FINAL REPORT

Competition Policy in Mozambique

An Assessment with Recommendations

NATHAN
ASSOCIATES INC.
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SUBMITTED TO
USAID/Mozambique

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PREPARED BY
A.E. Rodriguez, Ph.D.

UNDER CONTRACT NO.
PCE-I-00-98-00016
Task Order 834

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Preface

At the request of the Mozambican Ministry of Industry and Trade and under the sponsorship of the U.S. Agency for International Development, Nathan Associates assessed the likely benefits of Mozambique adopting a competition policy program. The assessment was conducted from October–December 2003 by Dr. Armando E. Rodriguez, an Associate Professor in the Department of Economics and Finance of the University of New Haven. Dr. Rodriguez specializes in domestic and international competition policy, econometrics, and financial microeconomics. He is also an experienced economist with substantial experience advising private sector firms, multilateral agencies, and government agencies. As an economist with the U.S. Federal Trade Commission, he planned and conducted antitrust investigations with staff attorneys. While on the staff of the Monterey Institute's Center for Trade and Commercial Diplomacy, he researched international and domestic competition policy and international trade and taught courses in industrial organization, law and economics, applied economics, data analysis, competition policy, and microeconomics. Dr. Rodriguez has also taught at the Cameron School of Business, University of St. Thomas in Houston, and in the Economics Department of the University of Texas at Austin.

Executive Summary

At present, numerous regulatory barriers, pervasive rent-seeking behavior, and other impediments to trade threaten the competitiveness of Mozambique's economy. Could a competition policy counter these threats? And how could it do so? Competition policy consists of two elements: law-enforcement anchored in antitrust law and competition advocacy. Regulatory barriers, rent-seeking and other trade impediments cannot be resolved with the law enforcement instruments that antitrust laws provide. In addition, enforcement requires professionals trained in antitrust and economics and a sound judicial system. Mozambique currently has limited human capacity in antitrust and economics, weak judicial institutions, and rigid budgetary limitations.

At this stage in its transition to a market-based economy, Mozambique is unlikely to derive any significant, near-term benefit from a full competition program.. A robust market economy, for example, can be more easily realized and at less cost by continued emphasis on deregulation, trade, and circumscriptions of governmental barriers to market entry. Vigorous trade, unimpeded entry, and continued strengthening of property rights and contractual enforcement institutions are not only less expensive but also more immediately beneficial than enforcing proscriptions against certain business practices.

Anticompetitive problems are natural targets of sound trade practices and deregulation, and the second element of competition policy—***competition advocacy***—is consistent with Mozambique's liberalization and deregulatory efforts. A full-fledged antitrust regime is not recommended. By postponing adoption of the full array of antitrust proscriptions Mozambique errs on the side of caution, embraces the compelling discipline of natural market forces, and minimizes the likelihood of chilling innovative practices, confusing investors, and raising market entry costs. By keeping its policy mission simple, Mozambique will not have to scrutinize a plethora of business practices and transactions. It will thereby avoid having an overburdened and inexperienced enforcing agency fall prey to rent-seeking interests, as have so many competition agencies around the world, including agencies in neighboring countries.

Given the salient problems confronting Mozambique's economy and observed constraints on the government's institutional capacity to manage an antitrust enforcement program, staged adoption of a competition law is recommended as a sound step forward. The law should focus exclusively on proscribing price-fixing behavior; the enforcing competition agency should eventually pursue competition advocacy. A first step is to ***assemble a working group within the Ministry of Industry and Trade.*** The group could consist of some of the participants of the competition policy workshops. The group will provide continuity for the following tasks and for those persuaded as to the merits of a competition agency and a competition policy. The working group will serve as a focal point for garnering support, funding, assistance, training, education, and constituency building. Its recommended tasks are as follows:

- ***Draft a competition law proscribing naked cartels, prohibiting price fixing, and empowering a competition agency to review proposed bill or statute within the government.*** Naked cartels are associations of competitors assembled solely to capture monopoly gains with no countervailing efficiencies. The prohibition and vigorous prosecution of horizontal price fixing is indispensable.
- ***Begin developing a competition policy.*** The working group should begin developing a competition policy focused on horizontal price-fixing proscriptions and challenges to government anticompetitive practices.
- ***Examine alternatives to antitrust law enforcement.*** Civil enforcement (private cause of action) of competition law is an obvious candidate.

The recommended competition agency should

- ***Be independent.*** Ultimately, the competition agency should be constituted as an independent agency staffed by well-trained attorneys and economists. It should be as independent as possible in order to enjoy some immunity from pedestrian political influences and so it can gain confidence and speak with authority and professionalism.
- ***Gradually undertake more enforcement.*** Additional proscriptions of business practices, vertical or horizontal, should be added to the agency's mission as it matures, trains its staff, forges jurisprudence, and builds a constituency. A young agency should not be saddled with an expensive array of law enforcement practices and procedures.
- ***Embrace advocacy functions once the economy matures.*** The agency could go beyond attacking price-fixing to advocating competition, primarily by challenging governmental anticompetitive power. Such advocacy functions should be enhanced to go beyond those typically allowed western agencies. As a matter of policy, the competition agency should aim to limit and abridge the ability of government to erect or preserve anticompetitive practices.

Ensuring the viability of the competition regime will require considerable expenditure. Given current Mozambique's budgetary constraints and priorities it is unlikely that the government will fund any preliminary steps. Thus, the working group should attempt to solicit funds from various multilateral agencies interested in supporting efforts related to competition policy. The working group should also monitor discussions about international competition policy so that Mozambique will be able to prepare for possible negotiations in the near future.

1. Introduction

Does Mozambique need competition policy? Is so, what should the policy be? And if Mozambique could benefit from such a policy, is it ready to implement it? Mozambique may ultimately benefit from a competition policy emphasizing advocacy and the prosecution of cartels. But the foundations, institutions, and stakeholders required to enable a successful implementation are not yet present. They have to be built, nurtured, and prodded.

Competition policy has been accepted as a tool for addressing competition problems in transition economies, nearly all of which are characterized by extensive privatization and deregulation. Ostensibly, competition policy wards off the ill-effects of cartels and the transformation of public monopolies into private monopolies. But in most transition economies firms are not resorting to traditional cartel forms and anticompetitive business practices. Rather, lobbies and special interests work to capture or obtain rents, activities neither proscribed by antitrust legislations nor amenable to law enforcement.

Importantly, the implementation of competition policy in other countries has often been the result of conditionality or the quid-pro-quo to bilateral financial assistance or other similar incentives. Hardly ever has adoption of competition policy been preceded by national introspection, debate, and deliberation of the policy's advantages and disadvantages or a candid assessment of institutional capacity to administer a policy program.[1] Mozambique is among the few nations considering competition policy that is seeking information for a genuine debate on the matter before adopting competition laws; those responsible should be commended.

Competition policy is often conflated with antitrust law—a dizzying array of elaborate laws and proscriptions spanning all possible areas of business conduct. Like most countries, Mozambique could simply copy a foreign law and adopt the full array of practices. But

[1] For insightful commentary on Egypt's consideration of a competition program see Ahmed Farouk Ghoneim's "Competition Law and Competition Policy: What Does Egypt Really Need?" *Boletin Latinoamericano de Competencia*, No.17 (July 2003).

competition policy is considerably more than antitrust law.[2] It embraces objectives consistent with broader goals of liberalization and deregulation, is a voice for market forces that are often at odds with the private sector as well as the government, and must often strive to allay the misgivings of a populace fearful of a free market after many years of state mismanagement. Competition policy contains advocacy tools to challenge anticompetitive behavior by the government, as well as consumer protection elements that support the goal of speaking for consumers.

To be effective, a competition policy for Mozambique should reflect the country's institutional and economic context. Simply adopting a foreign law, procedures, and practices will not work. A general administrative strategy for any policy requires deploying the most cost-effective, efficient, and practical tools to solve the problems of a particular country. Otherwise, policy administration is an irrelevant exercise. Accordingly, Mozambique's competition policy should be based on careful examination of the country's present stage of transition and firm understanding of related problems.

For example, the main problems threatening liberalization today in Mozambique are the insidious forces of protectionism and non-tariff and tariff barriers. Obstacles for consumers are disguised as nationalistic measures, self-serving policy goals, calls for the imposition of quality considerations, arbitrary phytosanitary standards, and demands for subsidies and special financing. These activities erode the success of Mozambique's policy reforms, but they are not law-enforcement problems. They cannot be prosecuted. Effectively countering them requires distinguishing anticompetitive protectionism from legitimate and often pro-competitive social goals.

A liberal trade and investment policy stance can ensure competition and ensure it less expensively than an elaborate antitrust law enforcement program.[3] Unimpeded imports and free entry provide effective price discipline and enhance consumer welfare.[4] In Mozambique, it appears that trade and liberalization policies—rather than competition policy—provide, as one commentator puts it, the most "bang for the buck."[5] Granted, prohibiting and vigorously prosecuting horizontal price fixing is indispensable to a competitive environment. But devising additional proscriptions of business practices, vertical or horizontal, should be part of the mission of a competition agency as it matures, gains experience, trains its staff, forges

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[2] See, generally, William E. Kovacic's "Institutional Foundations for Economic Legal Reform in Transition Economics: The Case of Competition Policy and Antitrust Enforcement," *Chicago-Kent Law Review*, Volume 77 (2003).

[3] Blackhurst, Richard. 1991. Trade Policy is Competition Policy. In *Competition and Economics Development.* Paris: OECD.

[4] See James Levinsohn's "Testing the Imports-as-Market-Discipline Hypothesis," in the *Journal of International Economics*, Vol. 35 (1993) 1-22, which contributes to a steady stream of empirical papers that conclude that imports constrain domestic prices. See also, "Symposium on Antitrust Law and the Internationalization of Markets" in the *Chicago-Kent Law Review,* Vol. 64 (1988).

[5] Hoekman, Bernard and Petros C. Mavroidis. 2003. Economic Development, Competition Policy and the World Trade Organization. *Journal of World Trade*, Volume 37, Number 1 (pp. 1-27, at 5).

jurisprudence, and builds a constituency. A new agency should not be saddled with an expensive array of law enforcement practices and procedures.

The competition agency should be ultimately constituted as an independent agency staffed by well-trained attorneys and economists insulated from political interference as much as possible. The nature and pressures of politics may be inescapable, but only an independent agency can enjoy a modicum of immunity from political influence and gain confidence in it s own authority and professionalism.

A Mozambican competition agency remains in the future. More immediately, Mozambique should set up a "working group" possibly ascribed to a Ministry, to craft and foster a law. A working group will provide continuity to this early task and to the efforts of those persuaded on the merits of a competition agency and a competition policy; a working group will serve as a focal point for the steps necessary to garner support, funding, assistance, training, education, constituency building.

In the next section we describe the historical development of competition problems now facing Mozambique, especially the pervasiveness of rent-seeking practices. This is followed by a critical discussion of international efforts to adopt competition policy. We conclude that few of the arguments advanced by proponents are sound on the merits. More importantly, the multinational competition initiative offers little consumer welfare gains for Mozambique that it could not gain more cheaply through other instruments, such as trade and further deregulation. In the concluding section we discuss the most appropriate competition policy for Mozambique given its competition problems.

An overview of the elements of competition policy—including advocacy and antitrust policies on relevant markets, price fixing, predation, merger analysis, non-price horizontal restraints, vertical restraints, and price discrimination—is provided in Appendix A.

2. Historical and Economic Setting

After it emerged from colonialism in 1974, Mozambique's economy was characterized by pervasive price controls that put most of the country's production, transport, commerce, and service sectors in the hands of the state.[6] Since the end of the 1980s, the Government of Mozambique has been systematically liberalizing the country's economy and seeking a broader role for the private sector.[7] If not always consistent, these efforts have been steady and successful.

Liberalization Process and Benefits

To integrate into the globalized economy, Mozambique implemented a series of standard stabilization measures, including fiscal adjustment, monetary restraints, and exchange rate devaluation. Deregulation—reducing or eliminating burdensome and inefficient regulations—was a central component of the liberalization program.[8] And institutional reforms of the financial sector and a privatization program for state enterprises were key components of deregulation.[9]

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[6] Arndt, Channing, Henning Tarp Jensen, and Finn Tarp. 2000. Stabilization and Structural Adjustment in Mozambique: An Appraisal. *Journal of International Economic Development*, Volume 12, Number 3, April (p. 299); António A.S. Francisco. 2002. Evolução da Economia de Moçambique da Colónia a Transição para a Economia de Mercado. In *A Economia Moçambicana Contemporânea*. Ministério do Plano e Finanças: Maputo, Moçambique. June.

[7] The Government of Mozambique's reform process started in 1987 with its Economic Rehabilitation Program, renamed the Economic and Social Rehabilitation Program in 1989. The stated objective was to lay the foundation for a shift to a market-based economy (Arndt *et al,* 302, note 7).

[8] In recent years, privatization and deregulation policies have been part of a major structural change from active industrial policy to a market economy. The movement toward privatization of state-owned enterprises is chronicled in L. Cowan's *Privatization in the Developing World* (1990); S. Hanke's *Privatization and Development* 1987; Albert Fishlow's "The Latin American State," in the *Journal of Economic Perspectives*, Volume 3 (1990); P. Guislain's *Divestiture of State Enterprises: An Overview of the Legal Framework* 1992; and C. Vuylsteke's "Methods and Implementation 1, Techniques of Privatization of State-Owned Enterprises," World Bank Technical Paper No. 88, (1988).

[9] See Anne M. Pitcher's *Transforming Mozambique* (2002), especially Chapter 4, "A Privatizing State of a Statist Privatization?"

Trade, widely recognized as an engine of growth and development, has been another important component of liberalization. The Government of Mozambique moved from a system of managed trade toward a liberal regime with imports subject to ad-valorem tariffs. Since 1987, quantitative restrictions on imports and exports have been scrapped, the number and average level of tariff rates substantially reduced, and licensing procedures simplified or rendered automatic.[10]

Mozambique's reforms were intended to induce competitiveness, economic growth, and better living standards. Deregulation, encouragement of new market entry, and increased competition would make firms more efficient. Efficient firms would necessarily become more productive and better able to compete in world markets. Increased competition would benefit consumers by providing more choices, better quality, and lower prices. So far, results have been encouraging. Substantial price decontrol and vigorous trade liberalization appear to have enhanced microeconomic efficiency and the capacity of the economy to withstand external shocks.

Price liberalization has been vigorous and comprehensive. In 1986, products with fixed prices accounted for about 70 percent of GDP. In July 1993, prices for major food groups such as maize meal, cooking oil, and rice were liberalized. By 1996, only wheat flour, bread, rents, fuel, utilities, and certain transportation fares remained regulated. As of April 2002, only utilities and some taxicab fares were regulated.[11]

Mozambique's privatization program, when measured on the basis of the moving of assets from the state into private hands, has also been successful. In 1994 there were 125 privatizations and in 1995, 261. By mid-1999, more than 1,200 firms had been privatized with 87 of these considered large enterprises. The World Bank referred to Mozambique's privatization program as "one of the largest in Africa."[12] A joint study by the World Bank and the Government of Mozambique found that enterprises increased output by a multiple of nearly four in the three-year period following privatization.[13]

Threats to Liberalization Benefits

The actual and potential benefits of deregulation and privatization programs depend heavily on vigorously competitive markets unencumbered by cartels, lobbies, or any other pressure group intent on protectionism. Regulatory reform and privatization may remove government

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[10] Arndt *et al*, 304, note 7.

[11] IMF. Republic of Mozambique: Statistical Appendix, (July 2002), Table 13, Mozambique: Prices Administered by the Government, 1999-2002.

[12] Sowa, A. 1996. Evaluating the Impact and Effectiveness of the Enterprise Restructuring Program. Private Sector Finance Technical Unit (The World Bank: Washington, DC, August 1996).

[13] World Bank and Republic of Mozambique. 1997. Mozambique: Policy Framework Paper 1997-1999. Washington DC.

inefficiency but may also unintentionally forge market inefficiencies that jeopardize the entire process. For example, a privatization policy that simply replaces government monopoly with private monopoly merely transfers monopoly profits to private groups without removing inefficiencies. A demonopolization policy that divides a firm may produce no benefits if its former constituent components recreate a cartel or a monopoly.[14] If private firms discover that forming a cartel is more attractive than facing competition, cartels will proliferate.[15]

In addition to cartels and monopolies, non-tariff barriers, tariff barriers, veiled and not-so-veiled protectionism, are serious threats to competition. Non-tariff barriers and similar mechanisms, like cartels and monopolies, reduce output, limit consumer choice, and raise the prices of goods.[16] The artificial scarcity and higher prices resulting from anticompetitive behavior and higher transaction costs reduce consumer welfare and prevent widespread benefiting from free trade.

Interestingly, cartels, monopolies, and protectionist forces may have identical interests and objectives in Mozambique's current state of development: to curtail further market entry and limit competition. Firms, for example, can (1) form a private cartel and seek to exclude, boycott, or otherwise limit further entry or imports and thereby competition; and/or (2) work together to lobby government to curtail entry or imports and thereby also limit competition.

Why organize into lobbies or cartels? Imports and new market entrants imply increased competition and a deterioration of profits, so preventing entry ensures the creation or continuity of monopoly rents. Given these choices, the best strategy for any actual or potential group of firms in Mozambique is not to constitute a naked cartel intent on establishing supracompetitive prices. Supracompetitive prices would beget entry. Rather, most firms, cartelized or organized into lobbying groups will focus on soliciting preferential treatment from the government and more permanent barriers to entry; they will lobby to prevent the entry of new rivals and to proscribe or curtail imports into the Mozambican market. The two alternatives are not mutually exclusive, so a group of firms could pursue both, forming a private pricing cartel and avidly soliciting protection to exclude or limit competition.

Consider Mozambique's thriving informal sector. It plays a formidable role in disciplining prices in many tradable goods. It has few and low barriers to entry and numerous participants. Its continued presence prevents emergence of a successful pricing cartel. Its vigor is related directly to the taxation and tariff structure as well as to other elements of the trade regime. In other words, the informal market is prima facie evidence of the distortionary

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[14] Black, Bernard, *et al.*, 2000. Russian Privatization and Corporate Governance: What Went Wrong? *Stanford Law Review*, Volume 52.

[15] Laffont, Jean-Jacques. 1998. Competition, Information, and Development. *Annual World Bank Conference on Development Economics.* World Bank.

[16] See, generally, F.M. Scherer and David Ross, *Industrial Market Structure and Economic Development*, 3rd edition, 1990.

effects of tariffs and taxes as well as lax law enforcement. Thus, it is not surprising that curtailing the agility and vigor of the informal sector is a prime goal of organized lobbies.

But why solicit preferential treatment instead of forging a strong private cartel to exclude or boycott entry? *Because it is both cheaper and more effective to ask the government for protection than it is to organize a private cartel*. Without government assistance it is unlikely that any business association can organize an effective private boycott of the informal sector. As a general rule, government-sanctioned anticompetitive practices limit or sharply reduce the disciplining effects of imports and competition just as effectively as naked cartels or monopolies. Clearly, business groups have great interest in harnessing the powers of government to their benefit. Even an antitrust agency could serve protectionist purposes by erecting barriers to entry, raising rivals', costs and punishing foreign entry.

Countering Threats to Competition

Is it possible to curtail such threats to competition? Unfettered entry and the threat of entry into a market are capable of maintaining competition, restraining anticompetitive behavior, and ensuring that prices remain competitive. Therefore, *Mozambique's investment and trade policy should remain a top priority and a key policy tool for ensuring competition in the economy.* To help ensure competition, investment and trade policy should continue to emphasize deregulation, elimination of trade barriers and trade impediments, trade facilitation, and domestic and foreign investment incentives that increase new entry and output.

A sound competition policy is an equally attractive and complementary mechanism for curtailing the welfare-eroding effects of cartels, monopolies, and protectionism. Such a policy should be forged around an antitrust law of unambiguous proscriptions against anticompetitive practices and administered by an independent and autonomous agency. Such a policy may provide an important alternative for Mozambique in ensuring the pro-competitive potential of its economy.[17] In fact, competition policy legislation that proscribes anticompetitive practices are common amid market reforms in many transition economies for similar reasons.[18]

Unfortunately, despite its wide array of finely honed legal tools, antitrust law is powerless against legal lobbying initiated to solicit protection from the government. Thus, many antitrust proscriptions appear to be useless against the main threat to competition in

[17] See William E. Kovacic's "Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement," in the*Chicago-Kent Law Review*, Volume 77, No.1, 2001; and UNCTAD's "Competition Policy, Trade & Development in the Common Market for Eastern South Africa," Geneva, 2000.

[18] Gray, Clive S. and Anthony Davis. 1993. Competition Policy in Developing Countries Undergoing Structural Adjustment. *Antitrust Bulletin*. Volume 38.

Mozambique. A limited focus on horizontal price-fixing appears to be the only useful component of antitrust enforcement.

But competition policy is more than antitrust laws and enforcement. Competition advocacy, for example, consists of a full complement of enforcement tools, administrative procedures, and legislation aimed at government-sanctioned restraints that impair competition and harm consumers. It has the same objectives as trade theory and liberalization: to preserve and foster the gains from liberalization. And, when combined with an antitrust law enforcement initiative focused on the proscription of horizontal price-fixing, advocacy promises to be a highly effective mechanism for addressing easily identifiable goals.

Why focus on naked cartels to the exclusion of other practices? First, unlike some non-price horizontal practices and nearly all vertical practices, price-fixing has no efficiency benefits. Second, administering an antitrust program is expensive for any country. Administering a highly focused law is easier, more effective, and less expensive than managing the full instrumentalia of antitrust. Moreover, Mozambique has many institutional constraints that would make broad administration difficult at best: little tradition in antitrust, limited jurisprudence in competition, limited capacity to administer laws, little or no confidence in the legal system, no natural constituency for a competition agency, limited budgets, little experience with competition, limited human capital.

The experience of neighboring African countries that share institutional, historical and economic attributes with Mozambique has been, to put it mildly, disheartening. The capabilities of competition authorities in other African countries are constrained by lack of resources and poor institutional development:

> For example, the Zimbabwe Competition Commission due to budgetary constraints have failed to retain competitive staff and recruit new staff to fill existing vacancies. In Tanzania, there is no independent funding for Tanzanian Competition Commission and the Competition Tribunal and the available state funding is nowhere adequate.[19]

The misapplication of competition policy is not limited to Africa; consider the following commentary about the Russian Federation:

> In 1992, under pressure from Western donors, the government of the Russian Federation established an anti-monopoly committee to address the problem of industrial consolidation. It became immediately apparent that the new commission could not stand up to the political power of large enterprises, and it did not even try to regulate their activities. Instead, the commission started to compile list of small firms, such as bakeries, taking the position that such firms had the position of abusing their local market power. Small entrepreneurs had to register with the commission and often to pay bribes just to get off the lists of potential monopolies. The commission did nothing about the real problems of market power, added a level of

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[19] Hurungo, James and Modes Tekere. 2002. Multilateral Framework for Competition Policy; Where Do African Consumers Stand? Trade & Development Studies Centre: Harare, Zimbabwe. November.

> regulation of small firms, and provided lucrative opportunities for its own employees.[20]

In the next section we consider more closely the institutional and economic setting that any competition policy proposed for Mozambique should take into account.

[20] Boycko, Maxim, Andrei Shleifer, and Robert Vishny. 1995. *Privatizing Russia*. MIT Press. Cited in Edward L. Glaeser and Andrei Shleifer's "The Rise of the Regulatory State," *Journal of Economic Literature*, Volume XLI (June 2003).

3. Institutional and Economic Considerations

Rather than merely reproducing the laws and policies of other jurisdictions, an optimal competition policy should address an economy's salient problems and attend closely to its institutional and economic setting. Thus, before suggesting a competition policy suitable for Mozambique, we must identify and understand the problems that the policy should address as well as problems that will complicate implementation of the policy. Just as observable problems reflect a country's institutional and historical setting, so should potential solutions and policy instruments.

Tariff and Non-Tariff Barriers and Pressure Groups

Numerous observers of Mozambican liberalization warn of the persistence of rent-seeking behavior, the rigidity of non-tariff barriers, and the emergence of protectionism. Non-tariff barriers encompass a variety of measures. Some have little effect on trade while others, intended to reduce imports and benefit domestic producers, can significantly affect trade patterns.

It appears that the main threat to competition in Mozambique consists of non-tariff barriers, protectionism, and other forms of state interference in the economy. Such interference prevents further consolidation of gains from liberalization and generates a host of unintended negative consequences for competition.

One Mozambican identifies non-tariff barriers responsible for the modest successes of the intra-SADC trading accords:

> Por que razao os acordos entre os paises da SADC tendem a fracasar? …Os procedimientos, as leis e os regulamentos do comercio internacional entre os paises de SADC foram anlisados e como resultado foram identificados cinco problemas que constituembarreiras nao-tarifarias, a saber:
>
> - Or requisitos da documentacao necessaria;

> - Os procedimientos para a importacao e exportacao de produtos e factores de producao;
> - A falta de tecnologias de informacao eficazes e eficientes;
> - A administracao burocratica e arrogante dos servicios de alfandegas; e a falta de transparencia legal.
> - Os sistemas de vistos praticados na regiao dificultam o movimiento das mercadorias e das pessoas, contituindo uma barreira nao-tarifaria mas relevante.
>
> Os acordos comerciais nao podem funcionar com estas barreiras e, assim a seguranca alimentar dos paises da SADC sera sempre condicionada por factores negativos.[21]

And competition will be similarly compromised.

A recent report presents this reality starkly. Referring to a survey in which firms were asked to rank problems, the report states that

> Closely related to insufficient demand is competition. This category refers to complaints about competition from imports or lack of protection. Here again, small and locally-owned firms complained far more than large firms or ones with foreign ownership. The difference in importance attached to the lack of demand and competition between domestic and foreign-owned firms points to deeper issues. The opening of the market brought about both by the liberalization policies and by the end of the war has created many opportunities for Mozambican firms. However, not all firms are able to take advantage of them. Domestic firms, which until recently have been cut off from the world market, do not have the knowledge or skills to compete against imported goods or international firms. Most of these companies continue to use the same processes to make products of the same quality and design that they did when they faced competition. Consequently, their products are no longer competitive and the firms complain bitterly of insufficient demand, foreign competition and the need for government help.[22]
>
> Such rent seeking behavior not only erodes the country of its financial resources, but also, damages the credibility of the government and its policy reforms in the eyes of private investors.[23]

In addition,

> Mozambique's legal and judicial sector institutions have not kept pace with the accelerated economic growth of the country in the last half of the 1990s. The state of the sector is perceived by many to be a deterrent to investment and a hindrance to growth.[24]
>
> Corruption is tainting Mozambique's legal and judicial sector.[25]

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[21] Mucavele, F.G. 2002. Analise do Desenvolvimiento em Mocambique no Contexto da Africa Austral. *O Economista*, No.1 April.
[22] Biggs, Tyler, John Nasir, and Ray Fisman. 1999. Structure and Performance of Manufacturing in Mozambique. Regional Program on Enterprise Development (August), p. 37.
[23] *Ibid*, p.ix.
[24] The World Bank, Legal Vice Presidency, *Mozambique: Legal and Judicial Sector Assessment* (undated), p. 4.
[25] *Ibid*.

Mozambique's relatively successful deregulation, privatization, trade reform, and other liberalization processes have imposed gains and losses. For example, the reduction and elimination of domestic barriers to trade stimulated imports and entry. The resulting competition between imports and domestic production affected economic sectors differently. And while the benefits of such competition have usually been enjoyed broadly by consumers, import-competing industries bear the costs. Those affected tend to oppose further deregulation and to seek protection from imports or maintenance of protective barriers, or both. If import-competing commerce has more to lose than the export industry has to gain, incentives for protection can be stronger than pro-liberalization forces and can spearhead opposition to deregulation. Indeed, reformers are not unaware of the problem:

> Recent assessments of the reform efforts have concluded that the government has been making consistent efforts to remove administrative barriers to investment in recent years.[26]

Numerous government policies affect the ease of entry, some in obvious ways and others more subtly. For example, it takes 153 days to start a business in Mozambique. In addition, the "costs of bureaucracy are high resulting in delays and lead[ing] to high levels of corruption."[27]

Delays add costs, often insurmountable costs, that erode general competitiveness. In addition to disadvantaging small business, Mozambique's numerous government regulations restrict imports from entering national markets. Recently published statistics ranked Mozambique 19th among 24 African states on "hidden import barriers," 15th on "import tariffs and quotas" as serious impediments to access to foreign materials and equipment, and 15th in "overall openness to trade," as measured by levels of imports or export restrictions, licensing requirements, and exchange controls.[28] These statistics suggest that Mozambique has much to gain by increasing deregulation and pursuing trade enhancing measures rather than antitrust law enforcement.

Alleged Existence of Cartels and Monopolies

If a single entity captures an entire industry, monopoly can replace state control and choke off the benefits of competition. Cartel activity, by jointly reducing output and thereby raising prices, imposes comparable duress on competition. If carefully employed, antitrust law can protect the development of a market economy.

Mozambique's largest business association has characterized monopolies as a "huge" problem, observing that "the business environment in certain areas is dominated by

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[26] Foreign Investment Advisory Services, The World Bank and the United States Agency for International Development. 2001. *Mozambique: Continuing to Remove Administrative Barriers to Investment.* p. vi.
[27] Schwab, Klaus, *et al*. *The Africa Competitiveness Report 2000/2001*. p. 170.
[28] *Ibid*, pp. 247-248.

monopolies and oligopolies, with foreigners predominating in vital sectors."[29] The most prominent business association, the CTA, recommended antitrust policy to address alleged monopoly and cartelization problems, urging the state to "apply its function as a regulator of firms that are monopolies or oligopolies in such a way that the cost of their products of services does not penalise the less profitable sectors."[30] The sentiment is echoed by well known pro-reform technocrats:

> O Estado deve asegurar regras estáveis para efectivo funcionamento do mercado competitivo, a liver concorrência, a regulaçao dos monopólios e a protecção dos consumidores.[31]

In interviews, government officials voiced concern about the impact of mergers in the domestic beer and financial sector and of apparent cartel activity in bread distribution and retailing. Without a thorough antitrust investigation, including an investigation of the applicable regulatory regime, it is difficult to ascertain whether retail bread and beer vendors are indeed pricing anticompetitively without possibly unintended assistance from the government. However, after numerous interviews and conversations with officials, domestic journalists, and reporters one perceives both a vigorous nationalism associated with the concern about monopoly and a quick disposition to label the business concerns as monopolists. In fact, the interest in competition policy appears to be driven largely by these concerns.[32] Commentators view the penetration of South African capital into the Mozambican economy warily. Disproportionate dependence on any one source of foreign investment may be a legitimate concern for the polity, but that concern is best addressed by policy instruments other than antitrust.

Competing Social Goals

Modern antitrust practice favors an efficiency-based economic goal: maximized consumer welfare. Mozambique's goals have long been social and political: create jobs and reduce poverty.[33] These goals are not necessarily inconsistent in the long term but may be diametrically opposed in the short term. For example, to attract foreign investors and jobs, the government may agree to exclusive concessions. Exclusivity may entail contractual guarantees, restrictions on entry, or any of the many instruments governments use to attract investment, especially foreign investment. Exclusivity eliminates or reduces competition. Reduced competition in a market or sector is likely to result in a premium, distort marginal cost pricing, and enhance the firm's returns. It is precisely this guarantee of additional returns

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[29] CTA, Sixth Annual Conference of the Private Sector in Mozambique (Maputo, Mozambique: October 2001), p. 9.
[30] *Ibid*, p. 15.
[31] Ratilal, Prakash. 2003. Agenda 2025: Visão e Estratégias Nacionais. *O Economista*, No.4 (Setembro), p. 180.
[32] The Mozambican parliament had commissioned a prominent local attorney to draft a prototype law. Interview of Dra. Lucinda Cruz, November 4, 2003.
[33] Kovacic, William and Carl Shapiro. 2000. Antitrust Policy: A Century of Economic and Legal Thinking. *Journal of Economic Perspectives*, Winter 14:1, pp.43-60.

that may draw an investor. But this trades a long-term goal (economic efficiency) for a short-term goal (jobs).

Another oft-stated goal of the Government of Mozambique—foster and support small enterprises—may be inconsistent with an efficiency-based competition policy. Fostering small enterprises may be inefficient to the extent that doing so requires subsidizing them or curtailing entry of larger, more efficient competitors. The resulting enterprises may be uncompetitive if they are too small and they may never be able to compete with larger, more efficient enterprises if they cannot become more productive.

A competition agency that promotes consumer welfare is not likely to challenge national policy goals that embody criteria contrary to economic efficiency. Even if such an agency existed, policymakers would look askance at its challenges to projects designed to achieve social objectives. To be effective, a competition agency must be able to challenge anticompetitive government programs.

Small Markets and Minimum Efficient Scale Economies

What characteristics of small economies deserve particular attention when one is considering a competition policy?[34] Does Mozambique have these characteristics? All else being equal, small economies cannot support as many firms as larger economies. Across most industries, Mozambique's domestic demand is small compared to that required for minimum efficient scale. Minimum efficient scale is the scale of production corresponding to lower costs. Thus, industry concentration in Mozambique is relatively high because demand is sufficient for only one or two firms in each sector. Does this high concentration warrant antitrust oversight? High concentration need not imply market power; after all, free entry of products into Mozambique will ensure competition on price and quality. In addition, political boundaries need not be identical to the relevant economic market. While in any one case political boundaries might equal economic boundaries, the case-specific nature of antitrust markets makes this result coincidental. With increased trade and a liberalized economy Mozambique may very well be inserted into an economic market surpassing national political boundaries. Thus, the observed high concentration levels in Mozambique offer little guidance as to the likelihood of potential anticompetitive practices.

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[34] This debate has drawn considerable attention. See, for example, OECD, Small Economies and Competition Policy: A Background Paper, CCNM/GF/COMP(2003)4 (February 5, 2003)

Competitive Pressure from the Informal Sector

The informal sector puts considerable pressure on prices and competition. The existence and success of the informal sector is due largely to high taxes and tariffs rather than poor enforcement. Almost all firms that sell on the domestic market complain bitterly about competition from smuggled goods. These firms believe that they are at a disadvantage because they must pay high duty on legally imported goods while the government does little to stop smuggled goods.[35]

Many small and mid-sized firms reportedly face serious competition from informal sellers because the government does not administer tax laws, labor regulations, and other laws equitably. These firms complain that they must follow all government regulations and need a tax number in order to make a sale because they are subject to regular inspection. But the government does not inspect the small and informal sellers, who can undercut formal distributors because they do not follow labor regulations or pay circulation and other taxes.[36]

It is not surprising that domestic firms are intent on curtailing and possibly eliminating the informal sector. If they do so, supply will be reduced and prices will rise. Unless tariffs and tax burdens are reduced, however, eliminating informal markets will be difficult largely because they have become institutionalized, serving as discount outlets for mainstream, formal businesses:

> It is also not uncommon for shopkeepers to move goods more quickly by dumping them into the informal economy. The mobility and low prices of the informal sector provide and attractive venue for the sale of surplus ironing boards, sheets, extension cords, and clotheslines, from which the formal economy takes a hefty cut. Some traders also find the informal economy handy for the transmission of second-hand clothes, bricks and even food-aid, or whatever item they happen to buy in bulk that week.[37]

Unavailability and Limitations of Firm-level Data

To enforce antitrust laws, government agencies rely heavily on large amounts of data, documents, and testimony. Competition law must contain mechanisms to facilitate the acquisition of relevant, case-specific information while guaranteeing confidentiality. At present, the economic data routinely collected by the Mozambican national statistics agency is not suitable for antitrust enforcement, and the data gathered by the Statistical Agency (INE) is not readily available to other agencies because of confidentiality protections.

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[35] Biggs *et al*.
[36] *Ibid*. p. 33.
[37] Pitcher, p. 164.

Like most statistical agencies, INE collects and assembles firm-level data based on SIC, ISIC survey methodology or a close variant. But conventional standard industrial classification (SIC) code-based data has been notoriously difficult to use in antitrust enforcement.[38] Why are so much case-specific price and product data needed? To determine product markets. Product market definition seeks to identify all products that can be considered meaningful substitutes for a particular item. Defining a product market requires constructing a "small but significant and nontransitory" price test or using related price-based methodology.[39] (Geographic market definition seeks to define the spatial scope of the market.) Products reflect varying degrees of substitutability, with firms often operating in environments characterized by limited numbers of rivals, heterogeneity, imperfect information, and high transaction costs. Thus, all else being equal, without a meaningful context, even a price series at the 7-digit SIC level cannot be used to rigorously define an antitrust market.[40]

Observations of violations of the law-of-one-price appear to allow inference of market power. But concepts in economics, such as the law-of-one price and economic markets, have been surprisingly difficult to use in antitrust analysis. An ideal market assumes competition between numerous buyers and sellers in addition to homogeneous products, perfect information, and cost-free transactions. These factors force the product price to a uniform level. In reality, products reflect varying degrees of substitutability as noted above. Thus, the observation of a uniform price cannot be used to rigorously define a market. As a consequence, a considerable body of literature discussing how product and geographic markets should be delineated for antitrust purposes has emerged.[41]

When analyzing competition the analyst requires information on the behavior of *marginal* firms, not average firms. A marketing, advertising or any similar survey of consumer behavior and practices reflects data on average firms *not* marginal firms.[42] If this information is to be useful, the underlying causes of the data must be identified and then an explanation offered as to why these factors apply to marginal firms. Preferably, the marginal firms should be directly identified and polled.

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[38] SAL Consultoria e Investimentos. *Revisão de Critérios de Classificação dos Estabelecimentos Industriais.* Março de 2002. Given that the surveys vary in coverage and taxonomy rather than methodology it is likely that the observed limitations to the use of SIC data for antitrust enforcement are applicable to all other surveys.

[39] For a general discussion, see Greg Worden's "The Divergence of SIC Industries from Antitrust Markets," in *Economics Letters*, Volume 28 (1988) 193-197, criticizing the use of four-digit SIC industry data on the grounds that they are too aggregated, either geographically or over products.

[40] Werden, Greg and Russell Pittman. 1990. "The Divergence of SIC Industries from Antitrust Markets: Indications from Justice Department Merger Cases. *Economics Letters* Volume 33.

[41] Elzinga, Kenneth and Robert Rogowsky. 1984.

[42] The responses of the marginal firm are important for buyers and sellers. Marginal buyers can switch purchases away from the monopolized product, while marginal sellers can undercut monopoly price by expanding output if they are already in the market or by entering the market if they do not have a product offering. Thus, all the information gathered during the investigation must address marginal firms who may respond to monopolistic pricing.

Assembling data on structural parameters invites a traditional view of competition that may result in a national antitrust policy mistakenly based on singling out participants in highly concentrated markets for further scrutiny.

Limitations of a Weak Judicial System

A weak judicial system acts as a barrier to entry, limiting investments that could increase productivity.[43] When specific counter party commitments to any investment are at stake, the role of a competent court system is to clarify the party's responsibilities and obligations in the event of dispute. Where legal institutions are weak, however, relational contracting and informal constraints among a populace and trading parties may suffice to resolve disputes.[44] Through relational contracting, firms have productive interactions even when the courts cannot be used to enforce contracts. Unfortunately, relational contracting favors established partners with solid records and reputations over new entrants or poorly connected entrants and investors. Thus, a poorly working court system discourages firms from taking on untried partners.

A recent examination of the importance of courts in post-communist countries concluded that "transactions costs are lower when courts are effective than when firms must rely solely on relational contracts, and firms are most likely to seek out new trading partners."[45] Relational contracting relies largely on incentives that come from inter-firm relationships rather than by invoking the law. The gains to both counter-parties from the continued interaction are more valuable than the losses that would arise from contractual breach.

When a judiciary is weak a premium is placed on relational contracting. Mozambique's legal system is fragmented and its practitioners are under-trained, poorly paid, and ineffective. The private sector has little confidence in the system. A recent assessment of the judiciary highlighted the following problems:

> Mozambique's legal and judicial sector institutions have not kept pace with the accelerated economic growth of the country in the last half of the 1990s. The state of the sector is perceived by many to be a deterrent to investment and a hindrance to growth.[46]
>
> Corruption is tainting Mozambique's legal and judicial sector.[47]

Trade in Mozambique has favored joint ventures and foreign domestic partnerships for relational contracting.

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[43] Johnson, Simon, John McMillan, and Christopher Woodruff. 2002. Courts and Relational Contracts. *Journal of Law, Economics & Organization.* April

[44] North, Douglass. 1990. *Institutions, Institutional Change and Economic Performance.* See especially Chapter 5 on informal constraints.

[45] Johnson *et al*.

[46] The World Bank, Legal Vice Presidency, *Mozambique: Legal and Judicial Sector Assessment* (undated), p. 4.

[47] *Ibid*.

> [A]lmost all foreign investment in Mozambique takes the form of joint-ventures with participations by the state or national investors. Except for some limited cases as oil prospecting, very few large companies are owned outright by foreigners. Instead the state and/or national investors and are represented on the boards of almost every company in which there is foreign investment.[48]

> Nationals provide knowledge of the investment site, local tastes, fashions, or preferences, and they understand the nuances of investment, tax and labor laws. In addition they can navigate the intricacies of local and national bureaucracies and can open doors if they have government connections. Foreign companies thus have great political and economic reasons for forming alliances with national capital.[49]

Thus, it is clear that trade gains rely on mechanisms that bypass the courts altogether. Unfortunately, doing so is not only costly but discourages innovation and new capital. Mozambique is likely to benefit significantly if it revamps court operations. By the same token, the present limitations of Mozambique's judicial system offer little assurance that it can stand in dispassionate review of antitrust disputes. The complexity of business practices challenged by competition authorities demands considerable experience and sophistication from not only the prosecution and the defense but also from the bench.

Another problem is the perception of pervasive corruption. If neither courts nor regulators can resist subversion, the best policy is to leave imperfect markets alone. Otherwise, the harm done to potentially highly efficient practices and to investor expectations will outweigh any benefits in consumer welfare. In addition, implementing a competition policy would require considerable training of the bench, a highly expensive proposition.

Limited Human Capital and Resources

Mozambique suffers from a lack of trained professionals. A recent assessment of the judicial sector notes that "perhaps the most significant problem facing the sector as a whole is the relative lack of skilled human resources."[50] A competition agency must be staffed with highly specialized lawyers and economists with university-level training and practical training in well-established competition agencies. In addition, as antitrust enforcement stimulates the private sector's demand for antitrust know-how, sufficient numbers of skilled professionals must be available for companies to recruit directly or through employment agencies. In addition, active training of the bench and bar on antitrust methods and practices must accompany any attempt at implementing a competition policy.

Expenditures required to ensure the viability of the competition regime are considerable. Given current budgetary constraints and priorities it is unlikely that the Government of

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[48] Pitcher, p. 150.
[49] *Ibid*, p. 151.
[50] *Mozambique: Legal and Judicial Sector Assessment* , p. 4.

Mozambique will fund any preliminary steps. It may be necessary to solicit funds from various multilateral agencies interested in supporting efforts related to competition policy.

Transition Costs

In the long run, Mozambique may benefit from a competition policy and related advocacy and enforcement program. But the costs of implementing and administering such a program must be carefully considered and calculated; otherwise, decisions about the program are likely to be distorted. First, any long-term advantages from a reasonably workable competition policy, once discounted to reflect the time value of money, may be too small to justify the cost of implementing a competition program today. One provocative examination of the performance of the U.S. antitrust program asserts that

> the economics profession should conclude that until it can provide some hard evidence that identifies where the antitrust authorities are significantly improving consumer welfare and can explain why some enforcement actions and remedies are helpful and others are not, those authorities would be well advised to prosecute only the most egregious anticompetitive violations.[51]

Second, the costs of alternative ways of achieving competition in Mozambique are lower than the costs of a competition policy program. Pressing on with the liberalization program and further deregulation promises to be more fruitful and less costly than a competition program.

Last, the success of envisioned events, such as continued emphasis on further liberalization and deregulation may reshape the equilibrium and negate the need for competition policy enforcement. It is important to keep in mind that, once created, a competition policy program will be practically impossible to reverse.

Autonomy

The effectiveness of any regulatory policy depends in part on how it is administered. Although antitrust is often considered an example of "public interest" regulation, it is possible that the regulators will be co-opted by the targets of the regulation.[52] If the targets of regulation influence regulators, antitrust policies will not protect consumers from monopolistic pricing. In general, the more insulated a competition agency is from political control by the legislative and executive branches of government, the more likely it is to be free of influence by regulation targets. Administrative decisions should also be subject to court review. Administratively isolating the agency, making it independent of other government

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[51] Crandall, Robert and Clifford Winston. 2003. Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence. *Journal of Economic Perspectives*, Volume 17, Number 4 (Fall) pp. 3–26.

[52] Buchanan, James and Gordon Tullock. 1980. *Towards a Theory of the Rent-Seeking Society*.

entities, and ensuring effective review by the courts, minimizes the possibility of undue influence. Still, the public impact of the agency's actions raises the possibility of political interference.

4. International Aspects of Competition Policy

Interest in international competition protocols was boosted in 1994 when the World Trade Organization (WTO) turned its attention to trade and competition. Advocates for competition policy marshal some compelling arguments in favor of an international code governing competition.[53]

1. ***Trade liberalization is inadequate to ensure competition in domestic markets.*** Advocates argue that because multinational corporations act to gain or enhance anticompetitive market power rather than to increase operational efficiency, trade liberalization, unaccompanied by antitrust monitoring and sanctions, will impart only weak competitive pressures to domestic markets.

2. ***National competition agencies alone cannot deter cross-boundary cartels.*** Advocates also point out that international competitors, often in coordination with their home countries' governments, collectively seek non-tariff barriers and other protections when entering foreign markets. Presumably, such cross-boundary cartelization can be deterred only by cooperation between competition agencies. The political difficulties and economic costs of international litigation facing lone national agencies suggests that international cooperation between agencies is appropriate. It follows then that countries like Mozambique have much to gain by instituting competition agencies.

3. ***A common policy would reduce distortions.*** Advocates also argue that international treatment of competition would allow countries to commit to restricting each countries' discretion in granting preferential treatment to foreign and domestic interest groups. At present, countries define and administer competition policies very differently. A uniform competition policy would reduce the distortions that arise from distinct policies.

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[53] Davidow, Joel and Hal Shapiro. 2003. The Feasibility and Worth of a Trade Organization Competition Agreement. *Journal of World Trade*, Volume 37, Number 1, pp. 49-68. Peter Holmes. Trade Competition and the WTO. In *Trade Development and the WTO.* World Bank.

Contrary to these views, economic theory finds that trade and concurrent expansion of geographic markets are likely to reduce cartelization.[54] All things being equal, import competition is a countervailing force against market power in the hands of domestic firms. No doubt, cartelization, when successful, yields private gains. Domestic firms may respond to trade liberalization and a prospective reduction in profits due to increased import competition by threatening to collude. However, the effectiveness of a domestic cartel facing new import competition is doubtful. Presumably, if collusion were profitable and enforceable *before* trade liberalization, it would already be occurring. Furthermore, increased trade lowers the residual demand facing domestic firms and thus makes collusion less profitable and thus less likely. While domestic firms may invite a new foreign competitor into a cartel, it is unclear why a foreign rival, especially one with a cost advantage, would choose to participate. After all, foreign firms have incentives different from domestic incumbents' incentives.

While concerns about collusive arrangements between foreign and domestic rivals may be justified, domestic firms are much more likely to respond to trade liberalization by seeking protectionist measures from their domestic governments, especially in small transition economies such as Mozambique. Even then, competition policy may be ineffective at countering this response. As noted throughout this report, lobbying for protection is immune to law enforcement. To the extent that domestic trade associations choose to allocate lobbying resources in a trade-off between attempted cartelization and government influence, an active antitrust enforcement policy may not effectively reduce allocative losses due to cartelization.[55]

Individual countries may have different incentives and traditions in determining antitrust and other industrial policies; and national policies differ and may differ because countries are in different stages of development. In the United States, antitrust law is designed to protect consumers from anticompetitive private practices, but not from government-supported activity. In the European Union (EU), competition policy is designed to promote economic and political integration and enhance economic competitiveness versus non-EU firms. At least in principle, eroding asymmetries in the regulation and enforcement of competition policy can prevent government favoritism that benefits domestic economic actors. Removing distortions can improve overall economic performance in international markets. The WTO, however, was formed to establish a framework to reconcile conflicts between domestic policies and foreign interests in competition policy issues by ensuring *harmonization of trade practices*. Thus, the success of the WTO may undercut any need for a global antitrust authority under this rationale.

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54 Levinsohn, "Testing the Imports-as-Market-Discipline Hypothesis. " See also "Symposium on Antitrust Law and the Internationalization of Markets," in the *Chicago-Kent Law Review*, Vol. 64 (1988), for a discussion on how the internalization of markets and of competition affect antitrust law and antitrust policy.

55 This argument is explained in more detail in A.E. Rodriguez and Mark D. Williams, "The Effectiveness of Proposed Antitrust Programs for Developing Countries," *North Carolina Journal of International Law and Commercial Regulation,* Vol. 19 (1994) pp. 209-232.

In addition, the administrative efficiencies associated with internationalization of antitrust are questionable. For instance, antitrust methodology (e.g., defining product markets) can be largely satisfied with domestically available information. Most current antitrust enforcement focuses on practices that are deemed likely to reduce domestic, but not foreign, consumer welfare. In these matters, it is unclear how information gathered by another country would be useful in determining the scope and breadth of product and geographic markets or other factors relating to the likelihood of anticompetitive behavior limited to one country.

The best model for constructing antitrust harmonization agreements is also debatable. The paths to harmonization advocated by proponents range from pursuing modest bilateral cooperation in enforcement to establishing binding global competition codes. Finally, actions by a foreign antitrust agency could easily be viewed as unwanted influence on domestic matters.

What does Mozambique stand to gain from an international competition policy? Mozambique can reap the supposed benefits of such a policy through less costly instruments, such as trade policy and further deregulation and liberalization. Moreover, it is apparent that Mozambique does not yet have either the expertise or the capacity to negotiate effectively on the subject. Nonetheless, Mozambique needs to monitor discussions about international competition policy so that it will be able to prepare for possible negotiations in the near future.

5. Optimal Competition Policy for Mozambique

The main threats to competition in Mozambique—rent-seeking and non-tariff barriers—are not amenable to the antitrust enforcement component of competition policy. Antitrust law is powerless against legal lobbying by the private sector to solicit government-sponsored protection. In addition, administering antitrust enforcement protocols is exceedingly complex. Coupled with the possibility of an enforcing agency falling prey to undue influence, complex or improper administration is likely to chill novel business practices, create additional costs for investment, and establish more barriers on entry. At this time, the losses would be much more significant than any potential gains in consumer welfare.

Mozambique's present state of economic transition stands to gain considerably from encouraging market entry and investment. Accordingly, its competition policy should focus on (1) forcefully challenging government's anticompetitive behavior and (2) horizontal proscriptions, especially price-fixing. Regulations should rely on a *per se* methodology, narrowly defined to include only agreements on price.

The competition policy should aim to remove barriers to increased trade and to move the country's economy toward integration into the world economy. Cartels and monopolies cannot coexist with trade and imports. But even a nationwide price-fixing cartel cannot undermine trade and integration without government barriers. Unless accompanied by a boycott against imports, high cartel price simply trigger a flow of trade as consumers search for lower priced and higher quality products and services.

Why focus on cartels? First, in contrast to some non-price horizontal practices and nearly all vertical practices, price-fixing has no efficiency benefits. Second, administering a highly focused law is easier, more effective, and less expensive than managing the full array of antitrust procedures and ancillary infrastructure. Mozambique has little tradition in antitrust, a limited jurisprudence in competition, a limited capacity to administer laws, little or no confidence in the legal system, no natural constituency for a competition agency, constrained budgets, little experience with competition, limited human capital. Other similar institutional constraints abound.

Competition authorities often challenge other anticompetitive behavior, such as non-price horizontal agreements, vertical restraints, and price discrimination schemes, if the firms or coordinated groups of firms with monopoly power engaging in such behavior do so without efficiency justifications. However, analyses of such behavior are sure to be complex and require significant enforcement resources. Preventing such behavior will offer little benefit so it should not be an enforcement priority. Any Mozambican initiative should delay considering instruments for blocking non-price horizontal agreements, vertical restraints, and price discrimination until later.

Last, if a competition agency is to be constituted, it should be an independent authority with sufficient economic and legal expertise and industry know-how to use consumer welfare-based methodology to enforce competition laws and to oppose non-tariff barriers.

Mozambique should continue to build on the interest expressed in competition policy by first assembling a technical unit or working group in the Ministry of Industry and Trade (MIC). The group could be constituted by some of the participants from competition policy workshops (Appendix B). The group will provide continuity for the following tasks and for those persuaded as to the merits of a competition agency and a competition policy. The working group will serve as a focal point for garnering support, funding, assistance, training, education, and constituency building. Its recommended tasks are as follows:

- ***Draft a competition law proscribing naked cartels, prohibiting price fixing, and empowering a competition agency to review proposed bill or statute within the government.*** Naked cartels are associations of competitors assembled solely to capture monopoly gains with no countervailing efficiencies. The prohibition and vigorous prosecution of horizontal price fixing is indispensable.
- ***Begin developing a competition policy.*** The working group should begin developing a competition policy focused on horizontal price-fixing proscriptions and challenges to government anticompetitive practices.
- ***Examine alternatives to antitrust law enforcement.*** Civil enforcement (private cause of action) of competition law is an obvious candidate.[56]

[56] On the one hand, it is argued that limits on the government's antitrust resources require a policy to allow civil enforcement of the law. On the other hand, private litigants are likely to use antitrust laws to protect themselves, not competition. Unless the court system is well developed and experienced, it may not be advisable to allow for civil suits. A *private cause of action* is the recourse that the law provides for an individual firm to avail itself of the competition law and take action against another firm for violations of antitrust law. Because it pushes into the private sector the administrative burden of enforcing the law, a private cause of action would allow for more effective administration of the law. A private cause of action would create stakeholders. Parties to the lawsuit would retain attorneys and economic and other experts resulting in possible compensation to these advisors. A private cause of action would create antitrust expertise outside of

The recommended competition agency should

- ***Be independent.*** Ultimately, the competition agency should be constituted as an independent agency staffed by well-trained attorneys and economists. It should be as independent as possible in order to enjoy some immunity from pedestrian political influences and so it can gain confidence and speak with authority and professionalism.
- ***Gradually undertake more enforcement.*** Additional proscriptions of business practices, vertical or horizontal, should be added to the agency's mission as it matures, trains its staff, forges jurisprudence, and builds a constituency. A young agency should not be saddled with an expensive array of law enforcement practices and procedures.
- ***Embrace advocacy functions once the economy matures.*** The agency could go beyond attacking price-fixing to advocating competition, primarily by challenging governmental anticompetitive power. Such advocacy functions should be enhanced to go beyond those typically allowed western agencies. As a matter of policy, the competition agency should aim to limit and abridge the ability of government to erect or preserve anticompetitive practices.

Ensuring the viability of the competition regime will require considerable expenditure. Given current Mozambique's budgetary constraints and priorities it is unlikely that the government will fund any preliminary steps. Thus, the working group should attempt to solicit funds from various multilateral agencies interested in supporting efforts related to competition policy. The working group should also monitor discussions about international competition policy so that Mozambique will be able to prepare for possible negotiations in the near future.

the government. However, private causes of action appear to be inconsistent with Mozambique's present legal process.

Appendix A. Competition Policy Overview

In most western jurisdictions the primary role of competition policy is to proscribe and curtail restrictive private sector practices by means of antitrust laws. Competition policy also has advocacy tools for challenging government's anticompetitive behavior. As discussed in the main report, Mozambique should take some preliminary steps before adopting a competition law, and when it does adopt a competition program it should proscribe naked cartels but emphasize competition advocacy. The recommended emphasis reflects not only Mozambique's salient problems but a number of other current limitations. This appendix discusses the law enforcement and advocacy functions of competition policy order to show the complexity of administering and enforcing antitrust law.

Advocacy—Challenging Government's Anticompetitive Practices

One of the most underappreciated aspects of a competition policy is advocacy of competition for the benefit of consumers.[57] Although some regulations are necessary in the modern world, it is naive to expect them to be drafted without attracting advocates for special interests. To obtain advantages for its constituents, special interest groups attempt to influence regulations, solicit protection, and impede the removal of non-tariff barriers. This often results in regulations that deter, handicap, or delay market entry.[58] Even well-intentioned regulatory processes may end up instituting government directives or preventing the removal of regulations that block or delay entry. Countless other regulatory processes do not offer net public benefits.

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[57] See, for example, R. Shyam Khemani and Andre Barsony, eds., "Competition Advocacy," in *A Framework for the Design and Implementation of Competition Law and Policy,* World Bank and OECD, 1998.

[58] Peltzman. 1976. Toward a More General Theory of Regulation. *Journal of Law & Economics*, Volume 19. Posner, Richard. 1971. Taxation by Regulation. *Bell Journal of Economics*, Volume 2. Posner. 1974. Theories of Economic Regulation. *Bell Journal of Economics*. Stigler, George. 1971. The Theory of Economic Regulation. *Bell Journal of Economics Volume*, Volume 2, at 3.

The purpose of competition advocacy is to analyze and spotlight regulations' costs and implications. Presumably, information on tradeoffs results in better-informed decision-making that can steer the economy toward efficient markets in which consumers benefit. Most competition agencies have advocacy programs. Agency economists and attorneys prepare comments on policies proposed by other government agencies, bringing to bear their expertise in antitrust matters. The competition agencies also ensure that the public is aware of the consequences of proposed policies and actions on competition.

Because competition policy is new to the Government of Mozambique, it has no historical natural constituency or group that can provide a strong base of political support. Cultivating stakeholders will be almost indispensable for the success of a competition agency in Mozambique.

Consumers are a natural constituency because they can benefit directly from competition policy. A competition agency should strive to tell consumers specifically how they benefit, implicitly appealing for consumer support of the agency's mission. Benefits to consumers are distributed across all consumers whereas the direct costs of involvement in any political support of the agency are high. This favors political inaction on the part of consumers. But there appears to be an organized consumer collective in Mozambique with a clear understanding of competition's advantages that can overcome this "free rider" problem. A consumer protection bill sponsored by a Mozambican consumer's association is now before the parliament. Competition policy and consumer protection share natural affinities; in some jurisdictions the competition agency administers both sets of laws. Pursuing both competition policy and consumer protection at the same time should be considered. Conflating competition policy with the consumer protection initiative will likely expedite a political base among consumers.

Consumer organizations understandably focus on fighting legislation and initiatives that will affect consumers' pocketbooks. The concept of allocative efficiency, or getting prices right, is unappealing to most of us. Allocative efficiency implies the economically efficient price, which may or may not be the lowest price. In opposing price increases consumer groups are naturally intent on avoiding paying more for goods and services.

The business community presents a twofold challenge. On the one hand, the professional enforcement of competition laws and solid competition advocacy may command the respect and attention of the business community. The agency's motives cannot be impugned if its law enforcement is professional, impartial, and unbiased, and if its methods and operations are transparent. On the other hand, law enforcement is adversarial by its very nature. No one welcomes the possibility of being investigated by any agency. A clear commitment to professionalism and transparency may enable the agency to overcome businesses' dislike of government activism.

Other natural supporters may be the academic community and the bar. Connections to academia and the bar are likely to occur as the agency draws on the expertise of academic experts in economics and law and the talents of established practitioners. Several professors at the Eduardo Mondlane School of Law have a keen interest in competition policy. An explicit commitment to continuing and enhancing these links with the law school is clearly beneficial. Academic commentary and criticism can only enrich the process. In addition, given the relative scarcity of competition-related jurisprudence in Mozambique's civil code tradition, the attention of the legal community can hasten the development of relevant commentary.

It seems logical to consider the press a natural ally of a competition agency. This assumption may be incorrect. The press, like consumers' groups, may be more concerned about equity issues than allocative efficiency. If anything, the popular press may articulate consumer's distributional concerns and become an antagonist rather than an ally of the agency. The business press, on the other hand, may be more favorably disposed.

Antitrust Policies

Administering an antitrust enforcement program is complex for various reasons. For instance, most practices examined by competition authorities often entail curtailing competition. This requires understanding alternatives in order to determine the net effects of a "competitive" practice. Conducting these examinations requires specialized knowledge of industrial economics and law, but such specialization is usually not available in transition economies. The following overview conveys some of the complexity of evaluating most proscribed business practices. Antitrust practice naturally evolves to reflect developments in economics and jurisprudence.

RELEVANT MARKETS

Often, market definition is not only the first but also the crucial step in antitrust enforcement. Economic markets are not necessarily antitrust markets, nor do political boundaries necessarily define antitrust markets. Market definition consists of product definition and geographic definition. Product definition refers to the attributes (i.e., size, quality, function). of the products that comprise the antitrust market and that are subject to a potential increase in price. Once the product market is defined, the geographic area over which the product is traded is defined. The geographic market could range from the area surrounding a town to the entire world. It is the area in which the product's price can be raised. Once the geographic market is defined, the sufficiency of competition from other products and other geographic areas to prevent independent pricing is checked. If that competition is sufficient to prevent independent pricing, a broader product market must be considered.

An antitrust market must be defined with respect to consumers (demand-side) and producers (supply-side). From a demand perspective, the objective and associated qualitative questions concern the magnitude of a customer's response to a price increase, embodying what economists refer to as the *elasticity* and *cross-price elasticity* of substitution. If enough customers can choose other products, the ability of the producer to price independently is limited and the product does not represent an antitrust market. In other words, the demand side of the market encompasses consumers' realistic alternatives to the product. Theoretically, these alternatives can be measured by the elasticity of demand— the ratio of the percentage change in quantity demanded to the percentage change in price. (Data limitations usually preclude quantifying these parameters.)

The supply response is equally important. If other firms can quickly and profitably convert sufficient capacity to produce the good in question such that the product cannot be priced independently of the alternative products, the good in question does not comprise an antitrust market. This means that the supply response includes the viable reactions of new competitors striving to serve consumers. The elasticity of the supply response is the ratio of the percentage change in quantity produced by other firms to the percentage change in price of the product. A proposed market does not represent a valid antitrust market unless firms have sufficient flexibility to set price considering both demand and supply side factors simultaneously.

Data on past behavior is the best evidence on which to define a market. For example, if manufacturers have shifted productive capacity between two products in the past, it is likely that a relative price increase will induce a large shift. Thus, a narrow market cannot be substantiated. On the other hand, if prices in one geographic region have been maintained at a higher level than other areas following a market shock (i.e., increase in demand), then a narrow geographic market appears to be supported. Given sufficient historical data, it should be possible to identify the relevant market; again, the data may not be readily available.

Antitrust authorities in many jurisdictions rely on a qualitative, hypothetical price test to structure the investigation when strong historical evidence is not available. This approach breaks market definition into stages, focusing first on demand-side substitution and then on supply-side substitution. Antitrust analysis and market definition in particular must be forward looking. Thus, the approach asks if a firm (a hypothetical monopolist) that was the only present and future seller of the product in question would find it profitable to impose a "small, but significant and nontransitory" price increase. If the price increase is profitable, the potential market is accepted from the demand side and if the price increase is unprofitable, the analysis is repeated with a broader proposed market.

Once a proposed demand-side market is identified, supply-side substitution is evaluated. Any firm that could easily and economically manufacture and sell the product in question within a short period of time is considered in the market. The approach is applied to both the product and geographic market questions to define an antitrust market for analysis.

The hypothetical approach to market definition must be applied carefully. The most obvious pitfall involves using a price test in differentiated product markets where most competition occurs on non-price dimensions.[59] Although the approach is still valid, gathering relevant information is difficult because customers are not used to making price-based comparisons. Price movements in Mozambique are keenly influenced by the impact of movements in the South African Rand and by domestic inflation. Analysts need to carefully parse any likely influences that are not related to the examined anticompetitive behavior.

Institutional conditions that preclude substitution in the short run present another complication. For example, many manufacturing processes require costly qualifications for their inputs. Once an input is qualified, the manufacturer is unlikely to switch to any other input until the next product reformulation. By asking for the hypothetical response to a price increase at the next reformulation, the analyst would solicit more relevant information. Recognizing these particularities requires painstaking understanding of the process and nature of competition, the structure of contracts, the importance of relationships, and other such features within the industry being examined.

A third problem involves the qualitative nature of the data on product market substitution.[60] Both demand- and supply-side analyses require speculating on how consumers or producers would respond to a price increase. However, it is difficult to suggest an alternative technique if historical data do not exist. At best, one can try to quantify performance differences between related products and show how a 5 percent price change affects the dynamics of product choice. The evidence must show that a significant level of sales will not be lost to other products in response to a price increase to support a narrow market definition.[61] Also, on the supply side, the exclusion of a potential supplier from the market will only shift the analysis of its impact to the entry section.

A fourth and more elementary problem, unique to developing countries, is that a significant part of the market may consist of the informal sector.[62] Identifying market participants in informal sectors will be a significant problem for antitrust authorities attempting to assess the competitive environment. The mere existence of an informal sector, operating at the margin of the law, suggests government-imposed barriers to entry. The informal sector is likely to exert considerable competitive pressure and price discipline in the local economy. As an advocate

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[59]Although considerations other than price can be important in geographic market analysis, transportation costs tend to quantify most of the difference between locations.

[60]For geographic market analysis, the transportation costs into the region can be used to determine if a small price increase makes distant sellers competitive.

[61]Morris and Mosteller. 1991. Defining Markets for Merger Analysis. *Antitrust Bulletin*, Volume 36.

[62]See Rodrigues De Abreu, Silvina E. Antonio Pinto de Abreu, "Sector Informal en Mocambique: Ama Abordagem Monetaria," Banco de Mocambique, Staff Paper No. 5 (Setembro 1996); Lindauer, "Parallel, Fragmented, or Black? Defining Market Structure in Developing Economies," *World Development*, Volume 17 (1989); Jones & Roemer, Editors' Introduction: "Modeling and Measuring Parallel Markets in Developing Countries," *World Development*, Volume 17 (1989); Tokman, "Policies for a Heterogeneous Informal Sector in Latin America," *World Development*, Volume 17 (1989).

for competition in general, a competition agency can advance arguments facilitating removal of such barriers.

PRICE FIXING

Perhaps the core antitrust proscription is to insist that independent firms actually compete in the marketplace. The father of modern economics, Adam Smith wrote that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise price."[63] Such agreements are very unstable but while in force offer no benefits to society. Instead, naked price fixing agreements create market distortions by shifting resources out of the victimized industry and into other less productive areas. Thus, the social costs of higher prices are sufficient to justify antitrust challenge on agreements whose only purpose is to raise price.

To be effective, price fixing agreements must raise price and maintain it above the competitive level.[64] Raising prices is simple when market structure allows collusive firms to set price; it is more difficult if the customer sets price. Consider dealer networks or distributors acting as ringleaders: the cartel ask customers for price increases and then boycott uncooperative customers to force them to set higher prices.

Maintaining a price increase is more difficult when the cartel members post price because each competitor can offer secret discounts and undercut the agreement. To deter cheating on an agreement, collusive firms may have to allocate customers or geographic areas to particular firms. Or the cartel may explicitly agree on a bid rotation or allocation scheme so the price fixing agreement may define a particular firm to service each customer. Any of these actions would create a number of monopoly situations and eliminate the ability of other firms to secretly undercut the price. A cartel is easier to establish if the industry is concentrated, the product homogeneous, and the demand curve inelastic.[65]

In many jurisdictions, naked price fixing is considered a *per-se* violation of the law regardless of the market power of the parties, the reasonableness of the price, or the effectiveness of the agreement. However, the definition of price fixing is limited to agreements on price, group boycotts over price, and agreements that divide markets. Horizontal competitors can enter into agreements that may enhance the performance of the market. These agreements are typically judged by a less stringent standard and should be excluded from the purview of an incipient agency in Mozambique.

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[63]Smith, Adam. *The Wealth of Nations*, p. 128.

[64]For a discussion of price fixing in government procurement, see Malcolm Coate's "Techniques for Protecting Against Collusion Sealed Bid Markets," in *Antitrust Bulletin*, Volume 30 (1985), p. 897. Analysis of pricing patterns will be difficult in many developing countries because inflation and currency movements may blur collusive price increases. Standard investigational techniques for determining if an agreement was reached should still apply, however.

[65]Stigler, George. 1964. A Theory of Oligopoly. *Journal of Political Economy.* Volume 72.

Under the antitrust laws of the European Union, price fixing is also illegal.[66] Prosecution under Article 85 only requires proof that suppliers have agreed to fix prices, although it is possible for firms to apply for exemptions.[67] In contrast, laws in Spain, Sweden, and the United Kingdom judge the legality of horizontal price fixing under the rule-of-reason standard.[68] The WTO competition policy panels recommend a similar *per-se* proscription of price-fixing agreements.[69]

In Mozambique, price fixing should be an enforcement priority to assist creation of free markets after years of government-established prices. If the new competitive environment squeezes profit margins, firms may attempt to return to collusive pricing instead of innovating to reduce costs. To further reduce the likelihood of price fixing, the government should employ a *per-se* analysis instead of a rule-of-reason approach, because the per-se standard increases certainty and economizes on enforcement resources. Enforcement should be focused on obtaining evidence on agreements to set price, boycott customers, or allocate business to specific suppliers. Public education can aid enforcement by making citizens aware of how markets should work. Employees and rivals may also be able to provide useful information. Finally, the enforcement agency can monitor markets for irregularities in price movements or sales patterns. Industries where government price fixing has been the norm should perhaps be afforded a transition period to adapt to the new environment and this transition should be reflected in the penalty scheme. Nonetheless, policies that promote entry tend to undermine cartel pricing because entrants are less likely to abide by collusive agreements.

MONOPOLIZATION BY PREDATION

In addition to taking action against price fixing, antitrust policy is designed to prevent a single firm from obtaining or enhancing monopoly power. One must, however, distinguish a firm obtaining monopoly position through superior efficiency from a firm abusing the competitive process (predation) and making it impossible for rivals to compete. Predation can be defined as

> a firm's deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing except for the expectation either that (a) rivals will be driven from the market, leaving the predator with the market power sufficient to command monopoly profits, or (b) rivals will be

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[66]Treaty of Rome, European Economic Community, Mar. 25, 1957, art. 85, 1973 Gr. Brit. T.S. No.1 (Cmd. 5179-II) (official English translation) [hereinafter Treaty of Rome].

[67]Boner, Roger A. and Reginald Krueger. 1991. The Basics of Antitrust Policy: A Review of Ten Nations and the European Communities. World Bank Technical Paper No 160, p. 37. Korah, Valentine. 1990. *An Introductory Guide to EEC Competition Law and Practice,* at 119. Exemptions are rarely granted for price fixing agreements.

[68] Boner and Krueger, *supra*, note 67, p. 51.

[69]WTO. 2003. *World Trade Report.*

> chastened sufficiently to abandon competitive behavior the predator finds inconvenient or threatening.[70]

Given that predatory practices imply subsequent monopoly behavior, it is detrimental to consumer welfare.

Examples of predation include predatory pricing, non-price predation, and misuse of government process. Predatory pricing occurs when a firm sells below cost to drive out rivals and then later raise price to the monopoly level.[71] Such discounting is only profitable if rivals will not reenter the market. Thus, some form of entry barrier must exist to ensure that rivals do not quickly re-appear. Typically, government-sponsored entry barriers are responsible for impeding price-disciplining entry. Predation may also involve non-price means, such as innovation and promotion. Although such predation is likely to be cheaper than price predation, no simple cost rule to differentiate predation from competition exists. Again, the cost of predation must be recouped for the strategy to be profitable.[72] Misuse of government process (e.g., abuse of courts and government regulations) is a particularly effective way to delay or stifle competition because the predator is likely to incur only very low costs.[73] For example, an incumbent monopolist, fearing potential loss of business, may intervene in front of a regulatory authority or file a lawsuit to delay a new entrant. Such activity could be very profitable if the incumbent preserves its market position for a few more years.

For the most part, courts look (or ought to look) at two necessary conditions for predation: investment in securing a monopoly position and recoupment of the costs of this investment. For price predation, the evidence must show that the firm is selling at a price below average variable cost. Other forms of predation are more complicated, but the actions should appear unprofitable if the market remained competitive. Once predatory conduct is identified, it is necessary to find evidence to show that the costs can be recouped. The U.S. Supreme Court has ruled that "the success of any predatory scheme depends on maintaining monopoly power for long enough to recoup the predator's losses and to harvest some additional gain."[74] If the alleged predatory investment cannot be recouped, one simply infers that the activity

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[70] Bork, Robert. 1978. *The Antitrust Paradox: A Policy at War with Itself,* p. 68.
[71] Posner, Richard A. 1976. *Antitrust Law: An Economic Perspective*, p. 285.
[72] Another form of non-price predation is "raising rivals' costs." The predator is thought to undertake actions to directly raise its competitors' costs and hence the market price. It is not necessary to drive the rival from the market. Although it is impossible to prove that such predation cannot occur, a complete analysis shows that it would be extremely costly and hence quite rare. For a detailed discussion of the concept, see, Krattenmaker and Salop, "Anticompetitive Exclusion: Raising Rival's Costs to Achieve Power over Price," *Yale Law Journal*, Volume 96 (1986). For a discussion of the limitations of the concept, see, Brennan, Understanding Rival's Costs, *Antitrust Bulletin,* Volume 33 (1986). See also, Malcolm Coate and A. Kleit, "Exclusion, Collusion and Confusion: The Limits of Raising Rival's Costs, " Federal Trade Commission Working Paper No. 179, 1990.
[73] Bork, note 70, p. 158.
[74] *Matsushita Elec. Industrial Co. v. Zenith Radio, 475 U.S. 589* (1985).

was competitive.[75] A final point focuses on intent. To some extent, evidence on intent can supplement evidence of recoupment.[76]

Under the antitrust laws of the EU, predation is viewed as an abuse of a dominant position.[77] The evidence required for a predation case may be much weaker than in other jurisdictions, so the policy has been criticized as protecting competitors, not competition.[78] For example, the EU Court of Justice found Akzo guilty of abusing its dominant position by setting low prices in order to eliminate a competitor.[79] Given the intent to disadvantage a competitor, prices above average costs but below total costs could be illegal. Other cases have suggested that the predator has a duty to deal with its vertically related competitors even if they attempt to enter its market.[80] By refusing to sell, the predator would be able to defeat the attempt at entry. However, the dominance concept does not always require the ability to exercise market power and recoup the investment in predation.[81]

An active predation policy must be very careful to focus only on exclusionary tactics of would-be monopolists or parastatals and not on interactions associated with robust competition. This is particularly important in Mozambique, where small firms are likely to accuse large rivals of predation as the large firms introduce new competitive tactics in response to the shift to a market economy. Given that monopolization by predatory strategies is unilateral, it will be difficult to distinguish such strategies from competition. Legitimate aggressive long-term investment at the expense of short-term gains ultimately may lead to the outperformance and eventual demise of competitors; it is predatory only when its sole economic justification depends on the returns from the elimination of competitors. One approach to policy would implement a set of analytical screens to eliminate the numerous cases were predation cannot explain market behavior.[82] *The optimal policy for a transition economy like Mozambique is to refrain altogether from challenging predation*.

[75]Price can easily fall below cost if a small firm is investing to build share or a firm fails in the marketplace and is managing an orderly exit.

[76]It would be inappropriate to use evidence of intent as a substitute for evidence of recoupment. As Easterbrook wrote, "when recoupment is so unlikely, antitrust inquiry as to the intent of the parties is not justified. Only if the market structure makes recoupment feasible need a court inquire into the relation between price and cost." See *A.A. Poultry Farms, Inc. v. Rose Acres Farms, Inc., 881 F.2d 1396, 1401* (7th Cir. 1989).

[77]Article 86 of the Treaty of Rome deals with abuse of a dominant position and predation.

[78]Boner and Krueger, note 67, p. 63.

[79]Case 62/86, *AKZO Chemie BV & Anor v. E.C. Commission* [July 25, 1991] COMMON MKT. REP. (CCH) ¶ 686 (1991).

[80]See BBI/ Boosey & Hawkes 1987 O. J. (L 286) 36; Joined Cases 6 & 7/73, *Commercial Solvents* et al. *v. E.C. Commission* [1974] E. C. R. 223, COMMON MKT REP. (CCH) ¶ 8209 (1974); and British Sugar 1988 O. J. (L 284) 41. These cases generally prohibit actions that the predator took to maintain dominance in the face of entry from a vertically related market.

[81] Boner and Krueger, note 67, p. 66.

[82]For a more general approach, see, Frank Easterbrook's "Predatory Strategies and Counterstrategies," *University of Chicago Law Review*, Volume 48 (1981). The article considers the nature and potential for success of a number of possible predatory strategies and concludes that each strategy, although superficially possible, is unlikely to be profitable given the risks faced by the predator and the responses available to rivals. See also, Joskow and Klevoric, "A Framework for Analyzing Predatory Pricing Policy," *Yale Law Journal*, Volume 89 (1979), which presents conditions that should be met in a predation case.

MERGER ANALYSIS

In barring cartels, price fixing, and other anticompetitive horizontal practices, antitrust enforcement prevents firms from coordinating their actions to act as a monopolist. Thus, it is reasonable for antitrust policy to prevent firms from undertaking horizontal mergers that are likely to generate similar anticompetitive effects.

An antimonopoly policy is designed to prevent a firm from obtaining a monopoly or dominant position by acquiring its rivals in markets protected by barriers to entry. Two types of barriers are generally considered. The first type is a cost borne by the entrant but not by existing competitors.[83] These barriers allow incumbents to maintain prices above the competitive level for the indefinite future and are often traceable to a government policy. The second type of barrier is based on consideration of the time required for profitable entry.[84] If entry takes such a long time that incumbents could profitably raise price in the short run and tolerate entry in the long run, a competitive market structure is required to preserve competition. The U.S. approach, for example, relies on a two-year standard for entry, so mergers are not challenged if entry could profitably deter or defeat an anticompetitive price increase within two years. Because mergers often promise efficiency gains and improved competition, the two-year entry horizon adopted in the United States may be extended in Mozambique and transition economies in general to avoid prohibiting mergers that may be generally pro-competitive.

Efficiencies represent the key remaining issue and one of considerable importance in capital-starved transition economies. By combining the resources of two firms, horizontal mergers may allow the joint firm to produce more output with any given input level. Examples of efficiencies include lower transportation costs, economies of scale, and overhead cost savings. These efficiencies must be balanced against anticompetitive effects to define the optimal enforcement policy. Williamson observed that even small efficiency gains can outweigh the deadweight loss associated with large monopoly price increases.[85] This approach has been criticized for ignoring the higher price paid by consumers. If monopolists invest resources to raise price, the total value of the monopoly may be lost to society.[86] A policy that considers the price effects of mergers would require large efficiencies to offset monopoly pricing. An agency could also incorporate the likelihood of both efficiencies and anticompetitive effects in the analysis. Thus, likely efficiencies could outweigh relatively unlikely anticompetitive effects. A more specialized approach to efficiencies can be found in a failing firm policy.[87] If a

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[83]Stigler, note 58.
[84]Posner, *Antitrust Law*, note 71.
[85]Williamson, Oliver. 1968. Economies as an Antitrust Defense: The Welfare Tradeoffs. *American Economic Review*, Volume 58.
[86]Posner, Richard A. 1975. The Social Costs of Monopoly and Regulation. *Journal of Political Economy*, Volume 83.
[87]Kwoka and Warren-Boulton. 1986. Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis. *Antitrust Bulletin*, Volume 31.

merger partner can save a business that would otherwise exit the market, the implicit reduction in costs would benefit society.

In Mozambique, consistent with its focus on trade-led growth, merger enforcement may be unnecessary, certainly in the immediate future. Nonetheless, if present, merger enforcement policy should make allowances for scale and other efficiencies. As the economy reorganizes after years of state oversight, it is likely that the current market structure will prove inefficient and firms will desire to merge to better compete under the new conditions. In general, an enforcement focus on mergers to monopoly should allow firms to capture efficiencies.[88] Under even a monopoly-based merger policy, barriers to entry would be required for the merger to be of concern. It is possible that efficiency could outweigh monopoly concerns in industries with potential for international competition, while a tighter anti-monopoly policy would apply for local markets. By basing the choice of policy on the type of problem, the government can minimize enforcement costs.[89]

NON-PRICE HORIZONTAL RESTRAINTS

Non-price horizontal restraints involve agreements between direct competitors that limit a form of competitive behavior other than price. A few agreements, such as naked customer boycotts, may be directed at price, in which case they are considered a form of price fixing and proscribed. The competitive effects of other horizontal restraints can be evaluated with the rule-of-reason standard; such a standard balances the potential efficiencies and anticompetitive impacts of the policy in question.

Horizontal agreements are generally ancillary to some cooperative venture. If the product was not likely to exist without a horizontal agreement, the rule-of-reason standard generally would allow the agreement to ensure that society obtains the product. For example, music licensing requires firms such as nightclubs and radio stations to obtain a license to play copyrighted music.[90] If these firms had to deal with numerous composers, transactions costs could prevent the general use of many types of music. But if composers combine to issue blanket licenses, each user can obtain access to all the musical compositions. In effect, the joint licensing (a horizontal agreement) adds to consumer choice and can be considered pro-competitive.

In other markets, the choice is not as clear. A group of manufacturers wanting to offer a high quality product may agree on a set of restrictions for maintaining quality. Or a group of firms

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[88] Bork (1978, 222) suggests that leading firms with shares above 60-70 percent would raise monopoly concerns.

[89] Antitrust authorities often rely on a pre-merger screening system for large acquisitions to avoid problems associated with disentangling consummated transactions. In addition, screening ensures cooperation because the merger is not permitted until the review is complete. But costs associated with screening may deter efficient transactions. Thus, screening should be designed to minimize costs imposed on transactions, subject to the government's need for information.

[90] *Broadcast Music Inc. v. Columbia Broadcasting Systems, Inc., 441 U.S. 1 (1979).*

may set up a cooperative to purchase feedstocks at lower prices, but need to agree on a set of restrictions to ensure all members participate in the program.[91] In either case, the restrictions may also limit competition, so a rule-of-reason analysis would balance the efficiency and anticompetitive effects. In another example, a trade association may make rules that set minimum quality standards or limit advertising. A rule-of-reason analysis would first search for anticompetitive effects. If there are no anticompetitive effects present the analyst would search for market power. If the activity does not injure competition or create market power, no enforcement action is required. On the other hand, if either an adverse effect or market power is found, one must balance the anticompetitive effect with the efficiency benefits.

A third type of horizontal agreement involves an upstream or downstream boycott to disadvantage a horizontal competitor. Again, the analysis depends on whether the net impact of the agreement is pro- or anticompetitive. For example, a group of retailers may jointly threaten a manufacturer by refusing to carry its product if the manufacturer continues to sell through a rival distribution channel. If the retailers, acting together, can exclude the rival and transactions costs slow entry such that the exclusion results in higher (quality adjusted) consumer prices, one would find a violation if efficiencies did not offset the anticompetitive effect. On the other hand, if the retailers lack market power, they are unlikely to be able to affect price.

Non-price horizontal restraints should not represent an enforcement priority in Mozambique.[92] The benefits from an active proscription of these practices are likely to minimal in comparison to the returns from a direct attack on price fixing. Moreover, the costs associated with an active enforcement policy are likely to be high given the need to conduct rule-of-reason analyses to show that anticompetitive effects outweigh efficiency benefits. Finally, the beneficial effect of entry may offset anticompetitive effects before government action can affect the market. Thus, the optimal policy would appear to involve a limited number of horizontal restraint cases.

VERTICAL RESTRAINTS

In general, manufacturers use vertical restraints to control the behavior of distributors and retailers. Transaction costs generally preclude a manufacturer from integrating into the retail

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[91]See *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., 472 U. S. 284 (1985)*. The Court found that a cooperative could expel a member without committing a per-se antitrust offense as long as it did not have market power.

[92]Technology licensing is a type of non-price horizontal agreement where enforcement action is not justified under almost any circumstances. The innovating company (often foreign) may feel it is more efficient to license its technology to a domestic company to maximize returns. Although one could claim that the license is an agreement, it is really only a step in the exploitation of the patent or trade secret. Regulations against exclusive license agreements could force the innovating firm to enter the market itself (in a slower and less efficient manner) or forego participation in the local market entirely. Thus, overactive enforcement would injure domestic consumers. Of course, in some cases, the innovating firm would prefer to enter directly or form a joint venture with a local firm. Thus, policies to require licensing would also be inefficient.

sector, so a manufacturer must deal with independent distributors and retailers to sell its product.

In any market economy, trading requires both parties to incur transactions costs. Consumers incur search costs by gathering information about the quality and prices of products available in the market. Retailers incur costs as they deal with cash to finance transactions. In many market economies, manufacturers have found it more efficient to avoid the business of distribution by selling to the retail sector. Specialist retailers can economize on transaction costs by achieving economies of scale and investing in specialized knowledge.

Unless restrained, profit maximization may induce distributors or retailers to take actions that are not in the manufacturer's best interests. In effect, distributors and retailers may behave opportunistically and exploit opportunities for short-term profit. Manufacturers generally rely on vertical restrictions to preclude or at least reduce opportunistic behavior by retailers and distributors.

Vertical restrictions are described as either price or non-price. Resale price maintenance (RPM) is a price restriction in which the retailer agrees not to sell the manufacturer's product below a specified price. In general, such a restriction ensures that the retailer will provide the necessary service on the product, because the manufacturer is able to terminate any retailer that fails to perform. By guaranteeing the retailer a fixed margin on the sale of a product, the manufacturer creates a quasi-rent that is lost if the retailer behaves opportunistically.[93] Thus, the price premium bonds the performance of the retailer.

Non-price restraints also limit intra-brand competition, thereby indirectly establishing price premiums to bond performance.[94] These restraints restrict the territory or the customers available to a retailer. Hence, the retailer is less likely to behave opportunistically and undercut the manufacturer's suggested prices. In effect, non-price restraints function like price restraints.

In rare cases, vertical restraints may be anticompetitive. For example, if a few manufacturers form a cartel, they may institute RPM to ensure that retailers do not cause deviations from the collusive prices. To be effective, RPM would have to be employed by most, if not all, of the cartel participants. It is also possible for a retailer cartel to force a manufacturer to institute RPM to preserve a collusive price agreement on margins. However, in both these cases, the

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[93] Klein, Benjamin and Murphy. 1998. Vertical Restraints as Contract Enforcement Mechanisms. *Journal of Law & Economics*, Volume 31. For example, opportunism would include the failure to provide pre- or post-sale service.

[94] Another vertical restraint is exclusive distribution. Under this restraint, a manufacturer insists that a retailer not carry competitive products. In theory, such a restraint prevents the retailer from opportunistically using the product of one manufacturer to draw in customers and then sell the product of another manufacturer that carriers a higher retailer margin. As long as there is either a number of unconstrained retailers or easy entry into retailing, this practice cannot be anticompetitive.

RPM is a symptom of a horizontal problem and enforcement action could be taken against the horizontal agreement.

In some jurisdictions, RPM is *per-se* illegal. In the United States, however, the definition of vertical price agreement is narrowly interpreted: the manufacturer must almost enter into written contracts with retailers to violate the law.[95] Non-price vertical restrictions are now judged under a rule-of-reason standard.[96]

In general, vertical restraints are condemned as agreements among competitors under Article 85 of the Treaty of Rome.[97] This is particularly true of price agreements that are rarely exempted.[98] Vertical restraints also cause concern in the European antitrust tradition, when employed by a dominant firm (with dominance defined at relatively low share levels). For example, a number of cases involve a duty to deal with a vertically related firm.[99] In theory, dominant firms have the same efficiency incentives to employ vertical restraints as other firms, but the anticompetitive hypotheses do not apply if the dominant firm has unilateral market power. At best, the restrictions on vertical restraints facilitate entry by serving as a handicap for the dominant firm. Consumers would not appear to benefit from a policy that disadvantage large firms, forces price up, and induces entry by small inefficient rivals. Thus, it is hard to recommend dominance as a consideration for vertical antitrust policy.[100]

In conclusion, an optimal antitrust policy that considers enforcement costs and chilling effects should not focus on vertical restrictions.[101] Such a policy could be particularly important for a rapidly developing Mozambican economy in which historical business relationships do not exist, because many firms are relatively new entrants and do not have reputations. Thus, manufacturers are unable to rely on reputation and the careful selection of retailers to ensure an optimal distribution system. Instead, manufacturers may need to use vertical practices to control their downstream distribution systems.

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[95] *Business Electronic Corp. v. Sharp Electronics Corp., 485 U.S. 108 (1988).*

[96] *Continental T.V. Inc., v. GTE Sylvania, 433 U.S. 36 (1977).*

[97] See also Korah, note 67, p. 122. Korah notes that exclusivity and some territorial vertical restraints are exempt under 85(3); however, the EU does a poor job of distinguishing horizontal from vertical restraints. This suggests that vertical price restraints are unlikely to be exempted.

[98] Korah, note 67, p. 146.

[99] For example, in Case 22/78, *Hugin v. E.C. Commission, 1979 E.C.R. 1869, [1979] COMMON MKT. REP. (CCH) 8524*, the court found the firm dominant in spare parts for its own equipment and was likely to have a duty to deal. No action was taken, however, because the effects were limited to one country. In a number of other cases, the court ordered a firm to deal with or continue to deal with a vertically related entrant.

[100] Some dominance cases involve exclusive dealing in which the distributors are forced to refuse to deal with entrants. However, it would appear to be the predatory aspects of the case, not vertical aspect of the case which caused the most concern. See Case 50/89 *BPB Industries and British Gypsum v. E.C. Commission, 1989 O.J. (L 10) 50* sub judice. The Commission found that British Gypsum's distribution policies tended to force an exclusive distribution system and preclude entry into a market dominated by British Gypsum.

[101] Franchising agreements can be considered vertical, but do not raise antitrust concerns because of the efficiencies of franchising. The franchise system is defined by restraints that all franchisees agree to in order to assure consumers that the products offered by one franchisee are basically the same as products offered by another. Thus, one can obtain many of the efficiencies of a large firm, without incurring the costs associated with managing a large business.

One alternative to vertical restraints is vertical integration. Assuming large firms would choose a distribution system with vertical restraints, an active enforcement policy could force manufacturers to rely on less efficient integrated systems. Given that vertical integration requires higher capital expenditures, a tough vertical policy could slow industrial growth.

Even a vertical restraints policy limited to dominant firms is questionable. Given that dominant manufacturers are likely to be recently privatized or unprotected enterprises, it appears unreasonable to handicap their ability to compete against small efficiently configured entrants and importers by banning vertical restraints. Of course, it is still possible to take action against vertical restraints if the evidence shows the restraints played a role in price-fixing. However, this would be a horizontal, not a vertical case.

PRICE DISCRIMINATION

Price discrimination involves firms selling products to different customers at different quality-adjusted prices.[102] Discounting prices for marginal or more price-sensitive customers without discounting prices for core customers increases profitability. To be sure, if a firm has sufficient market power it may deter entry by offering discounts to customers likely to switch to an entrant. Price discrimination also involves firms offering discounts to specific customers. These discounts may be designed to pass on efficiencies to customers or to initiate or meet competition. A firm could target customers who can credibly threaten to deal with entrants. If the discounts deter entry, an incumbent, with market power, can earn monopoly profits from customers who lack alternatives. In theory, requiring a single price broadens the benefits of potential entry to the entire market. But this theory only applies to monopolistic or dominant firms facing a threat from entry. Active enforcement of regulations against price discrimination, like an active policy against predation, runs the risk of suppressing competition not monopolization.

Tying—monopolist conditioning of the sale of product A on the purchase of product B—is sophisticated price discrimination. At first glance, it would appear that tying allows the monopolist to increase revenues by forcing consumers to pay supracompetitive prices for product B. However, such a pricing policy would only reduce the price consumers are willing to pay for product A. In reality, tying may serve as a metering scheme to allow a manufacturer to price discriminate among customers. The manufacturer discounts the price of product A below the monopoly level, but requires consumers that use product A intensely to purchase large amounts of complementary input B and pay relatively high net prices. On the other hand, consumers that do not use product A intensely are able to purchase small amounts of product B and pay relatively low net prices. This approach to pricing increases

[102] An extreme form of price discrimination would be refusal to deal at any price. Such behavior could be a form of predation.

output as more consumers buy the "low-priced" product A and hence is pro-competitive. Alternatively, tying schemes may allow the manufacturer to economize on transactions costs.

In some jurisdictions some forms of price discrimination are *per-se* illegal, although limitations restrict the breadth of the regulations. In the United States, the Robinson-Patman law covers systematic price discrimination schemes that affect the price of a good (not a service) and injure rival competitors ineligible for the discount (therefore the good is not sold to end users).[103] Firms can escape liability if the discounts are designed to meet competition or create efficiencies. Occasional attempts at promotional pricing are not covered, while meeting competition and efficiency defenses are narrowly drawn. Competitive injury is generally inferred from systematic price discrimination,[104] although it is now possible to use evidence that breaks the link between the price differential and the lost profits to rebut the presumption of competitive injury.[105] Overall, the law tends to protect downstream competitors by ensuring all are on an equal footing in the long run. Tying is also considered *per-se* illegal. But the law only applies to firms with market power and then only when the tie has an adverse effect on competition in the victimized market.[106] Therefore, most firms would be able to use tying schemes.

European antitrust considers price discrimination and tying per se illegal when employed by dominant firms.[107] Of particular concern are schemes that base price discrimination on national boundaries within the EU.[108] However, discrimination appears legal to meet competition from other suppliers.

Price discrimination policies should be narrowly drawn in Mozambique if at all. *Preferably, price discrimination legislation should be avoided given the lack of experience with market economies.* Competition often occurs as firms price discriminate and offer selected customers price discounts; other firms respond and prices fall. An active price discrimination policy could deter this competition before it even starts, as firms either use the government policy as an excuse not to compete or are deterred from competition by respect for the law.

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[103] Bork, note 70, Chapter 20.
[104] *F.T.C. v. Morton Salt Co., 334 U.S. 37 (1948).*
[105] *Boise Cascade Corp. v. F.T.C., 837 F. 2d. 1127 (D.C. Cir. 1988).*
[106] *Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U. S. 2 (1984).*
[107] EEC Article 86, note 96. For example, in the *Hilti v. E.C. Commission, 1988 O.J. (L 65) 19*, sub judice (Case 98/88), the court ruled that Hilti tied the sale of cartridge strips for its nail gun with the sale of nails, thereby preventing competition for the nails. Boner and Krueger, note 67, at 62-63.
[108] Case 27/76 *United Brands v. E.C. Commission, 1978 E.C.R. 207, [1978] COMMON MKT. REP. (CCH) ¶ 8429* exemplifies the classic price discrimination case involving national boundaries. United Brands had a policy of selling bananas for different prices in different EEC countries. The court held that the discriminatory pricing was an obstacle to trade.

Appendix B. Competition Policy Workshop Participants

Competition Policy Workshop Participants

NOME	INSTITUIÇÃO	CARGO	TELEFONE FIXO	TELEMÓVEL	E-MAIL
Hélder Magaia	MIC / DRI	Economista Júnior	35 26 02	082 - 83 73 44	hmagaia@mic.gov.mz
Kpanguene	Sobec		32 00 25	082 - 30 37 29	panguene@tropical.co.mz
Mirela Chirindza	FADUEM			082 - 44 88 00	mimirel@hotmail.com
Sarah Büchner	FAO / UEM	Technical Assistance		082 - 49 29 86	sarahbuchner@yahoo.co.mz
Amílcar Arone	GEST / MPF	Economista	49 26 25	082 - 49 26 25	amilcararone@hotmail.com
Adérito Notiço	FD / UEM			082 - 28 89 33	aderito2092@yahoo.com
Francisco Langa	MIC / DNC	Technition	30 06 64	082 - 69 33 07	flanga@mic.gov.mz
Francisco Carrilho	SIRIUS	Director	42 87 52	082 - 30 38 90	sirius@teledata.mz
João Macaringue	MIC / GASP	Jurista	32 66 23	082 - 30 70 31	jmacaringue@mic.gov.mz
Cardoso A.M.Comboio	MIC / DRI	Jurista	35 26 25	082 - 28 28 91	ccomboio@mic.gov.mz
Arlindo Sumbana	AUSTRAL / CTA	Consultor	32 27 80	082 - 30 10 83	asumbana@austral.co.mz
Páscoa Thamba	Rural Consultant / CTA	Consultora	30 48 55	082 - 40 45 32	pthemba@hotmail.com
Sérgio Chitará	CTA	Director Executivo	31 13 34 / 5	082 - 30 29 28	schitara@cta.org.mz
Maria Hortense Uetela	MIC / DRI	Jurista	35 26 02	082 - 30 98 87	huetela@mic.gov.mz
Manuel Congolo	CJE	Assistente de Advogado	31 41 29	082 - 42 31 41	viriatot@zebra,uem.mz