabwe, particularly in industry, appears to be very well-founded. The existence of a competition problem is highlighted by four features of the current economic scene. Each of them alone would not necessarily imply a problem; taken together, (and especially given their interactive effects) they provide considerable evidence for the existence of a serious competition and competitiveness problem.

- The first is the existence of high rates of industrial concentration in most industrial sub-sectors. Three quarters of the 54 manufacturing industries in Zimbabwe show high levels of concentration. In half of the industries, single enterprises account for over 50 % of total production. The only industry with extensive competition is wearing and apparel.

- The second is the low level of investment and the consequent lack of change in the industrial and corporate structure over an extended period. Structural change in the economy, which was rapid in the period before the early 1970s, has ground to a halt. Compare this with the dizzying evolution of industrial and corporate structure in the highly competitive economies of Asia, where industrial and corporate structure bears little resemblance to that of twenty years ago. The lack of investment has inevitably led to a running down of the capital stock and the loss of any technological edge that may have been present in the past.

- The third is the lagging growth of exports. While exports have grown at a modest rate (4 % per annum) since independence, this is far below the potential that most observers saw at the time. Lagging export growth is the primary cause of the crippling foreign exchange constraint that Zimbabwe has faced. To return to the Asian comparison -- a generation ago, Zimbabwe exports were worth nearly ten times those of South Korea; today, South Korean exports are worth nearly twenty-five times those of Zimbabwe.

- The fourth is the continuing loss of skilled personnel, especially to other countries in the region. This is especially true of newly-trained professionals, whose skills are most advanced and up-to-date. While in the early years of independence these individuals were mainly white, they are now increasingly black. The loss of these individuals is both a sign of the lack of a competitive compensation environment in Zimbabwe, and at the same time has very negative implications for the nation's ability to maintain competitiveness in the future.

To understand how this situation evolved, it is necessary to look at both the pre-independence period and the years since 1980. Initial industrialization in Southern Rhodesia was spurred by: World War II, which by disrupting exports to the colony provided a strong incentive for the growth of local manufacturers; the post-war boom, which stimulated demand for exports and brought a large expansion of domestic demand; and, the formation of the Federation of the Rhodesias and Nyasaland, in 1953, which substantially enlarged the domestic market for Rhodesian industry. By the end of the Federation period, the Rhodesian economy was an extremely open one in which the manufacturing sector exported some 40 % of its production.

The evolution of the country's industrial economy was dramatically changed by the Unilateral Declaration of Independence in 1965 and the imposition of international economic sanctions that followed. In response to sanctions, the Smith regime substantially increased its direct intervention in the economy. Import restrictions were introduced that effectively barred imports that competed with domestic production. Tight control was exerted over all foreign exchange transactions as the government set up a complex system of foreign exchange allocation based on the individual needs of firms and the total foreign exchange available in the economy. Finally, investment controls were set up that restricted all investments utilizing foreign exchange and not producing for the export market. Since Rhodesia's manufactured exports were sharply restricted by international sanctions, the result of investment controls were further protection for domestic industry. The net impact of these policies were two-fold: first, to effectively protect existing firms from either outside or domestic competition; and second, to shift the incentives of domestic industry sharply towards production for the internal market.

After independence, the inherited policy regime served as the basis for the new government's efforts at regulation. While international sanctions (the rationale for the policy regime) were lifted, the new government's nationalism and socialist orientation led it to support the continuation of an extensive regulatory regime. The evolution of the new government's policies were also shaped by the downside of the mini-economic boom that accompanied independence in 1980 and 1981. In those years, the government loosened foreign exchange allocations and imports rose without a corresponding increase in exports as manufacturers responded to growing demand in the domestic market. When the downturn came in 1982, the government found itself with an increasing debt burden and the need to introduce stabilization measures. Rather than take this opportunity to change the entire incentives system so as to achieve external balance through export enhancement, the government responded by strengthening the existing regulatory system. As a result of these experiences, the foreign exchange allocation system was again tightened, while the Reserve Bank reverted to very conservative external financial policies. The resurgence in investment was nipped in its bud and an opportunity was lost to re-capitalize the industrial sector.

The independence government has wielded the regulatory system in a manner different from the Smith regime. In particular, while the Smith regime worked in close cooperation with the private sector, the ZANU regime was wary of business, and sought to ensure that the ability of industry to capture monopoly and oligopoly rents was limited. In particular, the government followed four policies, which among other objectives, counter the ability of monopolies and oligopolies to abuse market power.

- The first, and most important, was extensive price controls. Prices for "essential" products were determined directly by the Cabinet; those for "strategic" products were determined by the Ministry of Industry and Commerce; while prices for remaining consumer goods were determined on a cost-plus basis.

- The second was intervention by the government to fix wages and salaries and limit the ability of firms to release workers. This policy had both "redistribution of rents" and anti-inflationary aims. In the early years of independence, it led to sharp wage rises that could not be easily passed on, due to price controls. This squeezed profit margins and dampened interest in reinvestment.

- The third was the informal use of the foreign exchange allocation mechanism as leverage to keep firms from getting out of line. The lack of transparency and automaticity in the allocation of foreign exchange has allowed GOZ an important instrument of government influence over the business community.

- Finally, the government sought ownership in the industrial sector as a way to counter the influence of monopolies and oligopolies. While there are few public monopolies in the productive sectors, there is extensive government equity participation, including large shares in some of the leading industrial conglomerates.

The Zimbabwe government's efforts at intervention in response to the monopoly and oligopoly situation substantially achieved its aims, but did so at great costs.

- On the positive side, monopoly profits have been effectively limited, and the evidence of foreign-owned firms repatriating excessive profits is almost nil. Wage differentials diminished. At the same time, inflation was limited and some price stability and predictability achieved. There is no question that government achieved substantial influence over the business environment.

- On the negative side, in general, the pattern of regulation erected high barriers to entry, which served to freeze the existing industrial and corporate structure. Price controls and labor regulations, in particular, increased the risks that potential new entrants faced. The foreign exchange allocation system and industrial licensing system both deterred new entrants and gave a powerful incentive for existing firms to engage in collusion and other restrictive business practices. The growing barriers to entry reinforced the already existing incentives for firms to concentrate on the domestic market, while limiting the pressure on firms to maintain and improve the quality of their goods. Incentives for new investment were limited. Finally, the substantial public equity in large conglomerates, perversely, created a governmental stake in the maintenance of the status quo.

The structural adjustment program will create an entirely new environment for government's efforts to regulate monopolies and oligopolies. Price controls are already substantially lifted; over the life of the program, the foreign exchange allocation system will be fundamentally transformed; labor regulations have become much less extensive; and direct public ownership may diminish and some public enterprises will operate on a near commercial basis. It is in this context that the government has decided to look at alternative mechanisms for monopoly and oligopoly regulation, and at the general issue of competition policy. Such an investigation is especially timely given the government's commitment to broaden the basis of entrepreneurship in the country and to ensure that black African businessmen have ample opportunities to participate in industry.

1.3 The Structural Adjustment Program

In 1989, government declared its intention to restructure the economy and promote both private domestic and foreign investment. The government initiated steps to establish a "one-stop" investment center and liberalize controls over the remittance of dividends and profits. In 1990, the government began to develop a comprehensive program for economic reform. Price controls were weakened and labor market reforms were introduced. In July, 1990, the Zimbabwe Investment Centre was created. In early 1991, the government completed its "Framework for Economic Reform", which was presented to the donor community at the March consultative meeting. The Economic Stuctural Adjustment Programme (ESAP) is both a stabilization and a structural adjustment program. The program's central components are: (i) fiscal deficit reduction combined with prudent monetary policy; (ii) trade liberalization; (iii) domestic de-regulation; (iv) public enterprise reform; and, (v) measures to alleviate the impact of the reforms on vulnerable groups. The program is being supported by a World Bank Structural Adjustment Loan and Credit, an IMF Extended Arrangement, and by various bi-lateral donor grants.

In the past year, the government has moved ahead in implementing the program in the difficult circumstances of the Gulf War and the emerging drought. Not unexpectedly, progress in implementation has been uneven. As is the case in most countries, "pure" policy reforms have been easier to implement than reforms that include substantial institutional change. Exchange rate depreciation, for instance, has been undertaken much more rapidly than originally intended; while public enterprise (PE) reform is moving more slowly than anticipated.

Progress on fiscal policy is so far on target, with this year's deficit budgeted to fall to 8.3 % of GDP. The big question is whether the process of trimming the civil service and consolidating the number of government ministries will proceed apace in 1992. On public enterprise reform, progress has been solid on reducing the deficits of the railways and of the dairy and cotton marketing boards. Progress has been much slower on the more general deficit reduction, monitoring, autonomy, and divestiture components of the program. As a result, the overall reduction of direct subsidies to the PEs is behind schedule.

The government has had more difficulty meeting monetary targets, which is not surprising given the limited control government can exert over money creation. Inflation is running well above intended levels, largely the outcome of the maxi-devaluation and the decontrol of prices which unleashed hitherto suppressed inflation. In addition, the bumper tobacco crop necessitated extraordinary financing of the processing of leaf, which also expanded the money supply. On the institutional side, there are both political and technical problems with moving to a more market-driven system. Liberalizing interest rates is especially sensitive politically.

Trade liberalization is designed to gradually replace the current foreign exchange allocation system with an open, free market. This is to be accomplished through a series of interim steps, including exchange rate depreciation, the creation of an open general import licensing system, and an export retention scheme. As the administered system of foreign exchange allocation is phased out, tariffs and customs duties will become the principal source of protection for local producers. Thus far, the most progress has been made on exchange rate depreciation. At the present rate of exchange, the Zimbabwe dollar no longer appears to be over-valued.

The OGIL has expanded much less rapidly than targeted. In addition, detailed planning for its long-term evolution is not yet completed. This is likely to remain the case in 1992, given the government's need to import large volumes of food as a result of the drought. However, the government is committed under the agreement with the IMF to rapidly expand the export retention scheme. This will further limit the effectiveness of the OGIL. On the other hand, if effectively implemented, the export retention scheme promises to be a much more powerful instrument for liberalization of foreign exchange transactions, given that the OGIL has a very restricted range of goods.

Domestic de-regulation is designed to increase domestic competition and provide entrepreneurs with the freedom to respond to market conditions. ESAP encompasses the simplification of investment approvals, lessening controls over profit and dividend remittance, ending price controls, and easing labor regulations. The program also seeks to spur the development of small-scale enterprises and the informal sector. Unlike the other areas of the reform program, the de-regulation component has fewer specific targets.

Implementation of regulatory de-control has been sporadic at best. The Zimbabwe Investment Centre has been caught in legislative limbo, and, as a result, investment proposals continue to be caught in a bureaucratic muddle. Labor regulations have been substantially reformed, and it is now much easier for businesses to release workers. Rapid progress -- in practice if not fully in law -- has been made in price de-control. Strict price controls remain on fewer than ten products. In other areas, de-regulation remains slow. The Ministry of Local Government, which has the lead on the issue, is yet to develop a dynamic approach to its work.

Within the structural adjustment program, government is specifically concerned with competition and monopoly regulation issues. Partially, this is a response to the impending competitive threat from a post-apartheid South Africa; partially it derives from government's concern, in the context of ESAP, to: (i) protect consumers; (ii) ensure that exports are effectively promoted; and, (iii) to encourage indigenous entrepreneurs.

While it is clear that the ESAP will, in and of itself, go far in achieving these aims, it is not clear that the likely evolution of ESAP will be sufficient. It is in this context, that supplementary measures -- both legislative, and institutional -- in the area of competition policy and regulation are being considered.

While competitiveness will be greatly enhanced by these reforms, explicit competition policies are still needed in the context of ESAP because: (i) markets are not perfect; (ii) business behavior is not automatically pro-competition; and, (iii) policy measures may be unintentionally inconsistent. Competition policy within the context of structural adjustment programs should be designed to: (i) provide government and citizens with confidence that the ESAP will not be manipulated by special interests; (ii) ensure that the benefits of the ESAP are broadly shared among both businesses and consumers; and, (iii) further promote a switch to production for export markets.

Consequently, the main principles of competition policy are to: (i) Lower barriers to entry; and (ii) Reduce restrictive business practices.

The remainder of this report, thus, attempts to: (i) understand the nature and extent of barriers to entry and restrictive business practices in Zimbabwean industry; and, (ii) identify, and conduct a preliminary evaluation of, alternative competition policies and supporting institutional, legislative and procedural options which serve to lower barriers to entry, reduce restrictive business practices, and enhance the process of industrial competitiveness -- in the context of Zimbabwe's Economic Structural Adjustment Programme.

1.4 Objectives and Conduct of Study

The objectives of the study are to:

- Assess and analyze industrial concentration, restrictive business practices (RBPs) and regulation in Zimbabwe, and the impact of ESAP (Economic Structural Adjustment Programme) on RBPs and their regulation.

- Identify and analyze worldwide experiences with regulating RBPs, especially within the context of simultaneously introducing structural adjustment programs, so as to draw implications for Zimbabwe.

- Recommend policy actions and institutional, legislative and procedural options to regulate abuse of market power and RBPs in Zimbabwe.

The scope of the study includes assessment of:

- A wide range of restrictive business practices, irrespective of whether these were undertaken by monopolists or by firms in unconcentrated industries.

- Commercial, services and financial sectors in addition to the manufacturing sector (which was the main focus of the study).

- Parastatal monopolies (statutory and non-statutory) and enterprises of mixed private-public ownership, in addition to private firms.

The study was conducted by a team of seven specialists: a competition specialist/Team Leader; an RBP specialist; a judicial/legal specialist; a political economist; a business economist; and, two Zimbabwe business economists.

The study was carried out between January and March 1992. Meetings were held in Zimbabwe during the month of February with members of government, the private sector and academia. In addition, selected interviews on competition policy and RBP regulation were conducted in the United States, the United Kingdom and Switzerland.

In addition, a literature search was conducted to enable the team to draw upon the competition policy experience of other countries.

1.5 Structure of the Report

In the next chapter, the conceptual basis of competition is reviewed to provide an analytical framework for assessing the situation in Zimbabwe. In Chapter 3, the nature and structure of industry, the degree of competition, and the existence of restrictive business practices are reviewed. Next, the regulation and control of RBPs and abuses of market power in Zimbabwe are discussed in Chapter 4. In Chapter 5, the main dimensions of competition policy are described and preliminary guidelines for developing competition policy in Zimbabwe are presented. In Chapters 6 and 7, the means for executing competition policy -- institutional, legislative, and procedural -- are identified and major options for Zimbabwe are evaluated. Finally, in Chapter 8, recommendations and an early action program for implementing a new competition system are presented.

Several appendices follow the main body of the report and provide further detail on selected issues.

CHAPTER 2

THE CONCEPTUAL BASIS OF COMPETITION

It is important to understand the key dimensions of competition analysis in order to provide a common framework for examining the competition situation in Zimbabwe.

2.1 Market Structure and Efficiency

Economies with decentralized, competitive economic systems are generally regarded as more efficient and more supportive of economic development than centralized regimes. Yet experience has shown that unfettered competition (that is, with no ground rules) does not always serve national economic goals. Private entities often have economic incentives to acquire market power (i.e., discretion over price) through the erection of barriers to commerce, allowing them to raise prices[1] and lower output of goods and services, thus fostering inefficient business practices and impeding economic development.

Market structure is a major determinant in a firm's ability to attain market power and thus, potentially produce and compete in an inefficient manner. Broadly speaking, market structures are distinguished by how intense are the competitive pressures faced by incumbent firms. The primary structural characteristics of a market are the number of firms, the severity of barriers to entry, and the extent to which competing products are viewed by buyers as substitutable. On the basis of these characteristics, markets can be categorized in the following manner.

- <u>Perfectly competitive</u> -- refers to a market with many suppliers selling a homogeneous product[2] under conditions of free entry and exit.

- <u>Monopolistically competitive</u> -- identical to a perfectly competitive market except that the product is assumed to be heterogeneous, so that different suppliers provide close but not perfectly substitutable products.

- <u>Oligopolistic</u> -- a market with significant barriers to entry and few suppliers; the latter operate in an environment of recognized competitive interdependence (sales and profits of a single firm depend on its actions and the reactions of a few others).

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[1] "Price" refers to any component of the terms of trade between buyer and seller, including but not limited to product quality, service, warranties, and other conditions of sale, as well as the nominal price paid for the product.

[2] A homogeneous product is one whose physical characteristics do not significantly differ among suppliers. Cement, copper ore, and crude oil are examples. A heterogeneous product is one whose physical characteristics vary significantly between different suppliers. Automobiles, household appliances, and consumer electronics are examples.

- Monopolistic -- refers to a market supplied by a single firm insulated from competition because of high barriers to entry.

Generally speaking, as one moves from perfectly competitive structures to more monopolistic structures, the degree of market power enjoyed by incumbent firms rises and the level of overall economic efficiency diminishes.

In perfectly competitive structures, unconstrained market forces lead to socially optimal production levels at prices that exactly compensate suppliers for their necessary production costs, bringing therefore the attainment of static efficiency. With many firms supplying a homogeneous product, competitive pressures leave each supplier little discretion over pricing -- price differentials for identical products are quickly eroded. Naturally, each firm has no incentive to set its price below the market price, while selling above the market price results in the loss of business to other suppliers. Thus, each supplier possesses no market power. This means that the output of each supplier is limited only by cost increases (at high levels of output) that render further increases in output unprofitable.

In monopolistically competitive markets, each supplier possesses some degree of market power because certain consumers may have a preference for that supplier's product and will pay a premium for it. Price differentials are not eroded by arbitrage, thus reflecting the value of qualitative differences among products. Moreover, because suppliers possess market power, they may set output levels below those at which costs would be minimized.

Monopolistic competition fails to provide for static efficiency only in that production costs would be lower if the product were produced under perfect competition. Yet this comparison assumes that product variation has no social or economic value, an assumption that fails for markets such as apparel, for which style, color, and fit are important. If product variation has value to consumers, the attainment of static efficiency depends upon whether monopolistic competition provides for too much or too little product variation, given consumer preferences and production costs.

Even in monopolistic competition, free entry promotes more efficient conduct and superior economic performance by ensuring supply by the most efficient suppliers, providing buyers with more alternatives, increasing the elasticity of demand of each supplier, and limiting the exercise of market power.

Monopoly and oligopolistic market structures are distinguished from perfect and monopolistic competition in that entry is time consuming, costly, and risky. A monopolist typically possesses significant market power. On the one hand, by setting price just below the level that would attract rivals, the monopolist can earn supra-competitive profits. On the other hand, the monopolist may threaten or act in a predatory fashion towards entrants via selective price cuts, thereby raising the costs -- and risks -- and lowering the profitability of entry. Static efficiency fails therefore under monopoly because restricted entry and market power result in prices that are above, and output that is below, what is possible with available technology.

Oligopolies are characterized by entry barriers and a small number of suppliers. The performance of an oligopoly can range from competitive to monopolistic, depending on the characteristics of the market and the conduct of suppliers. Competition policy is concerned with oligopolies because of the possibility that the few suppliers, recognizing their interdependence, will resort to collusive behavior, essentially by avoiding competition among themselves and charging monopoly prices. Collusive, monopolistic behavior fails to attain static efficiency, as with a pure monopolist, because price is too high and output is too low, given available technology.

The simple microeconomic models described above provide considerable insight into many fundamental issues of competition policy. For example, the many varieties of exclusionary behavior (such as predation, resale price maintenance, exclusive contracting, and refusal to deal) are commonly enjoined by anti-competition enforcement because they inhibit entry or other forms of efficient conduct. Many anti-competition prohibitions -- against price fixing, unreasonable restraint of output, predation, and exclusion of rivals -- serve to inhibit the unilateral or collusive exercise of market power. Finally, certain corporate transactions, such as horizontal mergers, are restrained under merger control policies so as to maintain independence among competing suppliers and inhibit further concentration in markets with high barriers to entry.

The presumption that high levels of concentration lead to suboptimal economic performance has been criticized because under plausible conditions, high concentration may itself be the outcome of more efficient enterprises growing at the expense of their rivals. For example, if strict economies of scale or learning-by-doing drives cost reductions, then high concentration occurs as a direct result of firms behaving efficiently (by increasing output so as to reduce costs or speed the learning process). Thus, in some markets, technological advantages may allow large (or more experienced) suppliers to operate at lower average cost than small ones. The smallest firm (or plant) size consistent with the minimization of costs is referred to as the minimum efficient scale. The simplest example of a market for which a competitive market structure would not encourage economic efficiency is that of the natural monopoly, for which the minimum efficient scale is sufficiently large that one firm can serve the entire market. A natural oligopoly results when the minimum efficient scale constitutes a significant portion of the market so that only a few suppliers may efficiently serve the market.

Where technological factors allow large firms to be more efficient than small ones, the drive to minimize costs may result in a highly concentrated market. In this case, the exercise of unilateral or collective market power may be enhanced by suppliers' recognition of their competitive interdependence. Weighing the trade off between the efficiency advantages of large suppliers and competition presents some of the most difficult and interesting problems of competition policy.

2.2 Market Structure and Competition Policy Goals

The overall goals that might be pursued as part of a competition policy (see Chapter 5) are increasingly more difficult to attain as one moves along the continuum from perfect competition to monopoly situations. Primary goals of competition policy, in the case of Zimbabwe and many other countries, might include: (a) increased efficiency;[3] (b) enhanced consumer welfare; and, (c) expansion of the base of entrepreneurship.

- Efficiency. It is clear that the greatest efficiency is obtained under conditions of perfect competition, where, by definition, unconstrained market forces lead to socially optimal production levels at prices that exactly compensate suppliers for their necessary production costs and competitive pressures leave each supplier little discretion over pricing. The exception is industries where economies of scale exist, and a minimum efficient scale plant is required for cost minimization. Here, there is a difficult trade-off to be made between the efficiency advantages of large suppliers versus competition and the degree of market power those large suppliers command. A key question is whether those large firms in fact do minimize costs, and pass on those "savings" to consumers--that is, fulfill the efficiency and consumer welfare goals of competition policy, but at the expense of not fulfilling the goal of expanding the entrepreneurial base.

- Consumer Welfare. Consumer welfare is best served when a wide range of products of good quality are available at reasonable prices. Generally speaking, a more limited range of products will be supplied at higher prices, the fewer firms there are in a given industry, the less pressure of competition there is due to greater barriers to entry, and the extent to which there are fewer close substitutes for a product. Thus, under competitive market structures, consumer welfare is likely to be best served, as there are many different firms supplying homogenous products at prices that just meet "efficient" production costs. Whereas a monopolist increases prices to the level just below which a new competitor would be attracted into the industry and limits output -- to the detriment of consumers.

- Base of Entrepreneurship. Expansion of the base of entrepreneurship is best achieved when there are few or no barriers to entry. By definition, the barriers to entry and degree of market power commanded by incumbent firms increases as one moves from perfect competition to monopoly situations --and, thus the scope for new entrepreneurs to enter the industry diminishes.

[3] To further economic development and increase international competitiveness.

2.3 Sources of Market Power

If the degree of competition in a given economy and the extent to which competition policy goals can be reached are largely determined by: (a) the number of firms in the industry or degree of concentration; (b) barriers to entry; and, (c) the closeness of available substitutes then it is important to understand each of these three factors and their interaction.

2.3.1 Definition of the Competition Arena and Scope for Substitution

Abuse of market power is the major focal point of investigations into anti-competitive behavior. Market power is the ability to vary price without suffering large variations in sales, fundamentally due to a lack of alternative products. Analysis of market power therefore begins with an examination of the arena in which a particular supplier must compete.

A formal concept of the competitive arena is the antitrust or competition market. This consists of a set of sellers, buyers, and products for which substitution by the buyers, and competition among the sellers, encompasses the short-run competitive forces influencing the prices of the products. Competition markets have two components, the **product market** and the **geographic market.** The former consists of a group of products whose short-run prices are dependent primarily on competition from within the group. The latter consists of an area where suppliers are subject primarily to competition from within that area. This commonly occurs in products for which high freight costs or tariffs effectively limit competition to one region.

The legal standards for constructing competition markets often must be gleaned from court records. To inform the private sector about enforcement criteria for competition policy, some competition authorities publish guidelines describing the application of competitive analysis. The U.S. Department of Justice's Merger Guidelines, most often cited by competition agencies around the world, provide probably the simplest unified characterization of a competition market.

Under these guidelines, a product market consists of a group of products for which -- if the products were supplied by a hypothetical monopolist -- a significant, non-transitory price increase would be profitable for the monopolist. Similarly under the guidelines, given the product market, a geographic market consists of an area for which -- if the suppliers in the area were controlled by a hypothetical monopolist -- a significant, non-transitory price increase by all the suppliers would be profitable for the monopolist. Profitability from the hypothetical price increase depends on the immediacy of the market reaction to the increase. For constructing competition markets, the U.S. guidelines consider only those reactions that occur within one year of the hypothetical price increase.

These guidelines' assumption that all products and suppliers within a prospective competition market are controlled by a hypothetical monopolist focuses the analysis on competition from outside the prospective antitrust market. In particular, a group of products and suppliers fails as a competition market when the group does not encompass all significant sources of competition. Where the hypothetical price increase would be unprofitable due to competition from outside the prospective market, the competition market must be expanded to include these other sources of competition. This process of expansion continues until all significant sources of competition are included (in the sense that competition from outside the prospective market would fail to undermine a hypothetical price increase).

Countries around the world differ somewhat in their construction of competition markets. Under the U.S. guidelines, a competition or antitrust market includes competition from potential suppliers if that competition is sufficiently immediate (i.e., occurs within one year of a hypothetical price increase). In contrast, European (and most other) competition agencies consider only current suppliers to constitute the market. This difference in defining competition markets does not significantly affect the principles of anti-competition enforcement, but must be taken into account in comparing the scope of enforcement policies. This is particularly true for the use of market share standards in enforcement.

The size and configuration of <u>geographic markets</u> vary widely among products, from small areas to the entire world. Certain retail goods markets (notably grocery and department stores) have been found to encompass no more than the metropolitan areas in which they operate. In contrast, for the many products actively traded in international commerce, supra-competitive pricing by domestic suppliers often can be undermined by foreign suppliers. In this case, the scope of the relevant market is international.

Restrictive trade policies such as tariffs and quotas reduce the size and scope of competition markets because they inhibit (low tariffs) or prevent (binding quotas or high tariffs) the ability of foreign producers to supply the domestic market. In Korea, for example, Dong Yang's proposed 1982 stock purchase of Hankook, its sole domestic competitor in hydrogen peroxide, was blocked by the Korean Fair Trade Commission because a 30% tariff made imported hydrogen peroxide uncompetitive in the Korean market. The tariff barred entry by foreign suppliers into the Korean market and narrowed what would have been a broader market, served by a number of suppliers, to one served by a duopoly. Because of the tariff, the proposed merger would have resulted in a domestic monopoly. In contrast, a Canadian review of a merger between the only two newsprint manufacturers in British Columbia was allowed to proceed because the relevant market included the United States. Neither transportation costs nor trade restraints prevented U.S. newsprint suppliers from serving British Columbia.

2.3.2 <u>Degree of Concentration</u>

Within a valid competition market, the establishment of, and the ability to exercise, market power are strongly dependent on the number of competing suppliers. This aspect is captured in concentration indices, which measure the extent to which economic activity is concentrated in the hands of a few suppliers. There are two main sets of concentration indices used in competition analysis.

<u>Leading firm concentration ratios</u> which measure the proportion of sales accounted for by the leading firms in a competition market. The concentration ratio Ci is defined as the proportion of sales accounted for by the i largest suppliers to a market. For example, C1=100% for a

monopoly. If four equal-size suppliers compete in a market, then C1=25%, C2=50%, and so on. Alternatively, the index can be expressed as the market share, in percentage terms, accounted for by the "x" largest producers. The four firm concentration ratio is a common measure -- that is, the percent of the market accounted for by the four largest producers.

An alternative concentration index, which is gaining use in anti-competition enforcement, is the <u>Hirschman-Herfindahl Index</u> (HHI). The HHI is defined as the sum of the squared market shares (expressed in percentage terms) for all suppliers in a competition market. The HHI lies between 0 and 10,000. The HHI can be very small for competitive industries with many small suppliers. Alternatively, the HHI is 10,000 (100% x 100%) for a monopolist.

The HHI has gained use among competition authorities because it accounts for the relative importance of all firms, whereas concentration ratios indicate only the relative importance of leading firms. Thus, the HHI gives a more complete description of market concentration. In addition, empirical studies have found the HHI to be positively related to price-cost margins and profitability, both of which rise with the exercise of market power by suppliers.

Concentration indices increase as economic activity in a competition market becomes concentrated in the hands of fewer suppliers. Although the levels of concentration at which competition authorities in different countries intervene varies, intervention often occurs when high concentration and difficult entry support the presumption that the exercise of market power is likely.

The number of suppliers in a given market will substantially influence the feasibility of collusion among those suppliers. Generally, the fewer firms there are, other thing being equal, the easier it is to collude. Where the exercise of market power requires coordination among several suppliers, additional factors influencing the likelihood and feasibility of collusion must be taken into account. Effective collusion is difficult to maintain because collusion to raise prices creates a so-called "prisoners' dilemma" for the colluding parties. Fundamentally, it requires restraint by individual participants. Yet a collusive arrangement, by raising price, creates an incentive for each supplier to secretly undercut the agreed-upon collusive price to gain market share and increase revenue. Thus, the collusive group must have some means of monitoring the actions of its members and punishing those that stray from the collusive strategy. This is easier and less costly for a collusive group with fewer members.

Given the number of suppliers, the feasibility of collusion in a well defined market is influenced primarily by ease of entry (discussed in the next section) and by the following factors.

- In <u>heterogeneous product markets</u>, suppliers can compete not through price but through improvements in a number of characteristics valued by buyers (e.g., quality, timely delivery, after-sales service). As a result, administering a collusive price-fixing arrangement is more difficult for heterogeneous goods than for homogeneous goods.

- <u>Cost structure</u> influences the tendency toward collusion because suppliers with high fixed costs have an incentive to spread these costs over a larger volume of output and to operate at full capacity. Markets served by such suppliers often experience severe price wars during contractions in demand, and therefore collusion is attractive as a way of avoiding ruinous competition.

- Non-cooperative strategies are more profitable in rapidly growing markets. Therefore, other things equal, collusion is less likely in such markets.

- Markets for which transactions are large and infrequent (e.g., aircraft design and large public projects) provide suppliers with strong incentives to behave competitively.

- Where public information on price and output of individual suppliers is available, each supplier has little incentive to cheat on a collusive agreement (by increasing output) since doing so is likely to result in detection and retaliation by other colluding firms.

2.3.3 Barriers to Entry

Barriers to entry are of critical importance to determining the degree of competition in a given market and the ability of firms to abuse market power. High entry barriers can increase or maintain the high level of concentration in an industry, preclude entry by other entrepreneurs, and further the creation of uncompetitive market structures which serve to increase price and restrain output to the detriment of consumers. Reduction of entry barriers, thus, contributes to all the major goals of competition policy -- increased efficiency, enhanced consumer welfare, and expansion of the base of entrepreneurship.

In market economies, investment decisions are generally made by private parties. Profit-seeking by these investors results in the allocation of resources according to the relative profitability of different activities so that producers are attracted to expanding (or under-supplied) markets and exit from declining (or over-supplied) markets.

Financial gain from entering a particular market depends on the risks, delays, or costs of entry. In markets for which entry and exit are relatively easy, immediate, and inexpensive (i.e., entry and exit are "free"), potential suppliers enter and incumbents exit very quickly in response to periodic economic shocks that affect profits. In fact, entry and exit represent a dynamic process by which the supply of each product adjusts to economic shocks until the product price is at a level that makes further entry unprofitable or further exit unwarranted. Ease of entry and exit allows efficient suppliers to displace inefficient ones by offering products at prices at which the latter cannot be profitable. Furthermore, free entry and exit support allocative efficiency by directing resources, without impediment, across markets according to their relative profitability.

Entry conditions are a central feature of competition analysis because potential entry represents a significant market force that undermines incumbents' tendency toward unilateral or joint (collusive) exercise of market power. Fundamentally, the exercise of market power requires that suppliers restrain output, thereby creating opportunities for potential entrants. Where entry is easy, collusion to raise price, if successful, would attract new suppliers whose presence undermine the collusive arrangement. As a result, there is little incentive for incumbent producers to attempt collusion.

Similarly, the ability of a firm to abuse its dominant position in a particular market generally results from a paucity of alternative suppliers. For that reason, entry represents a powerful force restraining such abuse.

A firm with a high market share may be deterred from exploiting its apparent market strength by the threat of entry of new firms into the market or the growth of existing firms. Whether the threat of entry is an important constraint on existing firms depends upon whether there are any barriers to entry which present obstacles to the development of competition. Of course, there will always be some barriers to entry to any market. Entry into a market cannot be costless and a new entrant is likely, at least initially, to face higher costs than incumbents. What is relevant here is an assessment of the extent to which barriers to entry in practice limit actual or potential competition. For example, while there may be no legal obstacles, entry barriers may make market entry based on reasonable commercial considerations and motives unlikely. Such barriers need not preclude entry entirely nor need they exist indefinitely to limit competition. It may be enough if they delay or impede entry for a significant period of time.

Some of the most important barriers to entry are listed below. However, entry barriers can appear in many forms and some may be specific to a particular industry.

- <u>Limited supplies</u> of raw materials or facilities, or lack of access to appropriate technology.

- <u>Institutional or regulatory barriers</u>. These may include contract terms which tie customers to existing suppliers (e.g., long-term contracts, loyalty rebates, minimum requirement clauses, tie-in sales, full-line forcing). Government regulation can impose barriers to entry, for example licensing requirements, safety regulations or quality standards. Standards may also inhibit innovation by potential new entrants, because they are set in consultation with existing producers and/or do not necessarily envisage alternative technologies.

- <u>Economies of scale</u>. Scale economies can deter entry by ensuring that a new entrant has either to come in on a large scale, which risks both a strong reaction from existing firms and substantial losses if the entry is unsuccessful, or come in at a small scale and accept a cost disadvantage. In particular, economies of scale can be an entry barrier in situations where a new entrant must obtain a large market share in order to be able to operate at the minimum efficient size.

- <u>Economies of scope</u>. These arise where there are joint costs in producing two or more products. This may give a firm that competes in both product markets an advantage over a firm operating in only one market. Economies of scope may, therefore, deter entry into one market if there are barriers to entry into the other related market.

- Economies of vertical integration. There may be economies in a firm operating in successive stages of the economic process. In this case, the new entrant must enter on a vertically integrated basis or face a cost disadvantage. If there are barriers to entry in one part of the vertical chain, then entry into other parts of the chain may be deterred. An example of this type of entry barrier is where a producer's ability to gain access to distribution channels is limited by exclusive dealing arrangements.

- Sunk costs. It may be that it is more the presence of "sunk costs," rather than economies of scale, scope or vertical integration themselves, that act as a barrier to entry. If the fixed costs incurred by entry are largely recoverable, i.e., there are few "sunk costs," an entrant who fails can withdraw without substantial penalty and in such situations entrants are less likely to be deterred. But if costs are irrecoverable, there is an imbalance between the incumbent firm and entrant. The purchase of specialized assets (i.e., assets highly specialized to a particular business or location) and advertising are examples of sunk costs. If there are no sunk costs at all, a market is said to be "contestable." In a contestable market, the threat of new entry effectively constrains existing firms in the same way as if entry had actually occurred. Contestable markets in the strict sense are unlikely to occur in practice but for purposes of analysis, the concept is useful.

- Excess capacity. An incumbent may maintain excess capacity in order to react to or discourage new competitors. Excess capacity can act as a signal that the incumbent can retaliate quickly by increasing output in response to new entry.

- Product differentiation and brand loyalty. Established firms may have brand loyalty which has been built up over many years, perhaps through advertising or simply by being first into the industry. It may be difficult for a new entrant to match the strong brand image of an incumbent in a short period. Moreover, investments in establishing a brand name are very much sunk costs because they have no value if entry fails. As a result of brand loyalty, a new entrant may find it difficult to become established or may be deterred from competing at all.

- Social barriers. Barriers to entry can be erected via restrictive business practices exercised by a given social/ethnic group with the specific purpose of preventing another group from entering a given branch of business.

A potential entrants' expectations about the reaction of firms already in the market can also deter entry. If existing firms are expected to retaliate forcefully, then entry may not be attempted. Conditions that suggest the likelihood of strong retaliation to entry include the following.

- An incumbent's reputation for successful retaliation, whether it derives from his behavior in the same market in the past or in another market.

- The ability of an incumbent to finance losses incurred. Retaliation may involve the incumbent incurring losses in the short-term and these must be financed either through the use of cash reserves or unused borrowing capacity or by cross-subsidization from other products or markets.

- The incumbent's degree of commitment to the industry. An incumbent who is strongly committed to the industry, for example through the employment of highly specialized assets, is more likely to retaliate.

- The existence of barriers to entry. The threat of retaliation may deter entry if retaliation is seen as a rational strategy for the incumbent. This will be the case if, once competition has been eliminated, the incumbent can raise prices so as to compensate for the period of losses, without attracting new entrants. This in turn will depend on the strength of barriers to entry.

2.4 Manifestations of RBPs and Abuses of Market Power

Barriers to entry, industry concentration and availability of close substitutes all influence the ability of firms to abuse market power. In essence, they are the pre-conditions for establishing that the scope for abuse exists. Determining whether firms actually abuse market power involves a complex set of analyses, which are highly industry and country specific. Substantial resources and technical know-how are expended by countries to determine if one firm in a given industry over a certain period of time had abused its market power. Thus, there are no set "models", and countries must "learn by doing".

However, the manifestations of RBPs and abuses of market power are well known. These generally fall into two categories. The first is restrictive agreements or arrangements which are made between rival or potentially rival firms. Such actions can occur in industries with either a relatively large number of firms or relatively few (see discussion of conditions for collusion, above). The second is abuses of market power which almost always occur in industries characterized by high degrees of concentration and high barriers to entry.

Presented below are the major forms or manifestations of RBPs and abuses of market power. This list is derived from the UNCTAD draft of guidelines for a model law on RBPs.

1. <u>Prohibition of the following agreements between rival or potentially rival firms, regardless of whether such agreements are written or oral, formal or informal</u>:

    - Agreements fixing prices or other terms of sale, including in international trade;

    - Collusive tendering;

    - Market or customer allocation;

    - Restraints on production or sales, including by quota;

- Concerted refusals to purchase;
- Concerted refusal to supply;
- Collective denial of access to an arrangement, or association, which is crucial to competition.

2. Prohibition of acts or behavior involving an abuse, or acquisition and abuse of a dominant position of market power

A prohibition on acts or behavior involving an abuse, or acquisition and abuse of a dominant position of market power:

- Where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control a relevant market for a particular good or service, or groups of goods or services;
- Where the acts or behavior of a dominant enterprise limit access to a relevant market or otherwise unduly restraint competition, having or being likely to have adverse effects on trade or economic development.

Acts or behavior considered as abusive:

- Predatory behavior towards competitors, such as using below-cost pricing to eliminate competitors;
- Discriminatory (i.e., unjustifiably differentiated) pricing or terms or conditions in the supply or purchase of goods or services, including by means of the use of pricing policies in transactions between affiliated enterprises which overcharge or undercharge for goods or services purchased or supplied as compared with prices for similar or comparable transactions outside the affiliated enterprises;
- Fixing the prices at which goods sold can be resold, including those imported and exported;
- Restrictions on the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i.e., belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence, and where the purpose of such restrictions is to maintain artificially high prices;

- When not for ensuring the achievement of legitimate business purposes, such as quality, safety, adequate distribution or service;

  -- Partial or complete refusal to deal on an enterprise's customary commercial terms;

  -- Making the supply of particular goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods;

  -- Imposing restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported;

  -- Making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier or his designee.

- Mergers, takeovers, joint ventures, or other acquisitions of control, including interlocking directorships, whether of a horizontal, vertical, or a conglomerate nature, when:

  -- At least one of the enterprises is established within the country; and,

  -- The resultant market share in the country, or any substantial part of it, relating to any product or service, will result in a dominant firm or in a significant reduction of competition in a market dominated by very few firms.

* * *

In the next chapter, the concepts discussed above for assessing the nature of competition are applied in a preliminary fashion to the existing situation in Zimbabwe, particularly to establish: (i) levels of industry concentration; (ii) the presence of barriers to entry; and, (iii) evidence of RBPs and abuses of market power.

CHAPTER 3

COMPETITION AND RESTRICTIVE BUSINESS PRACTICES IN ZIMBABWE

3.1 Introduction

The industrial sector in Zimbabwe is distinctive among African economies in a number of ways. Some of the key characteristics of the sector are as follows.

- Manufacturing contributes approximately one-third of GDP, one of the highest shares in sub-Saharan Africa.
- The manufacturing sector produces between 6,500 to 7,000 different products, and as such, is one of the most diversified in sub-Saharan Africa.
- Domestic industry has been heavily protected against imports in the past, by high tariffs and quantitative restrictions.
- Plant and equipment in Zimbabwe tend to be very old and often obsolete, resulting in low quality goods and high costs of production. Obsolete equipment is particularly pervasive in import substitution-oriented industries which have had difficulty in obtaining foreign exchange to modernize.
- Value added in manufacturing is approximately three times the average of sub-Saharan Africa. While seemingly impressive, this may result from heavy protection and reflect inefficient operations.
- Zimbabwe has an embryonic capital goods sector, which may have grown largely out of the protectionist/isolationist era, but still makes Zimbabwe distinctive within the African context.
- The public sector owns, controls, or has investment interests in a significant share of industrial production capacity in Zimbabwe.

Subsectors of importance in the manufacturing sector in Zimbabwe include: foodstuffs, drinks and tobacco, textiles and ginning, clothing and footwear, wood and furniture, paper and printing, chemicals and petroleum products, non-metallic mineral products, metals and products, and transport and equipment.

The development of Zimbabwe's manufacturing base was given impetus by the necessity of an import substitution industrialization strategy following the Unilateral Declaration of Independence (UDI) in 1965, and subsequent imposition of sanctions on the country (see Chapter 1). A host of trade and price-related controls were imposed on the economy aimed at protecting the relatively infant manufacturing sector from import competition. Investment controls prevented the duplication of existing manufacturing activities. These policies, which accentuated concentration and erected barriers to entry, thus supported the development of monopolies and oligopolies with the subsequent decline in competition in the economy.

There is substantial evidence in recent literature that Zimbabwe's industrial structure is highly concentrated and as such characterized by a preponderance of monopolies and oligopolies. The Riddell Commission (1981)[4] commented, "In spite of this impressive expansion in the number of products manufactured within Zimbabwe, the economy is characterized by the phenomenon of monopoly production (one producer) or oligopoly (just a few producers). In 1980, 52% of all products manufactured in Zimbabwe were made by a single producer, 70% by two producers or less, and 80% by three producers or less". Only 20% of all products were manufactured by more than three manufacturers. This evidence has been confirmed by UNIDO (1985)[5] and World Bank (1987).[6]

Governments in Zimbabwe have been aware of the problems of market power for more than two decades. On November 11, 1965, the Minister of Commerce and Industry stated, "Price control will be introduced from tomorrow . . . to prevent people from taking advantage of the new circumstances with regard to imports." Since then, the system of price controls has been the major instrument for controlling the abuse of market power in Zimbabwe. The World Bank (1987) has argued that price controls have been effective in preventing the abuse of market power to generate monopoly rents.

In this chapter: (i) the nature and extent of industrial concentration, particularly in the manufacturing sector, are examined; (ii) the presence and prevalence of entry barriers are assessed; and, (iii) an indication of the existence of RBPs and abuse of market power is given.

3.2 The Nature and Extent of Industrial Concentration

Analysis of the extent of industry concentration, combined with an assessment of entry barriers, provides a good indication of where RBPs and abuses of market power are likely. The examination of industrial concentration in Zimbabwe focuses mainly on the manufacturing sector because this sector is of strategic importance to Zimbabwe's structural adjustment and because of the lack of data available for non-manufacturing sectors.

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[4] Riddell, R. Commission of Inquiry into Incomes and Prices, 1982. Given that the overall structure of industry has changed little in the last decade, these results are still largely valid.

[5] UNIDO Study of the Manufacturing Sector in Zimbabwe, 1985.

[6] World Bank Zimbabwe: An Industrial Sector Memorandum, 1987.

3.2.1 Manufacturing Sector

Data from surveys or censuses of manufacturing output are frequently used to measure industrial concentration. Enterprises are classified among branches of industry according to their principal products, whereupon for each branch one or another index of concentration is calculated on the basis of member enterprises' gross output or value added.

At the request of the Ministry of Industry and Commerce, for the purposes of this study the Central Statistical Office provided a microcomputer file based on the 1989/90 Census of Production, giving data on the inputs and outputs of 1,045 enterprises, mostly relating to the financial year 1st April 1989 to 31st March 1990. The census distinguishes 57 branches of manufacturing, of which one -- "Other manufactured products n.e.c. (not elsewhere classified)" -- is so heterogeneous as not to constitute a "branch" in any meaningful sense.

In using and interpreting this set of data, two issues should be kept in mind.

- Firstly, the quality of data collected by the CSO is unknown. The raw data could be of poor quality and/or there could be errors in entering the data into the computer files. However, this is the best data that is readily available.

- Secondly, the concept of industrial concentration makes sense only in the context of a "market" where products are close substitutes for one another. The majority of ISIC categories for which Herfindahl indices and CR4s are calculated in this chapter use data at the four digit level. Thus, they comprise many distinct markets, with the result that these parameters understate the true extent of concentration. That is to say, a category could contain many different products, some of which are produced by monopolies and others which are not (e.g., carbonated drinks are produced by monopolies, while fruit juices which are not), or similarly there could be a monopoly or near monopoly at given stage of the value chain (e.g, auto assembly is highly concentrated but if auto distribution is added, the industry at the 4-digit level registers a lower level of concentration).

Exhibit 3-1 lists the 57 branches in order of their ISIC (International Standard Industrial Classification) codes, giving Herfindahl indices and CR4s for each branch. Exhibit 3-2 reorders the branches (excluding the miscellaneous "branch" 3900) in order of their Herfindahl indices. Branches marked with * include the miscellaneous term "n.e.c." in their headings, suggesting a heterogeneity of products which throws the designation "branch" into question.

Exhibit 3-3 compares the Herfindahl indices and CR4s of the respective branches, arranged in declining order of H. H is measured on the left hand vertical scale, while CR4 is measured on the right hand scale. Overall CR4 follows H downwards, but the correlation is far from perfect, registering an R-squared of 0.445. Among other facets, 12 branches have CR4s of 100 with Herfindahl indices ranging from 9,162 down to 4,686. This is because any branch confined to 2, 3 or 4 producers will have a CR4 of 100 and an H of less than 10,000. Only five branches are true monopolies by virtue of containing a sole producer and thus having an H of 10,000.

EXHIBIT 3-1

BRANCHES OF ZIMBABWEAN MANUFACTURING INDUSTRY, HERFINDAHL INDICES & CR4s IN ORDER OF ISIC CODE

(indices calculated from CSO 1989/90 Census of Production, gross output data)

ISIC	Branch description	Nos.of enterprises 1970/71	1986/87	1989/90	Concentratio data, 1989/9 H index	CR4
3111	Slaughtering & processing of meat	10	8	8	5,961	98.
3112	Manufacture of dairy products	5	2	2	7,340	100.
3113	Canning & preserving fruits & vegetables	6	4	4	8,425	100.
3114	Canning & preserving fish, crustacea, etc.	2	1	1	10,000	100.
3115	Manufacture of vegetable & animal oils & fats			1	10,000	100.
3116	Grain mill products	10	6	6	4,826	97.
3117	Bakery products	60	57	54	951	53.
3118	Sugar factories & refineries	1	2	2	5,211	100.
3119	Chocolate & sugar confectionery	9	6	6	2,364	94.
3121	*Manufacture of food products n.e.c.	22	11	13	3,319	86.
3122	Manufacture of prepared animal feeds	n.a.	3	2	9,162	100.
3131/ 3132	Distilling, blending & rectification of spirits; wine industries	5	2	1	10,000	100.
3133	Malt liquors & malt	6	8	8	2,819	92.
3134	Soft drinks & carbonated water	9	9	8	2,589	88.
3141	Tobacco packing & grading	9	2	6	2,041	86.
3142	Tobacco products (cigarettes, cigars, etc.)	4	7	2	5,015	100.
3211	Spinning, weaving & finishing textiles	24	21	25	2,870	86.
3213	Knitting mills	12	9	9	2,345	89.
3214	Manufacture of carpets & rugs	1	3	3	3,866	100.
3215	Cordage, rope & twine industries	n.a.	5	7	4,226	97.
3219	Other textiles products	12	23	11	3,484	92.
3220	Wearing apparel	124	95	103	320	25.
3230	Leather & leather products	5	16	14	4,291	92.
3240	Footwear	7	10	13	4,414	89.
3310	Sawmilling & wooden products except furniture	46	30	30	1,605	68.
3320	Furniture & fixtures except primarily of metal	41	49	50	676	38.
3411	Manufacture of pulp, paper & paperboard	3	2	2	5,214	100.
3419	*Manufacture of pulp, paper & paperboard prods. n.e.c.	15	13	10	2,150	82.
3420	Printing, publishing & allied industries	83	69	67	613	40.
3511	Manufacture of basic industrial chemicals except fertilizer	5	3	4	4,338	100.
3512	Fertilisers, insecticides & pesticides	8	4	4	2,531	100.
3513	Manufacture of synthetic resins, plastic materials & man-made fibres except glass	1	1	1	10,000	100.
3521	Paints, varnishes & filling materials	9	5	5	3,793	95.
3522	Manufacture of drugs & medicines	26	9	8	3,724	97.
3523	Manufacture of soap & cleaning preparations, perfumes, cosmetics & other toilet preparations	n.a.	24	26	2,975	79.
3529	*Matches, ink, candles, glues, polishes & other chemical products n.e.c.	10	11	13	1,501	70.
3540	Manufacture of misc. products of petroleum & coal	3	2	2	6,205	100.
3550	Rubber products	12	12	13	3,272	80
3560	Plastic products	26	26	25	1,848	69
3610	Manufacture of pottery, china & earthenware	1	6	6	3,955	97
3620	Manufacture of glass & glass products	3	5	5	5,081	99
3691	Structural clay prods. including bricks	23	8	8	2,555	94
3692	Manufacture of cement, lime & plaster	3	3	3	4,686	100
3699	*Manufacture of non-metallic mineral materials n.e.c.	33	29	24	3,291	[illegible]
3710	Iron & steel basic industries	14	22	22	2,869	89
3720	Non-ferrous metal industries	10	8	6	2,977	92.
3810	Fabricated metal products	169	163	176	380	31.
3820	Non-electrical machinery & equipment	51	41	44	617	38.

2

ISIC	Branch description	Nos. of enterprises 1970/71	1986/87	1989/90	Concentrati[illegible] data, 1989/[illegible] H index	CR4
3832	Manufacture of radios, television & communications equipment & apparatus	2	6	[illegible]	2,642	93.[illegible]
3839	*Manufacture of electrical apparatus & supplies n.e.c.	40	32	[illegible]3	987	47.
3842	Manufacture of railroad equipment	3	2	2	6,814	100.
3843	Motor vehicles including reconditioning	31	32	46	1,510	61.
3844	Manufacture of motorcycles & bicycles	1	1	1	10,000	100
3845	Manufacture of aircraft	6	0	4	3,373	100.
3849	*Manufacture of transport equipment n.e.c.	5	4	5	3,138	99.
3850	Manufacture of professional, scientific, measuring & control equipment & photographic & optical goods	11	8	12	2,190	82.
3900	*Other manufactured products n.e.c.	59	59	52	671 #	44.
	TOTAL	1096	999	1047		
	TOTAL NO. OF REGISTERED MANUFACTURING ENTERPRISES	1240	1094	n.a.		

* Denotes branches whose descriptions contain 'n.e.c.' (not elsewhere classified).
# Indices calculated as a matter of form--no economic significance sh[illegible]ld be attributed [illegible] data for this 'branch'.

Sources:

Number of enterprises, 1970/71 and 1986/87: P. Bennell, "Market Power and Mark-Ups: Manufacturing Industry in Zimbabwe, 1970-1986", Working Papers in Economics, Department of Economics, University of Zimbabwe, 1991, pp. 8-9.

1989/90 data: analysis by IPC Team of CSO Census of Production.

EXHIBIT 3-2

RANKING OF ZIMBABWEAN INDUSTRIES (ISIC CATEGORIES) BY HERFINDAHL INDEX
(calculated from CSO 1989/90 Census of Production, gross output data)

ISIC	Branch description	H-index	CR4
3844	Manufacture of motorcycles & bicycles	10,000	100.0
3115	Manufacture of vegetable & animal oils & fats	10,000	100.0
3131	Distilling, blending & rectification of spirits	10,000	100.0
3513	Manufacture of synthetic resins, plastic materials & man-made fibres except glass	10,000	100.0
3114	Canning & preserving fish, crustacea, etc.	10,000	100.0
3122	Manufacture of prepared animal feeds	9,162	100.0
3113	Canning & preserving fruits & vegetables	8,425	100.0
3112	Manufacture of dairy products	7,340	100.0
3842	Manufacture of railroad equipment	6,814	100.0
3540	Manufacture of misc. products of petroleum & coal	6,205	100.0
3111	Slaughtering & processing of meat	5,961	98.5
3411	Manufacture of pulp, paper & paperboard	5,214	100.0
3118	Sugar factories & refineries	5,211	100.0
3620	Manufacture of glass & glass products	5,081	99.5
3142	Tobacco products (cigarettes, cigars, etc.)	5,015	100.0
3116	Grain mill products	4,826	97.5
3692	Manufacture of cement, lime & plaster	4,686	100.0
3240	Footwear	4,414	89.9
3511	Manufacture of basic industrial chemicals except fertilizers	4,338	100.0
3230	Leather & leather products	4,291	92.7
3215	Cordage, rope & twine industries	4,226	97.6
3610	Manufacture of pottery, china & earthenware	3,955	97.8
3214	Manufacture of carpets & rugs	3,866	100.0
3521	Paints, varnishes & filling materials	3,793	95.1
3522	Manufacture of drugs & medicines	3,724	97.0
3219	Other textiles products	3,484	92.0
3845	Manufacture of aircraft	3,373	100.0
3121	Manufacture of food products n.e.c.	3,319	86.5
3699	Manufacture of non-metallic mineral materials n.e.c.	3,291	76.2
3550	Rubber products	3,272	80.7
3849	Manufacture of transport equipment n.e.c.	3,138	99.3
3720	Non-ferrous metal industries	2,977	92.8
3523	Manufacture of soap & cleaning preparations, perfumes, cosmetics & other toilet preparations	2,975	79.1
3211	Spinning, weaving & finishing textiles	2,870	86.0
3710	Iron & steel basic industries	2,869	89.8
3133	Malt liquors & malt	2,819	92.9
3832	Manufacture of radios, television & communications equipment and apparatus	2,642	93.5
3134	Soft drinks & carbonated water	2,589	88.2
3691	Structural clay prods. including bricks	2,555	94.0
3512	Fertilisers, insecticides & pesticides	2,531	100.0
3119	Chocolate & sugar confectionery	2,364	94.4
3213	Knitting mills	2,345	89.0
3850	Manufacture of professional, scientific, measuring & control equipment & photographic & optical goods	2,190	82.2
3419	Manufacture of pulp, paper & paperboard prods. n.e.c.	2,150	82.7
3141	Tobacco packing & grading	2,041	86.7
3560	Plastic products	1,848	69.9
3310	Sawmilling & wooden products except furniture	1,605	68.4
3843	Motor vehicles including reconditioning	1,510	61.9
3529	Matches, ink, candles, glues, polishes & other chemical products n.e.c.	1,501	70.5
3839	Manufacture of electrical apparatus & supplies n.e.c.	987	47.4
3117	Bakery products	951	53.3
3320	Furniture & fixtures except primarily of metal	676	38.4
3820	Non-electrical machinery & equipment	617	38.1
3420	Printing, publishing & allied industries	613	40.4
3810	Fabricated metal products	380	31.9
3220	Wearing apparel	320	25.4
3900	#Other manufactured products n.e.c.	671#	44.4

#Indices calculated as a matter of form--no economic significance should be attributed to data for this 'branch'.

Exhibit 3-3

COMPARISON OF HERFINDAHL INDEX & CR4 FOR 56 ZIMBABWEAN INDUSTRIES
(Industrial branches arranged in declining order of Herfindahl index)

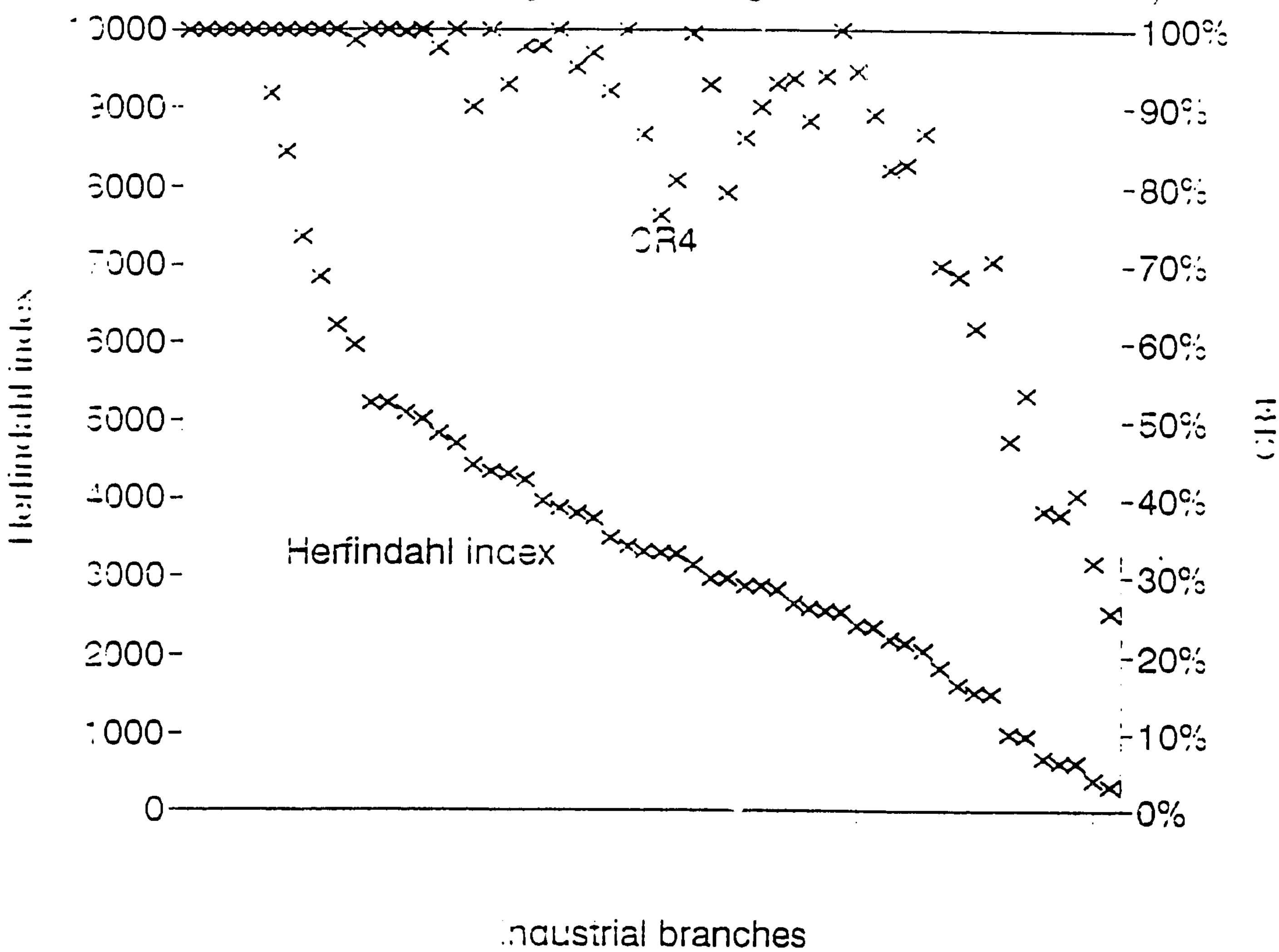


Table 3-1 and Exhibit 3-4 compare the distribution of CR4s of three countries, namely Zimbabwe (1989/90 census of production), Morocco (1986), and the United States (1972). The horizontal axis of Graph 2 distinguishes five ranges of CR4s, declining from left to right. The vertical axis measures the proportion of each country's manufacturing output originating in industries whose CR4s fall within the indicated ranges.

Table 3-1

DISTRIBUTION OF FOUR-FIRM CONCENTRATION RATIOS (CR4) IN MANUFACTURING INDUSTRIES OF MOROCCO, UNITED STATES AND ZIMBABWE

Range of CR4s	Number of Industries			% of All Industries			% of Total Output*		
	Morocco	U.S.	Zimbabwe	Morocco	U.S.	Zimbabwe	Morocco	U.S.	Zimbabwe
80-100%	45	22	43	46%	5%	77%	34%	9%	69%
60-79%	21	55	6	21%	12%	11%	25%	14%	12%
40-59%	19	118	3	19%	26%	5%	18%	21%	7%
20-39%	11	169	4	11%	37%	7%	16%	34%	12%
0-19%	2	87	0	2%	19%	0%	7%	23%	0%
Totals	98	451	56	100%	100%	100%	100%	100%	100%

*Measure of output is sales in Morocco and Zimbabwe, value-added in United States.

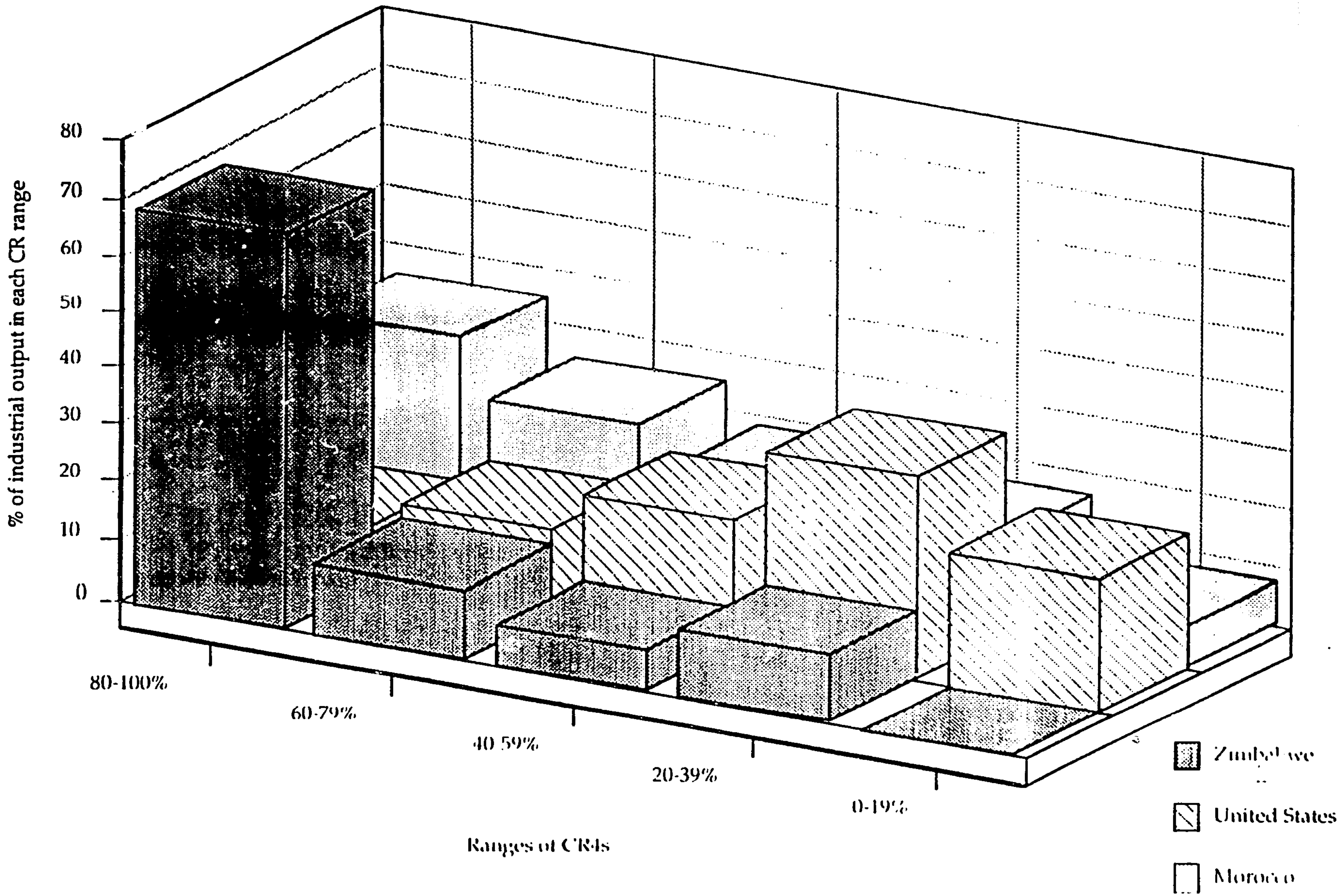
Sources:
Morocco -- analysis of 1986 Industrial Survey, T. Mounsif and C. Gray.
U.S. -- L.G. Reynolds, Microeconomics - Third Edition, Irwin, 1979, p. 212, based on U.S. Bureau of the Census, Census of Manufactures, 1972: Special Report Series: Concentration Ratios in Manufacturing.
Zimbabwe -- analysis by IPC Team of 1989/90 Census of Production.

The relatively high degree of concentration in Zimbabwean industry is reflected by the high bar for Zimbabwe in the 80 to 100% CR4 range. In other words, as shown in Table 3-1, 69 per cent of Zimbabwean manufacturing originates in industries where the four largest enterprises account for at least 80 per cent of gross output. The corresponding figure for Morocco is 34 per cent, and for the U.S. a mere 9 per cent (of 1972 value added).

Conversely, the most important CR4 range in American industry, accounting for a third of manufacturing value added in 1972, is 20 to 39 per cent. Only 12 per cent of Zimbabwean output occurs in industries with such low CR4s. At the right end of the spectrum, no Zimbabwean industry covered in the census of production has a CR4 below 20 per cent -- the CR4 of the wearing apparel industry is the lowest at 25 per cent -- whereas almost a quarter of America's 1972 manufacturing value added was produced by industries of such low concentration.

Exhibit 3-4

Distribution of Four-Firm Concentration Ratios (CR4) in Manufacturing Industries of Morocco, United States and Zimbabwe



While these data across countries are not directly comparable due mainly to differences in base years and industrial classification standards, the contrast in the results is so stark that the overall observations are probably still valid.

The comparative positions of the three economies are to some extent a function of their relative sizes. Morocco's 1987 Gross National Product was 2.3 times that of Zimbabwe's in 1989,[7] while U.S. GNP in 1972, measured in 1989 U.S. dollars, was 530 times as high as Zimbabwe's 1989 level.

It would have been interesting to compare the CR4 distribution in Zimbabwe -- or better still, the distribution of Herfindahl indices -- with that of one or more other developing countries producing roughly similar volumes of manufacturing output. Such comparisons would provide scope for assessing how far Zimbabwe's historical-political circumstances -- colonial domination, UDI-induced autarchy, post-independence policies -- have biased the industrial structure towards concentration. However, such an analysis was not permissible within the scope and resources of the present study.

A key question in interpreting concentration indices is to determine at what levels of concentration oligopolies or near-monopolies exist and thus, provide these firms with the scope for abuse of market power. Guidelines provided by the U.S. Department of Justice (DoJ) give an indication of the sorts of thresholds countries have adopted.

Under its current merger guidelines, the DoJ normally opposes a merger or acquisition if it estimates that the combined unit will have sufficient market power to raise its selling prices by at least 5 per cent and maintain the increase for at least 12 months. From experience and analysis of the outcomes of previous mergers and acquisitions, the Department considers that mergers/acquisitions which fail to raise the relevant industry's Herfindahl index above 1,000 do not confer such market power on the combined unit. Conversely, it considers that transactions in industries where H already exceeds 1,800, or which raise H above that level, are likely to confer such power, and the mergers/acquisitions in question are generally not approved. Situations featuring pre- or post-merger H's between 1,000 and 1,800 are examined case-by-case.

A rough idea of the structure of an industry with an H of 1,800 is conveyed by calculating Hs of industries with alternative numbers of firms on the simplifying assumption that each firm has an equal share. An industry with five firms of equal size yields an H of 2,000, while one with six firms has an index of 1,667.[8] The corresponding CR4s are 80 and 67 per cent, respectively. The DoJ guideline implies that industries of such structure are normally oligopolistic in the sense that sellers: (i) operate along non-perfectly elastic demand curves, i.e. they can raise prices at any time without losing their entire market share; and, (ii) they tend to act in concert, if not explicitly then implicitly.

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[7] Based on figures in World Development Indicators section of IBRD; World Development Report, 1991 and 1989.

[8] Figures are obtained from the formulae $5*(100/5)^2$ and $6*(100/6)^2$ respectively.

If an industry with an H of 1,800 or above is considered oligopolistic in the United States, then it is likely to behave similarly in Zimbabwe.[9] As shown earlier in Exhibit 3-2, only ten out of the 56 industrial branches identified in Zimbabwe show Herfindahl indices below 1,800. Nine of these, plus one other, have CR4s below 70 per cent.

For a more accurate measure one must disaggregate the branches, looking at individual products. According to UNIDO's 1986 survey, citing 1982 data, "although the sector produces over 6,000 different products, 50 per cent of these are produced by only one firm and 80 per cent by one, two or three firms."[10] In the same year "7.8 per cent of the firms produced 41 per cent of the output." The study also observed that there had been no significant change in industrial concentration between 1970 and 1986. This is, however, not surprising given that the industrial policy has a bias against competition, over the period with the maintenance of quotas on imports.

3.2.2 Non-Manufacturing Sectors

Systematic data is not readily available in Zimbabwe for non-manufacturing sectors. Thus, only qualitative information can be provided.

Monetary Banking Sector

Zimbabwe's financial sector plays a major role in the economy. The main institutions in the sector are the three discount houses, four merchant banks, five commercial banks, four building societies (one of which was recently approved), five finance houses, insurance companies, pension funds, the Post Office Savings Bank and one development bank. It is apparent that there is high concentration in the banking sector, if ratios are calculated for sub-sectors. All classes but one (commercial banks) would have a CR_4 ratio of 1.

Transportation Sector

Urban public passenger transport is operated by a monopoly -- Zimbabwe United Passenger Company (ZUPCO) -- through a franchise granted by the Government. Rural passenger transport, however, is operated competitively by several bus companies. The road haulage subsector is also competitive given the large number of road haulers (small, medium and large size, as well as foreign operators), although they have been subject to a number of regulations and licensing requirements.

[9] As discussed in Chapter 2, assessing whether oligopolists actually abuse market power is complex. It depends not only on market structure and concentration, but also on the behavior of incumbent firms and other factors affecting the likelihood of collusion.

[10] UNIDO, The Manufacturing Sector in Zimbabwe. Report PPD/R.2, 13 November 1986. p. 1.

Parastatals and Government Control of Industry

The public sector owns, controls or has investment interests in a substantial share of industrial production capacity in Zimbabwe. Particularly significant is the large number of parastatals or public enterprises. Many of these are monopolies because government has given them sole rights to provide a given set of goods or services, either through acts of Parliament (these are statutory parastatals) or through barriers to entry largely erected by government. Some parastatals operate in oligopolistic markets but they generally occupy dominant positions and face little competition, due to barriers to entry created by government and/or direct or indirect subsidization.

In addition, the government itself, the ZANU party or members thereof, own and/or control a considerable portion of private sector industry. GOZ and/or its agencies for example directly own 80% of Astra Holdings, about 43% of CAPS Holdings, 59% of Zimbank, about 40% of Delta Corporation, and 51% of Zimbabwe Newspapers. GOZ has holdings of less than 50% in a wide range of traded companies. Looking at publicly traded companies alone, the GOZ directly owns or controls about 12.5% of total stock market capitalization. It controls more than 50% of equity in six public companies and has a blocking interest in a total of ten. In addition to the Government, the leading political party is significant in the market, with extensive holdings channeled through M&S Syndicate and Zidco Holdings. Government/Party control is even more extensive, when the high degree of interlocking directorships and/or the extensive holdings of conglomerates are considered.[11]

In creating a competitive environment, it is critical that firms compete on an "equal footing" and that no one or group of firms benefits from "special treatment" or government barriers to entry specifically erected to protect those firms. Thus, attaining the goals of ESAP and competition will depend heavily on: (a) privatizing public enterprises and the "commercialization" of parastatals which remain in the public sector; and, (b) subjecting firms which the government either owns and/or has an interest in, to the same rules of competition and regulation as the private sector.

3.3 Barriers to Entry

It is evident from the above that the vast majority of manufacturing sectors and many other sectors in Zimbabwe display high levels of concentration. Concentration alone is insufficient to establish whether market power exists or if it is being abused. It is the combination of high concentration and significant barriers to entry which indicate market power and the potential for its abuse. Furthermore, there are certainly instances of industries which are not characterized by high levels of concentration which nonetheless collude and engage in RBPs due to the presence and/or creation of barriers to entry.[12]

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[11] Such cross-holdings and inter-locking directorships are not unique in Zimbabwe to government entities. Several major private groups display similar characteristics.

[12] RBPs can be both "causes" and "effects" of abuses of market power.

In the past in Zimbabwe, barriers to entry have been pervasive. Perhaps the most important overall have been: (i) the high levels of government regulation overall and the lack of transparency in related procedures; (ii) the smallness of the domestic market/economy combined with the high levels of protection and insularity from outside competition; and, (iii) the granting of sole rights to parastatals to provide a given service or product.

Barriers to entry come in many forms. Barriers to entry emanate from: (i) actions of government; (ii) industry structure and technology; and, (iii) behavior of businesses.

3.3.1 Government Regulation and Other Actions

Government regulations have contributed significantly to the existence of high industrial concentration in Zimbabwe in the past.

- **Price Control** -- The GOZ maintained an extensive system of price controls to counteract RBPs and reduce monopoly rent-seeking. This has been a very effective means of controlling firm's ability to charge monopoly prices, but at the same time has erected considerable barriers to entry, reduced the level of productive reinvestment, and decreased the overall efficiency of the economy.

- **Exchange Control and Import Quotas/Bans** -- The foreign exchange allocation system has tended to favor existing importers or the integration of firms with import licenses. The effect of this has been to deter new entrants or investment into many sectors of the economy which required imported raw materials. The shortage of foreign exchange has forced certain firms which operated below optimal production to close down. The system resulted in vertical integration, mergers and acquisitions as large firms attempted to gain access to foreign exchange allocated to smaller firms. The trade regime protected manufacturing firms from external competition, as imports that competed with domestic goods were barred. Quotas and bans on imports have had similar effects.

- **Labor Regulation** -- Zimbabwe has had a very extensive and complex labor code. It provided a high degree of regulation in such areas as hiring and firing practices and wage levels and compensation adjustment. and limited the degree of collective bargaining. This has led to a misallocation of resources, and increased the cost of doing business (due to the complexity of the regulations themselves).

- **Investment Control and Concessions/Licensing** -- The investment approval system in Zimbabwe tends to be biased against duplication of existing facilities. This policy protected the monopoly or oligopoly position of firms. In addition, the lengthy application and approval process has acted as a deterrence to foreign and domestic investors seeking to establish production facilities in Zimbabwe, adding to the "cost" of entry (cost, delay and risk). Similarly, the government has limited directly the number of concessions or licenses going to producers in a number of sectors. This increased concentration and limited competition.

- **Financial Market Regulation** -- The financial system is highly regulated in terms of new entrants, deposit and lending rates, portfolio composition and financial innovation (especially the issue of new financial instruments). Such regulation has tended to reinforce high concentration in the financial sector, as well as promote restrictive business practices. This ultimately leads to a misallocation of financial resources in the economy overall, and increases the cost of doing business.

- **Public Enterprises** -- As discussed above, the large number of parastatals in the economy has given rise to significant barriers to entry and non-competitive situations in a number of sectors. Entry has been denied through acts of Parliament, direct and indirect subsidization, or RBPs on the behalf of government (e.g., tying agreements with raw material suppliers, discriminatory pricing, and so on).

3.3.2 Industry Structure and Technology

Industry structure and technology related barriers to entry are typically factors which cannot be readily changed in a short period of time and generally do not result from either the practices for business or government (although they are not totally independent).

Typical barriers to entry in this category are: (i) limited supplies or access to technology; (ii) economies of scale, scope and vertical integration; (iii) sunk costs; (iv) excess capacity; and, (v) product differentiation and brand loyalty.[13] The degree to which these barriers exist in Zimbabwe depends on the industry sector in question. Many sectors in the past experienced difficulty in obtaining supplies due to the small domestic economy and the lack of imported inputs. Technology access has been limited, due to the lack of new investment by firms with technology, particularly from overseas. Many industries are subject to economies of scale, and particularly where the goods/services produced are non-tradeable, the small size of the economy has further made it economic for there to be only one producer. Excess capacity certainly exists in a number of industries and pose a "threat" to prospective entrants. The "frozen" industrial structure has meant that there have been limited choices among competing brands, and as a result brand loyalty has built up (for example, soft drinks and cigarettes).

A truly meaningful analysis of industry structure and technology barriers must be conducted on an industry-specific level. However. such barriers to entry have existed in Zimbabwe in the past, but will diminish to some extent in the "non-natural" monopoly sectors, as the economy opens up.

3.3.3 Business Behavior and Practices

Business behavior is seldom pro-competition -- certain firms attempt to prevent entry into an industry or to restrict competition within the sector, to reap monopoly rents. This sometimes takes the form of Restrictive Business Practices (RBPs). However, it is important to distinguish

[13] See Chapter 2 for fuller general descriptions of these barriers.

between conduct that is anti-competitive and exclusionary, from aggressive competition. Aggressive competition may take the form of technological innovation or efficiency improvement in order for a firm to capture a larger market share -- certain firms may be eliminated and industrial concentration may increase as a result. Anti-competitive behavior is conduct that seeks to eliminate competition and reap monopoly rents through restrictive business practices. Restrictive business practices have, in this way, contributed to industrial concentration and erected barriers to entry in certain industries in Zimbabwe.

There are a number of restrictive business practices that are common around the world (see Appendix on Worldwide Experiences), particularly if they go unchecked by well enforced prohibitions against RBPs. In section 3.4 below, limited evidence of RBPs in Zimbabwe is presented. Certainly many of the RBPs listed below have been present in Zimbabwe in the past -- given that the scope for such practices has been amply provided by government and industry barriers to entry and the lack of enforced, explicit prohibitions against RBPs.

- Collusion in price setting by firms.
- Collusive tendering.
- Exclusive dealing (restricting a client's freedom to purchase and deal in products of other suppliers).
- Differential pricing and discounting.
- Refusal to supply, boycott of supplier.
- Tied sales.
- Resale price maintenance.
- Area restriction.

3.4 Evidence of RBPs and Abuses of Market Power

The above demonstrates that there are a substantial number of industrial sectors in which there are both high levels of concentration and significant barriers to entry. Barriers to entry are also manifest in industries which have low levels of concentration. Thus, ample scope exists for abusing market power and engaging in RBPs.

However, evidence of actual abuses of market power and engaging in RBPs are not readily available and the usefulness of trying to collect such evidence is questionable.

- Firstly, and most importantly, the radical reforms contemplated under ESAP will have fundamental repercussions on the structure of the economy, will significantly change the basis of competition, and eliminate or diminish a wide range of barriers to entry that were manifest in Zimbabwe in the past (see the next Chapter). Within this context of change, the usefulness of conducting a historical analysis to determine abuses of market power is extremely limited -- in this case, "past is very much not prologue".

- Secondly, it is very difficult to prove actual abuse of market power. Statistical analyses are fraught with data and methodological difficulties. RBPs and abuses of market power, by their nature, are clandestine practices, whether undertaken by government-owned enterprises or private firms. Countries such as the UK, US and Germany with well-developed competition systems spend considerable resources on extensive analysis of one firm in one industry sector to determine the existence of an RBP or abuse of market power over a given period of time. Even after such thorough analysis, findings and decisions are often contested -- even by "neutral" parties such as academics who have no vested interest in the outcome.

The distinction is that pre-conditions for abuse of market power have been amply demonstrated in the case of Zimbabwe -- that is, high concentration and significant barriers to entry. Both from a theoretical point of view and the experience of many countries around the world, this is sufficient to conclude that: (i) the scope for abuse of market power exist; and, (ii) such abuse is actually occurring in a not insignificant number of instances (because it is the natural tendency of business to do so, when the occasion arises).[14]

All of the above notwithstanding, certain indicative analyses can be undertaken to provide some evidence as to whether abuses of market power have been manifest in a "ex-post" sense. Two main forms of ex-post analysis are discussed below -- each has its methodological weaknesses.

- First is the analysis of statistics to determine if: (i) there is a correlation and any causality between the degree of concentration and the price-cost margins commanded in a given manufacturing sector; and, (ii) the observed rates of entry and exit in given manufacturing sectors over time indicate the relative ease of entry/exit and thus, the level of entry barriers present.[15]

- Second is qualitative and anecdotal information gathered in the course of interviews, where the party being quoted states that certain RBPs and abuses of market power exist in certain cases, in their opinion.

[14] This was true in the recent transitionary period during which price controls have largely been removed but RBP regulations have yet to be promulgated and enforced.

[15] Exit barriers, such as sunk costs or specialized assets, are analogous to entry barriers because the high costs of exiting an industry acts as a deterrent to firms contemplating entering that industry in the first place.

3.4.1 Statistical Analysis of Monopoly Power and RBPs

Relationship Between Industrial Structure and Price-Cost Margins

In the Appendix on Worldwide Experiences, reference is made to ongoing World Bank-supported research into the relationship between trade regimes and a variety of industry parameters, including the Herfindahl concentration index. It is noted that, on the basis of both cross-section and time series data from several countries, the research has identified a positive correlation between price-cost margins (PCM) and the Herfindahl index. To be sure, this correlation by itself is no proof of the existence of restrictive business practices, including abuse of market dominance, that might be addressed by competition policy, since relatively high price-cost margins can reflect relative efficiency as well as RBPs.

Seeking to test the PCM-H correlation for Zimbabwe, the IPC team was limited to cross-section data from the 1989/90 Census of Production (data from earlier censuses have yet to be downloaded from the CSO's minicomputer onto microcomputer-readable diskettes). In an effort to limit heterogeneity of industrial branches, the team eliminated from the analysis all eight ISIC categories whose descriptions include "not elsewhere classified." This left 49 branches, comprising 873 enterprises.

For each branch a weighted average PCM was calculated, consisting of the ratio of (i) the value of gross output less variable costs, i.e. personnel costs and purchases of materials and services, to (ii) the value of gross output. The residual comprising (i) represents a gross return to capital, both equity and debt, including interest, depreciation and profit.

In the event, this exercise of correlating the PCM with the Herfindahl index yielded no significant correlation, the R-squared being .044. This suggests that in 1989/90, industries in Zimbabwe with relatively high levels of concentration did not systematically display higher levels of "profit."

The unavailability of time series data removes a significant dimension for testing the PCM-H relationship. Specifically, by being unable to observe the relationship over time within individual industries, the analysis is reduced to a single-year comparison of different industries with unrelated technologies and demand conditions. In one industry such conditions may force a monopoly or oligopoly to produce on its average cost curve while different conditions faced by a second, more competitive industry in the same year enable producers to reap temporary "supernormal" profits pending the entry of new firms.

Due to confidentiality restrictions on release of Census of Production data, PCMs cannot be presented for individual ISIC branches. The aggregate PCM for all 1,045 enterprises covered in the 1989/90 census is 0.269, which is well within the range of mean values estimated by

World Bank researchers for Chile, Colombia, Ivory Coast, and Turkey over periods of a decade, more or less, ending in the mid-1980s:[16]

	PCM
Chile	0.333
Colombia	0.274
Zimbabwe	0.269
Ivory Coast	0.267
Turkey - private sector	0.205
- public sector	0.131

Price Control and Industrial Structure

Using 1986/87 Census of Production data to correlate a slightly different version of the PCM with the CR4 concentration index, and obtaining a result similar to the foregoing, Bennell (1991) offers the following explanation:[17]

> ". . . This absence of any relationship between market power and profitability is most likely due to the impact of government price controls on a wide range of final and intermediate manufactured products which has prevented enterprises from reaping high profits as a result of their enjoying high levels of market power.
>
> In addition, however, considerable product differentiation in some industries coupled with low production volumes (especially of "one-off" products in the capital goods sector) has rendered price controls inoperable in many product markets. Thus, with high levels of market concentration in most industries, the variable incidence and impact of price controls appears to have undermined any relationship there might have been between enterprise market power and mark-ups."

The IPC Team sought to test the impact of price control by examining the CSO's Consumer Price Index for lower-income urban families to see what had happened to the foodstuffs and drink & tobacco components following removal of price controls from several commodities in

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[16] Data for Chile, Colombia and Ivory Coast are summarized in Lavy & Newman (1991), p. 13. The Turkish figures are computed from Foroutan (1991), Table 10, p. 41.

[17] Bennell, 1991, p. 7. Aggregating a number of ISIC branches, Bennell ran his regression on only 31 industries. He used CR4 rather than H as his concentration variable, and added two explanatory variables: (i) advertising expenditure as a proxy measure for barriers to entry; and, (ii) the percentage increase in industry sales between 1985 and 1986 "as an indicator of the state of the market in each industry". The adjusted R^2 is .027. Bennell's definition of PCM differs from that used by the World Bank researchers, as well as in the present study, in that he subtracts reported depreciation from the numerator, and purchased material inputs from the denominator. His estimates of PCM thus cannot be compared either with ours or with those calculated by the World Bank researchers for other countries.

those categories in mid-1991. Exhibit 3-5 traces the evolution of six components of the CPI since December 1989. Values are ratios to the current All-Items index, normalized on the basis of 1989 levels -- that is, each ratio starts from a 1989 base of 100.

As of December 1991, the foodstuffs component of the CPI showed almost no change from 1989 relative to the All-Items index, apart from a slight bulge of about 3 per cent in mid-1991. As of the same moment, the ratio of the drink and tobacco component (unstressed dotted line) was about 4 per cent above its 1989 level, although it had dropped to about 92 per cent of that level by August 1991 and then shot up 16 percentage points by November, largely in response to decontrol of beer and cigarette prices.

Clearly before attributing such an increase to abuse of market position by monopolistic or oligopolistic enterprises exploiting price liberalization, one must discard the possibility that price control had earlier depressed prices below long-run marginal cost, and that producers were taking advantage of liberalization to "catch up." No evidence was available to the IPC team on this issue. It is too early to test the relationship of price decontrol with industry structure and profitability.

Number of Manufacturing Enterprises

Exhibit 3-1 gives numbers of manufacturing enterprises covered in the CSO production censuses for 1970/71, 1986/87, and 1989/90, into and broken down by 4-digit ISIC code. For the two earlier years, the total number of registered manufacturing enterprises has been taken from Bennell (1991). The first series shows that the number of enterprises covered in the census has hovered around 1,000 for nearly 20 years, while the number of registered enterprises showed a significant decline between 1970/71 and 1986/87. An additional source, the 1986 UNIDO report (Table 3-3), cites 1,344 units in 1982 on the basis of the 1981/82 Census of Production.

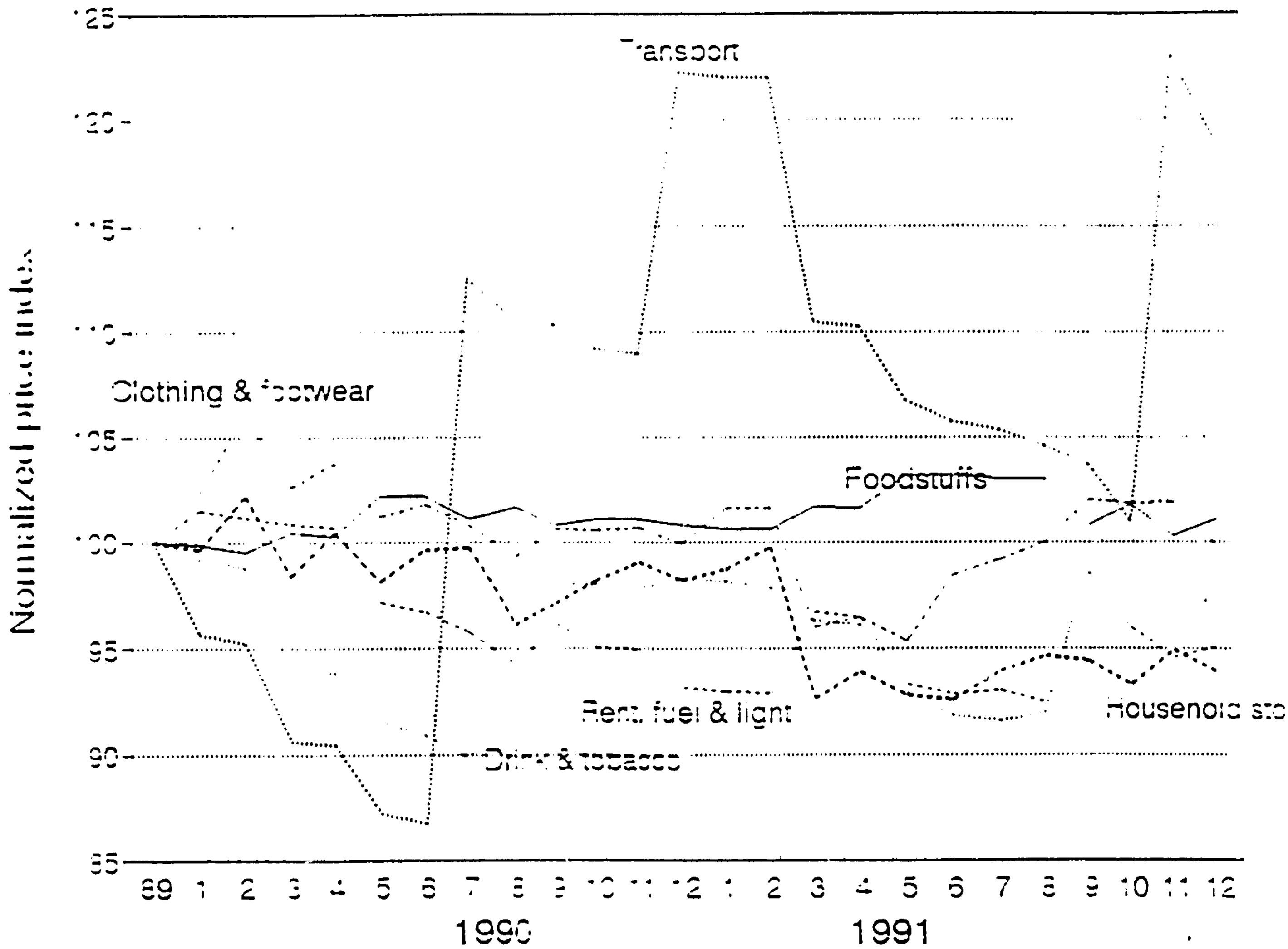
It is not clear how to interpret these figures. Even with no change in the number of producers, coverage in the census should increase as inflation lowers the real value of the threshold for inclusion (turnover of Z$2,000). On the other hand, some variation is to be expected as a function of managers' willingness to take the trouble to complete the CSO questionnaire and the CSO's perseverance in pursuing them. Variation in the number of registered producers may be a function of the vigor with which the Registrar of Companies eliminates defunct enterprises from his records.

The above notwithstanding, the data reflect the continuing stagnation in industrial investment that is much discussed in Zimbabwe and has been documented in reports by UNIDO and the World Bank. It is difficult to believe that a dynamic, competitive industrial sector would see no significant increase in producing units in ten years following independence.

Exhibit 3-5

CONSUMER PRICE INDEX, LOWER-INCOME URBAN FAMILIES

(normalized values, ratios to "All Items" index, 1989 = 100)



Source: CSO, Government of Zimbabwe

3.4.2 Other "Evidence" of RBPs

Presented below are the RBPs that are thought to be the most prevalent in Zimbabwe. Identification of these RBPs is based upon information collected during the conduct of about 50 interviews in Zimbabwe during February 1992, six structured case studies, and the experience of the IPC Team with pre-conditions for RBPs elsewhere in the world.

Collusive Price Setting/Price Fixing

There is evidence that firms which produce goods that have price controls tended to collude in negotiating price controls with the government. This was particularly evident in situations in which firms with different cost structures negotiated for a similar percentage price increase. In certain instances firms reduce supplies and increased stocks in anticipation of a price increase.

This behavior is not entirely a result of firm behavior but also the government price control system. The process of awarding price increases is such that firms are requested to submit their proposed price increases at more or less the same period. This was exacerbated by the existence of import controls which limited competition. Firms could thus propose price increases (in some cases divergent from world border prices) without the risk of losing their market shares to imports. The scope for collusive behavior in submitting applications in such an atmosphere is thus great given the common objective of profit maximization.

There is substantial vertical integration amongst Zimbabwean firms. Certain firms used this as a method of gaining monopoly rents by placing mark-ups at each stage of the inter-firm transaction. In certain instances, intermediate products were not sold to any other unrelated firms or were sold in limited quantities.

Collusive Tendering

An example of collusive tendering was reported in the construction industry. The mode of collusion in the industry is different from the classical oligopoly situation whereby firms would agree on a price. It was reported that large construction firms had a market sharing arrangement for large contracts. The large firms managed to rotate contracts amongst themselves.

Differential Pricing and Discounting

Differential pricing and discounting occurs when firms charge their customers different prices for the same goods and services. This often results in the customers having different cost structures and unfair competition in downstream industries. The resources obtained can either be misused for concealing inefficiencies in large firms or eliminating competition by predatory pricing. (It is important that this is not the same as charging different prices for cash and credit purchases or bulk purchases and small purchases. These differences are due to legitimate transactions costs in a competitive environment.)

Tied Sales

Tied sales or conditional selling occurs when a distributor forces a consumer to purchase goods as a precondition for the purchase of another good. Tied sales were reported in the distribution and retailing of scarce commodities. These commodities are: cooking oil, margarine, sugar and rice. A recent newspaper article cites that "more than 600 businessmen in Manicaland have been . . . overcharging or selling scarce goods conditionally."

Area Restriction

Area restriction arrangements have been observed in urban public transport and cement production in the early 1980s. The Urban Areas (Omnibus Services) Act, 1977 provides for the granting of franchises to bus operators in urban areas which restrict other bus operators from providing a competing service. However, according to the case study on the subject, this is a justifiable restrictive business practice that enhances public welfare.

Up to the early 1980s, the two cement producers had an agreement which controlled the distribution of cement from cement plants. The plant in Harare only distributed in the northern region while the other plants distributed in the southern region. The area restriction that was agreed by the cement firms was against public interest. Cement could be in short supply in one region while there was adequate supply in the other region. There was, therefore, an opportunity for rent seeking activities. Even though this agreement was abandoned because of cement shortages, there is no mechanism to prevent it from being re-constituted in times of low demand.

Restrictions of Associations

Some observers believe that many of Zimbabwe's trade associations restrict both membership in their associations as well as prevent members from doing business with non-members. However, it is legitimate for associations to have certain minimum standards for membership. Thus, restrictions on membership becomes subjective in terms of determining if it constitutes an RBP.

* * *

The implementation of ESAP will fundamentally change the nature of competition in Zimbabwe, by lowering barrier to entry, decreasing the level concentration in many industry sectors, and introducing a greater degree of competition. In the next chapter, the measures Zimbabwe has used in the past to combat RBPs and abuses of market power are examined, and the impact ESAP on competition and competitiveness is assessed.

CHAPTER 4

REGULATION AND CONTROL OF RBPS AND ABUSES OF MARKET POWER IN ZIMBABWE

In the past, the Government of Zimbabwe has used several means to regulate and control restrictive business practices and abuses of market power. These included price controls, labor regulation, the foreign exchange allocation mechanism, and direct government ownership in the industrial sector. Many of these instruments will be lost or their effectiveness diminished as a result of the implementation of ESAP. However, ESAP will create a competitive environment and provide countervailing forces to RBPs and abuses of market power through reforms in four specific areas: trade liberalization, price decontrol, domestic deregulation, and parastatal reform.

Current legal means in Zimbabwe for controlling RBPs and abuses of market power are limited. However, the legal system is well-viewed as a legitimate forum for conflict resolution and could be developed to effectively deter abuses of market power and handle RBP cases.

4.1 Past Efforts to Regulate and Control RBPs

In the past, the government has used four primary means to counter RBPs and abuses of market power.

Price Controls. Until recently, Zimbabwe has maintained direct price controls on a wide range of consumer prices. The objective of the price control policy has been to ensure that basic foodstuffs and other goods remained affordable to the broad population and to contain monopoly pricing. As of July 1990, price controlled goods fell into three categories: essential products; strategic products; and, other products.

- Essential products are basic products whose prices were determined directly by the Cabinet and included bread, maize meal, beef, cooking oil, matches, cement, steel, fertilizer, sugar, milk, motor fuel, and domestic air fares.

- Prices for strategic goods, which included packaging products, pork, batteries, tires, stockfeeds, paper, beer and cigarettes, were set by the Ministry of Industry and Commerce. The Ministry reviewed producers' applications for price increases on an annual basis, taking into account agreed mark-ups used during the previous five year period.

- Prices for the remaining products were determined on the basis of percentage mark-ups on cost. For a considerable number of goods, the mark-ups were specified by the law regulating the price control system. For these products, producers can raise prices to match cost increases without ministerial approval.

In January 1991, the following reforms were introduced:

- All price controls were removed on five products (cigarettes and pipe tobacco, wines, spirits, safety glass, and motor vehicle batteries); and,

- A number of products were moved from the category of strict controls to that for which the Government announces fixed maximum or specified prices. These included agricultural produce including food or cash crops, livestock and fish, building materials other than cement, food additives, mineral raw materials, motor vehicles, and stockfeeds.

Thus, only ten products remained on the strict price control list, for which prices are determined directly by the Cabinet.

Labor Market Regulation. The second form of government intervention that limited the ability for firms to command "monopoly level" profit was labor market regulation. Since Independence wages have been set administratively to contain inflation and as a means of supporting the Government's income distribution objectives. Until 1989, the Government fixed mandatory wage increases, with larger increases going to the lowest paid, and restrictions were also imposed on individual firms' scope for laying off employees to provide job security. During the 1989 to 1991 period, a number of reforms were undertaken.

- In 1989, a limited form of collective bargaining was introduced.

- In 1990, ceilings on wage increments were abolished.

- In 1991, dismissal practices were liberalized, whereby although dismissal of any worker still required Ministry approval, this was administered flexibly to allow retrenchment of redundant workers and termination of employment for disciplinary action.

Foreign Exchange Allocation. The third area to combat abuse of market power was the informal use of the foreign exchange allocation mechanism as leverage to keep firms from getting out of line. Past policies emphasized tight control on the limited supply of foreign exchange. During the period when import substitution policies were dominant, tight allocation of foreign exchange was a powerful means of influencing the business community, because foreign exchange was critical to international purchases of raw materials and more importantly, capital equipment. The lack of transparency and automaticity in the foreign exchange allocation mechanism accentuated the role of foreign exchange allocation as a means for government to exert "leverage" over the private sector.

Public Ownership. Finally, the government sought ownership in the industrial sector as a way to counter the influence of monopolies and oligopolies (as well as to reduce South African ownership). There are a large number of parastatals in Zimbabwe. The majority operate either as monopolies or oligopolies in their respective industries. Many are statutory parastatals, which are thus constituted as monopolies by act of parliament. Government control of industry is even greater when government equity positions in industrial holding companies and shareholdings in private companies listed on the stock exchange are included.

These government efforts at intervention substantially achieved their aims, but did so at great costs. On the positive side, the ability to monopoly rent seek has been effectively limited, and the evidence of foreign-owned firms directly repatriating "excessive" profits is almost nil.[18] Wage differentials diminished. At the same time, inflation was suppressed and some price stability and predictability achieved. There is no question that government achieved substantial influence over the business environment.

On the negative side, in general, the pattern of regulation erected high barriers to entry, which served to freeze the existing industrial and corporate structure. Price controls and labor regulations, in particular, increased the risks that potential new entrants faced. The foreign exchange allocation system and industrial licensing system both deterred new entrants and gave a powerful incentive for existing firms to engage in collusion and other restrictive business practices. The growing barriers to entry reinforced the already existing incentives for firms to concentrate on the domestic market, while limiting the pressure on firms to maintain and improve the quality of their goods. Incentives for new investment were limited. Finally, the substantial public equity in large conglomerates, perversely, created a governmental stake in the maintenance of the status quo.

4.2 The Effects of ESAP on RBPs and Abuses of Market Power

The structural adjustment program will create an entirely new environment for government's efforts to regulate RBPs and abuses of market power. Major reforms in all four of the areas used in the past to regulate RBPs or control abuses of market power are either underway or contemplated as part of ESAP. Price controls are already substantially lifted; over the life of the program, the foreign exchange allocation system will be fundamentally transformed; labor regulations have become much less extensive; and, public ownership may diminish and parastatals are targeted to run on a "commercial" basis.

However, the degree of success ESAP reforms will have on stimulating competition and competitiveness, and thereby reduce the scope for RBPs and abuses of market power, is subject to debate. The coordination and effectiveness of implementation of ESAP will bear heavily on its success with regard to competition and competitiveness. It is already evident that fiscal and monetary related reforms in ESAP, such as price decontrol, tariff reform and devaluation, will be implemented on or ahead of schedule, whereas actions requiring institutional and/or

[18] Transfer pricing is another means used by firms to repatriate profits. Transfer pricing is difficult to prove and was not a focus of this study, but given the severely limiting past foreign exchange regime in Zimbabwe, it is reasonable to assume that a significant number of firms with foreign interests practiced transfer pricing.

legislative reforms, such as full creation of the Zimbabwe Investment Centre (ZIC) or public enterprise reform, are likely to involve lengthy processes and be implemented behind schedule.

4.2.1 Price Decontrol

Elimination of government control of prices is critical to creating a competitive environment. It will allow prices to be set by market forces, and send signals to economic actors. There are, however, positive and negative consequences of price decontrol, particularly in the near term. On the positive side, market prices in the longer run will limit the amount of "rent" seeking by existing enterprises, because if they raise their prices too high for an extended period of time, the "excess profit" will stimulate new firms to enter the industry and drive prices downwards.[19] Decontrolled prices will also "drive" inefficient producers out of business. In addition, decontrol will allow firms to earn adequate returns for reinvestment, which is critical for the modernization and competitiveness of Zimbabwe's industrial base. In the near term, however, incumbent firms may engage in price gouging. Existing firms will be able to increase prices substantially in the near term at the detriment of consumers because: (a) it can take time for effective competition to gear up (build factories, set up distribution channels); and, (b) so many industries are dominated by one or two firms whose market power will not be substantially diminished quickly.

The intent of ESAP is to remove price controls on all but a few basic foodstuffs, and to decontrol the prices of products as and when they are put on the OGIL. Rapid progress, in practice but not yet in law, has been made. A number of products have been moved from the category of strict control to that for which the Government announces fixed maximum or specified prices. Price controls have been removed altogether on a substantial number of other products. Strict controls now remain only on ten or so products which are primarily basic consumption items or are strategically important. Except for these ten items, the remaining price controls are generally not enforced. Restrictive and wide ranging legislation, particularly with respect to items subject to the cost-plus mark-up formula, does however remain in place.

4.2.2 Trade Liberalization

Trade liberalization can have a very positive effect on competition and competitiveness. The lowering of trade barriers, removal of exchange controls, and reduction of restrictions on foreign investment, in theory should: (a) make domestic producers more competitive by making them subject to the discipline of international competition, and thus, stimulate increases in productivity and push prices to their import parity levels; (b) stimulate growth and efficiency by opening new export markets; and, (c) widen the range of goods available to consumers, both by introducing newly imported goods and expanding the range of goods produced by domestic companies.

As part of ESAP, the government is committed to a phased program of trade liberalization to move the present foreign exchange allocation system to a market-based system by 1995. This program includes expanding the Open General Import License and Export Retention systems,

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[19] This assumes that no significant degree of collusion occurs between incumbent firms and new entrants.

tariff reform, supportive exchange rate policy, and improved export incentives. The trade liberalization program to date is ahead or on schedule with respect to devaluation, ERS and tariff reform, but behind schedule for OGIL and other export-related incentives.

- Exchange rate developments are well ahead of schedule and the recent devaluations have been quite sharp and massive. These moves have been successful in improving the balance of payments, have helped Zimbabwe to qualify for "soft" loans (lower interest) from the World Bank/IMF, and made Zimbabwean exports more price competitive. However, the high hopes for the devaluation's positive effects on competition and competitiveness, have been largely unmet. The higher cost of imports has limited the extent to which imports constitute an effective disciplinary force on domestic producers. It has also increased the cost of re-tooling domestic industry, which is a pre-requisite for some of Zimbabwean industry to become competitive. Unfortunately, slow progress in OGIL (see below) has muted some of the positive impact of devaluation, and government still retains primary control of foreign exchange allocation.

- The Export Retention Scheme (ERS) is a key to reducing the role of government in foreign exchange allocation, and thus, provide firms with more ready access to the foreign exchange needed for modernization. This also provides a strong incentive for firms to target export opportunities and earn foreign exchange themselves and Zimbabwe much needed foreign exchange. The ERS was introduced in July 1990 and initially allowed exporters to retain 5 to 7.5 percent of their export earnings and to use these funds to import goods needed for their business. The ERS is meant to be expanded gradually, eventually to allow exporters to import goods worth up to 35 percent of their export earnings, by the middle of 1993. These goods will be freely transferable. This will provide an important incentive to shift to export production. However, this is a minimum but not sufficient condition for re-orientation of production towards exports.

- Tariffs, according to the ESAP plan, will become the principal source of protection for local producers. A phased program for rationalizing and harmonizing import tariffs, including a flat rate surtax, customs duties, the industrial drawback of import duties and the import tax, is set out in ESAP. The phasing called for major actions in 1991, 1993 and by 1995. However, this element of the program has been accelerated, and by October 1991, the minimum tariff across the board was raised to 10% and the minimum duty on all goods under OGIL subject to levies of 20%.

- Two basic categories of OGIL have been introduced, to allow local industries time to adjust and modernize. One is unrestricted, the other has end use restrictions. The latter is designed to strengthen export performance and help industry prepare to face external competition during the early years. According to the ESAP, the first goods placed on OGIL will largely be raw materials, irrespective of whether they are domestically produced. This will be followed by intermediate goods. Capital goods will be initially made available by special lines of credit through ZIC. In the middle years of the program, capital goods will be added to the list of unrestricted OGIL. Consumer goods will be placed on OGIL only in years four and five. Performance of the OGIL to date has been less than was planned.

- The OGIL is behind schedule. The end of 1991, OGIL goal was to move 30% of all imports onto the unrestricted OGIL, and an additional 20% on to the end-use restricted OGIL. However, as of the end of 1991, less than 14% of the 6-digit SITC categories were placed on OGIL, a figure which includes unrestricted and end-used specific OGIL goods. This falls well short of the 50% year-end target. When expressed in terms of value of imports, the OGIL now accounts for about 15% of total imports.

- Importation of capital goods has been stifled by the poor functioning of ZIC as an institution, the high rate of rejection of loan applications submitted to ZIC, and the relatively weak demand for the facility, which is only available to exporters who can demonstrate immediate positive foreign exchange cash flows. Only 40% of the IFC loan administered by ZIC had been disbursed by the end of 1991.

- The slow progress in OGIL implementation has served to perpetuate the government's control on foreign exchange. The logic of phasing different categories of goods (raw through to consumer) on to OGIL is well founded if OGIL is taken in isolation. However, the sharp and massive devaluation of the Zimbabwean dollar in the last couple years, particularly 1991, would seem to afford sufficient protection from imports to all domestic producers irrespective of whether they make intermediate, capital or consumer goods.

• Other <u>export incentives</u> are envisaged under ESAP. The primary candidate at the moment is the refinement of the duty drawback scheme, aimed at improving the transparency of the scheme and at providing more effective relief from taxes on inputs for exporting sectors. As of late 1991, proposals for an average duty drawback system where the exporter is paid immediately upon receipt of export proceeds was under review by an inter-ministerial committee.

4.2.3 <u>Domestic Deregulation</u>

The purpose of domestic deregulation from a competition point of view is to reduce the level of regulation and streamline procedures, so as to reduce the cost of doing business, increase business confidence and lower risks, and thus, lower barriers to entry and stimulate investment.

The stated objective of ESAP in this area explicitly supports the competition goal -- "reform of the regulatory system to increase domestic competition and provide entrepreneurs with the freedom to respond to market forces". The program encompasses the simplification and further liberalization of investment approvals, exchange controls on profit and remittance, price and distribution controls, labor and wage regulation, and increased enablement of the small scale and informal sectors. However, it does not specify in much detail what actual reforms are to be undertaken nor how they are to going to be implemented.

Progress to date on domestic deregulation has been disappointing.

- Early efforts at legally constituting and creating an effectively functioning investment center (ZIC) were dismal, with the corresponding significant loss of momentum in foreign and domestic investment deregulation. Thus, significant barriers to entry still exist and the opportunity for new entrants to impose competitive pressure on incumbent firms has been greatly reduced.

- Some significant advances have been made in the area of labor deregulation, both prior to and in the early years of ESAP. However, Zimbabwe started from a base of a highly restrictive set of labor laws. The codes remain cumbersome and complex compared to those of successful developing countries. In addition, while the situation in the labor market is much improved in practice, significant reform is still needed from a legislative perspective.

- Progress has been slow to materialize in other areas. Most importantly little progress seems to have been made by the Deregulation Committee, chaired by the Ministry of Local Government. The establishment of a Commission on Monopolies (the subject of this report) is behind schedule, and relaxation of licensing restrictions on hawking and street vending have been slow to materialize.

4.2.4 Public Enterprise Reform

The objective of a parastatal reform is for public enterprises (PEs) to operate on a commercial or near "market like" basis, and to eliminate any subsidies and strains on public finances. From a competition point of view, it important that the role of the private sector and market forces is increased, that barriers to entry even in sectors previously dominated by parastatal monopolies be reduced, and that public enterprises not be protected from competition either through regulation, legislation and subsidization.

Unfortunately progress with PE reforms has been slow and many public enterprises remain in monopoly or highly protected positions. A major retarding force has been difficulties and delays experienced in appointing a team of consultants to study reform issues and options for ten of the more major and loss-making PEs. Some PEs have initiated their own programs of rationalization but have been slow to implement them. This is largely because the PE's legal status and the future role of current management is unknown, pending the outcome of the delayed consulting study and other issues.

Most PE-related reforms were scheduled to start in 1991 – few have been. Given both this delay, and the lengthy process necessarily involved in the legal, regulatory and organizational reforms required in PE restructuring, it will be many years before certain significant sectors of the economy are liberalized, fully open to competition and the remaining government entities operating on a commercial basis.

4.2.5 ESAP's Impact on Competition and Competitiveness to Date

Overall ESAP reforms will greatly improve the degree of domestic competition and international competitiveness, if ESAP is fully executed. However, a major challenge will be to coordinate implementation of the various elements of ESAP so as to maximize the impact on competition and competitiveness and to minimize the costs during implementation and transition.

Unfortunately, to date, few reforms that in theory provide a significant impetus to competition have been fully implemented, and those that have been put in place have had their competition effects muted.

- Domestic deregulation is a key to stimulating competition by lowering barriers to entry and facilitating new investment or the "supply" response. The domestic deregulation program is not specified in great detail in ESAP and is very behind schedule. This may reflect the fact that domestic deregulation is institutionally and legislatively very intensive, and these are the sorts of reforms that are slow to happen, particularly it seems in Zimbabwe.

- Price decontrol is well advanced but the risks of price gouging and/or the intensification of market power of incumbent firms is high. Neither effective domestic nor international competition is likely to emerge in the short term in many of the industrial sectors for two main reasons.

    - With respect to domestic competition: (i) without substantial domestic deregulation, significant barriers to new entrants remain; and (ii) without PE reform, many sectors will still be characterized by one dominant, government-owned enterprise.

    - With respect to international competition: (i) the lack of domestic deregulation makes investment by foreigners in the domestic economy unattractive to the foreigner; and, (ii) the greatly devalued currency provides high levels of effective protection to domestically produced goods which otherwise might be subject to competition from imports.

- Trade liberalization is one area where many reforms are relatively easy to put in place quickly and thus the discipline of international competition would seemingly be fairly immediate. However, the exchange rate first needs to support balance of payments and macro-stabilization objectives. The devaluation has been very effective from this prospective. However, it has made imports very expensive and served to diminish the early competition effects of ESAP. Of course, exports are much more price competitive but the ability of domestic producers to respond has been limited by the lack of domestic deregulation, the continuing heavy government control of foreign exchange, the high cost of imported inputs, and the lack of specific pro-export initiatives to facilitate prospective exports. The international competition aspects of ESAP would be enhanced by actions in two areas.

- Expansion of an unrestricted Export Retention Scheme and getting OGIL back on schedule (that is, at least 50% of goods on OGIL), so as to reduce the degree of government control on foreign exchange.

- Provision of explicit pro-export incentives and facilitation. Export markets are difficult to penetrate, require substantial sunk costs, and often are perceived to be more risky than domestic markets. This is particularly true in Zimbabwe where many firms are new to exporting and their products and production facilities are below international standards. If ESAP is going to have a significant export supply response, reforms will be required in at least two areas:

  -- Institutional arrangements which fill market gaps and place domestic exporters on at least an equal footing with their foreign competitors, such as timely access to imports at international prices, access to pre- and postshipment export finance and credit and insurance, and support by government and private sector agencies in acquiring technological, management and marketing know-how.

  -- All barriers to domestic competition function as export barriers by increasing the relative profitability of domestic sales. Thus it is essential to remove these barriers and introduce a balanced and effective mix of competition policies.[20]

4.3 Legal Means for Controlling RBPs and Abuses of Market Power

ESAP, if effectively implemented, will lower barriers to entry and stimulate a substantial degree of domestic competition and international competitiveness. As a result, the scope for abuses of market power and many RBPs will be reduced. However, even in a post-ESAP period the scope for some RBPs would remain, particularly price fixing and various other forms of collusion. Most countries have pursued, at a minimum, a legal response to deal with this issue. Thus, review of existing statutes and the state of the legal system overall in Zimbabwe will help to determine the extent to which legal remedies could be pursued.

4.3.1 Existing Laws

Zimbabwe currently has few laws which prohibit RBPs. From 1954 to 1989, a limited number of provisions were in place which addressed certain forms of horizontal price fixing and conditional/tied sales. A law still remains in effect which places restrictions on conditional sales of motor vehicles. However, despite a well-developed and long-standing legal system in Zimbabwe, enforcement of these RBP-related provisions in the past has been minimal.

From 1954 until 1989, the Control of Goods Act of 1954 (Act 12 of 1954) provided limited controls upon RBPs. Section 10 of the 1954 Act contained the following "Prohibition Against Establishing Prices by Associations and Others":

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[20] "Competition Policies for Industrializing Countries", World Bank, 1989.

> No association or group of persons who in the course of their individual businesses sell any commodities or render the service of delivery of any commodities shall, without the prior approval of the Minister, establish a uniform price or uniform prices or a uniform margin of profit for observance by the members of such association or group or any other person in respect of the supply of such commodities or the service of delivery thereof.

Section 14 of the 1954 Act supplied the following ban upon "Conditional Selling":

> (1) Save as is provided in subsection (2) no person shall sell any controlled goods to any person on condition that such other person purchases or acquires from him or from any other person any other goods whatsoever in addition to such controlled goods.
>
> (2) Nothing in this section shall apply to any sale described in subsection (1) if the other goods referred to in that subsection are --
>
> (a) goods which, according to the custom of the trade, are not sold separately from the controlled goods referred to in subsection (1); or
>
> (b) goods forming part of the same set of goods as such controlled goods.

Thus, until 1989, Zimbabwe had in effect statutory prohibitions against certain forms of horizontal price-fixing (Section 10 of the 1954 Act) and tying arrangements involving price-controlled goods. These provisions of the 1954 Act were repealed in 1989 by Statutory Instrument 153B of 1989. There are few reported instances of efforts to enforce these provisions. The basis upon which these provisions were discontinued in 1989 is not widely known.

Statutory Instrument 153B of 1989 left in place a sole restriction on RBPs Section 37 of that measure established "Restrictions on conditional sales of motor-vehicles," which provide in part:

> (1) No person shall refuse to sell any motor-vehicle on the grounds that the purchaser does not wish to --
>
> (a) purchase with that motor-vehicle any accessory or body not ordinarily fitted to such motor-vehicle; or
>
> (b) trade in another motor-vehicle in part payment for such motor-vehicle.

This prohibition on tying arrangements involving sales of motor vehicles appears to be the Zimbabwe's only existing statutory or regulatory provision dealing with RBPs. There are no reported instances in which Section 37 of Statutory Instrument 153B has been enforced. The extent to which other elements of the Control of Goods Act provides a starting basis for new/revised statutes pertaining to RBPs needs further investigation.

4.3.2 Legal Basis for RBP-Related Legislation

The legal system overall provides a relatively solid base for developing and subsequently, enforcing RBP-related legislation, even though few laws currently exist which specifically address RBPs. Public enforcement which relies on the legal system has a strong precedence and "track record" in Zimbabwe. However, private cause of action or class actions basically do not exist. If this enforcement means is considered desirable, then substantial changes in current legal practices would be needed.

The Zimbabwean courts apply common law principles derived mainly from the Roman and Dutch legal traditions.[21] The common law doctrines in Zimbabwe provide a limited basis for challenging RBPs under theories based in contract (that is, laws governing contracts) or in delict (that is, civil offenses of a non-contractual nature).

Contract Theories

Under the Zimbabwean common law of contracts, courts will not enforce categories of agreements that violate existing legal prescriptions (e.g., agreements to commit crimes); undermine good morals (e.g., certain wagering agreements); or, contradict public policy.

Under the category "contradicting public policy", courts have the scope for refusing to enforce certain agreements that are deemed to be in "restraint of trade."[22] A number of theoretical possitbilities exist as grounds on which to argue selected RBP cases within the parameters of contract law in Zimbabwe. However, the members of Zimbabwe's legal community whom the IPC Team interviewed were aware of no decision that has endorsed such an approach in the context of a challenge to RBPs.

Thus, it is reasonable to assume that Zimbabwean common law contract doctrine supplies no reliable basis for litigants to combat agreements by which firms seek to reduce output or increase prices. Even with respect to non-competition covenants related to an employment agreement or a sale of business, the Zimbabwean courts appear to apply a basic presumption favoring enforcement of challenged contracts. Several Zimbabwean legal practitioners noted an increased judicial unwillingness to void "unreasonable" or "unconscionable" contracts containing such noncompetition restrictions.

Thus, though plausible theoretical arguments can be advanced, common law contract principles in Zimbabwe do not appear to provide promising grounds for attacking RBPs.

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[21] By contrast, many of Zimbabwe's statutes governing the formation and operation of business enterprises have been influenced deeply by English law. For example, the Companies Act of Zimbabwe adopts many central features of the United Kingdom's Companies Act.

[22] See Christie (1985); Nherere (1988).

Delict Theories

A second common law body of doctrine that bears some relation to restrictive business practices is the law of delict (torts), that is civil offenses of a non-contractual nature. The law of delict supplies a limited basis for challenging certain "unlawful competition" or fraudulent business tactics such as "passing off" (representing one's own goods to be the goods of another producer), wrongfully interfering with contractual relations, or stating injurious falsehoods about the products of a rival seller.[23] As with contract law, doctrines governing actions based on delict provide no substantial basis for firms to challenge RBPs such as price-fixing or predatory pricing.[24]

Institutional Implications

Although it does not offer an effective tool for combatting RBPs, the evolution of the Zimbabwean common law of contracts and, to a lesser extent, delict has noteworthy institutional implications for the adoption of a new competition system designed to redress RBPs. In confronting "restraint of trade" and "unfair business practice" claims, legal practitioners and courts have acquired an important degree of familiarity with analytical principles that would be important to the application of new prohibitions on RBPs. For example, to make distinctions between reasonable and unreasonable non-competition covenants related to the sale of a business, courts have been forced to devise principles for weighing the pro-efficiency consequences of such agreements (enabling business owners to obtain full value for goodwill by providing a mechanism to assure the buyer that the seller will not undermine the buyer's investment in that goodwill) against their efficiency-reducing potential (the removal of a competitor from the market). The process of devising standards to balance competitive benefits against competitive harms is generally similar to the "rule of reason" methodology that tribunals with RBP jurisdiction often use to evaluate claims of anticompetitive behavior.

Thus, legal practitioners and courts appear to be well versed in certain core concepts that would characterize a system which legislated against RBPs.

Legal Procedures

Trials before Zimbabwe's courts take place with a framework of procedural rules and practice requirements that are largely the same as principles embraced by legal systems derived from the European Continent and the United Kingdom. Several distinctive features concerning the operation of a competition policy regime are worthy of mention.

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[23] See Boberg (149-70); Feltoe.

[24] See Hussein (1991). We are aware of one South African decision that used the delict of unlawful competition to bar a wholesaler from, in effect, insisting that its commercial customers adhere to a resale price maintenance scheme. See Silver Crystal Trading (Pty) Ltd. v. Namibia Diamond Corporation (Pty) Ltd., 1983 (4) SA 884 (1).

First, Zimbabwean practice does not use juries. All civil and criminal matters are tried solely before judges. In countries that allow for jury trials in civil cases, plaintiffs tend to prefer having a jury (rather than a judge) perform the fact-finding role, as juries historically demonstrate a somewhat greater sympathy for smaller firms when such firms bring RBP cases against larger companies. The absence of juries plainly elevates the significance of the judge in the adjudication process. Thus, to the extent that Zimbabwe's judiciary plays a institutional role in a new competition policy scheme, the preferences of judicial nominees will influence how RBP prohibitions are interpreted and applied.[25]

Second, Zimbabwe practice essentially does not recognize the use of the class action. The country's procedural laws do permit the joinder of claims, but only after relatively demanding prerequisites have been met. Conventional civil practice provides no feasible means for seeking recovery for aggregate damages suffered by a large body of consumers at the hands of a price-fixing cartel. In countries that allow consumer suits to recover overcharges attributable to RBPs, the class action is an important tool for overcoming the unwillingness of individual consumers to incur the substantial costs of litigation in return for the prospect of recovering the comparatively small amount by which they individually were overcharged.

A third, closely related procedural feature is that Zimbabwe does not allow legal practitioners to accept representation on a contingent fee basis.[26] Clients are expected to pay as they go through the litigation process. The requirement that legal practitioners be paid on an hourly basis -- and not a percentage of funds ultimately recovered -- reduces the prospective number of plaintiffs who can be expected to bring legal cases. Without class actions or contingent fee arrangements, it is a rare consumer who would be willing to fund a significant litigation effort. Nor can most businesses readily absorb the costs of adjudicating a commercial dispute.

Fourth, Zimbabwe's courts essentially follow a "loser pays" rule with respect to litigation costs. Among other increments of expense, a significant percentage (set by tariff for each court) of a party's attorneys fees ordinarily can be included in the costs taxed against the loser.[27] Accordingly, the prospective plaintiff must consider the possibility that a defeat in court will not only mean the loss of desired relief and the payment of out-of-pocket legal costs, but also the payment of a significant part of the victor's total legal bill.

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[25] On the importance of judicial selection to the operation of an RBP regime, see Kovacic (1991).

[26] Several members of Zimbabwe's legal community noted the possibility that contingent fees ultimately may gain acceptance in Zimbabwe. When such a development might occur is entirely a matter of speculation.

[27] The court-determined tariff schedules for reimbursing attorneys fees do not pay 100 cents on the dollar of fees actually incurred. As a rough measure, several members of Zimbabwe's legal community indicated that actual recoveries under the tariff schedule often constitute approximately 50 percent of attorneys fees incurred. In recent years, Zimbabwe has operated with a unified bar that draws no distinction between the counselling and advocacy functions, though some vestiges of the historical bifurcation remain. A small subset of the bar continues to practice advocacy exclusively in "advocates chambers." In some circumstances, Zimbabwe practice allows the fees of advocates to be recovered in full.

The fifth procedural characteristic relates to the availability of pre-trial discovery tools. Although Zimbabwean civil procedure provides for standard devices such as interrogatories and demands for the production of documents, depositions ordinarily are allowed only if the deponent resides outside Zimbabwe. Where spoken commitments supply the means for establishing a price-fixing agreement, the pre-trial deposition can be an especially effective tool for uncovering the details of an illicit contract.

Sixthly, many of Zimbabwe's existing forms of economic regulatory legislation (for example, restrictions on transactions involving foreign exchange) are enforced by criminal sanctions.[28] It would not be a major departure from current practice to use criminal enforcement tools to punish and deter particularly harmful RBPs such as horizontal price-fixing or collusive tendering to government purchasing authorities. Zimbabwe's economic crimes are punishable by both fines and imprisonment. The power to proceed criminally ordinarily rests exclusively with the Attorney General. However, Zimbabwe's rules of criminal procedure in some instances also allow private parties to prosecute criminal actions on the government's behalf when the Attorney General declines to initiate criminal proceedings. Thus, the notion of a two-tiered enforcement process that contemplates both public and private enforcement of a set of business controls would not depart substantially from past Zimbabwean practice.

Finally, multiple damages are not feasible under the current legal system. In civil practice dealing with contract and delict actions, courts typically award only "actual patrimonial loss" (compensatory damages). There is no recovery for emotional distress, and punitive damages are available only to redress defamation. Thus, an RBP scheme that permitted courts to award multiples of actual damages (for example, by trebling actual losses along the lines of the United States model) would represent a novel approach in the Zimbabwean remedial scheme. In the experience of other countries with an RBP control regime, the availability of multiple damages has provided an important inducement for the filing of private enforcement actions.

A number of reforms to the legal system are being contemplated, according to the Law Development Commission, which may have a bearing on the treatment of RBP and anti-competition cases. These include: (i) introducing contingent fee basis; (ii) passing of a Consumer Contract Protection Act; (iii) providing legal provisions for group or class action suits; (iv) establishing a small claims court; and, (v) passing a Product Liability Act. All of these reforms are at different stages of being proposed and considered. None has yet to be approved as part of current legal practice in Zimbabwe.

Overall, Zimbabwe has a sophisticated judicial system that the business community generally regards as a fair and competent forum for the resolution of commercial disputes. Original jurisdiction over commercial lawsuits resides in both the nation's Magistrates Court and the High Court, which also exercises appellate jurisdiction (review of cases already tried in lower courts or special tribunals) in some matters. The Supreme Court serves as the forum of final appeal in Zimbabwe. The Zimbabwe judiciary seems to enjoy considerable legitimacy and respect in the eyes of business and the society as a whole. As one commentary has said, "Zimbabwe is

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[28] See Hooper (1991).

respected at present as having a strong independent judiciary and this in turn has created the image that Zimbabwe is a democratic state and therefore a good place to do business in."[29]

[29] Coltart (1991: 10). Coltart also notes that "The Supreme court of Zimbabwe has a proud history of the last few years of being fiercely independent. It has been praised internationally because it has not kowtowed to Government. It is no secret that government has resented many of the decisions handed down by the Supreme Court as those decisions have effectively restrained Government from acting in the way it wanted to." Id. at 9.

CHAPTER 5

COMPETITION POLICY

5.1 Rationale for Competition Policy

Creation and maintenance of a competitive business environment in Zimbabwe is required to ensure the success of the economic reform program. Implementation of an effective competition policy in concert with the ESAP will result in the creation of a competitive industrial structure. This should then serve to: (a) improve productivity; (b) promote innovation; (c) facilitate new entries; (d) stimulate export performance; and, (e) enhance consumer sovereignty.

Explicit competition policy and regulation should be seen as a necessary complement to ESAP reforms because: (a) markets are not perfect; (b) business behavior is not automatically pro-competition; and, (c) policy measures put in place by government may be inconsistent and/or fail to be fully implemented. Competition policy's role is, thus, to provide a code of conduct, alter market structure where required, and ensure that the full pro-competition elements of government action come to fruition.

Certain abuses of market power and RBPs would persist even if ESAP were in place today. These will require some form of regulation and control.

- Countries such as Germany, the United States, Britain and Canada have more open and market-based economies than Zimbabwe and experience much lower levels of industrial concentration, yet have some of the more stringent and complex sets of regulations regarding RBPs and abuses of market power.

- While the market power of monopolies and oligopolies which currently exist in Zimbabwe largely due to the effects of government regulation or entry barriers erected by businesses may be reduced by ESAP reforms, some monopolies will still remain due to economies of scale or other aspects of market structure or technology. These so called "natural" monopolies, such as utilities and telecommunications, for which it is economic for only one main producer to exist, will require sector-specific regulation not contemplated in ESAP.

- In addition, some RBPs will still exist, such as horizontal price fixing, collusive tendering and market or customer allocation schemes, because it is a natural tendency of companies to engage in some collusion or other form of restrictive business practice, if they go unchecked.

Creation of a pro-competition advocacy role is essential to ensuring that the competition enhancing aspects of ESAP come into effect and have their full, designed impact. Lobbying for the removal of existing regulations that impede the competitive process and vetting the competitiveness consequences of newly proposed legislation and regulation, is a worthwhile undertaking under any circumstance.

RBP regulation is also required to guard against RBPs and other abuses of market power during the transitionary period while ESAP is being implemented. It is unlikely that all the reforms envisaged in the ESAP can be implemented, in practice, in a timely and coordinated fashion. A well designed interim set of RBP regulations can serve to mitigate the "opportunities" for the more harmful RBPs that may transpire during implementation of the ESAP.

Finally, a well orchestrated competition policy is timely given the government's commitment to broaden the basis of entrepreneurship in the country and to ensure that black businessmen have ample opportunities to participate in industry. The removal of RBPs which act as entry barriers are a key to the broadening of economic participation.

5.2 Key Dimensions of Competition Policy

The explicit goals addressed by competition varies by country, and depends on the overall objectives of government and the nature and structure of the economy. In the case of Zimbabwe, the competition policy goals should at a minimum include the following.

1. Protect consumer welfare.

2. Promote economic efficiency and international competitiveness.

3. Expand the base of entrepreneurship.

The focus should be to enhance the degree of competition in domestic markets and the competitiveness of Zimbabwean producers vis-a-vis the world market. As a result, Zimbabwe should adopt a policy that strives to achieve the following objectives.

- Enhance competition among domestic producers in a given branch, to oblige some or all of them to reduce unit costs, offer their products to domestic consumers at lower prices, and in the process, become more competitive on the world market, both in exporting and competing with imports.

- Enhance competition among domestic producers in their purchase of domestic inputs, to oblige them to offer "fair" prices to local suppliers.

- Allow, in branches where efficiencies are attainable through economies of scale which outweigh those attainable via competition among multiple producers, one or more of these to attain sufficient size to exploit such economies, even if the number of viable producers is thereby reduced.

- Facilitate the formation of producing and trading units of sufficient economic power to absorb the overhead costs of breaking into new markets, including both export markets and domestic markets hitherto dominated by imports.

- Prevent large producers from abusing their market power to destroy or hamper the growth of efficient smaller enterprises.

The primary means for achieving these goals and objectives are to:

1. Lower barriers to entry; and,

2. Reduce restrictive business practices.

Restrictive business practices and barriers to entry emanate from three principal sources.

1. Policy, regulatory and institutional environment.

2. Anti-competition business behavior.

3. Market size and structure, and the nature of technology.

The first category are actions of government which inadvertently or otherwise reduce the degree of competition and competitiveness, such as price controls, licensing and concessions, foreign exchange restrictions, and import barriers. The second category is characterized by the behavior or conduct of businesses which serve to restrict entry and limit the degree of competition. Such practices include price fixing, collusion. tied sales and market or customer allocation schemes. The third category relates to market size and structure. These are typically industries were economies of scale are manifest, in which it is uneconomic for more than one or a few firms to participate in the industry. These are so called "natural" monopolies such as domestic electricity distribution.

Many of the envisaged ESAP reforms will go a long way towards alleviating or removing many of the current barriers to entry, particularly those which result from government actions. Trade liberalization will lower import barriers. remove exchange controls, and reduce restrictions on foreign exchange. Domestic deregulation, if fully implemented, will diminish government controls over prices, and should streamline a whole range of business-related procedures. The main focus of competition policy is thus to: (a) ensure that reforms in government policy and regulations that positively affect competition and competitiveness are well designed and fully implemented; (b) provide a code of conduct for businesses which establishes the "rules of the game" by which private exchange through market forces should occur; and, (c) alter market structure through appropriate monopoly and mergers and acquisitions regulations, where the economic benefits outweigh the costs.

The extent to which government can exercise control over the remedial actions required in each of these areas decreases as one moves down the list. While not easy to put in place, it is fully within government's control to change the policies, regulations and institutional arrangements which have served in the past to limit competition. The behavior of businesses can be regulated, but as the next two chapters demonstrate, creating and operating an effective competition system to accomplish this is not an easy task and will take time to develop. Even in its mature stages, the competition system will be unable to detect all occurrences of restrictive practices or to enforce restrictions on all offenses that are brought to its attention. Economies of scale change very little over time and will remain a barrier to entry, particularly in an economy as small as Zimbabwe's. The economic benefits of breaking up companies in industries manifest by economies of scale are minimal, and should not be undertaken lightly.

5.3 Selected Key Principles

Experience in countries around the world and a preliminary review of the situation in Zimbabwe, suggests that a number of key principles and guidelines should be considered while formulating competition policy.

- The purpose of competition policy is to protect the process of competition not individual competitors. Emphasis should be placed on reducing all entry barriers and restrictive business practices irrespective of which groups they affect.

- Parastatals and other government entities should be subject to the same set of competition policies and regulations as private companies. This is particularly important in Zimbabwe where: (a) the government owns or controls such a high share of productive capacity; and, (b) a main objective of ESAP is increased reliance on market forces. The transition to greater reliance on market forces is almost meaningless if the majority of the market is not subject to these forces, and the private sector is dealt with in a discriminatory fashion.

- It is the abuse of market power or dominant position which reduces the degree of competition, not high market share or being a monopolist or oligopolist, per se. Just because a monopoly or oligopoly exists does not mean that harm is being done to the economy. In fact, in the case of economies of scale, the economic benefits may far outweigh any costs.

- An open trade system is not a substitute for competition policy, because: (a) not all goods are inherently tradeable; and, (b) introduction of foreign competition may reduce the degree of concentration, but does not necessarily limit the scope for collusion or other RBPs.

- The forces of competition should be allowed to "drive" inefficient, uneconomic entities out of business. Much of the benefit of an open, competitive economy is the increased pressure on producers to become efficient. This will accelerate the modernization of

Zimbabwe's industrial base and enhance its international competitiveness. Government should encourage such modernization, but not subsidize or protect inefficient producers.

- Transparency and impartiality in the competition system is a pre-requisite for its success. It is essential for the business community to have confidence in the competition system, and perceive it as a facilitator of the competitive process, not a hinderance to efficient business operations. Generating such credibility is particularly important in the early years of developing the competition system.

- A successful competition policy will rely just as much on effectively performing pro-competition and advocacy functions of the system, as the elements which combat RBPs and anti-competition actions. In this manner, the full competition and competitiveness impacts of ESAP will materialize.

* * *

Options regarding the institutional, legislative and procedural means through which competition policy is implemented, are the subject of the next two chapters.

CHAPTER 6

INSTITUTIONAL OPTIONS

6.1 The Means for Implementing a Competition System

Selection and development of an appropriate competition system depends largely on: (i) the nature and extent to which RBPs and the scope for abuse of market power exists or is likely to exist in the foreseeable future (Chapter 3); (ii) the goals and objectives selected for competition policy (Chapter 5); and, (iii) the existence of, and feasibility of developing, the capacity and resources required for implementation.

The instruments and action areas required to build and operate a competition system include the following.

1. Creation and/or strengthening of institutions charged with executing both the pro-competition advocacy and anti-competition regulatory functions of the competition system.

2. Enactment of legislation to: (a) create laws governing RBP and abuse of market power offenses; (b) legally constitute the institution(s) charged with executing competition policy; and, (c) provide the requisite institution(s) with the legal power to enforce the laws governing RBPs.

3. Development of procedures to guide the "day to day" operations of the institutions and/or legislation which make up the competition system.

4. Provision of the training and technical assistance required to develop and sustain the institutional, legislative and procedural elements of the system.

In this chapter options for the institutional means of executing competition policy are reviewed. In the following chapter, selected issues related to the legislative and procedural dimensions of a competition system are discussed.

It is important to note the following from the outset.

- A competition system is not and should not be static. It should evolve over time, as required.

    - A prudent path to take may involve adopting in the first instance a few simple laws and strengthening an existing institution, and as experience is gained and more resources become available, a more robust set of institutions and laws can be contemplated.

- It takes many years to establish a fully developed competition system. Many countries' first laws governing competition were enacted 80 to 100 years ago (Australia: 1906; Canada: 1910; and, US: 1890) yet were still amending those laws in the last 20 years (Australia's most recently amended law was in 1974; Canada in 1986; and, the US in 1976). Obviously, countries learn from the experience of others and can shorten the process -- for example, the UK and Germany, both of which have highly developed systems, enacted their first statutes in 1948 and 1957, respectively, and each has had at least five amendments or new laws since. However, creating a competition system still takes time, cannot not be adopted wholesale from another country but rather must be tailored to the specifics of the country in question, and requires an element of "learning by doing".

- There are risks and costs associated with selecting an inappropriate competition system and/or poorly implementing it. A commitment is required to provide resources, transparency of procedures, and to create independence from the influence of special interests.

  - It takes considerable resources and time to build effective institutions, create and enforce new laws, and to develop specialized skills in the legal and business/economics communities. All but the "do nothing" option will require substantial resources -- resources which Zimbabwe can ill-afford to use in a misdirected fashion, given the competing demands placed on those resources by the drought, implementation of ESAP and other pressing national business, and the additional pressure created by the commitment to reduce the civil service.

  - A competition system which is either poorly equipped technically and/or which is not independent from special interests may do more economic damage than good. For example, in industries where economies of scale are present, a large producer can reduce unit costs considerably. This can benefit domestic consumers through lower prices and/or benefit the economy as a whole by generating foreign exchange and stimulating growth as the reduction in unit costs will make the firm more competitive internationally. However, the presence of economies of scale can create firm(s) in a dominant position and act as a barriers to entry. If existing monopolists or oligopolists in this industry are broken up, or mergers and acquisitions which would lead to a firm being in a dominant position are prevented, without due consideration and balancing of the economic benefits, then the economy will suffer and business confidence in the competition system would decline.

  - A poorly designed and/or implemented system may also undermine ESAP reforms and erode confidence that the reforms will lead to a near-full reliance on market forces. Of course, as argued in Chapter 5, a competition system can do much to enhance and complement ESAP, as well.

- Creation of a Monopolies Commission is not a pre-requisite for establishing an effective competition system, and in Zimbabwe's case may be one of the least desirable courses of action in the nearer term. A wide range of options exist for developing an effective competition system.

  These range from: (a) the "do nothing" option predicated on the assumption that full implementation of ESAP is all that is needed; (b) new laws, and procedures for their enforcement, but no new institutions; (c) new institutions and procedures, but no significant new laws; and, (d) substantial new laws <u>and</u> new institutions with supporting procedures.

6.2 Institutional Options

Several types of institutions can be envisaged under the broad category of a competition system.

1. Institution(s) charged with "prohibition" functions such as combatting RBPs (largely those exerted by businesses) and taking action to change market structure (monopolies, mergers and acquisitions).

2. Institution(s) which perform a pro-competition advocacy function, particularly to address actions of government which have, inadvertently or otherwise, led to a reduction of competition and competitiveness.

3. Institution(s) created with the explicit role of protecting consumer interests, such as a Consumer Protection Agency.

4. Institution(s) charged with assisting groups judged to be disadvantaged vis-a-vis competition, and worthy of special assistance.

It is universally accepted that the institutional component of a competition system would include at a minimum Category 1 above. It is not unusual for the system to also include an institution whose sole or partial function addresses Category 2 above, pro competition advocacy. Many countries also have entities charged explicitly with the consumer protection function. However, these entities are seen as closely related to, but not a part of, the competition system.

There is a much greater divergence of experience and approaches with regard to addressing the issue of disadvantaged groups. At one end of the spectrum are countries such as the UK and Sweden which have typically incorporated clauses into competition legislation itself which allows for the possibility of exemptions or "special" treatment for disadvantaged groups. They have also institutional means for facilitating disadvantaged group's involvement in the competition system. At the other end of the spectrum are countries such as the US which prefer to leave the competition system itself "pure" and unbiased, so it can create a "level playing field" and protect the process of competition, rather than specific competitors. There are, nonetheless, numerous programs to assist the disadvantaged groups in the US, but they reside outside of the competition system.

While it may be attractive to create institutions to perform all of these functions explicit consideration must be given to the fact that it takes time and resources to build and/or strengthen institutions and to enact the supporting laws required to constitute those institutions and give them enforcement rights. In recognition of this, the IPC Team has mainly focused on assessing institutional options which address the first two functions highlighted above -- "prohibition" vis-a-vis RBPs and market structure, and pro-competition advocacy.

6.2.1 Models of Institutions Charged with Combating RBPs and Abuses of Market Power

Upon deciding to implement a competition system, one must decide which entity or entities will be responsible for carrying out the program's functions (e.g., data collection, preparation of studies, case selection, prosecution, and adjudication).

At one pole of the distribution of possibilities, one could imagine all or most of these functions being unified in a single government entity. At the other pole, it would be possible to decentralize these functions by, for example, giving both the government and private parties standing to sue to remedy RBPs. Even where competition policy authority resides exclusively within the government, it is possible to allocate discrete functions among a variety of public bodies. For example, an independent government competition council might be responsible for conducting industry studies and submitting recommendations to the Attorney General for possible prosecution of RBP violations. The Attorney General in turn might try RBP cases before either the existing courts of Zimbabwe (e.g., the High Court) or a special tribunal with exclusive jurisdiction over RBP matters. In short, there is considerable flexibility to tailor a competition program to account for Zimbabwe's policy preferences and resource constraints.

Five basic models for the institutions through which the anti-competition elements of a competition system could be installed and applied are presented below. The discussion of institutional models does not cover all possible organizational permutations, but focuses on the chief structures that might be used. Important variants of these models exist, and hybrid mechanisms that borrow approaches from two or more models can be constructed.

This range of models is presented for illustrative purposes. It is not the opinion of the IPC Team that all these models are either feasible and/or appropriate courses of action for Zimbabwe.

A. No adjustment in legal system other than full implementation of the ESAP reforms.

This approach entails no change in the existing legal system or creation of new institutions. It relies on the full implementation of ESAP reforms. The rationale for an ESAP-only competition policy would be that full execution of ESAP will inspire the growth of self-correcting market forces that promise to reduce dramatically the significance of existing concentrations of domestic productive capacity and to inhibit private efforts to simulate the output restriction and entry-deterrence mechanisms that the government formerly used to control economic behavior. In short, a fully-installed ESAP may suffice to give the Zimbabwean economy the competitive stimulus, based on market forces, that it needs.

The sensibility of an ESAP-only strategy depends upon completely effective implementation of ongoing and contemplated structural adjustment initiatives. The decision to implement a competition policy regime extending beyond the competition-enhancing features of ESAP requires a basic judgment about how effective the new competition policy program is likely to be. Starting with an ESAP-only baseline serves an important analytical purpose. Most industrial organization economists agree that the operation of an economic system based mainly on private commercial exchange generates market failures. Yet it is also clear that there are government failures associated with the design and routine administration of any program of public intervention in the economy. Thus, the policy choice is not between imperfect markets and perfect government. Rather, one is attempting to decide whether the net effect of imperfect public intervention will be to improve the status quo. In effect, the desirability of a new form of government intervention depends on an assessment of whether the social costs of market failure surpass the social costs imposed by failures of administration that will accompany the adoption of the new intervention program. Thus, one's predictions about the likely success of a new, explicit competition system involving new regulations and institutions, are crucial to determining whether to proceed with the adoption of such a system at all.

B. New competition laws with a private cause of action and no public enforcement apparatus.

Experience in developed and developing nations suggests caution in concluding that ESAP alone will solve the RBPs problem. Even in countries such as the United States, Germany, the UK and Canada, which have comparatively liberal trade regimes and relatively deregulated domestic economies, there are numerous instances of efforts by firms to fix prices, rig bids, and allocate markets and customers. Developing countries such as Kenya, Morocco, India, and Sri Lanka have also sought to create legal statutes to combat RBPs. As the Worldwide Experience Appendix to this report indicates, trade liberalization and deregulation do not completely eliminate opportunities for firms to collaborate in setting the terms on which they will act. Although ESAP may well diminish the frequency and seriousness of RBP problems, there is evidence elsewhere in the world to suggest that certain forms of RBPs will persist, and should be prevented.

The private enforcement model requires the lowest degree of public involvement in the operation of a new competition system. The main element of public intervention would take the form of adopting a new competition statute which establishes the illegality of specified forms of RBPs and empowers affected private parties[30] to sue to enforce the statute. The main benefit of decentralizing the decision to prosecute to private parties is that it harnesses the self-interest of economic actors who often have the most immediate knowledge of the harm in question. Such a mechanism also imposes comparatively minor demands on the public treasury, as it does not require the establishment of a new government entity.

However, it is important to recognize that a private right of action might in practice be comparatively ineffective unless the competition statute increased the capability and incentive of private parties to prosecute RBP claims. Consumer suits may be infeasible unless the statute established the availability of class actions, allowed damage recoveries in excess of actual damages, permitted the use of contingent fee arrangements, and reduced the plaintiffs exposure for litigation costs in the case of unsuccessful suits. These represent on the whole quite extreme departures from existing legal practice in Zimbabwe. The feasibility and/or desirability of making such reforms is questionable. However, several members of Zimbabwe's legal community interviewed by the IPC Team suggested that a significant number of small- and medium-sized firms -- either acting unilaterally or pooling their resources -- might be willing to use a private cause of action to challenge RBPs.

Nonetheless, if private commercial interests are to invoke the private cause of action in more than a handful of instances, adjustments similar to those needed to facilitate consumer suits (particularly multiple damage awards and contingent fee arrangements) would be necessary. However, in removing obstacles to plaintiff suits, one would need to be careful not to eliminate so many risks as to encourage the prosecution of vexatious, baseless claims.[31] The social costs of plaintiff rent-seeking can be reduced substantially if the cause of action permits only suits designed to rectify demonstrably harmful conduct such as horizontal price-fixing.

As discussed below, establishing a system of private enforcement could coincide with the creation of a public competition authority that lacked enforcement power but performed industrial analysis and maybe also competition advocacy functions. By this approach, enforcement of RBP prohibitions could reside entirely in the hands of private parties, with the new public competition authority being responsible for conducting industrial organization studies and advocating pro-competition policies before government bodies. It is also possible to have

[30] The roster of potential private litigants probably would include consumers and commercial entities such as the defendant's rivals, input suppliers, and downstream purchasers. A subsidiary issue to be considered is whether non-resident firms (e.g., firms seeking to import goods into Zimbabwe) could establish standing to sue.

[31] The establishment of virtually any legal cause of action creates some potential for strategic misuse. In the commercial arena, it is not unheard of for firms to threaten to file or to actually prosecute substantively weak claims in order to impede entry or otherwise raise the costs of rivals for reasons unrelated to efficiency. One example is the use of copyright or patent infringement suits to block or chasten new entrants. A major objective in designing a legal system's substantive standards and procedural rules is to minimize opportunities and incentives for the strategic pursuit of frail or baseless claims.

both public enforcement and private action coexisting in the same competition system. The availability of private action, in this case, serves an important role as an counter to the potential corruption or inaction on the part of public enforcement officials.

C. New competition laws and public enforcement through an RBP division of the Attorney General's office of the Ministry of Justice and Parliamentary Affairs.

This arrangement would require enactment of laws governing RBP and related offenses, and places enforcement authority exclusively within a new RBP division of the Attorney General's office. Whatever enforcement scheme is ultimately approved, some participation by the Attorney General will be necessary if the competition statute provides for criminal sanctions. Compared to private parties such as consumers or companies, a special division of the Attorney General's office probably would have superior resources to prosecute RBPs. If obstacles to private suits were not reduced, the Attorney General model (or some other form of public enforcement) constitutes a major alternative. However, a system which uses both private action and public enforcement could be established -- they are not mutually exclusive.

A public enforcement process residing in the Attorney General's office would enjoy several institutional advantages. The office appears to be regarded as the premier law office in the national government. It is the government's best repository of litigation skills, and it benefits from an important measure of continuity in key senior civil service positions. The office also is respected for the independence and professional detachment of its judgment. However, like any other office resident in a government ministry, it ultimately could be subject to political pressure and control with respect to specific law enforcement initiatives.

Considerable strengthening of the AG's office would be needed. The AG's office is generally considered to be under-staffed by over-worked and under-paid professionals. Its four main departments include Legal Drafting, Legal Advice, Civil, and Prosecution. With the exception of Prosecution, the other departments employ far less staff than they are designed to -- Drafting employs 7 people but is established to have 13. Legal Advice has 9 of its 13 positions filled, and Civil is designed to have 15 professionals but only employs 8. The compensation earned by attorneys in Zimbabwe's leading law firms substantially outstrips the wages paid to attorneys of comparable skills and experience in the government. There is a high rate of turnover at the mid- and junior professional levels. A common practice is for recent law graduates to gain their initial experience in the public sector where they have greater responsibility earlier on than in the private sector, and then within 2 to 5 years to join private practice where they then can command a premium. The Civil Department is considered to the most inadequate in the AG's office; whereas, the Prosecution Department, which tries criminal cases and is supported by courts and magistrates throughout the country, is relatively well staffed.

Thus, the need to strengthen the AG's office will be in particular a function of the extent to which RBP statutes call for the investigation and litigation of cases on a civil basis.[32] However, even if all RBP statutes were to be treated on a criminal basis, the AG's office would still need strengthening -- to train the litigating attorneys in RBP-related areas, and to create an RBP investigations capacity, as currently all criminal investigations are conducted by the Police.

To staff a new RBP division in the Attorney General's office, it would be necessary either to recruit attorneys expert in RBP jurisprudence or to train current professional staff or new attorneys. It would appear feasible to begin the new division with a modest staff (perhaps three to five attorneys). Cooperation programs involving countries with well-established RBP control regimes might provide arrangements by which competition agencies of foreign governments loan skilled competition policy professionals to the Zimbabwe government to assist the new RBP division (or other Zimbabwean competition agency) in organizing its affairs and developing methods for selecting cases.[33] Training and expertise problems could be minimized if the competition statute mainly targeted "per se" offenses (e.g., collusive tendering) for which the Attorney General's chief task in the litigation would be to prove the fact of an illegal agreement.[34]

Consistent with Zimbabwe's legal traditions and practice, the operation of a public enforcement system within the Attorney General's office could coexist with the private cause of action model described above. This enforcement system also could be supplemented by the creation of a government authority to conduct industry analysis and perhaps also competition advocacy functions. It would also be possible to give the Attorney General enforcement authority while preserving a private right of action for RBP violations. A limitation of giving enforcement power exclusively to private parties is that criminal enforcement would not be possible unless the Attorney General were permitted to perform a screening or quality control function to see that delegated prosecutorial powers were not applied abusively.

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[32] Under Zimbabwean law, any contravention of a law subject to fines is considered a criminal act and thus, legal proceedings would be conducted through the Prosecution Department.

[33] For example, teams of U.S. Department of Justice and Federal Trade Commission attorneys and economists current are resident in Czechoslovakia and Poland as part of a program to assist those countries in implementing a competition policy enforcement program.

[34] The logic of per se rules is that the behavior in question is so overwhelmingly prone to result in resource misallocation and harm to consumers that a blanket prohibition is appropriate. This ordinarily eliminates consideration of the defendant's purpose or proof of the actual effects of the defendant's conduct. For purposes of administrability, the per se rule willingly sacrifices the occasional (presumably rare) instance in which the conduct in question has beneficial effects. The result is a much simpler evidentiary burden for the prosecutor, compared to a merger case in which market definition and market power measurement are indispensable (and often analytically difficult) ingredients of the plaintiff's case.

D. New competition laws with public enforcement by means of a Competition Commission resident within an existing government ministry.

Public enforcement also could be carried out by means of a new Competition Commission. If the Commission is to have a law enforcement role (either bringing, recommending, or adjudicating cases), it would appear necessary for Parliament to enact a statute that proscribed specific RBPs or delegated to the Commission authority to promulgate subsidiary legislation that banned RBPs. Thus, some form of legislative action would be necessary for the Commission to perform a law enforcement role. A Presidential Decree, standing alone, would probably be sufficient to create a commission and to enable it to perform purely research, analysis, and advisory functions.

One approach to establishing a commission would be to place the new competition entity within an existing ministry. Important considerations in choosing a host ministry would include public and business perceptions of the ministry's competence and the consistency of a competition policy mandate with ministry's other functions. The Ministry of Industry and Commerce is one obvious candidate. The chief policy disadvantage of pursuing this path is that the competition unit's enforcement mission may be subordinated to other functions of the same ministry. There is also the possibility that the commission will lack the visibility and focus of purpose that it would achieve with independent status. As the Worldwide Experience Appendix indicates, developing country experience with such commissions suggests that independence from existing ministries is a valuable trait.

The office of the Ombudsman in the President's office is also, to some extent, a theoretical candidate as a government entity which might be charged with public enforcement of RBP statutes. However, this would involve building an organization that is substantially larger than the current office, and providing the Ombudsman with far greater litigation and prosecution powers than it currently enjoys. Criminal cases, at some stage, would still need to be tried through the AG's office, and the relationship of the Ombudsman's office to the Supreme Court with regard to the appeals process would need clarification. Finally, the Ombudsman's Office is unlikely to be perceived as independent and free of political influence,[35] particularly by the business sector. However, this does not mean that the Ombudsman has no role in the competition system, but it should not form the primary means of public enforcement. One role for the Ombudsman may be to act as the overall "watchdog" for the legal aspects of the competition system, as a safeguard for ensuring statutes and legal procedures are followed in the manner intended.

[35] In fact, the impartial weilding of power by the Ombudsman's office in the past, has recently led Government to leave the office unoccupied for several months while the selection of a suitable replacement candidate was carefully weighed.

E. New competition laws with public enforcement by means of an independent Competition Commission.

A competition commission also could be created as an autonomous government unit, independent from any existing government body. Such an approach was endorsed by a number of representatives of the business and legal communities interviewed by the IPC Team. Several observers noted that an independent commission would be less prone to manipulation by existing agencies, thus increasing the prestige and stature of the new body in the eyes of economic actors within its jurisdiction. Independence was seen as a valuable asset for the new entity, particularly if it were to perform enforcement, adjudication, or competition advocacy functions.

In the case of an independent commission (or a commission resident within a ministry), the commission's role in the law enforcement process could assume at least four forms.

1. The Commission could select cases and prosecute them exclusively in existing courts of general jurisdiction, such as the High Court.

2. The Commission could select cases and prosecute them before a specialized tribunal with jurisdiction over RBPs.

3. The Commission could select cases and prosecute them before an internal administrative tribunal.

4. The Commission could identify potential candidates for prosecution and recommend such matters to the Attorney General's office, which would assume responsibility for litigating the government's position.

It is clear from the five models described above, and variants on these models, that a wide range of institutional options exist, and any model chosen is likely to change over time. Once an overall institutional model is chosen for combating RBPs, then its organization and staffing can be specified. Key elements include:[36]

1. Composition of the Authority, including its chairmanship and number of members, and the manner in which they are appointed, including the authority responsible for their appointment.

2. Qualifications of persons appointed.

3. The tenure of the office of the chairman and members of the Authority, for a stated period, with or without the possibility of reappointment, and the manner for filling vacancies.

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[36] Adapted from the August 1991 version of the UNCTAD "Model Law" on RBPs.

4. Removal or dismissal of members of the Authority.

5. Possible immunity of members against prosecution or any claim relating to the performance of their duties or discharge of their functions.

6. Procedures for avoidance of conflict of interest for Authority members.

6.2.2 Pro-Competition Advocacy Function

As discussed above, an early priority for the new competition system is performing the function of pro-competition advocacy. The objectives are to reduce barriers to entry, particularly those which result from government action, create a "level playing field," and stimulate competition. A primary task in the first instance is to ensure that the competition enhancing elements of ESAP are well specified and implemented.

There are a number of institutional options for executing the pro-competition advocacy function. It could reside within another institution, which could be either governmental such as the AG's office or a ministry such as the Ministry of Industry and Commerce, or it could be part of a largely non-governmental institution, such as an independent Competition Commission (Model E above), were one created. A related issue is that if it is to be within another institution, should it be in one that also has an enforcement role in RBP offenses or not. Alternatively, it could be an independent entity, separate from any other existing or to be created institution.

The IPC Team opinion is that given the main role of such an entity is to comment on the actions of government -- be it on government created barriers to entry, government's design and implementation of ESAP, or other aspects of government policy (education, technology)[37] -- the pro-competition advocacy function should be carried out by an independent entity. It is important for the pro-competition advocacy function to reside outside government, so it can be as free as possible from political influence and/or be required to serve other objectives in addition to the pro-competition advocacy function. If it is to be institutionally independent from government, then the two main alternatives are to: (a) establish as new entity uniquely to perform this function; or, (b) add the pro-competition function to the agenda of a new RBP-combating entity such as a Competition or Monopolies Commission.

The advantage of adding the advocacy function to a new Competition Commission is that economizes on resources required for institution building. However, it may dilute the effectiveness of the new Commission, either due to too many functions being tackled at once and/or conflicting objectives. This option is also obviously contingent upon a new Competition

[37] The Korean Fair Trade Commission (FTC) sets an interesting example in this regard. Under Korea's Fair Trade Act, ministries are required to consult the FTC before submitting draft legislation affecting competition or issuing orders under existing laws. According to a 1991 report, during its first ten years of operation, the FTC reviewed nearly 500 draft laws and regulations and recommended changes about one third of the time.

or Monopolies Commission being established -- thus, it would have had to have been selected as the institutional means for performing the RBP-combating function.

Creation of a new institution solely dedicated to pro-competition advocacy is appealing because it does not rely on another institution being created and would be less subject to "mixed" objectives. It is also important that the means for performing this function be created and made operational as soon as possible in order to maximize the competition enhancing aspects of ESAP.[38] Such an entity requires the use of institution building resources and would need to have a higher status than that of an appendage to a particular ministry. Ideally, the members would be appointed and the chairman designated by the President. The effectiveness of such an entity would obviously rest upon the skills and motivation of the persons appointed as members, particularly full-time members, and on the investigative resources they mobilize.

6.2.3 Consumer Protection

Competition policies typically have as one of their main objectives the goal of providing consumers with the best possible array of product choices -- namely, to increase the range and quality of products offered at "reasonable" or lower prices. These policies are sometimes complemented by policies designed to ensure that consumer choices are not distorted by business misconduct such as fraud, deception, misrepresentation, and false advertising.

Worldwide experience universally suggests that a consumer protection function is needed, but there is divergence regarding the appropriate institutional arrangements for carrying out this function. In the United States, consumer protection functions reside within the same entity that executes competition policy concerning RBPs. Commentators who have considered this issue within the context of developing countries disagree about the wisdom of consolidating these functions in a single body. For example, the Government of Bulgaria was applauded by the American Bar Association for consolidating the two functions in a new Commission on the Protection of Competition, whereas a world renowned expert on RBPs recently applauded Venezuela's proposal to place these two functions in different agencies.

Zimbabwe currently has common law doctrines and statutes that control advertising content, regulate packaging and labelling, require proper identification of the origin of goods, and restrict various other deceptive marketing practices. How well and widespread enforcement of these laws is, is not known with precision. In addition to these statutes, the Consumer Council of Zimbabwe appears to be an active advocate for consumer protection, at least in the main urban areas. Proposed legislation in such areas as consumer contract protection and product liability would also enhance consumer protection.

Thus, the protection of consumers in the near term is probably reasonably well served by existing consumer laws and the Consumer Council combined with the consumer welfare enhancing aspects of an improved competition system. Therefore, creation of a new consumer

[38] Some observers feel that a pro-competition entity should have been created prior to the initiation of ESAP or at least at the same time.

protection entity is not a priority area for early action in Zimbabwe. Resources for institution building are limited and what resources do exist should be directed toward the RBP-combatting and pro-competition advocacy functions first, which themselves will have a favorable impact on consumer welfare. As the competition system matures, an enhanced government role in consumer protection should be contemplated.

6.2.4 Disadvantaged Groups

All economic actors, regardless of size or race, should have an equal chance to compete. The most important means for achieving this goal are to lower entry barriers and reduce RBPs and other discriminatory practices, so as to broaden the base of entrepreneurship and provide equal opportunity. However, it must be stressed that a competition system should strive to protect the process of competition not individual competitors.[39]

The extent to which special interests should be served by granting them exemptions to competition policy and statutes is a subject of debate, and the experience and choices made by other countries varies considerably. Several countries have either added such exemptions to the legal statutes governing competition and/or have systems which allow great discretion in the administering and interpretation of the laws. Institutionally this has meant that enforcement lies with a special tribunal/administrative entity and/or government entity. The UK and Sweden, for example, have followed this pattern. The result is that the effectiveness of the competition statutes are weakened and the system is not regarded as impartial. The vast majority of countries with well developed competition systems do not make substantial provisions in the statutes or treatment/rulings on cases for special groups. Even those systems which do have such exemptions, such as the UK and Sweden, are moving away from this discretionary approach.

The early experience of several developing countries such as Kenya has been that select politicians have used poorly designed competition systems to favor a specific group. Whether the group in question is disadvantaged or not tends to depend on the vested interest of the politician.

There is significant pressure in Zimbabwe to broaden the base of entrepreneurship, especially amongst smaller and/or black entrepreneurs. While these groups deserve special treatment and need extra assistance, the IPC Team believes that such assistance should be provided largely outside of the competition system in the initial period of implementation. Firstly, as with any system and especially given the radical reforms being undertaken as part of ESAP, it is very important to establish in the early years the credibility and impartiality of the competition system. Secondly, exemptions provided to special interest groups largely rely on RBP laws which are argued on a rule of reason basis. Whereas Zimbabwe would be well advised to start with a limited set of RBP laws which are argued solely on a per se basis. This will automatically leave little to no scope for providing exemptions or special treatment in the

[39] An affirmative action policy and program, while interrelated with development of a competition system, is outside the direct scope of this study.

administering and interpretation of RBP-related law. Finally, such exemptions are best administered through special tribunals or government entities. As argued elsewhere, the IPC Team believes that Zimbabwe's experience to date with special tribunals (for example the water board and the rent council) is not very encouraging and new competition authorities should reside as much as possible outside of government (perhaps with the exception of the AG's office).

This is not to say that special assistance should not be provided to disadvantaged groups, merely that it should not be incorporated as an integral part of the competition system. In addition, implementation of ESAP, removal of barriers to entry, an effective program to combat RBPs and a well executed program for domestic deregulation, may help to redress some perceived imbalances. As in many other countries, though, small entrepreneurs may still need special assistance in key technical skill areas such as business planning and access to financial resources as well as from special entities in government.

With regard to the competition system, disadvantaged groups may need assistance in accessing the system, but the system itself should remain impartial. For example, if private cause of action is selected as one of the means for the enforcement of RBP laws, then the government may want to consider sponsoring, in some fashion, a groups of lawyers (probably within the AG's office) who could represent small businesses which have worthy RBP cases but lack the financial means to hire legal representation.

Explicit consideration should be given to actions required to provide an enabling environment for small and/or black businesses and ensure they benefit fully from ESAP reforms and a new competition system. However, such an undertaking is outside the scope of this study.

CHAPTER 7

LEGISLATIVE AND PROCEDURAL ISSUES

7.1 Selected Legislative Issues

Choices regarding the legal complexion of a competition system are not independent of the institutional model(s) chosen. However, existence of a strong legal system can serve to limit the number and/or size of new institutions which might otherwise need to be created. The legislative component of a competition system can include three broad functions:

1. Create laws governing RBP and abuse of market power offenses.

2. Legally constitute the institution(s) charged with executing competition policy.

3. Provide the requisite institution(s) with the legal power to enforce the laws governing RBPs and abuses of market power.

While there are numerous issues related to the legal elements of the range of competition systems presented above, four areas are particularly worthy of discussion.

1. Scope of Law. Which groups should be subject to the law? What set of specific RBP and market structure laws are to be enacted? How many RBP and market structure areas are to addressed? Which laws are to be treated on a per se basis versus rule of reason? How should the number of laws enacted and their treatment change over time?

2. Means of Enforcement. Which entity or entities will have the right of enforcement of legal statutes? What set of remedies and penalties will be available? Should any competition-related offenses be considered criminal actions? How will treatment vary between civil versus criminal proceedings?

3. Legal Recourse and Rights of Appeal. What recourse and on what basis will parties have the right to appeal legal decisions? What procedures and which institutions should be involved?

4. Legal Constitution of Entities. Which entities should be legally constituted to perform the various functions of a competition system? What alternatives exist for creating such institutions and what are the implications?

The discussion below highlights some of the key points. More detail of legal issues should be specified once a broad strategy for proceeding with a competition system has been selected and "blueprints" of its key components are in the process of being developed.

7.1.1 Scope of Law

There are a large number of possible RBP and abuse of market power offenses which could be included in a competition act or new statute. Broadly speaking, these serve to:

- Control restrictive business practices such as price fixing, collusive tendering, market or customer allocation, restraints on production or sales, refusals to purchase or supply, and collective denial of access.

- Control acts or behavior constituting an abuse or acquisition and abuse of a dominant position of market power. This includes, but are not limited to, predatory or discriminatory behavior by a dominant firm, the break-up of monopolies, and the prevention of mergers, takeovers, joint ventures or other acquisitions of control.

Selection of which actions to prohibit by law largely depends on their prevalence, or likely prevalence in a given economy and the institutional and administrative capacity to effectively enforce the statutes. In the case of Zimbabwe, the more binding constraint in the coming years is likely to be the institutional and administrative capacity. This would argue in favor of adopting only a limited set of actions which are to be considered illegal.

The choice of which practices or abuses should be selected again rests on their prevalence and the ease of administering and enforcing them. As a general rule of thumb, RBPs such as price fixing,[40] collusive tendering and allocation of markets or customers tend to be universally considered as violations which the vast majority of the time have a net negative affect on competition. As a result, they are considered violations in most countries' statutes. For the most, they are also treated on a "per se" basis -- that is, it only needs to be proved that the practice actually occurred, not whether in addition, the negative effects of the practice outweighed the economic benefits. The alternative is "rule of reason" treatment, under which it must be determined whether, in a particular case, the economic benefits outweigh the detriment caused by the RBP or abuse of market power. However, even proving a case on a "per se" basis will not be easy. Litigators will need a thorough understanding of the RBP statutes. In addition, an investigations capacity, hitherto largely non-existent in Zimbabwe, will need to be created. The low levels of transparency and information disclosure requirements that current characterize Zimbabwe will add to the burden of investigations function.

Acts and behavior which are considered abuses of dominant market position are even tougher to deal with legally. One needs to prove that: (a) the action actually occurred; (b) the alleged offender (firm) actually has market power or is in a dominant market position; and, (c) the act or behavior on balance is detrimental to the economy. For example, it is analytically complex to decide whether it is in the public interest to require that the largest operators in a concentrated industry divest themselves of a portion of their capacity. In deciding such questions, the appropriate authority will have to delineate markets, measure firm's market shares, assess the

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[40] Universally, horizontal price fixing is considered a harmful practice and most likely to be treated as a per se violation, whereas vertical price fixing is reviewed largely on a rule of reason basis.

importance of scale economies, forecast the effect of mergers, acquisitions and divestitures on domestic competition as well as on firms' motivations and ability to export and, weigh the benefits of affirmative action in favor of new, emerging businessmen against the risk of deterring investment and employment creation by established firms, foreign and domestic.

Beginning with market delineation, none of these tasks are simple. What products are close substitutes for one another? In general, B is a close substitute for A if a rise in A's price will induce enough customers to switch to B to limit the increase to a modest level, say 5 percent. But forecasting such an event on the basis of past trends is no simple task.

Once the product market has been delineated, it is often difficult to accomplish the seemingly easy task of measuring market share. The Central Statistics Office in Zimbabwe records firm's turnover, but most firms produce multiple products and serve distinct product markets, for which CSO data are not broken down. Indeed, companies devote considerable effort to comparing their market shares with those of competitors, and have access to sources, notably distributors, which the statisticians cannot easily tap.

Finally, such practices as price fixing, collusive tendering and market or customer allocation are restrictive practices which are quite prevalent currently in Zimbabwe, and which ESAP may do little to reduce.

If laws regarding RBP offenses are adopted, such as a ban on horizontal price-fixing or market divisions, then one must decide which entities (private or public) will be bound as subject to these laws. In Zimbabwe, a wide range of parties might be made subject to RBP prohibitions such as individuals, private business, trusts and associations, and government entities.

Of all these groups, government entities pose the greatest difficulties for determining the applicability of RBP prohibitions. One response would simply be to preclude all RBP suits against government or government-controlled entities. This approach would come at the cost of removing an instrument for discouraging certain forms of competition-suppressing conduct by parastatals and companies in which the government holds a controlling interest. On several occasions in interviews with representatives of Zimbabwe's business and legal communities, the IPC Team was told that parastatals and government-controlled enterprises had resorted to exclusionary tactics to discourage entry by rival firms. In addition, government owns or controls a substantial share of productive capacity in Zimbabwe. Thus, if government entities are not made subject to RBP laws, then much of the economy would be exempted -- leaving the remaining purely private sector entities feeling discriminated against. It is thus unwise to give the government immunity from RBP laws when an entity it owns or controls engages in conduct that would be illegal for a private company or association.

7.1.2 Means of Enforcement

The chief goals of a competition policy remedial scheme are to cure injuries caused by prohibited conduct, and to achieve an optimal level of deterrence.[41] The power of a competition system to deter future violations is largely a function of the perceived likelihood that illegal conduct will be detected and the severity of the penalty imposed for violations that are discovered. RBP systems in developed and less-developed countries typically use a mix of civil sanctions and criminal penalties. Civil remedial schemes to rectify RBPs usually include some combination of the following:

1. Damages (actual damages or multiples such as doubling or trebling);[42]

2. Cease and desist orders;

3. Assurances of voluntary compliance;

4. Injunctions and restraining orders;

5. Divestitures of assets or subsidiary operations; and,

6. Restitution (e.g., requiring the participants in a price-fixing cartel to disgorge overcharges attributable to their collusive behavior).

Of these remedies, the divestiture option poses the greatest challenges for industry analysis and administration. These problems are most acute when divestiture is used as part of a program to deconcentrate longstanding aggregations of corporate assets.[43] Dissolving existing monopolies without significant adverse effects is not impossible, but successful execution of a divestiture program places a premium on correctly analyzing the operations of the dominant firm and its industry, to determine which spin-offs or other asset realignments will be necessary to create viable successor entities.[44]

A significant number of RBP control regimes in developed and less-developed countries supplement civil remedies with criminal sanctions. The logic for doing so is that the prospect of indictment, conviction, imprisonment, and fines provides a more powerful inducement for

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[41] See Elzinga and Breit (1976).

[42] The most common paths for measuring actual damages are to determine lost profits arising from the defendant's use of RBPs or to calculate the amount of overcharges arising from the use of RBPs.

[43] The comparatively simplest divestitures involve requirements that firms spin-off assets or operations just acquired by merger or acquisition. Even so, divestitures resulting from a merger enforcement program can become complicated once the acquiring entity has begun to integrate the acquired firm into its own structure.

[44] See Kovacic (1989).

economic actors to not engage in prohibited practices. Systems of criminal sanctions to penalize and deter RBP violations usually incorporate one or more of the following punishments:

1. Fines for natural persons and organizations;

2. Imprisonment for natural persons; and

3. Probation or other forms of oversight for convicted organizations.

Most criminal penalty schemes establish maximum fines and prison terms and give the court discretion to choose penalty levels up to the ceilings established by law. In some instances the court's choice of penalties is further confined by the establishment of mandatory punishments for certain crimes, or the use of guidelines that create relatively narrow bands of discretion within which the court may act in sentencing offenders. Recourse to imprisonment can have noteworthy resource implications, as incarceration often requires the state to make substantial expenditures for the confinement and care of violators.

A system of criminal punishments also has implications for the form in which conduct prohibitions are stated. To satisfy due process requirements that defendants be given clear notice of conduct that will constitute a crime, violation of per se offenses usually is the sole basis on which criminal proceedings are pursued. Limiting criminal enforcement to clearly, delineated "per se" offenses (e.g., horizontal price-fixing or market allocations) may be necessary to give adequate notice to affected actors and to convince the public and business that the application of the state's criminal enforcement powers proscriptions is fair and reasonable.

7.1.3 Legal Recourse and Rights of Appeal

A recurring theme of the IPC Team's interviews was that judicial review be available for the results of adjudication processes entrusted to either a commission-based administrative court or an independent RBPs tribunal. Judicial review by way of an appeal to either the High Court or the Supreme Court was cited as an important component of efforts to create business and public confidence in the legitimacy of the adjudication process. The standard of review applied by a court of appeal could be defined in several ways, but two basic possibilities stand out.

i. Review concerning questions of law, procedure, and fact.

ii. Review concerning questions of law and procedure, with substantial deference given to agency policy judgments and interpretations of facts.

Under existing doctrine governing review of administrative agency action in Zimbabwe, appeals courts generally defer to agency policy judgments and interfere with such judgments only when they lack substantial evidence.[45] Such a standard of review would be the logical starting point

[45] The chief purpose of a substantial evidence standard is to preclude judicial reversal of agency action simply because the court believes the agency made an inferior policy choice.

to consider options for judicial oversight of the actions of a new competition commission. A decision to adopt a more exacting standard of review might be appropriate if one entertained serious doubts about the likely institutional capability of the new competition policy-making agency, or if stringent judicial oversight were deemed necessary to gain business and social acceptance for the operation of the competition policy regime. The objectives of judicial oversight also can be achieved in part through the specification of prohibited conduct in the enabling statute. Greater precision in enumerating conduct more clearly delineates the bounds of prosecutorial discretion and thereby facilitates judicial efforts to determine whether the prosecutor has acted within the bounds of his authority.

In any event, it is apparent that judicial review of competition commission decisions would be an extremely important component of a new competition policy system. Appeals review would increase the perceived legitimacy of the competition regime in the eyes of affected economic actors and would serve to deter abusive, inept, or otherwise ill-conceived exercises of public prosecutorial discretion. Recent experience in Kenya in which a single Minister had a high discretion over final rulings argues in favor of recourse to the higher courts. Likewise, the debate surrounding one of the earlier versions of the Land Amendment in Zimbabwe, which proposed to preclude judicial review of the adequacy of compensation for compulsory land transfers, highlights the hazards of withholding judicial review. As one member of Zimbabwe's legal community has explained, "Any undermining of the judiciary will inevitably affect not only the internal economy but also the confidence of future investors."[46]

7.1.4 Legal Constitution of Entities

One or more new institutions could be created as part of developing a competition system and/or the functions performed by existing institutions could also be changed or enhanced. To provide these entities with clear and effective power to perform these functions, laws will be required to: (a) legally constitute or create those institution(s) charged with executing competition policy and regulation; and, (b) provide the requisite institutions with the legal power to enforce the laws governing RBPs and abuses of market power.

However, laws are not enacted over night. They need to be drafted and re-drafted, proposed, reviewed by a number of entities, and finally enacted. This process in Zimbabwe can take several years.

If an effective competition system is to be created, one which is synchronized with the implementation of various ESAP reforms, legal constitution of competition institutions may not be timely enough. More rapid ways of creating institutions need to be found, but must be methods which still give the entity considerable credibility and standing in the eyes of the business community and government -- so as to have sufficient "clout" to perform its early functions. Creation through Presidential Decree may be one way of avoiding lengthy legal processes. The ultimate goal, however, should still be to legally constitute the entities. Thus,

[46] Coltart (1991: 10).

one strategy might be to create a Competition Council through Presidential Decree but to simultaneously initiate proceedings for its legal constitution.

7.2 Selected Procedural Issues

The establishment of a competition system would involve a number of choices about the scope of new/enhanced institution's powers and method of operation. Whatever the exact content of the institution's substantive charters, it will be necessary to consider the type of administrative processes they shall be permitted to use (or compelled to follow) in executing its competition functions.

7.2.1 Information Gathering

Many of the policy-making functions that a new competition commission might perform (e.g. preparation of industry studies, selection of matters for prosecution) would require that the agency have access to industry data. Without adequate access to industry data, it will be impossible for the agency to make intelligent assessments about the state of competition in Zimbabwe, or make sensible decisions about exercising law enforcement responsibilities. Although the new entity may be able to obtain a considerable body of data through publicly available sources, or through voluntary compliance with non-compulsory requests for information, agency functions that require sophisticated industry analysis are unlikely to proceed successfully unless the agency can compel the disclosure of relevant information. The agency's compulsory information gathering powers might include some mix of the following techniques:

1. Subpoenas or other investigative demands to compel the production of documents and the testimony of witnesses:

2. Search warrants that permit the agency to visit the premises of a business and review or seize records that might otherwise be destroyed if the agency's enforcement intentions were made known in advance;

3. Routine on-site inspection or review of records that firms are required to maintain and preserve in the ordinary course of business;

4. Interviews and depositions:

5. Compulsory submission of periodic reports; and,

6. Whistleblower mechanisms that encourage employees to report episodes of misconduct.[47]

[47] For example, a whistleblower system might encourage employees to alert the commission about apparent instances of collusive tendering directed toward public purchasing authorities. To discourage collusive tendering, several countries in recent years have experimented with systems that pay bounties to employees who alert the government to efforts by their employers to defraud government purchasing agencies.

With the exception of depositions and whistleblowing mechanisms, similar methods and instruments currently exist in Zimbabwe legal practice and procedure.

7.2.2 Clearance Processes for Certain Forms of Transactions

If Zimbabwe ultimately adopts a merger control regime, it may be useful to require pre-transactional notification for contemplated mergers (or joint ventures) exceeding certain size thresholds. Such a mechanism would give the agency an opportunity to consider the competitive effects of a proposed transaction at a time when there is the strongest possibility that an effective remedy -- either an injunction to stop the transaction, or a divestiture order that requires the spin-off of assets that have yet to be integrated into the acquiring firms operations -- can be applied. Such a notification process would be coupled with a requirement that gives the agency a comparatively short period in which to decide whether to challenge the transaction. It would be unwise to unconditionally freeze transactions until the agency gives its approval or decides to oppose the transaction. Such an approach runs a substantial risk of subjecting many benign or pro-competitive transactions to extensive delays as the agency, owing to reasons of bureaucratic delay or political pressure, exercises its review powers. The better approach would be to create a comparatively short mandatory waiting period coupled with fixed deadline before which agency can exercise a negative option.

7.2.3 Compliance Procedures

If the new agency has law enforcement powers, it will be necessary for the agency to develop standards for designing decrees and procedures for ensuring that firms subject to RBP-related orders comply with such orders. The establishment of a new competition agency's compliance mechanism would require consideration of at least three basic issues of institutional design.

First, the agency must set policies governing the duration of decrees banning RBPs. The duration of decrees should be a function of the competitive dangers posed by the conduct in question. For example, indefinite prohibitions would be appropriate for horizontal restraints such as collusive tendering. For conduct with more mixed competitive consequences (e.g., mergers), decrees should be made subject to provisions that terminate the operation of the decree after a fixed period of time. A compliance program should include provisions for the affected firm to submit periodic reports detailing measures it has taken to ensure fulfillment of the decree's terms.

Second, the agency should establish procedures by which firms subject to existing decrees can seek modification or vacation of decrees. Such procedures ordinarily should require a notice and comment process by which interested parties can address the merits of the requested adjustment.

Third, the competition system should provide a mechanism for punishing decree violations. This can be accomplished either through direct administrative assessment of penalties or through the prosecution of penalty actions before a tribunal external to the competition agency (i.e., a court of general jurisdiction such as the High Court or a special RBP tribunal). As a safeguard against arbitrary or abusive administrative conduct, the amount of permissible penalties should be specified by statute, and any administrative mechanism for imposing penalties should be subject to judicial review.

7.2.4 Procedures for Granting Exemptions

Experience with competition systems in other nations suggests that the implementation of an RBP control regime in Zimbabwe will generate requests by some affected parties for exemptions from RBP conduct prohibitions. This raises a basic and important question about the process the government should use to respond to such requests. As the Worldwide Experience Appendix indicates, permissive standards and procedures for approving exemptions can swiftly undermine the operation of a competition system. As a basic rule of thumb, governments seeking to promote market rivalry should adopt fundamental position of not favoring exemptions. In substance, exemption procedures should force exemption candidates to make a strong showing of need for dispensations from generally applicable competition principles. In form, the exemption process should be highly transparent to permit full, uninhibited comment and debate about the merits of specific proposals.

One approach is to require parliamentary approval for exemptions. Firms seeking dispensations would be required to persuade parliament to amend the competition statute to incorporate an exemption. Insisting upon an amendment to the competition act would give exemption proposals considerable visibility, thus ensuring close scrutiny and extensive debate by affected business and consumer interests. Allowing exemptions by statute only may create the strongest institutional safeguard against permissive granting of competition dispensations.

If a competition commission is delegated power to grant exemptions, it is imperative that the commission's decision making processes be genuinely transparent. Commission procedures should permit interested parties (e.g., actors likely to be adversely affected by the grant of an exemption) to participate in the exemption proceeding by, for example, filing comments on the proposed dispensation. Ideally, the delegation of exemption authority to the commission would include a specification of the standards the commission must apply in deciding whether an exemption was appropriate. The commission would then be required to articulate the rationale for granting specific exemptions, and its decisions would be subject to judicial review.

7.2.5 Rulemaking Authority

The legitimacy of any commission-based competition system will be enhanced if the commission makes its procedures and enforcement guidelines transparent to outside observers. This can be done by the routine promulgation of enforcement guidelines or interpretative rules. Particularly where the commission has been delegated power to define standards of conduct, the agency could be required to follow notice and comment procedures to ensure participation by interested groups.

CHAPTER 8

RECOMMENDED STRATEGY AND ACTION PROGRAM

8.1 Recommended Strategy

Reforms in addition to those in ESAP will be required to enhance domestic competition and international competitiveness, and to address RBPs. A strategy for moving forward needs to be developed in the context of resource constraints and the practicalities of an implementation process.

- The implementation of ESAP reforms is proceeding behind original schedule. Owing to a variety of reasons (most prominently, the food crisis occasioned by the lengthy drought), it is conceivable that some key ingredients of ESAP, particularly aspects of domestic deregulation and public enterprise restructuring and privatization, may not be in place for several years. This means that there necessarily will be a substantial lag before ESAP-generated forces of competition fully come to bear upon the economy and create robust, self-correcting market forces to promote efficiency and dissolve impediments to entry and expansion by new enterprises.

- Experience in numerous other countries, both developed and less developed, indicates that firms will continue to attempt to engage in certain forms of RBPs -- notably, horizontal price-fixing and collusive tendering -- even if ESAP were fully implemented today. In short, though ESAP could go a great ways toward diminishing the frequency and seriousness of RBPs, they are very likely to remain. This will call for further public policy response.

- Zimbabwe faces stringent resource constraints. Establishment of new competition policy, institutions and legislation will tax these limited resources further. The imperative to reduce civil service employment levels will make public officials wary about committing substantial resources to the creation of a new government entity. At least for the coming few years, the development of a new competition system is likely to take place under conditions of austerity.

- There is a strong sense within the government and within important segments of the private sector that, notwithstanding resource constraints and the press of other national business (such as implementing ESAP and combatting the drought), it is important to proceed in the near term with the development of a new competition system. This is apparent, for example, in the government's repeated commitment that Zimbabwe will establish a "monopolies commission" as one element of structural adjustment. Movement in this direction would: (a) serve the important symbolic purpose of underscoring the government's commitment to rely more heavily on business rivalry and free markets as the organizing forces for the economy; and, (b) begin the process of putting in place machinery to ensure that firms do not privately attempt to recreate the types of entry barriers and output-reducing schemes that government policies formerly, and often unintentionally, advanced.

Given the above objectives and constraints, a strategy for establishing an appropriate competition regime should proceed in phases that take into account resource limitations and time lags associated with putting the necessary foundations for authority in place. Past experience in Zimbabwe suggests that building effective institutions and enacting appropriate legislation will be a deliberate and lengthy process. The following framework is proposed as one way to achieve the government's aims as it implements ESAP and copes with resource limitations.

The first area that needs to be addressed is development of an overall competition policy. This should set out goals and objectives, an overall strategy for installing an appropriate competition system, and guide the further development of the institutional and legislative means for executing the strategy. A competition policy statement should be produced as early as possible by government.

Secondly, the institutional and legal components of the initial strategy need to be put in place. Two broad functions should be addressed: (i) pro-competition advocacy to promote competition; and, (ii) an enforcement capacity to address restrictive business practices. The IPC Team recommends that the institutional means for executing these two functions be kept separate, and that a Competition Council be created to perform the pro-advocacy function and that, in the first instance, the Attorney General's office be enhanced institutionally to address RBPs.

- The early tasks of the Competition Council are to reduce barriers to entry, particularly those which result from government action, create a "level playing field" and stimulate domestic competition. It should act as an advocate for competition, and address itself to government, business and society at large. One of its main roles should be to help ensure that competition aspects of ESAP are appropriately specified and are well implemented.

- The enhanced Attorney General's office in the early phase should focus on combatting restrictive business practices by enforcing a limited set of simple statutes covering the most obviously detrimental RBPs and to try them on a per se basis.

Creation of the Competition Council and enhancement of the AG's office will require action in three areas: (i) institution building and strengthening; (ii) legislation; and, (iii) training.

- The Competition Council needs to be created as an institution and appropriately staffed, and the AG's office will need new staff to perform the specific RBP-related functions.

- Legislation will be required to put in place statutes covering the initial set of most evidently abusive RBPs for treatment on a per se basis, as well as to legally institute the Competition Council and to give the AG's office enforcement powers related to RBPs.

- Training will be needed in several areas. Economics and legal staff at both the Competition Council and enhanced AG's office will need training in monopolies, competition and RBP related areas, as will judges in the high courts and to a lesser extent in the Supreme Court.

Thus, in the initial phase of the implementation process emphasis is placed on the adoption of relatively simple measures that minimize resource demands and minimize the potential for implementation error, while taking important steps toward the development of an effective competition system. In summary, the initial phase would broadly involve four main thrusts.

1. Develop an overall competition policy to guide further evaluation of institutional, legislative, and procedural options.

2. Create a Competition Council, to perform a pro-competition advocacy function and ensure that the full competition effects of ESAP materialize.

3. Draft and enact legislation covering an initial, limited set of most evidently abusive RBPs for treatment on a "per se" basis.

4. Enhance the Attorney General's office's capacity and legal authority to both investigate and litigate anti-trust/RBP cases.

In the longer term, depending on the success of the initial strategy recommended above and the overall success of ESAP, the competition system might evolve. For example, the AG's office might progressively enforce more complex statutes addressing an expanded set of RBPs and try cases increasingly on a rule of reason basis. Progression to this level would depend on the success of the early efforts in combatting RBPs and would only be possible as a result of the increased experience of the AG's office, private sector and government in RBP issues and the growing body of legal cases from which to draw precedence.

8.2 Recommended Action Program

The following action program, with ten key steps divided into three phases, should be undertaken to implement the initial phase of the strategy recommended above (Exhibit 8-1).

Phase I should occur in the first 6 months of the program. The four key steps are to:

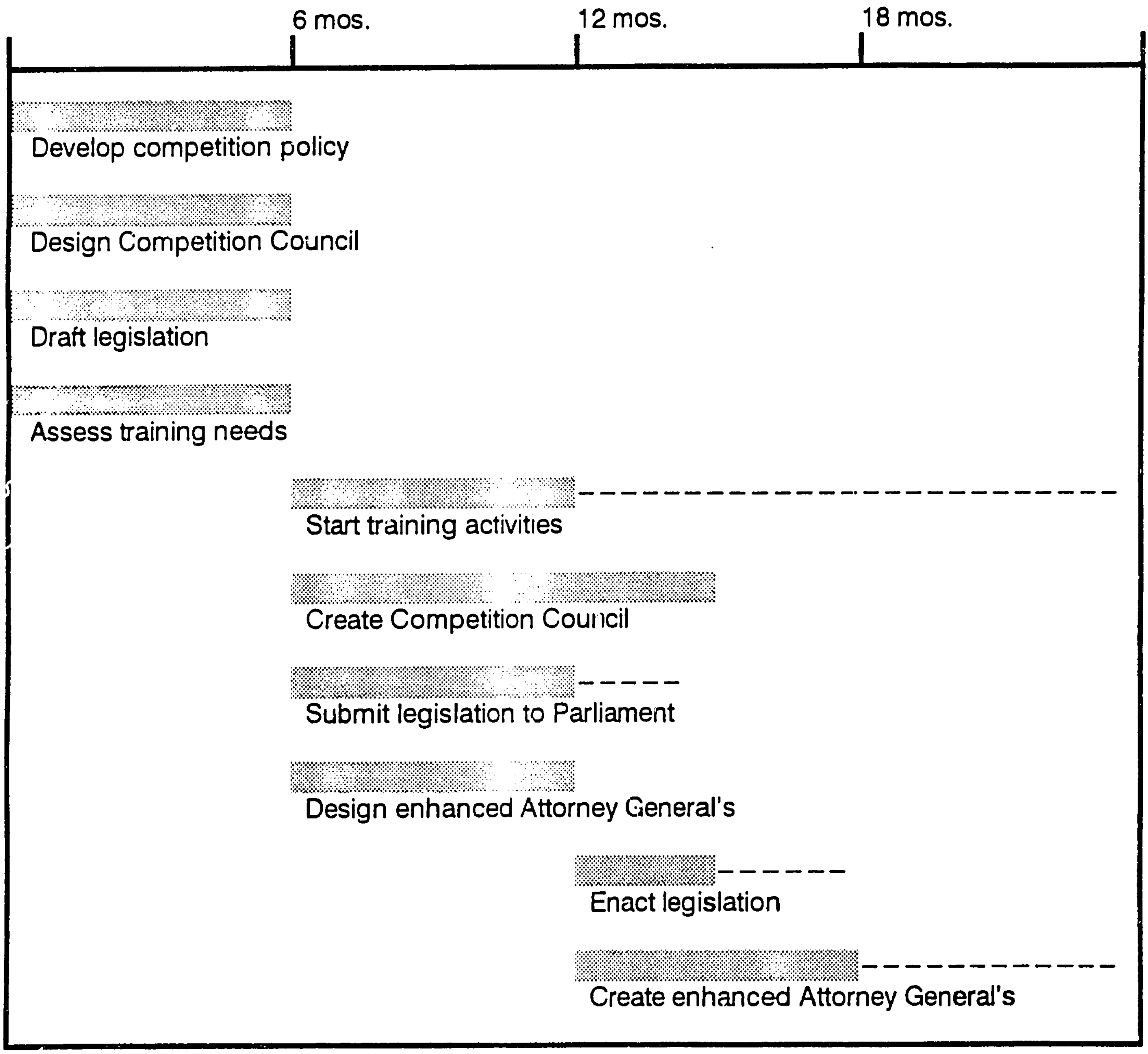
1. Develop an overall competition policy to guide further evaluation of institutional, legislative, and procedural options.

2. Design a Competition Council, to perform a pro-competition advocacy function and ensure that the full competition effects of ESAP materialize.

Exhibit 8–1

Zimbabwe Monopolies and Competition Policy

Time Table for Implementation of Next Steps



3. Draft legislation covering an initial, limited set of most evidently abusive RBPs for treatment on a "per se" basis.

4. Assess training needs in monopolies and competition related areas for the Competition Council, enhanced Attorney General's office, and the court system (High and Supreme).

Phase II should be executed between months 6 and 12, and include the following four key action items.

5. Start the training activities, as identified in action item 4 above.

6. Create, staff and begin the operation of the Competition Council, as designed in action item 2 above.

7. Submit RBP legislation, as drafted in item 3 above, to Parliament for consideration and approval.

8. Conduct institutional strengthening design of the enhanced Attorney General's office, capable of investigating and trying RBP cases.

Phase III should be started by about the 12th month, assuming Phase I and II are on schedule, and should include two main action items.

9. Enact the legislation covering an initial, limited list of RBP abuses, as approved in item 7 above.

10. Create and staff the enhanced Attorney General's office, as designed in item 8 above.

Recommended guidelines and design considerations for developing and executing the action program are as follows.

A. <u>Competition policy</u>.

Competition policy should be seen as an important complement to ESAP and as a pre-requisite for the full impact of ESAP to be felt. Competition policy is critical to promoting an open and competitive environment and for the efficient functioning of markets. Execution of a competition policy should be coordinated with implementation of ESAP. A policy statement should be developed as soon as possible.

It must be recognized that an open trade system is not a substitute for effective competition policy -- the two are complementary dimensions of overall competitiveness. Not all goods are inherently tradeable, and international and domestic competitors alike can have incentives to engage in collusion or other RBPs.

The key to effective competition policy is the lowering of all entry barriers (economic and social) and reduction of restrictive business practices. Demonopolization of industry structure, through the break up of firms, is costly for all parties involved, technically complex if assessed in an analytically rational manner, and should be seen as a last resort.

A limited yet achievable set of goals should be addressed by competition policy. Transparent and evenly applied regulations are required. The extent to which exemptions in the public interest are addressed by competition policy should be considered carefully.

The competition policy statement, once approved, should be widely disseminated within government and the business community, and form the base of a business code of conduct.

B. Competition Council.

Competition authorities have an important role to play as advocates for competition. Government as well as the business community and society at large should be the focal point for attention by such authorities.

The Competition Council should have three broad functions in the early years.

- Advocacy. Particularly a proactive role in getting government to specify and carry out domestic deregulation and to view competition in holistic and coordinated fashion.

- Industry/Regulatory Studies. The Council should conduct studies to determine constraints and improvements to competition, and to assess competition-reducing effects of selected industries. However, the Council should not be the main institution charged with identifying offenders of RBP laws.

- Case Referral. The Council should be able to refer cases to the Attorney General's office but not be empowered to require that the AG's office investigate the case in question.

The Council should be a lean institution with a small, full-time staff. An illustrative organizational structure is presented in Exhibit 8-2.

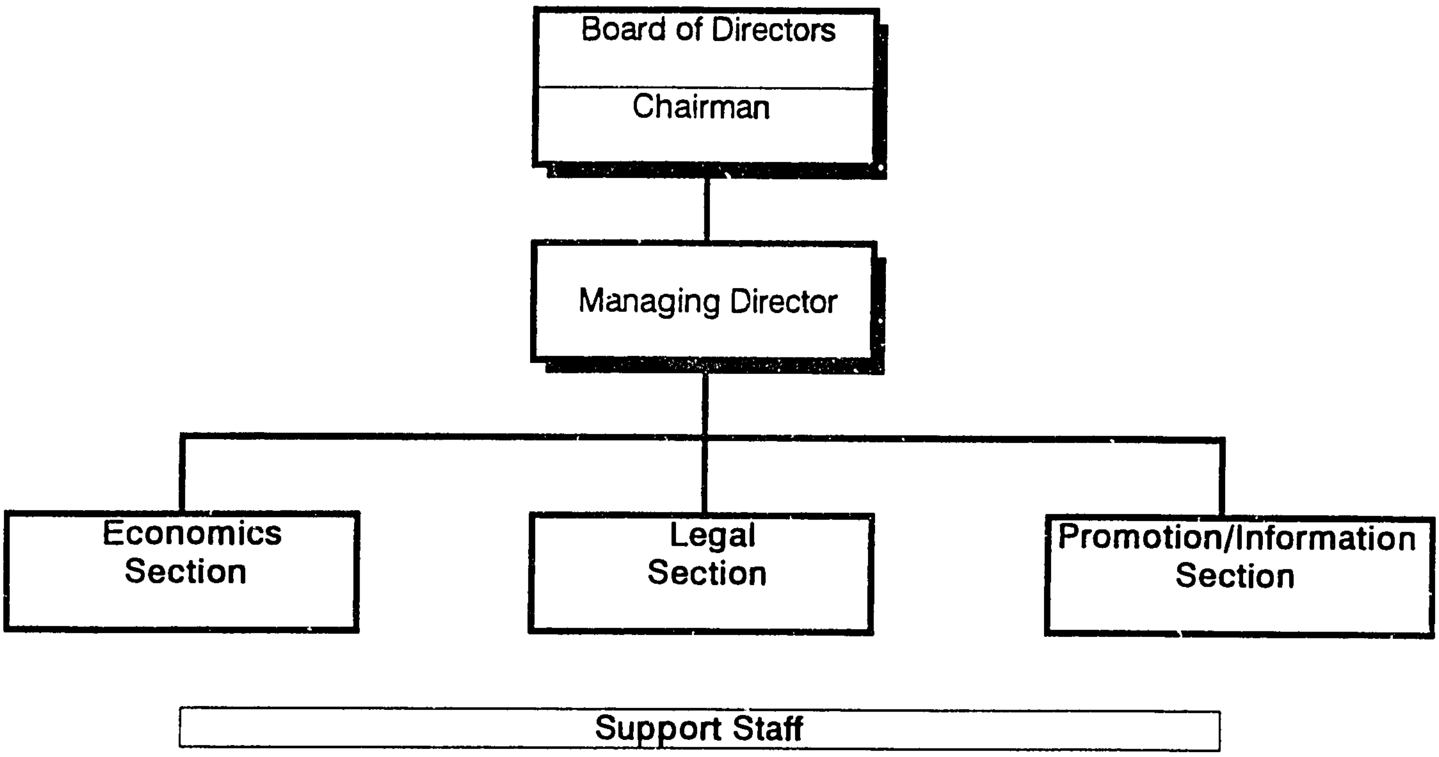
- There should be a part-time Board of Directors comprised of representatives of the public and private sectors as well as consumer interests, and representing a wide range of relevant disciplines such as business economics, law, policy and regulatory analysis.

- There should be a full-time Chairman of the Board who is devoid a strong political affiliations or other potentially competing interests.

Exhibit 8–2

Zimbabwe Monopolies and Competition Policy

Competition Council: Illustrative Organizational Structure



- The Council staff should be led by a Managing Director and have sections or divisions which cover economics, law and promotion/information, respectively. There should be at least one senior and one junior person in each section -- to allow for training on the job and facilitate institutional learning. A support staff of 4 or 5 people may also be needed.

- Step 2 in the action program will provide detailed design of this institution.

In the first instance, the Competition Council could be created by Presidential decree to avoid any possible delays caused by a process reliant on the legal system. However, the Council should be legally constituted as soon as possible. To the maximum extent possible the Council should be funded from non-government budget sources. The Council should add to its skills base by hiring on a part-time consulting basis local academics specialized in law and economics.

C. <u>Legislation</u>.

Effecting change in laws and the legislative system is not a simple or quickly achieved task. Zimbabwe is resource constrained and has a limited basis for developing monopolies related legislation. However, the level of trust in the legal system is quite high, and the profession at the upper levels is well trained -- this is something which should be leveraged. The following broad parameters should be taken into consideration for the early phase of implementing legislative elements of the action program.

- In the first instance only a limited set of laws should be put in place which address the more pervasive and obviously detrimental RBPs, such as horizontal price fixing, collusive tendering, and market allocation schemes.

- Maximum use should be made of any relevant, existing legislation, which through modification or amplification would form a (partial) base for the RBP statutes.

- Similarly in the first instance, cases should be tried on a per se basis only, whereby it only needs to be proven that the RBP occurred not whether it had detrimental effects.

- Parastatals and other forms of government-owned enterprises should be equally subject to RBP laws as private corporations.

- Public enforcement of RBP laws should be put in place, and reside in the Attorney General's office initially.

- The feasibility of private or class action should be investigated. While the current legal system does not readily lend itself to this form of enforcement (neither class action nor legal representation on a contingent fee basis are currently allowed), it is an important counter-force to sole reliance on public means of enforcement, which might suffer from biases or inaction.

- Rights of appeal need to be ensured. There should be recourse to the Supreme Court as final arbitrator.

D. Enhanced Attorney General's Office.

The Attorney General's Office should be the main public enforcement vehicle for investigating alleged RBP violations and for bringing cases. Consideration should be given to establishing a special division within the office.

- The special division should be proactive in searching out purported RBP offenses and should be the main public entity which receives complaints.

- The division will need at least two sections. The first would be an investigations division charged with scanning for RBP offenses and conducting studies of cases it initiates or of cases brought to its attention by others. The second section should be a trial or litigation group which has responsibility for preparing legal cases and subsequently trying those cases which it deems merit being heard in court. Procedures for civil versus criminal cases will be different, particularly at the litigation stage.

- Staffing for the AG's office can be augmented over time. However, it should aim for the following staff composition within 1 to 2 years of RBP laws being passed: 1 to 3 lawyers and 2 to 3 business economists in the investigations section, and 2 lawyers and 2 paralegals in the litigation section. It will also need to have access to the general support staff of the AG's office.

E. Training and Technical Assistance.

Training needs must be assessed as a matter of priority, particularly because the existing set of relevant skills starts from a low base, the technical skills required for monopolies related analysis are quite specific and complex, and training takes a long time to implement. Training will be required at several levels and will rely on a number of delivery models.

- Economists capable of conducting monopolies related analyses will be required to staff both the new Competition Council and the enhanced AG's Office. In the first instance, they will need to define relevant markets and geographies, determine which firm(s) have market power, and establish whether RBPs are being exerted. Formal degree training should be initiated for some staff. However seasoned economists could benefit from short courses conducted in other countries or special seminars in Zimbabwe, and by taking up exchange assignments in the economics divisions of other countries' monopolies commissions and competition councils.

Rotating 6-month visits to Zimbabwe by foreign experts employed by other competition agencies would also be an effective means for developing appropriate skills in economics.

- Lawyers will need training in RBP related areas, both to investigate and try cases. There will be specialist legal staffs in both the Competition Council and the enhanced AG's Office. These skills could be transferred through short-term training courses or seminars in Zimbabwe, seconding legal staff from existing monopolies commissions and similar institutions in other countries, or by sending key individuals overseas for resident stays in another countries' monopoly commission.

- High Court judges and to a lesser extent Supreme Court judges will need specialized training. However, given the competing demands on their time and the level of technical complexity they need to command, short (say 2 week) in-country courses conducted by overseas experts probably will suffice -- with "refresher"courses provided every so often to keep existing skills sharp, or to upgrade skills as the complexity of RBP statutes increases over time.

APPENDIX I

CONSULTANT'S SCOPE OF WORK

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STUDY OF MONOPOLIES AND COMPETITION POLICY IN ZIMBABWE

__Scope of Work__

The Contractor shall conduct the following tasks:

A. Task 1: Assessment and analysis of industrial concentration, restrictive business practices and regulation in Zimbabwe, and the impact of ESAP on restrictive business practices and their regulation.

Sub-Task 1-A: Synthesize, analyze, and to the extent possible, update locally-available research on industrial concentration, extending it, if necessary, and possible to the commercial, services and financial sectors as well. The Contractor shall utilize, at a minimum, four-firm concentration ratios or the more precise Herfindahl-Hirshman Index (i.e., sum of squares of market shares of all firms in the industry), if the data permit.

Sub-Task 1-B: Undertake search and analysis of locally-available literature on evidence of restrictive business practices in Zimbabwe which may include the following:

-- Manipulation of prices/imposition of unjustified costs by a single supplier.

-- Collusion in price setting by two or more firms.

-- Collusive tendering.

-- Exclusive dealing (restricting a client's freedom to purchase and deal in products of other suppliers).

-- Differential pricing or discounting (unequal treatment of dealers/distributors/stockists despite similar circumstances).

-- Refusal to supply, boycott of supplier.

-- Tied sales.

-- Resale Price Maintenance.

-- Area Restriction.

Sub-Task 1-C: Identify and analyze the existing GOZ means of regulating or controlling the Restrictive Business Practices identified above.

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Sub-Task 1-D: Analyze ESAP and related reforms and their impact on industrial concentration, restrictive business practices and implications for restrictive business practices policy and implementation in Zimbabwe.

B. Task 2: Identify and analyze worldwide experiences with regulating restrictive business practices, especially in the context of simultaneously introducing Structural Adjustment Programs.

Sub-Task 2-A: Update and critically analyze existing literature searches on worldwide experience with restrictive business practice regulations and policy reform. The following issues should receive special, but not exclusive, emphasis:

-- Role of trade liberalization in preventing restrictive business practices.

-- Restrictive Business Practices (RBPs) regulation as a component of SAPs.

-- Restrictive Business Practices regulations as a vanguard of removing price controls.

-- Estimated welfare loss (say impact on GDP) of restrictive business practices in developing countries -- especially to other structural deficiencies being addressed by SAPs.

-- Lack of competition in non-tradeable goods and services and the subsequent impact on a country's competitiveness in the tradeable goods and services sectors.

-- Role of Restrictive Business Practices in promoting increased domestic competition, impact on competitiveness and its role in preparing a country's economy for international competition.

-- Political economy of introducing restrictive business practice regulations.

-- Definition of monopoly and monopoly power, "natural" monopolies, acceptability of monopoly or oligopoly situations in small economies, pricing goals and determination when regulating monopolies.

Sub-Task 2-B: Collect and analyze critically "model" restrictive business practice legislation and guidelines, e.g., the UNCTAD <u>Handbook of Restrictive Business Practices Legislation</u>, in the context of the findings of Sub-Task 2-A.

C. Task 3: Recommend policy actions to regulate monopoly power and other restrictive business practices in Zimbabwe

The Contractor shall recommend policy options and their sequencing in the context of:

-- policy reforms already scheduled to be introduced under the ESAP;

-- capacity in the GOZ to introduce policy given the distractions of the ESAP and the mandated cutbacks in the civil service; and

-- the political economy of Zimbabwe.

The Contractor's policy recommendations shall include the identification of priority industries or sector for restrictive business practices regulation; address the question of a prima facie illegal test of restrictive business practices versus a more discretionary approach; address application of restrictive business practices policy to parastatals and "natural" monopolies.

D. Task 4: Recommend institutional and procedural options to regulate restrictive business practices in Zimbabwe

The Contractor shall consider the following in developing their recommended **institutional and procedural options**:

-- Whether to make restrictive business practices control exclusively a bureaucratic function or. alternatively, to establish a Monopolies or other Commission that enjoys some autonomy from a GOZ ministry;

-- Which ministry/department should host the apparatus or refer cases to an autonomous Commission:

-- Who should select and confirm the Commissioners' what kind of tenure should they enjoy;

-- Whether an autonomous Commission should have quasi-judicial powers or merely make recommendations to a GOZ ministry;

-- Whether the ministerial unit or Commission should be empowered to determine sanctions for violations; and

-- What the parties' rights of appeal to the judiciary should be and how far should the judiciary delve into questions of substance.

The Contractor shall make institutional recommendations in the context of:

- Existing ministerial and regulatory structures and the political economy in Zimbabwe;

- Capacity in the GOZ to implement options given the distractions of the ESAP and the mandated cutbacks in the civil service; and

- Transparency in the Restrictive Business Practices rules and implementation so that the business community can clearly understand what is permitted so as to not unduly deter productive activity.

E. Task 5: Briefing and Preparation of Final Report

The Contractor shall brief the Monopolies Commission Inter-Ministerial Committee and other relevant officials as required. Based on the comments received on the draft final report from the Committee and USAID/Zimbabwe, and the feedback from the briefing, the Contractor shall prepare a final report to the Government of Zimbabwe.

APPENDIX II

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SELECTED BIBLIOGRAPHY

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APPENDIX III

MEMBERS OF THE INTER-MINISTERIAL COMMITTEE ON THE MONOPOLIES COMMISSION

MEMBERS OF THE INTER-MINISTERIAL COMMITTEE ON THE MONOPOLIES COMMISSION (partial list)

Mr. M. M. Gutu-Munyati (Chairman)
Under Secretary
Ministry of Industry and Commerce

Mr. O. M. Tshabangu (Alternate Chairman)
Deputy Secretary
Ministry of Industry and Commerce

Miss I. Rackiewiczova (Secretary)
Ministry of Industry and Commerce

Mr. C. Manzira
Under Secretary
Fiscal and Economic Coordination
Ministry of Finance, Development, and Economic Planning

Mr. F. B. C. Chanetsa
Assistant Secretary
Ministry of Industry and Commerce

Mr. W. K. Chidakwa
Administrative Officer
Ministry of Finance, Development, and Economic Planning

Mr. A. S. Hamadziripi
Zimbabwe Investment Center

Mr. C. Chaitezvi
Assistant Director of Valuation
Customs Department

Ms. Y. Nxumale
Reserve Bank of Zimbabwe

APPENDIX IV

PARTIAL LIST OF CONTACTS

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PARTIAL LIST OF CONTACTS

Zimbabwe

Alka Paint Corporation (Private) Limited

Mr. D. MacIntosh, General Manager

Architects Council

E.T. Gurney, Chairwoman

Diana Mitchell

Astra Paints

Mr. B. Ketteringham, General Manager

Atherstone and Cook

Lindsay Cook, Partner

Berger Paints Zimbabwe (Private) Limited

Mr. T. Stocks, General Manager

Bread Basket Bakers

Laiza Marongwe, Managing Director

Central Statistics Office

Gibson Mandishona

Cluff Resources Zimbabwe Ltd.

Roy A. Pitchford, Managing Director

Cone Textiles (Private) Limited

Mr. K. O'Toole, Finance Director

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Mr. P. Stoddart, Financial Manager

Confederation of Zimbabwe Industries

John A. Deary, President

Mike Humphrey, Chief Economist

Stella Mushiri, Economist

Anthony Read

Construction Industry Federation of Zimbabwe (CIFOZ)

Barry Brunette, Chief Executive

Consumer Council

Muchaneta Nyambuya, Managing Director

David Whitehead Limited

Mr. T. P. Cullen, Managing Director

Dulux Limited

Mr. N. Collyer, Financial Manager

First Merchant Bank of Zimbabwe

John Robertson, Chief Economist

Ford Foundation

Michael Chege, Program Officer

Geoberta Manufacturing

Gloria R. Mkombachoto. Director

Gill, Godlonton and Gerran

James H. P. Back, Partner

Sue Brighton, Attorney

Indigenous Business Development Centre

Wilbert Chihuri, Executive Director

John T. E. Mapondera, National President

Johnson and Fletcher

Mr. Rutledge, Managing Director

Lyons Brooke Bond

David Long, Managing Director

Michael Hughes, Finance Director

Ministry of Finance

Mrs. Guti

Dr. Manzira

Ms. Mfofo

Mr. Mashinge, Acting Deputy Accountant-General

Ministry of Justice, Legal, and Parliamentary Affairs, Attorney General's Office

Brian C. Brown, Director of Legal Advice

Ms. D. L. Mandaza, Chief Law Officer

Tony McMillan, Law Development Commission

Ministry of Local Government, Rural and Urban Development

Mr. J. M. Zamchiya, Director of Physical Planning

Portland Holdings Limited

Mr. C. E. Rickwood, Financial Director

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Reserve Bank of Zimbabwe

R.V. Wilde, Deputy Governor

P. Machaya, Legal Advisor

A. Bvumbe, Chief Statistician

R.G. Nyadzayo, Chief Economist

J.N. Dhliwayo, Deputy General Manager, Exchange Control

S. Kufeni, Executive Assistant to the Governors

Retrofit

Strive Masiyiwa, Managing Director

Standard Charter Bank of Zimbabwe

Mervyn Ellis

Mario Dosremedios

TA Holdings

Mr. Cannon

United Nations Development Programme

A. Hauge, Program Officer

United Touring Company

Mr. D. Cruttenden, Managing Director

University of Zimbabwe

Geoff Feltoe. Professor. Faculty of Law [through 2/29/92] and Editor, Legal Forum

Arthur Manase. Professor. Faculty of Law

Pearson Nherere. Professor. Faculty of Law

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Julie Stewart, Professor, Faculty of Law

Women in Business Zimbabwe

Violet-Lana Madzimbamuto, National Treasurer

World Bank

Lloyd MacKay

Zimbabwe Building Contractors Association (ZBCA)

Marx Mazondo, Executive Director

Zimbabwe Development Corporation

C.M. Ushewokunze, Chief Executive

Zimbabwe Iron & Steel Company (ZISCO)

K. T. Brightman, Managing Director

Zimbabwe National Chamber of Commerce

Jim Torond, President

ZIMTRADE

Mike Humphrey

<u>Washington</u>

Anti-Trust Division, U.S. Department of Justice

Federal Trade Commission

World Bank

<u>Geneva</u> -- UNCTAD, Restrictive Business Practices Unit, Manufactures Division

<u>London</u> -- Monopolies and Mergers Commission

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APPENDIX V

GLOSSARY OF SELECTED TERMS

GLOSSARY OF SELECTED TERMS

Class or group action — A legal action undertaken by one or more plaintiffs on behalf of themselves and all other persons having an identical interest in the alleged wrong.

Collusion — Acting in agreement or in concert with others either pursuant to a clandestine agreement or for an illegal end or by an illegal means.

Collusive bidding/tendering — The practice whereby competitors secretly agree beforehand, upon purportedly independent bids, in order to eliminate competition between them or to exclude other competitors.

Delict — A wrongful act for which a civil action will lie, except one involving a breach of contract.

Horizontal — A term applied to a market relationship among enterprises if they are on the same functional level in the same market, ie., they are all producers or they are all distributors

Jurisprudence — A system or body of law, or the course of court decisions.

Market power — The ability of a single enterprise or group of enterprises to set prices and/or the terms of trade largely without regard to the reactions of existing or potential competitors.

Monopoly — An enterprise operating in a market in which it is the sole supplier, is insulated from competition due to high barriers to entry, and can fix prices and terms of trade to a large extent without regard to the action of potential competitors.

Oligopoly — A group of enterprises operating in a market with significant barriers to entry and in an environment of recognized competitive interdependence (sales and profits of single enterprise depend on its actions and the reactions of a few others).

Per se treatment	The treatment of legal cases regarding restrictive business practices and abuses of market power where the law requires only proof that the conduct has occurred -- the competitive impact or potential efficiency effects of the conduct need not be addressed in addition, to establish it's legality.
Price fixing	A situation between competing enterprises whereby, rather than setting prices independently, they enter into a cooperative agreement regarding prices.
Price leadership	A form of conscious parallelism with regard to prices, whereby the price policy of one enterprise, the price leader, is deliberately followed by the others.
Resale price maintenance	The practice by a supplier of prescribing and taking action to enforce retail or wholesale prices for the resale of his goods.
Rule of reason treatment	The treatment of legal cases regarding restrictive business practices and abuses of market power where the law requires proof that both: (a) the conduct has occurred, and (b) the harm to competition resulting from the conduct more than offsets any efficiency or other beneficial effects of the conduct.
Tying agreement	An agreement or practice whereby as a condition of furnishing a product, service, patent or technology, the recipient is required to take one or more other products or services.
Vertical	A term applied to a relationship among enterprises if they are on different functional levels in the same market, ie., one firm is the producer of a given product and another firm is the distributor of that product.

APPENDIX VI

WORKING PAPER ON WORLDWIDE EXPERIENCE IN FORMULATING AND IMPLEMENTING COMPETITION POLICY

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RECENT WORLDWIDE EXPERIENCE IN FORMULATING AND IMPLEMENTING COMPETITION POLICY, WITH SPECIAL REFERENCE TO DEVELOPING COUNTRIES ENGAGED IN STRUCTURAL ADJUSTMENT

INTRODUCTION

The objective of this working paper is to analyze worldwide experience with regulation of restrictive business practices, especially in the context of developing countries that are pursuing structural adjustment programs.

The paper begins by summarizing the evolution of concern with RBP in developing countries. It shows that only a small number of developing countries have thus far established machinery for RBP control, although the last few years have seen a quantum jump of attention to the field, and it offers an explanation for the initial lack of interest as well as the recent upsurge.

Chapter 2 reviews the current state of the debate on competition policy in industrialized countries, and draws implications for developing countries that are considering adoption of RBP control laws and regulations along with establishment of machinery to implement them. In this vein particular attention is paid to options being considered by the countries of Eastern Europe, which have moved rapidly to introduce RBP control machinery as part of their transition to market economies.

Chapter 3 reviews evidence concerning the prevalence and impact of restrictive business practices in developing countries. It describes both the practices by which governments themselves have severely restricted business development, and the origins and extent of RBP instigated by business enterprises. Quantitative evidence in regard to developing countries is described as consisting primarily of estimates of industrial concentration, along with tabulations of RBP control activities conducted by competition authorities in countries such as India and Korea.

Chapter 4 examines trade liberalization as an approach to augmenting competition in developing countries which has thus far received priority in structural adjustment programs. It reviews recent evidence on the link between liberalization and domestic competition, and offers indicators of the volume of economic activity not directly affected by liberalization. The policy implications of this dichotomy as perceived in industrialized countries are then explored.

With a view to illuminating specific country experiences that Zimbabwean policy makers might find relevant as they consider their own options in the field of competition policy, Chapter 5 summarizes the evolution of RBP control policies and institutions in three developing countries actively engaged in structural adjustment programs--Kenya, Morocco and Sri Lanka--as well as in the Republic of Korea. In addition, the recent experience of selected countries in Eastern and Central Europe is examined.

In the final chapter a critique of the applicability of the UNCTAD Model Law is provided.

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1. EVOLUTION OF CONCERN WITH RBPs IN DEVELOPING COUNTRIES

Early initiatives in developing countries. Before 1980 governmental initiatives in the field of competition policy were rare in low-income countries. In 1969-70 India and Pakistan adopted laws regulating monopolies and restrictive business practices (RBP), and established agencies to implement them. Even earlier, some Latin American countries had passed laws largely inspired by the United States' lengthy record in the anti-trust field, although enforcement remained weak or nonexistent.[1] The next developing country to take a serious interest in the field was Greece, passing a law in 1977, followed by Thailand in 1979. The 1980s saw modest acceleration of interest, with Korea, Portugal, Sri Lanka and Kenya passing legislation, the latter being the first (and thus far only) African country to do so.

Multilateral institutions and competition policy. At a multilateral level, the United Nations Conference on Trade and Development (UNCTAD) circulated as early as 1979 a model law for consideration by developing country authorities, and revised versions of this were produced during the ensuing dozen years. In 1980 the U.N. General Assembly approved a document prepared under UNCTAD auspices called "The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices".

Since then UNCTAD, through close-to annual meetings of its Inter-governmental Group of Experts on Restrictive Business Practices (shorthand title: IGE), has promoted a regular dialogue on the relevance of competition policy to developing countries. Beginning in 1986 it has circulated annually a document described as a 'handbook' of RBP legislation, containing the competition laws of one to four countries.[2] In 1989 the OECD's Committee on Competition Law and Policy made its first public appearance on the development scene, organizing a symposium in which representatives of a number of developing-country competition authorities participated.[3]

If enactment of competition laws and establishment of RBP-control agencies had counted among conditionalities of donor aid for structural adjustment, more developing countries would probably now have such facilities. In the event, the financing agencies have stressed (i) trade liberalization, including removal of exchange controls, (ii) relaxation of domestic regulatory systems such as discretionary licensing and price control, and (iii) privatization of state enterprise, to the exclusion of RBP-control policy. No IBRD structural adjustment program thus far has included

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[1] Cf. Luis José Diez-Canseco Nuñez (1991, pp. 83-84) and Winston Fritsch & Gustavo H.B. Francop (1991, p. 206).

[2] Through 1991 legislation of 17 countries had been circulated through this medium: Brazil, Canada, Chile, Denmark, France, Finland, Germany, Kenya, Korea, Norway, Pakistan, Poland, Portugal, Spain, Sri Lanka, Sweden and the United States. Cf. UNCTAD (1986-1991, annual).

[3] Cf. the collection of symposium papers in OECD (1991b). Eleven of the 26 authors are from developing countries.

a conditionality in respect of combatting anti-competitive behavior by business organizations.[4] Only within the past year or so has the Bank established a research unit focussing specifically on domestic market structure, conduct and performance and their regulation.

Reasons for hesitancy of Third World policy makers. As for low-income countries themselves, one can identify several factors that have forestalled the development of effective constituencies on behalf of domestic competition policy:

1. Many industrial sectors have been opened up by enterprises established by or with major support from the state, and governments have taken an interest in seeing them prosper even at the cost of suppressing competition.

2. Governments have considered that, since their national markets will support only one or a small number of producers at economic scale in a given industry, monopolistic or oligopolistic market structure is something they must and can live with.

3. Governments have viewed competition which leads to excess capacity and ultimately exit of weaker firms as wasteful of capital, socially burdensome and politically costly (through worsening of unemployment). They have thus tended to limit entry and tolerate market-sharing arrangements among producers.

4. Governments have trusted in their bureaucracies to acquire the information necessary to determine socially desirable price ceilings, making it superfluous to combat collusion in price-fixing.

5. Governments whose development strategy has centered on promoting exports of manufactures have operated on the premise that only concentrated producing units, occupying dominant positions in the local market, would be strong enough to compete with developed-country industries.

6. Consumer associations are still in their infancy in most developing countries; conversely, business interests whose freedom of action would be constricted by RBP control exert political pressure to forestall it.

Recent upsurge of Third World interest. As of early 1992, one can say that the pace of interest among developing countries in formulating and legislating competition policies is quickening. In Africa, Zimbabwe, Zambia and Ghana are known to be pursuing concrete initiatives. In Asia,

[4] Illustrative of the Bank's hesitancy in this field is its current structural adjustment loan and credit to Zimbabwe. The government's 'Letter of Development Policy' underlying the program states a firm intent (para. 63) to set up a Monopolies Commission once government has studied the present report and decided which options to pursue. In some 15 pages devoted to discussing the program, the Bank president's report to the IBRD executive directors reproducing the Letter (IBRD [1992], p. 43) makes no reference to the Monopolies Commission.

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strengthening of monopolies control is a component of Korea's democratization movement, and Sri Lanka's Industrialization Commission has invited proposals for upgrading the Fair Trading Commission established in 1987. In Latin America, Peru adopted a new law in 1990(?), while Brazil passed one at the beginning of 1991.

This acceleration of interest is overshadowed by the pace of activity in Eastern Europe. To meet a need posed by the economic decontrols undertaken before democratization, Poland promulgated an anti-monopolies law already in 1988: this was strengthened in 1990, and most of the other countries in the region had enacted competition laws by late 1991, with inputs from European and American competition authorities. Donors considering a new structural adjustment package for Russia are looking at possible inclusion of competition policy. The Eastern European initiatives are discussed further in the next chapter.

Summarizing its current technical assistance program in the RBP-control field, UNCTAD's Trade and Development Board cites 22 developing countries as having attended regional seminars or workshops under its sponsorship; eight as having held national seminars and 16 more (including two E. European countries) requesting UNCTAD assistance in organizing such events; one (Ghana) as currently receiving assistance in drafting legislation, with six more having requested such aid; and ten, five of which have already adopted legislation, as receiving or requesting assistance in staff training.[5]

Reasons for changing attitudes. The upswing in interest in competition policy on the part of developing countries as well as economies in transition from central planning to market orientation can be viewed as mirroring changes in the attitudes enumerated above:

1. The economic performance of state enterprises has been disappointing, and their presence in sectors other than natural monopolies is increasingly seen as retarding growth, in part precisely because their survival has necessitated imposing restrictions on more dynamic private-sector alternatives.

2. While accepting that their domestic markets cannot support as many producers in a given branch of modern industry as can a developed country, governments of developing countries are coming to the view that consumer prices and customer industries' production costs are lower when producers are subjected to import competition or, in nontradeable sectors, regulated so as to combat collusive behavior.

3. Excess capacity is regarded less and less as an inherent waste of resources, and increasingly as a factor inducing producers to compete with one another domestically and enter export markets by adopting technological and other improvements that lower variable costs. At the same time, steady turnover of

[5] UNCTAD (1991b), p. 5.

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enterprises is increasingly seen as a healthy phenomenon whose social costs can be limited through means other than propping up unviable enterprises and drastically restricting lay-offs.

4. Experience with price control has shown that it discourages investment, decapitalizes enterprises and wastes valuable management time. In many countries the responsible bureaucrats have proven unable to avoid these pitfalls, and even where they act responsibly, decision-makers thwart their good intentions by managing price control as a political football.

5. While producing units whose concentration has been encouraged by government policy have played a role in launching some industries into export markets, many have outlived their usefulness early on and ended up retarding initiative in their sectors (cf. Korean experience cited in Chapter 5 below).

6. Consumer associations are forming and becoming an ever stronger voice against RBP.

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2. THE RELEVANCE OF OECD RBP POLICY TO DEVELOPING COUNTRIES

Introduction

Many OECD countries have a long history in competition policy formulation and implementation. While these countries' policies are not directly transferrable to developing countries, there may be lessons learned which are relevant.

The extent to which the competition policies and practices of a given OECD country is relevant to developing countries, depends largely upon the goals an individual country sets for competition policy. Countries pursue different competition goals -- economic efficiency, consumer welfare, broadening the base of competition, and other goals related to industrial policy or affirmative action. These goals reflect the nature of the economy in question, its political orientation, and the capacity and nature of its administrative and judicial systems.

Given the large number of factors affecting the choice and design of competition policy, it is not surprising that: (a) developing countries rarely, if ever, adopt wholesale the competition policy of an OECD country; and (b) no two countries' competition policies are exactly alike. However, elements of many OECD countries' existing competition policies are over a century old and have benefitted from several major revisions. In light of this, it is useful to review the competition policies of major OECD countries, especially the differences between their policies, and to determine the relevance for developing countries.

Common Lessons Learnt in OECD Countries

While many differences can be observed in the RBP regulation exercised by the various OECD countries, a number of common precepts have emerged[6].

1. Competition policy is regarded as critical to promoting an open and competitive environment and for the efficient functioning of markets.

2. Competition legislation should be seen as a means of improving the prevailing commercial culture and developing a supportive business environment -- establishing an appropriate competition regulatory regime is thus particularly important in developing or transition economies building market mechanisms and institutions.

3. An open trade system is not a substitute for effective competition policy -- the two are complementary dimensions of overall competitiveness.

[6] Boner & Krueger (1991).

4. Competition legislation, in both design and implementation, should strive to protect the process of competition and not individual competitors.

5. The design and implementation of competition legislation is not trivial -- requiring sophisticated legal and economic expertise. Even with appropriate resources, the costs of regulatory failure may be significant, and might outweigh whatever benefits are derived from correcting perceived market failures in the competitive process.

6. Competition law is implementable, even in developing countries, as long as initial goals are not too ambitious -- in the beginning countries might start with well-codified, simple, transparent per se rules, and gradually move towards rule of reason treatment as they gain experience.

7. Implementation of competition regulation needs to be supported by a legal system characterized by enforcement of contractual obligations and ownership rights.

8. Competition authorities have an important role to play as an advocate for competition not only with society at large, but also with government agencies.

Comparison of Key Differences in OECD RBP Regulation

A number of key differences in the RBP regulations of major OECD countries can be observed.

Goals and Objectives

Historically, competition policy has been employed primarily to protect the competitive process in relatively mature economies for which internal competition is an important feature of commerce. Hence, the strictest competition policies are those of the United States, Germany and the EEC. Some European countries traditionally have designed and implemented policies to protect both small producers and the competitive process.

Competition laws that serve a variety of goals, as opposed to those that support competition as an important means for attaining these goals, allow greater political discretion and generally provide for weaker enforcement. This has been an important element of the industrial development policies of the UK, Sweden and France. For competition laws relying on judicial decision, political discretion comes primarily from the granting of legal exemptions, an important feature of Japan, Korea and Germany.

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Judicial Systems

In the German and American systems, which have served as models for competition legislation and administration in the rest of the world, judicial decisions play a central role in defining and enforcing competition law, a feature shared with Australia, Japan, Korea, Canada, the EEC, and recently France. In contrast, judicial decisions play a relatively minor role in the competition laws of the UK, Sweden, and Spain. These nations employ an administrative system for which the interpretation and enforcement of the law rests with an administrative court and an appointed official of the executive branch, usually a ministry.

Statutory Design

In terms of statutory design, competition law can intervene in three distinct areas: the conduct of business, the structure of economic markets, and in economic performance.

Conduct Regulation

The greatest commonality across OECD countries is in conduct regulations, which are usually stated as prohibitions of conduct that either restrains trade, lessens competition, or abuses a market-dominating position. In certain circumstances, many of these competition-restraining types of conduct can contribute to economic efficiency, and competition laws are generally designed to balance harm to competition against improvement of efficiency.

In this regard, competition laws of the US, Germany and the EEC judge restraints on competition under a stricter standard than other countries, requiring greater evidence that the restraints improve efficiency. Elsewhere, the regulation of restraints of trade is more lenient, particularly in such economies as Sweden and the UK where restraints are judged by goals (eg, regional employment, balance of payments) other than competition.

In mature economies two areas of conduct regulation are universally addressed and in an increasingly common manner: (i) horizontal collusion in oligopolistic markets, i.e., agreements through which independent suppliers fix prices and/or divide up markets; and, (ii) practices by which firms in dominant positions, acting singly or in concert, abuse their market power to suppress current or potential competitors in a weaker position (e.g., predatory pricing and tied sales).

There is a third area of RBP conduct regulation -- control of vertical restraints, notably exclusive dealing and resale price maintenance between successive stages of the distribution chain --for which consensus has yet to emerge. Traditionally such practices were considered as anti-competitive across the board. However, recently the US has been ruling in some instances that such arrangements promote efficiency, which is not outweighed by consumer loss, and thus is permissible. Other countries are paying close attention to this evolution.

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Market Structure Regulation

Competition law, as it applies to the structure of economic markets, intervenes in intercorporate transactions, usually mergers, joint ventures and asset transfers. It also covers other instances of increased inter-corporate control such as interlocking directorships. Regulation of market structure occurs when these transactions would weaken the independence of competing suppliers and raise concentration in economic markets to high levels.

Historically only Germany and the US have actively intervened in market structure, by requiring pre-merger notification and prohibiting corporate transactions leading to high concentration in economic markets. Traditionally, most other OECD countries have not exercised significant control over market structure owing to a conviction that large economic entities are better able to compete in international markets. However, as an economy develops and experiences rising levels of industrial concentration, there is a tendency for governments to exercise greater control over market structure. It is this area of competition law that has developed most rapidly throughout the 1980s, with the EEC, the UK, Spain, Germany, South Korea and Canada all strengthening the oversight and control of market structure.

Control of market power still features a relatively wide range of philosophies and degrees of state intervention. The UK, France and Germany define thresholds of market control -- most commonly 25 percent -- beyond which a merger is either in principle forbidden, or cannot be consummated without government approval. Most smaller countries, considering that firms in some industries cannot exploit economies of scale and compete internationally without larger shares of the domestic market, eschew quantitative criteria.

Two other forms of regulatory control can be used to combat market concentration -- divestiture and demonopolization. Divestiture can be used in instances where multi-product firms are planning to merge and it is in only a few of their product areas that high degrees of market concentration would occur after the merger. These firms, either acting in anticipation of merger authorities' rulings or at the request of the authorities, may choose to spin off (divest themselves of) those divisions or product groups which would be viewed post-merger as having excessive market power.

Whereas merger controls, most of which require pre-merger notification or set market share or absolute size limitations, and divestiture are forms of ex-ante control, demonopolization is a form of ex-post control, which seeks to break up companies which are seen as being in monopoly positions. In OECD countries this measure is seen as a last resort for restoring competitive market structure in concentrated markets and has been used exclusively against monopolies. Demonopolization is seen by most OECD countries as extremely difficult to put in effect, high in cost and likely to be a lengthy process.

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Performance Regulation

Performance policies, those by which the state corrects monopoly situations or restraints of trade by dictating prices or output, are available in certain instance but little used in OECD countries. Fundamentally such policies are perceived as incompatible to some degree with the belief that markets do a better job of determining prices and outputs. The US makes little use of performance policies in enforcing its competition law. They have been used in the past in Japan, Korea and the EEC.

Exemptions

The competition laws of most OECD countries allow antitrust exemptions as a means of supporting industrial policies designed to promote sector-specific development. These usually allow greater concentration of economic activity under the assumption that this will lead to greater efficiency and thus development, and offset the negative effect on consumer welfare implied by increased concentration. However, industrial policies such as these often have significant net anti-competitive effects. For example, historically Japan, Korea and Germany have often sanctioned cooperative activities among domestic suppliers.

Yet as development has progressed, owing to the increasing strength of consumer interests, these nations have become increasingly concerned about the anti-competitive consequences of certain industrial policies and are increasingly skeptical that industrial concentration promotes economic development. Reservations regarding the effectiveness of sector-specific industrial policies, such as cartelization, have led to increasingly stringent competition laws and more narrowly defined criteria for exemption from those laws.

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3. PREVALENCE AND IMPACT OF RESTRICTIVE BUSINESS PRACTICES IN DEVELOPING COUNTRIES

In considering practices that restrict the expansion of business activity, and along with it economic growth, employment and exports, it is important to keep in mind that both governments and business enterprises, acting separately as well as in concert, can be the originators of such practices. Indeed in most countries both parties share the blame, in degrees that vary from one country to another, for the restrictive practices that prevail.

A. Governments as instigators of RBP

It is fair to say that in the majority of low-income countries, governments carry the major responsibility for practices that have restrained business development to a level far below its potential. Administration of official regulations in such fields as (i) licensing and concessions, (ii) labor practices, (iii) regulation of financial markets, (iv) price control, and (v) control of foreign exchange and imports, has imposed high costs on local as well as foreign business enterprises.

Licensing and concessions. In most countries, the inauguration or expansion of a business enterprise requires a variety of official permits. In theory these are designed to safeguard public health as well as to ensure that location of enterprises conforms with rational space use planning and the availability of infrastructure.

In practice, issuance of permits often becomes a maze of red tape by which bureaucrats justify their existence and sometimes seek rents on the side. The celebrated volume **The Other Path** (1989) by Peruvian economist Hernando de Soto quantifies the costs of obtaining certain licenses. Simulating the opening of a store in Lima, de Soto & associates found the required procedures would take 43 days and cost 1 year 3 months equivalent of the minimum wage. Petty traders joining together to build a market would need 8 years to obtain the necessary permits. Obtaining approval for a mini-bus route would take a group of owners 26 months, while 27 months would be required for a single owner to obtain a concession to ply the route.

Taking a sample of 50 informal manufacturers, de Soto et al. found that the direct recurrent cost of keeping abreast of legal procedures would have amounted to nearly 350% of after-tax profit and 11.3% of production costs, 73% of this corresponding to nontax legal costs. Surveying 37 legally established manufacturers, they found that 40% of the administrative staff's working hours were devoted to complying with bureaucratic procedures.

In deciding whether to grant licenses, governments sometimes take it upon themselves to police entry into particular sectors on commercial grounds and/or second-guess the commercial judgments of entrepreneurs. In 1985 India's Ministry of Industry rejected over 100 investment proposals on one or more of nine different grounds, including (i) the existence of 'adequate'

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capacity in the sector in question, (ii) the proposal fell short of 'minimum economic capacity', and (iii) the feed-stock or raw material required by the project was 'not available'.[7]

Finally, governments exclude private business altogether from 'strategic' sectors of the economy which are reserved for state-owned enterprises. The deficits incurred by such enterprises burden the government budget and/or the banking system, thereby depriving the private sector of credit, inducing inflation and destabilizing the balance of payments.

Labor regulation. Many developing countries have detailed labor codes that end up by curbing employment in the formal sector. Adopted in response to a combination of pressures from trade unions, politicians seeking support from formal-sector wage-earners, and intellectuals who believe that labor regulation can improve the welfare of the masses, the codes typically include minimum wages, required supplements for overtime or night work, minimum safety and health conditions, vacation periods, participation in the social security system, restrictions on firing (which often requires government approval), severance pay, and procedures for settlement of labor disputes.

All these provisions increase the cost of hiring labor for those employers, notably the formal sector, who are subject to government supervision. Security from dismissal hampers discipline and reduces workers' incentives to become more productive. Operators respond by substituting capital equipment and other factors of production for labor, and for some operations prefer to hire on a part-time and/or casual basis rather than expand the regular payroll. The stricter the code, the greater the risk that some potential investors will be deterred from any commitment. Strict codes also reduce mobility of labor between firms and industries, limiting the cross-fertilization of skills which has accelerated development of such economies as Taiwan, Hong Kong and Singapore. Unrealistic increases in the minimum wage unaccompanied by fiscal and monetary discipline aggravate inflation to the detriment of the development effort.

Financial market regulation. Governments engage in financial 'repression', such that controls on deposit and lending rates of interest, resulting in negative real rates, together with sectoral allocation of credit, constrain the formal financial sector's role. Entry into the sector is closely controlled, but inadequate attention is paid to prudential supervision. Judicial systems are frequently unprepared to deal on a low-cost and timely basis with the enforcement of contracts involving loan repayment. Large groups in society satisfy their credit needs with informal lenders, but the legal ban on such activity drives it underground and increases costs.

Price control. Most governments of developing countries have at one time or another instituted legislation and machinery to control wholesale and retail prices of so-called 'essential' goods and services. Traditionally such measures have been motivated by a populist concern to protect the masses or selected groups from exploitation by producers and traders. Some governments (and

[7] Government of India (1992), p. 9.

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not only in poor countries) have resorted to across-the-board price controls as a measure to control inflation.

Nowadays the consensus is that price controls on products other than those of 'natural monopolies' result in curbing investment and thus supplies, leading eventually to shortages which raise prices for many consumers, often among the poorest, who lack access to regulated distribution channels within which the controlled prices are enforced. Producers and distributors incur costs in order to evade the controls, thereby raising the cost of distribution.

In the case of Morocco, a team of government and university economists examined the impact of price controls and their removal on the business environment in that country.[8] The study found that a substantial share of management energy was devoted to seeking positive action on requests to raise price ceilings in response to cost inflation. Firms tended to regard the ceilings as simultaneously minima and maxima, so that price competition was suppressed, and market shares remained static. Firms invested enough to retain market share but refrained from equipping themselves for export in the expectation that permitted margins on domestic sales would not cover the costs of breaking into foreign markets.

<u>*Exchange control/import bans and quotas.*</u> Allocation of foreign exchange to importers by administrative fiat, and the closely related procedure of assigning quotas (including outright bans) by category of imports, in lieu of a market-clearing exchange rate *cum* customs tariff, has had a depressing effect on economic activity in many countries. A particularly restrictive measure applied by some governments is that of requiring a would-be importer to obtain a 'no-objection' certificate from a local producer of similar goods.

Much management energy is devoted to seeking bureaucratic favor on behalf of requests for foreign exchange and quotas. Nonfavored enterprises are forced into a stop-and-go mode of production, pay monopoly rents for their inputs, cannot supply either domestic or foreign customers reliably, and are discouraged from expanding.

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For the reasons given, even honest administration of excess regulation in accordance with its statutory objectives depresses production, investment and employment creation. However this negative impact is compounded by the opportunities that regulation opens up for rent-seeking by politicians, bureaucrats and middlemen. Accordingly, decisions are delayed while regulators negotiate bribes, adding to the costs and uncertainties of doing business.

[8] Cf. Zouaoui et al. (1992).

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B. Restrictive practices of business enterprises

RBP as a generic tendency of business enterprise. If governments themselves are responsible for the regulations and practices that most severely impede business enterprise, it does not follow that their abolition will ensure an optimally competitive environment. A discussion of the restrictive practices in which business enterprises in developing countries, both local and foreign-controlled, engage in order to enhance market share and profit margins can do no better than to begin by quoting Adam Smith's celebrated tirade:[9]

> 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 prices. 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.

If this was an accurate reflection of the state of affairs in 18th century England, the burden of proof rests on anyone wishing to argue that human nature has changed in the interim, making Smith's statement inapplicable to the developing world of the 1990s, or for that matter to the industrialized nations of today.

A propos of the latter, it is worthy of note that, in the United States, where antitrust laws go back more than a century and offending businesses have paid out hundreds of millions of dollars in fines and seen their executives serve jail terms for RBP, violations continue unabated. For example, the U.S. Department of Justice obtained 16 criminal convictions for price fixing during 1989-90.[10]

Estimating the burden of RBP in low-income economies. If it were feasible to estimate the deadweight loss occasioned by RBP in a given developing economy, one could do a benefit-cost analysis of the expenditure of resources necessary to curb them by successively greater degrees. In the event, the authors are not aware of any effort to make such an estimate. Even for the United States, economists differ widely in their estimates of the deadweight loss occasioned by monopoly and oligopoly rents.[11]

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[9] Adam Smith (1776).

[10] Robert D. Willig, 1991, p. 4. The sectors concerned and implications with respect to trade liberalization and competition are explored further in Chapter 4 below.

[11] An estimate of 1.5 percent of GNP was propounded by Arnold C. Harberger (1954). Scherer (1980) reviews this and other estimates and suggests a figure of 0.7 percent, subject to a wide margin of error.

Empirical work on developing countries up to the mid-1980s focused largely on measuring market concentration,[12] often by computing industry ratios symbolized by CR4, the proportion of an industry's output accounted for by the four largest component firms. A 1988 study (published in 1991) compared the distribution of CR4s in Morocco and the United States. showing--to no one's surprise, given the comparative sizes of the two markets--that Morocco has relatively more industries with high concentration ratios.[13]

Subsequent econometric work supported by the World Bank research department[14] has correlated price-cost ratios, taken as an index of gross return to capital. with, inter alia, market shares of individual firms and Herfindahl concentration ratios of industrial sub-sectors in five countries, namely Chile, Colombia, Côte d'Ivoire, Morocco and Turkey.[15] Industry entry and exit rates (the proportion of firms in an industry entering and exiting each year) have also been correlated with the Herfindahl index and other explanatory variables.

In general the studies find price-cost ratios to be positively correlated, and entry rates negatively correlated, with concentration, but are ambiguous as to whether these relationships are associated with RBP, including abuse of market dominance, that might be addressed by competition policy. Relatively high price-cost ratios can reflect relative efficiency as well as RBP, and low entry rates into concentrated industries can reflect the presence of economies of scale as well as artificial entry barriers.[16]

Tabulation of enforcement actions as an indicator of RBP prevalence. Some (not all) of the existing competition authorities in developing countries publish activity reports that go into varying levels of detail about market structures and practices they have identified and sought to modify, either through consent agreements. unilateral orders or references to the legal system. India has produced a supplemental literature of considerable depth, including the report of a 1977-78 Monopolies Inquiry (Sachar) Commission, and a 1984 treatise which cites inter alia close to 150 legal cases arising out of enforcement of the 1969 Monopolies and Restrictive Trade Practices (MRTP) Act.

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[12] Gray (1991a), pages 411 and 413-14, cites a dozen studies in this regard, the subject countries or regions being Egypt, India, Kenya, Korea, Latin America, Malaysia, Morocco and Pakistan. Cf. also Bennell (1991).

[13] Gray (1991), pp. 413-14. The comparison was between 451 U.S. industries as reported in the 1972 Census of Manufactures, and 98 Moroccan industries reported in that country's 1986 industrial survey.

[14] These World Bank studies are cited individually, and major conclusions summarized, in Chapter 4 below, concerning the relation between trade liberalization and market structure and performance.

[15] The Herfindahl index (H), a more precise measure of concentration than CR4, is the sum of squares of individual market shares of all firms in an industry, the shares being treated as whole numbers (e.g. if a firm has a 25 percent share, it contributes $25^2 = 625$ to its industry's H). Values of H range from near 0 (perfect competition) to 10,000 (100^2 = pure monopoly).

[16] Cf. Foroutan (1991), pp. 15-16, and Lavy-Newman (1991), p. 8.

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Table 1 tabulates transactions during a recent year under the Act. The extent of business practices regarded as potentially subject to scrutiny is illustrated by the 34,000+ business agreements registered by the end of 1985. That year's MRTP report provides capsule summaries of hundreds of current RBP cases, categorized by the report itself as follows:

1. Area restriction (producers or distributors limiting the area of operation of their dealers/stockists);

2. Tied sales (most frequent example: gas connection or supply of cylinders made conditional on purchase of a gas stove);

3. Refusal to supply (considered an RBP only where a supplier cannot prove a legitimate interest in restricting the number of its outlets); also boycott of a supplier by dealers;

4. Differential pricing or discounting (resulting in unequal treatment of dealers/distributors/stockists despite similar circumstances);

5. Exclusive dealing (restricting a client's freedom to purchase and deal in products of other suppliers);

6. Resale price maintenance (RPM--the act provides for exempting classes of goods where the MRTP Commission judges that, absent RPM, the public interest would be harmed by a reduction in the quality or variety of goods for sale, eventual increase in prices, or reduction of after-sales service);

7. Collusive tendering (all the cases cited involve response to tenders issued by state agencies or corporations):

8. Concertation in pricing; and

9. Manipulation of prices/imposition of unjustified costs on consumers by a single supplier.

Information on the kinds and extent of anti-competitive practices uncovered from 1981 to 1990 in another Asian country, Korea, entering the RBP-control field a decade after India, is provided by Table 2, taken from a 1991 report of the Fair Trade Commission. The table shows slightly over half the 4,800 actions reported being taken against 'unfair trade practices'; these are categorized under (a) false or deceptive advertising, (b) deceptive bargain sales, (c) abuse of dominant position, (d) excessive offer of premiums, (e) trade coercion/collective boycotts, (f) exclusive dealing, tied selling, etc.. (g) resale price maintenance, and (h) refusal to deal.[17]

[17] Government of Korea, 1991, pp. 18 & 27.

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Summary descriptions of actions in a recent year by the competition authorities in Argentina, Chile, Pakistan and Portugal are provided in Gray (1991a), pp. 417-24. Actions by Sri Lanka's Fair Trading Commission through September 1991 are reported in Gray (1991b).

It was noted in above that state-owned enterprises, apart from the monopoly position that governments often legislate for them, have been among the leading perpetrators of RBP against suppliers, competitors and customers.[18] Competition agencies lack legal authority to tackle legislated monopolies, nor do many have the political clout to go after parastatal RBP. The cases cited in competition agency reports thus reflect only the tip of this particular iceberg of anti-competitive activity.

[18] One of the first cases to come before the Kenya Monopolies and Prices Commission concerned exclusive dealing arrangements imposed on liquor retailers by a parastatal enjoying a monopoly in the importation of wines and spirits. For further details see Chapter 5 below.

4. TRADE LIBERALIZATION AND COMPETITION

As already noted, from the beginning of 'structural adjustment' programs in the late 1970s, economists have treated relaxation of counter-productive government interference with markets--the kinds of regulation described in chapter 3.A above--as the first priority for promoting economic growth in developing countries. Among the different categories of regulation, reforms pointing towards the liberalization of trade have generally been given the highest priority.

This is because, in many countries, exchange controls and import bans and quotas are judged to have shaved more points off potential growth rates than any other form of government interference with the market. More than for any other reason this has happened because the controls hamper competition. Directly, they ban or restrict competition with domestic producers by suppliers of foreign goods and services, and among domestic producers according to which ones are favored with licenses, allocations and quotas. Indirectly, by facilitating overvalued exchange rates and raising costs of production, the controls hamper domestic producers from competing on world markets through exports.

According to this doctrine, opening up domestic markets to foreign competition induces producers of tradeable goods and services to become more efficient, both through tighter management and more rapid adoption of new technologies, in order to protect their market shares. Firms incapable of adjusting to competition from imports either shift to other lines of production or close down, freeing resources to be allocated elsewhere. At the same time enhanced efficiency and more realistic exchange rates make producers more competitive on export markets, to which they look increasingly to make up for domestic market share lost to imports.

With many developing countries now having made significant progress towards trade liberalization, three new questions have arisen: (1) what increase of competition in domestic markets, as well as competitiveness *vis-a-vis* export markets, does liberalization bring with it? (2) what impediments to competition remain that are unlikely to be lessened by further liberalization? and (3) what additional policy measures are desirable to overcome these impediments?

Extending question no. 3, one cannot escape the fact that enacting RBP control is tantamount to introducing a new mode of government regulation, thereby running counter to the trend towards deregulation. Is it an efficient approach towards enhancing competition, or is a country better off allowing its business enterprises complete freedom of action?

A. Trade liberalization and competition in tradeable manufactures.

Recently the World Bank's research department has attempted to quantify the impact of trade liberalization on parameters such as import penetration, productivity, profit margins, and firm

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entry and exit in branches of manufacturing in selected developing countries. Relevant findings of country studies conducted thus far under the research project, titled "Industrial Competition, Productive Efficiency, and Their Relation to Trade Regimes", are summarized below:

1. **Côte d'Ivoire.** Data for the period 1975-1985, before Côte d'Ivoire liberalized its trade regime, suggest that:

   higher concentration in an industry tends to increase profit margins while import penetration tends to do just the opposite. Higher levels of concentration deter entry and encourage exit from an industry while import penetration leads to higher exit rates.[19]

2. **Colombia.** This study relates to the period 1977-1985, featuring initial gradual trade liberalization and then a tightening of restrictions in the early 1980s. The researcher concludes that price-cost margins were lowered and efficiency enhanced by the competitive pressure arising from import penetration.[20] The level of response varied across sectors and plants within a sector, and efficiency growth appears to be largest in highly concentrated industries. Conversely import penetration had no discernable impact on industry entry and exit rates.

3. **Chile.** The period studied here, 1979-1985, followed substantial dismantling of trade barriers in the late 1970s, and also featured a severe recession leading to insolvency and exit of many producers. Entry rates fell, and many producers switched product lines, resulting in a rationalization of production. The researcher finds that, among different industries, competitiveness as reflected in a relatively high rate of entry and low price-cost margin is correlated with import penetration.[21] However this correlation does not hold within individual industries over time, suggesting to the researcher that Chilean industry is close to the frontier of competitiveness, with relatively little market power to be 'disciplined' by further import penetration.

4. **Turkey.** During the 1976-1985 period reviewed by this study, import liberalization was carried out in two major steps, namely in 1981 and Dec. 1983-Jan. 1984. Availability of data distinguishing private from publicly-owned enterprises enabled the researcher to estimate the differential impact of import penetration on the two sectors.[22] In the private sector it decreased the price-cost margin and accelerated productivity growth. Conversely the productivity performance of state-owned enterprises was not affected, and only in public enterprises with above-average capital intensity did the price-cost margin contract.

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[19] Lavy & Newman (1991), p. 17.

[20] Roberts (1989), p. 60.

[21] Tybout (1991), p. 29.

[22] Foroutan (1991), p. 36.

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A progress report on the project notes a lack of "stable, predictable correlations...on the trade/productivity link." One general conclusion is that "exposure to increased foreign competition is not closely linked with entry patterns, tends to induce reductions in plant size, and may cause some improvements in technical efficiency."[23] Another report concludes that "exposure to foreign competition...impose(s) pricing discipline on firms and offset(s) to some extent the effect of barriers to entry in domestic markets".[24]

B. Sectors not affected directly by trade liberalization.

If as expected trade liberalization exposes some domestic manufacturers to greater competition, significant areas of marketed production are unaffected except insofar as their costs of tradeable inputs are reduced. This includes branches of manufacturing that produce nontradeable goods.

Goods that are nontradeable from the viewpoint of country A are those whose ratio of weight or bulk to production cost is such that the cost of transporting them from any foreign country B, added to the marginal cost of production in B, exceeds the marginal cost of production in A. In most countries construction materials such as bricks, sand and gravel, crushed rock and building stone are obvious members of this set. Most products whose bulk consists of water--beer, soft drinks, injectable solution--fall in the same category, as do perishable foodstuffs which lose their value unless transported expensively by air.[25]

Estimating the proportion of nontradeables in manufacturing by classifying each product would be a Herculean task. The World Bank research project cited above uses a rough convention whereby, under conditions of relatively free trade, a sector exporting more than 25 percent of its output, on average, or in which imports account for more than 25 percent of domestic sales, is classified as producing exportables or importables, while firms in all other sectors are classified as nontradeable producers.[26]

Only one of the country studies conducted under the project, that for Turkey, indicates which industries were classified in one or the other category, as per the following list:

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[23] Tybout (1991), p. 52.

[24] Lavy and Newman (1991), p. 17.

[25] Note that ambiguities arise in connection with perishable commodities. Thus, fresh milk is generally nontradeable but dehydrated and condensed milk are widely traded via surface transport. These are partial but not perfect substitutes for fresh milk, and while fresh milk commands a premium, its selling price is limited by the c.i.f. prices of the substitutes.

[26] Cf. Tybout (1991), p. 31n. Tradeable producers are broken down into exportable and importable producers.

Exportable	Importable	Nontradeable
Textiles	Industrial chemicals	Food processing
Wearing apparel	Non-ferrous metals	Beverages
Wood & cork	Non-electric machinery	Tobacco
Furniture & fixtures	Transport equipment	Fur & leather prods.
Glass & glass prods.		Leather shoes
Professional equip.		Paper & paper prods.
		Printing & publishing
		Other chemicals
		Petroleum & coal
		Petroleum derivatives
		Rubber products
		Plastics
		Ceramics & porcelain
		Other non-metal prods.
		Iron & steel
		Metal products
		Electrical machinery

The proportion of industrial output accounted for by each category is not stated but can be inferred from other data in the report. Other reports in the series enable these percentages to be estimated more approximately for Chile. Colombia and Morocco; the results for all four countries are as follows (in percentages of total manufacturing output):[27]

Country	Exportables	Importables	Nontradeables
Turkey	26%	19%	54%
Chile	15%	60%	25%*
Colombia	0*	46%	54%
Morocco	23%	58%	29%*

It is evident on inspection that each of the Turkish sectors identified as 'nontradeable' covers many products figuring prominently in international trade. It should also be noted that none of the four countries featured a pure free trade regime during the relevant period--rather, both tariff and non tariff barriers were present in varying degrees. As liberalization continues, the proportion of output fulfilling the definition of nontradeable in the IBRD studies will drop significantly.

[27] Multiple regression is used to reconstruct weights of the respective categories from data given on averages of certain parameters for the respective categories and industry as a whole. Initial estimates of starred coefficients, having t-ratios of between 0 and .5, were not significant and have been replaced by residuals of unity less the sum of the other two coefficients, whose t-ratios range from 1.5 to 2.7 in the cases of Chile. Colombia and Morocco. More precise data for Turkey yield t-ratios of 6.7 and above.

Impediments to competition are by no means limited to manufacturing; they are found in other sectors of marketed production which, taken together, contribute much more to national output than does tradeable goods manufacture. The following list gives 1990 output in nine sectors of the Zimbabwean economy as a ratio to (i) total manufacturing output, and (ii) domestic product at factor cost:[28]

		Ratio of sectoral output to: manufacturing output	domestic product at factor cost
1.	Agriculture and forestry	.49	.12
2.	Mining and quarrying	.31	.08
3.	Manufacturing	1.00	.26
4.	Electricity and water	.12	.03
5.	Construction	.08	.02
6.	Finance and insurance	.21	.05
7.	Real estate	.03	.00
8.	Distrib., hotels & restaurants	.43	.11
9.	Transport & communication	.28	.07
	Subtotal without manufacturing	1.98	.52
Total (including manufacturing)			.78

In other words even in Zimbabwe, where manufacturing contributes more to output than in most developing countries, other sectors of marketed production contribute twice as much, and marketed output as a whole accounts for nearly 80 percent of domestic product at factor cost.[29]

Not all these sectors provide the same scope for RBP or market dominance as do some branches of manufacturing. The bulk of agriculture and forestry features atomistic producing units that are more likely to be the target of RBP, notably from public or private distributors and monopsonistic or oligopsonistic processors, than they have any opportunity to engage in them. Electricity and water, and certain components of transport and communication, are usually thought of as 'natural monopolies' where economies of scale preclude competition (though not necessarily private management) and government regulation is appropriately conducted by agencies other than a competition authority.

Some products of nonmanufacturing sectors are no less tradeable than are manufactured goods. Canada, Uganda and Zambia, among other countries, export electricity, while Kenya, the United States and Zimbabwe, among others, import it. One can award construction contracts to foreign

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[28] Computed from Central Statistical Office data as presented in Reserve Bank of Zimbabwe (June 1991), Table 7.2, p. S-41.

[29] Activities accounting for the remaining 22 percent of output are public administration and defence, education, and 'other services', comprising health, private domestic service and imputed banking service charges. Needless to say, the 'other services' category includes some marketed output.

builders or bank and insure with foreign financial institutions. A country is free to allow foreign shipping and airline companies to conduct domestic transport, even if for political reasons almost none does so. Thus, freeing of import barriers is one option for enhancing domestic competition in services, and liberalization of trade in services does indeed feature in some structural adjustment programs supported by multilateral institutions.[30]

Nevertheless, even if liberalization is carried to an extreme, a wide sphere of activity remains where removal of import barriers is no insurance against RBP and market dominance. Giving foreign agencies free reign to operate in the service sectors (Nos. 5-9 in the preceding list) is no guarantee that those taking up the challenge will not turn around and conspire with domestic counterparts to limit supply, fix prices and sabotage new entrants. As with RBP in manufacturing, the result will be to lower the population's living standards and undercut local business initiative.

Moreover, RBP in the production of nontradeable inputs, whether goods or services, raise the cost of exporting both manufactures and primary produce. This makes an economy less competitive and undercuts the objectives of trade liberalization.

C. The policy response.

An increasing realization that trade liberalization does not do the whole job--does not by itself guarantee a desirable level of competition in an economy, is currently generating increasing interest in competition policy options for developing countries. Governments of these countries and aid donors note that industrialized countries have found regulation of RBP to be an indispensable component of their policy toolkits, no less needed than laws and institutions for the purpose of enforcing contracts or, for that matter, to combat murder and larceny.

More specifically, development policy-makers note that even as industrialized economies become more and more open, with steadily growing ratios of trade to GNP, firms continue to engage in anti-competitive practices, requiring constant vigilance by the authorities. Recalling that,[31]

> over the last two years, the (U.S.) Department of Justice has obtained convictions for price fixing of soft drink bottling, milk delivered to institutions, bus bodies, concrete pipe, moving and storage services, dentistry, road construction, trash collection, billboard space, building construction, fencing, auto parts sold to General Motors, hinges, gasoline, delivered ice cream, and commercial auctions,

[30] Conditionalities in this area figure prominently in the IBRD's current nonproject lending in Madagascar.

[31] Willig (1991), p. 4.

American antitrust expert Robert Willig finds it striking that

> this list is comprised of goods and services that are mostly sold in local markets. The list serves as an effective reminder of the diversity and importance of local markets, and, therefore of the vulnerability of an open economy to anti-competitive conduct.

In the terminology of this report, Willig's 'local markets' comprise transactions in goods and services that are either nontradeable or of such a nature that nontradeables account for a significant share of market price. By implication, even after attaining a degree of trade liberalization characteristic of the United States, a developing country will find that the share of nontradeables in domestic market transactions provides plenty of scope for restrictive business practices.

No less significant is the expanding role of competition policy in the European Community, even as the integration of the member economies has accelerated. This has manifested itself along two major fronts: firstly, members which had fallen behind on the RBP regulatory front have passed major new laws--cf. France (1986) and Denmark and Spain (1989)--and/or revamped their implementing authorities in the direction of harmonizing national policies within the Community. Secondly, the EC's own office for competition, backed by the European Court of Justice, has intervened with increasing rigor against Market-wide cartels. In 1988 it caused the European business community to sit up and take notice as it fined 23 petrochemical companies a total of US$70 million for price fixing.

Yet another model of the complementarity between trade liberalization and competition policy is the rapid initiative of the Eastern European countries in introducing competition laws and institutions, already cited in Chapter 2.

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5. SELECTED COUNTRY CASE STUDIES

This chapter touches on recent developments in the competition policy field in three developing countries, the Republic of Korea, and in selected countries in Central Eastern Europe. The cases highlight pitfalls that developing countries have encountered in mounting an effective competition policy in the context of structural adjustment programs. The three countries in question are Kenya, Morocco and Sri Lanka, all of which have actively pursued such programs since at least the mid-1980s.

Kenya

Kenya's Restrictive Trade Practices, Monopolies and Price Control Act entered into effect on Feb. 1, 1989. In effect it converted the long-standing price control office in the Ministry of Finance into a Monopolies and Prices Department of the Ministry.

The legislation limits the Minister's previous authority to set maximum prices for any commodity or service at his discretion (in practice, prices of basic foodstuffs were and still are determined by Cabinet). Under the new law this authority applies only to goods produced or services rendered by 'monopoly undertakings', meaning an undertaking that, together with one or at most two other independent undertakings, each supplying more than 5 percent of the market, controls at least 50 per cent of the Kenya market for a given good or service.[32] The law also allows the Minister to fix, for any goods not controlled under the foregoing provision, a maximum percentage profit over cost, to which sellers may add no more than 'ordinary' transport costs.

The intent of the Kenyan technocrats who commissioned the first draft of the law already in 1983 was to supplant a price control system that was increasingly found to hamper business investment, employment creation and exports, as successive ministers sought political credit for suppressing price increases. It was felt that applying the less direct regulatory approach of RBP control would enable the government to combat inflation arising from price fixing or abuse of market dominance, but reduce the temptation to politicians to interfere with normal business response to market conditions. In a word, RBP control was regarded as pro-competition, while price control had proved to hamper competition.

The bill languished as the responsible minister saw no need to change the situation and was uninterested in RBP, but after two years the business slowdown resulting from price control became an embarrassment to the government, which ordered submission of a policy paper on short notice. The policy paper waiting on the shelf happened to cover RBP control as well as reform of price control. The former appealed to some government leaders inter alia as one means of redressing racial imbalances in the economy, and the upshot was an instruction to government's legal draftsmen to prepare an integrated bill.

[32] Government of Kenya (1988), p. 248.

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No reports have been issued on the first years of operation of RBP control, but the business community has expressed concern over some early instances of political interference with competition policy implementation. When a local distiller challenged exclusive dealing arrangements imposed on retailers by a parastatal wine and spirits import monopoly, the minister exempted the parastatal from the law's coverage, something for which the law conveyed no authority.

A second case involved a receiver's effort to sell the assets of a small bankrupt furniture factory to another small factory which had presented the highest bid. Since the act required that any merger or acquisition be approved by the Minister, omitting any market-share threshold for his intervention (such an omission is virtually unknown in merger control elsewhere), the matter was submitted for his approval, whereupon he demurred and ordered the assets to be sold to a phantom company owned by a fellow minister. Again it turned out that the law conveyed no authority to order a sale to any particular party. As of early 1991 both cases remained unresolved.

The establishment of any regulatory authority poses a danger that politicians will seek to pervert its objects and use it as yet another instrument to interfere with the market in pursuit of political or personal goals. In that event a competition law and apparatus may end up impeding rather than promoting competition.[33]

The long drawn-out process by which Kenya finally enacted a competition law reveals less than solid political commitment to the nominal goals of competition policy. Moreover the delay in establishing the quasi-judicial authority provided in the act, the Restrictive Practices Tribunal, enlarged the scope for political intervention. It is to be hoped that this will lessen as the Tribunal, finally constituted in 1991, moves into operation.

The Kenya experience points to the dangers present in running an RBP and merger control authority out of a government department. Government officers may be charged with staff work required to implement competition policy, notably receiving complaints, identifying RBP, developing cases, negotiating consent decrees and putting cases to a tribunal. However, unless judgments are left to a quasi-judicial authority with sufficient autonomy and integrity to merit the business community's confidence, implementation of a pseudo competition policy will increase business uncertainty and risk, likely causing more harm than good.

Morocco

RBP control legislation was first tabled in Morocco in 1985 by the Ministry of Commerce and Industry, patterned on the legislation then in effect in France. Subsequently the initiative was seized by staff of the Ministry of Economic Affairs, which held primary responsibility for determining maximum prices for at one point as many as 130 different goods and services or

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[33] This concern underlies the hesitancy and ambiguity that continue to characterize the World Bank's attitude towards RBP control policy as a component of structural adjustment.

product classes, but by 1985 was well along on a program of liberalization. As in the Kenya example, the ministry considered RBP control to be pro-competition and thus a preferable mode of regulation to price control. Economic Affairs tabled a new draft bill in 1989, meanwhile arranging exchange visits with the French competition authority, with a view to examining the reforms instituted with France's 1986 competition law.

Staff of the two ministries touted their respective bills in a 1990 forum sponsored by the national employers' federation. Subsequently an inter-ministerial staff committee was formed, including also the Ministry of the Interior, which had long maintained an inspectorate to police local markets for compliance inter alia with controlled prices.

The committee agreed on most provisions of a competition bill, including establishment of an autonomous tribunal, but was unable to agree on its composition, which minister should appoint it, or what the qualifications of the implementing staff should be and where they should be located. The respective ministers allowed the committee to forward its report to the Prime Minister, leaving these matters open.

In the intervening 2½ years it has become clear that any 'constituency' for competition policy which exists in Morocco lacks the necessary influence to prompt the national leadership to resolve the jurisdictional issues and submit a bill to parliament. Leading elements of the business community--including certainly some accustomed to pursuing practices that an RBP control mechanism would combat--have expressed fear that RBP control would become another vehicle for state interference with business decision-making.

Sri Lanka

As part of an ambitious new program for promoting industrialization, the Sri Lanka government recently (September 1991) undertook a review of the first four years of operation of its Fair Trading Commission (FTC). While endowed with some autonomy, this body is basically an appendage of the Ministry of Trade and Commerce. Like its counterpart in Kenya the FTC began life with a dual mandate, to control RBP and administer price controls, the latter involving 47 commodities or commodity categories.[34]

Under a 1990 law nearly all these items were 'deprescribed', leaving only wheat flour, bread, and pharmaceuticals under control. The new law gives the FTC authority to control prices of food products and pharmaceuticals in cases of 'unreasonable' or 'excessive' increases; it also provides for the Commission to keep prices of key items under review and recommend additional imports at reduced tariffs if necessary to combat 'unreasonable' increases.[35] During

[34] For four 'essential' commodities the FTC was charged with setting prices, in the other 43 cases manufacturers required FTC authorization to increase prices.

[35] Government of Sri Lanka (1990).

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1991 it reviewed increases affecting four classes of goods, found that none of them constituted "gross abuse in pricing", and recommended no reductions in import duties.[36]

During nearly three years from 1989 to September 1991 the FTC dealt with only six cases in which businesses complained of anti-competitive practices by suppliers or competitors. Concerned over this low volume of business, the Commission and its parent ministry noted that, in spite of publicity, the practices reported did not include "major anti-competitive practices normally found in trading", and proposed that the FTC act be amended "to specifically prohibit... better known and internationally accepted anti-competitive practices", namely:

(a) Exclusive supply dealing arrangements
(b) Exclusive purchasing contracts
(c) Long term supply contracts
(d) Restrictive terms
(e) Selective distribution system
(f) Tie-ins
(g) Restrictions on the supply of parts or other inputs required by competitors
(h) Restrictive licensing policies.[37]

Through September 1991 the FTC had disposed of four cases involving 'monopoly situations', each time ruling that the subject of the inquiry, while indisputably dominating its market, was not 'acting against the public interest'. One of the cases involved a multinational corporation (MNC) that dominated the soap market and would not export in competition with affiliated producers operating in most countries of the region. It was suggested that the MNC might be asked to move into higher-technology items and cede part of its soap market to give independent local producers a launchpad into export markets. However the FTC did not regard the export question as part of its brief.

This led to a proposal in some quarters that the FTC be upgraded into a National Competition Council, with presidentially-appointed members responding to a broader mandate than the present Commission. Specifically, it was suggested that the Council be charged both with promoting domestic competition and with enhancing Sri Lanka's competitiveness in the world economy. Pursuing the latter brief, the Council would be entitled to order divestiture of at least part of the capacity of a dominant producer found to be blocking access to export markets.[38]

Similarly, in deciding whether to intervene in a given merger or acquisition it would take into account the likely impact of the transaction on exports. Depending on the nature of the product

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[36] Cf. Gray (1991b), p. 7.

[37] *Ibid.*

[38] Many other considerations would enter into a final decision on this matter. It might be found, for example, that the disincentive effect of the divestiture action on domestic and foreign investment outweighed any benefits to be gained by it.

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and its market, this could of course cut either way. In some branches, the experience of newly industrializing countries (NICs) suggests that units with a larger domestic market share are in a better position to absorb the costs of breaking into the world market. In other branches, it turns out that overcapacity and intense competition in the domestic market has been the force driving producers to seek market share abroad. In such cases a Competition Council should forestall mergers and acquisitions that threaten to lessen domestic competition.

A practical issue arising in the Sri Lanka reform proposals was how to equip a Competition Council to gather the necessary information on which to base its decisions. Given fiscal constraints and public *versus* private salary scales, the Council would not be in a position to recruit qualified business economists full-time. The option proposed was for it to contract the necessary talent on a part-time basis, *inter alia* from university faculties. It was hoped that foreign technical assistance might support such a strategy during a trial period.

Korea

A number of developing countries are looking closely at the experience of South Korea to see what elements in that country's successful industrialization strategy might be adapted to their own conditions. Some are organizing study tours of business people and officials to Korea (and Japan), *inter alia* to look at the organization and functioning of export trading companies.

Korea's Fair Trade law was enacted in 1980 in response to what the authorities have described as ''adverse effects of the government-directed economic policy...:

- Distortion of resource allocation, particularly in the area of capital;
- Weakening of initiative and entrepreneurship in the private sector;
- Overconcentration of economic power among the nation's large conglomerates;
- Unfair trade practices by monopolistic enterprises;
- Deteriorating international competitiveness of domestic industries due to relatively high import restrictions and other protection...''[39]

Through subsequent amendments in 1986 and 1989 the Fair Trade Commission acquired new authority to mitigate concentrations of economic power by restricting financial flows among member companies of a conglomerate and regulating mergers and acquisitions. A 1989 amendment accorded the FTC enhanced status as an independent regulatory agency, and provided harsher sanctions for many contraventions of the law.

At a September 1991 symposium in Seoul on "Corporate Policies and Competition for Development", Korean economists said their country has found competition policy to be an

[39] Government of Korea policy statement reproduced in UNCTAD Handbook series (1986-1991), document TD/B/RBP/42, August 1987, p. 18.

essential tool for rectifying imbalances arising during the industrialization push. An economist member of the FTC concluded as follows from his country's experience:[40]

> It is sometimes argued that monopoly is necessary to obtain efficiency, whereas competition tends to be wasteful in the early stage of economic development. Although the logic of this argument may not be entirely denied, it should be noted that eventually 'artificial' monopoly not only hampers economic efficiency itself, but more importantly, discourages the competitive spirit of society that is the real engine of economic growth.
>
> Private monopolization by government intervention may give rise to community of interest and concomitant 'government failures', which cannot be eliminated easily in a society marked by traditional communitarianism and bureaucratic authoritarianism. Competition policy or fair trade policy should therefore be assigned a foremost position in the agenda for long-run self-sustaining economic growth. Unless the general public is market-minded, market-oriented economic policy cannot succeed

Eastern and Central Europe

The experiences of Eastern and Central Europe in developing and designing competition policy and laws may be quite relevant to selected developing countries currently undertaking the process themselves. This is both because the Eastern and Central European countries have only just recently drafted RBP and monopoly regulation (i.e., it is very recent experience), and because there are a number of economic and institutional similarities between Eastern and Central Europe and some developing countries.

1. These countries are in the process of economic transition, somewhat analogous to structural adjustment but perhaps more extreme, and have had to contend with developing competition policy and law in the context of simultaneously effecting numerous other reforms required to develop an efficient market system.

2. While these countries have borrowed from the experiences of OECD countries and in fact have sought technical assistance, they have largely developed their own laws without substantial reference to OECD laws or the UN model law (perhaps reflecting the uniqueness of the competition challenges these countries face in comparison to the issues addressed by OECD competition law).

3. These countries have sought to develop competition laws quickly, yet in the context of having no body of case history from which to derive judgments.

[40] Lee (1991), page 51.

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4. There are some specific economic goals being pursued by Eastern European countries which are similar to those of certain developing countries, such as the introduction of trade liberalization and competition in the place of price controls, and pursuing efforts to de-concentrate their highly concentrated industrial sectors through privatization, demonopolization of vertical as well as horizontal monopolies, and encouragement of foreign direct investment -- in other words, efforts not only to guard against anti-competitiveness but also measures aimed specifically at creating a competitive environment.

Economic and institutional differences between Eastern and Central European countries and those of the OECD, serve to highlight the departures taken by these countries in designing competition law[41].

1. Either state-owned monopolies or a small number of state-sponsored cooperatives dominate industry.

2. The removal of import impediments such as import controls and hard currency shortages will not ensure competition in many industries.

3. Significant barriers to entry exist in Eastern and Central European markets -- including the lack of capital markets, basic communications infrastructure and a well-trained entrepreneurial group.

4. Eastern bloc managers have been trained to collude, rather than compete.

These four aspects of the Eastern and Central European economies illustrate the important role that market power and efficiency questions play in competition analysis. In addition, the recent history of the centrally planned economies would suggest that answers to these questions will vary greatly from those reached in analyses of market economies. Many of the variations, in fact, suggest that greater potential for anti-competitive activities exist in these countries, at least during a transitional period, than in the US or Europe.

Not only must Central and Eastern Europeans modify and privatize state-owned enterprises in order to create a market economy, they must also streamline the other elements of the public sector to facilitate the transition. Selected institutional issues highlight the reforms required.

1. The demand for prompt privatization exemplifies the need for quick decision-making by competition agencies. Citizens in these countries have suffered declines in living standards over a long period and their patience is wearing thin. If competition policy slows the transition process and the reaping of economic benefits, then its costs may outweigh its benefits.

[41] Langefeld & Blitzer

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2. To develop competition policy governments must provide their competition agencies with effective organization. Institutional arrangements need careful consideration if competition policy is to work as designed.

3. The agencies' be able to analyze competition issues quickly and concurrently shape antimonopoly laws. Where administrative, technical and judicial expertise and capacity are lacking, countries have tended to adopt simple, per se rules early on.

4. To effectively implement competition policy these governments must consider the manner in which they address industrial organization matters. The central planning mentality and the inclination to administer prices and output must be subordinated to allowing managers of competing enterprises to make their own decisions -- reflecting a common belief that markets, not government, best set prices.

Reflecting common economic challenges and institutional similarities, the competition laws of the Eastern and Central European countries have broad structural similarities, with the principal operational provisions focusing on agreements among firms, dominant firm behavior, and mergers and organizational restructuring.

The Hungarian and RSFSR laws include provisions attacking "unfair" or "unscrupulous" competition; the CSFR and Polish laws do not. The Polish and RSFSR laws include a provision empowering the competition agency to order the involuntary break-up of monopolistic firms; the Hungarian law does not, while the CSFR law requires the Ministry of Privatization to seek the approval of the appropriate Office of Economic Competition before approving the privatization plan for an individual firm.

The laws are closer in spirit and structure to those of the European Community than to that of the United States, particularly in their delineation of individual business practices that are forbidden -- US law is written in more general terms, with the case law developing the specific strictures. Not surprisingly, given the current economic structure in Central and Eastern Europe, the new laws also tend to focus more than US law on controlling the behavior of dominant firms.

Currently, the laws in Eastern and Central Europe can only be assessed as written rather than their implementation and effect, as the laws have only just recently been enacted. Seven specific issues addressed to varying degrees by these laws, which reflect both the unique circumstances of these countries as well as the debate and evolution of RBP regulation in OECD countries, are worth highlighting[42].

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[42] Pittman. ....

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1. Distinction between horizontal and vertical agreements.

2. Treatment of naked cartel arrangements as per se illegal.

3. Wether provisions exist that restrict vertical agreements by firms lacking market power.

4. Protection of entrants from exclusionary behavior by incumbent firms.

5. Whether it is illegal to harm a competitor.

6. Whether provisions for restricting the behavior of "dominant" firms which make it too easy for a firm to be labelled dominant exist.

7. Whether the law seeks to control the prices charged by dominant firms.

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6. CRITIQUE OF THE APPLICABILITY OF THE UNCTAD MODEL LAW

The United Conference on Trade and Development (UNCTAD) has been in the process of drafting a "model law" on restrictive business practices for over a decade. The latest version is dated August 1991 and is still considered a draft.

The applicability of the model law to developing countries is subject to debate. The model law mainly provides an outline on the possible content of the articles of a prospective law. It provides very little in terms of guidelines or evaluation of alternatives, and leaves much to the discretion of the country in question.

The companion set of documents produced by UNCTAD, The Handbook on Restrictive Business Practices, addresses this deficiency in part by providing empirical descriptions of the main elements of. or revisions to, selected individual countries' RBP laws -- as provided by the governments concerned. However, the "handbook" has not been condensed into one volume, and does not contain a comparative analysis across countries.

There are several recognized limitations of the Model Law. Firstly, it needs to be modified according to a given countries' economic situation, legal system and so on (ie, it is not meant to be adopted wholesale). Secondly, the law addresses issues relating to the maintenance of competition or the prevention of a reduction in competition, but it does not explicitly address measures to create a competitive situation.

Given that the model law is fairly generic by design and only presents an outline for the articles of an RBP law, its content is subject to few substantive criticisms. Specific criticisms emanate mainly from the orientation of individual countries or approaches. For example, criticisms expressed by US officials include: (i) the lack of explicit recognition in the law for "per se" rulings; (ii) the inclusion in the objectives section of the law of "economic development" as one of the areas being promoted by the law -- the US is opposed to this because it resembles too closely overt industrial policy; and, (iii) a fairly lenient provision for companies to obtain authorization for exemptions. These provisions are, however, acceptable to many other countries with well developed competition policies and laws.

More widely accepted criticisms are:

(i) the law does not address the issue of mergers, acquisitions and joint ventures explicitly or adequately enough, especially given that this has been a major focus of the revisions made to competition law by several countries during the 1980s -- no guidelines are provided on whether market share thresholds should be used and if so, at what level, or whether absolute sales levels should be used;

(ii) the treatment of quality and safety in the model law, which are issues that traditionally competition authorities are ill-equipped to handle, provides a major "out clause" which is difficult to apply fairly and evenly;

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(iii) limited explicit distinction between horizontal and vertical restraints -- as shown in Chapter 2, there is perhaps the greatest variation in treating vertical versus horizontal restraints amongst the OECD countries. The US in contrast to European countries has found a number of vertical restraints acceptable on efficiency grounds in a number of instances, and again in contrast to Europe is lenient toward vertical mergers: and.

(iv) it provides very limited guidelines for a process and basis for appeals -- applying transparent and equitable processes for appeals can do much to stimulate confidence in the overall RBP regulation process.

Specific contributions made by the model law which are generally considered as positive advances include allowance for private actions for relief or damages, and provision of useful guidelines on the organization, functions and powers of the Administering Authority.

It is interesting to note that there is little explicit treatment of monopolies, except implicitly through the article on the abuse of dominant position of market power. There are no provisions for de-monopolization, which may reflect the lack of a "competition creating" aspect to the law. This is perhaps why no countries in Eastern and Central Europe or developing countries that are characterized by a large number of monopolies (private or state-owned), have incorporated the major provisions of the model law to any great extent. The law also leaves ample room for exempting state-owned enterprises or parastatals from the provisions of the law.

Thus, overall the model law provides a useful reference document for countries drafting legislation but should not form the core of such legislation. The model law is weakest in those areas which might be of relatively high priority to Zimbabwe -- abuse of market power through mergers/joint ventures; acquisition of control through interlocking directorships; monopolies; and, parastatals.

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Interviews were conducted in January 1992 with the following agencies:

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- Federal Trade Commission
- World Bank

Geneva
- UNCTAD, Restrictive Business Practices Unit, Manufactures Division

London
- Monopolies and Mergers Commission

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