Competition
and Development
THE POWER OF COMPETITIVE MARKETS

Competition Policy Spurs Economy-wide Gains

Legislation on competition brings productivity and business investment to Tanzania.

Increasing competition within an economy is no easy task. People often fear for their futures when free-market policies are introduced. Tanzania, however, has shown that promoting fair play through competition policy improves the performance of manufacturing firms. This translates into gains for the overall economy.

No matter how well an economy is doing, politicians like to say that for each voter who loses their job, the unemployment rate is 100 percent. It's an old line, but it speaks to an important truth regarding the challenges that developing nations face when they try to boost competition within their economies.

A key obstacle facing reformers is that the benefits of increased competition, such as greater investment, better productivity, and more exports, can be hard to see, especially when riding the frequent ups and downs of a developing economy. But everyone notices when inefficient state-owned or state-protected businesses are suddenly subjected to the market's "invisible hand" and begin to shed jobs.

A close look at manufacturing firms in Tanzania provides evidence in favour of competition policy. A study by Godius Kahyarara, an economics lecturer at the University of Dar-es-Salaam, shows that efforts to protect consumers against anticompetitive practices have had a positive impact on firm productivity and business investments, and thus, on economic performance as a whole.

Competition and development

Kahyarara defines competition policy as the laws, regulations, and institutions that control the behaviour of dominant firms, prevent companies from becoming monopolistic through mergers, and prohibit anticompetitive behaviour such as price-fixing and bid rigging.

IDRC: Peter Bennett

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"Competition policy is critical to any development process to ensure the effective utilization of resources, as well as the proper allocation, marketing, and pricing of those resources," Kahyarara says. "This research showed how fair competition was key in influencing the performances of enterprises in an African context."

The research was part of a broader initiative by the United Nations Conference on Trade and Development (UNCTAD) and supported by Canada's International Development Research Centre (IDRC). More than a dozen researchers looked into the broader issues of competition policy, competitiveness, and development. The goal was to provide research-based evidence to the growing number of developing-country governments that are attempting new initiatives in this area.

Many such countries have been in a decades-long quandary regarding whether the promotion of competitive markets is more likely to empower the poor, a thesis the UNCTAD study affirmed, by assessing the specific experiences in a variety of nations, such as Brazil, Nepal, Tanzania, and Thailand.

Tanzania's challenges

Tanzania is one of the world's poorest countries. During 2006, the country generated per capita gross domestic product (GDP) of just US$382, which according to a United States Agency for International Development (USAID) report is less than half the average level of other low-income sub-Saharan African countries.

According to USAID, Tanzania, like many lesser developed nations, depends heavily on its agricultural sector, which employs 80 percent of its population, but contributes just 45 percent of the country's GDP. The sector's low relative productivity, which is common among developing nations, indicates the need to reach higher levels of investment and productivity wherever possible, to build the economy and reduce poverty. In Tanzania, competition policy very quickly triggered significant increases in productivity and investment in the manufacturing sector.

"Prior to the 1980s, competition policy did not exist in many developing countries," Kahyarara observes. "Many manufacturing firms in developing countries were natural monopolies under state ownership. The presence of a large state sector partly explained why many did not find it necessary to have a competition policy."

Although these state-owned enterprises and privately held monopolies tended to invest heavily, they generally left much of their productive capacity unused. As a result, many became increasingly inefficient and overreliant on government subsidies.

These relatively large firms employed a substantial number of privileged workers who were secure in their jobs but whose salaries were not significantly tied to productivity improvements in their workplaces. Compounding this problem was the fact that strong Tanzanian legal and regulatory impediments made it difficult for managers to fire or transfer unproductive personnel.

Years of reforms

Many of these former state-owned firms have since been privatized. "However (these) were not sufficient conditions for eliminating monopoly and market imperfections," Kahyarara notes. To build a solid foundation that would form the basis of sound long-term growth, a series of reforms were also enacted in areas ranging from banking to foreign exchange, to agriculture, to investments.

According to Godfrey Mkocha, Tanzania's Commissioner in charge of the Fair Competition Commission, one crucial milestone was the passing of the *Fair Trade Practices Act* in 1994 that set out the rules for consumer protection. It regulated monopolies and prohibited unfair business practices and misleading or deceptive conduct.

In a submission to the Organisation for Economic Co-operation and Development's (OECD) Global Forum on Competition, Mkocha identified several key advances encompassed in the new legislation. These included broad provisions governing trade practices that restrict competition and ministerial authority to order companies to divest holdings that interfere with legitimate and successful competition.

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The 1994 competition legislation also established the office of the Trade Practices Commissioner to deal with competition cases. The Commissioner has ruled on mergers among multinational accounting firms, disputes in the beer brewing industry, and false advertising claims.

The difference competition makes

Manufacturing has been one of the key sectors to benefit from competition policy. The Tanzanian firm-level study provides “direct evidence, based on microeconomic data of how existing government policy and institutions charged with overseeing fair competition have succeeded in ensuring competitive production that is fair and in line with the public interest,” concludes Kahyarara.

Kahyarara used government statistics and surveys to arrive at this conclusion. He compared firm performance before and after the *Fair Trade Practices Act*. His results show that firms were about 50 percent more productive on average after the introduction of the Act and firm investment increased by 100 percent. Exports remained unaffected.

“The presence of a competitive environment motivates firms to consistently make different decisions regarding investment, training, technology, and the selection of inputs, and thus raises their productivity,” Kahyarara notes.

“It is only through fair competition that domestic firms […] can be assured of future certainty, which gives them substantial incentives to invest in improving the efficiency of their operations,” he points out.

IDRC: Peter Bennett

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Kahyarara also found that, quite apart from the effects of the Act, the existence of competition — measured by the presence of five or more competitors — increased firm productivity by 13 percent. When facing competition, firms were more likely to plan investments. Interestingly, older and exporting firms were less likely to have five or more competitors.

The effects of strong competition can of course be negative on some enterprises. When Kahyarara looked at firms that had ranked competition as one of their three biggest problems, he found that their productivity was reduced by 35 percent under the Act. These firms were less likely to invest in the future. Competition problems were more often cited among smaller firms, non-exporters, and firms in certain sectors such as textiles and lumber.

Kahyarara’s results emerged once he accounted for the swings in performance indicators, which varied significantly over the 1993 to 2002 period from which he drew his data. He was able to discount the effects of the government’s industrial policy and taxation and other factors that could have had an impact on the fluctuating performance of Tanzania’s manufacturing sector.

According to Lucian Cernat, the UNCTAD Economic Affairs officer who coordinated the multi-country research project, Kahyarara’s study has unique features. “It is one of the few microeconomic analyses that talks about the impact on real people and industries,” Cernat says. “Furthermore, having such a study done in a lesser developed country, where this kind of study is rare, is in itself an accomplishment.”

A new, stronger law

As the broader UNCTAD research showed, however, new laws alone are not necessarily sufficient to spread the benefits of competition. In fact, if such laws are badly designed or implemented, they can have some negative effects.

Tanzania’s *Fair Trade Practices Act*, for example, although it was amended in 2001, had many weaknesses. “The provisions against restrictive business practices were so broad that they could catch pro-competitive conduct and/or cover micro enterprises [which are usually not covered by competition law],” Godfrey Mkocha reported to the OECD’s Global Forum on Competition. He also said that the 1994 Act accorded excessive discretion to the Minister of Industry and Trade in overseeing certain cases.

In 2003 the Parliament of Tanzania passed a new *Fair Competition Act* that attempts to correct many of these shortfalls. The Act created the independent Fair

Competition Commission as well as the Fair Competition Tribunal to hear appeals, and the National Consumer Advocacy Council. The Commission can order companies to stop engaging in anticompetitive behaviour and pay compensation for damages. It can also impose fines on those who commit offences against the Act.

Evidence for competition policy advocates

Kahyarara's conclusions were published in 2004 in *Competition, Competitiveness and Development: Lessons from Developing Countries*. This UNCTAD book gives policymakers an important tool that will help them to build alliances with those who stand to benefit from a strong competition policy.

Despite the growing number of governments that are implementing competition legislation, Cernat says that there is still no consensus on the desirability of these policies. As an example, he says that it is not certain whether competition will figure in trade negotiations within the African Caribbean Pacific–European Union Partnership Agreement. "The conclusions from the Tanzania research," he says, "provide evidence that they should."

This case study was written by Peter Diekmeyer, a Montreal-based freelance business and economics writer. It is based on the chapter "Competition policy, manufacturing exports, investment and productivity: Firm-level evidence from Tanzania manufacturing enterprises," by Godius Kahyarara, in Competition, Competitiveness and Development: Lessons from Developing Countries (UNCTAD 2004).

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