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‘Natural monopolies’ – the role of competition authorities

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A ‘natural monopoly’ is generally understood to occur in a market in which scale considerations permit of only a single efficient provider. As the pre-amble for this session suggests these are generally confined to providers of basic goods and services – telecommunications, water, certain transport services and electricity transmission. We all know that major technological developments call into question how many of these monopolies remain ‘natural’ in this strict sense. I won’t get into this complex area. My starting point is simply that while these goods and services were generally provided by publicly owned SOEs, subsidised through the fiscus, many, probably most, developing and transition economies have, because of the strain on the fiscus and the poor quality of the service provided, moved decisively towards a model of ownership in which these enterprises have been ‘corporatised’ either by establishing corporations owned by the treasury but excluded from fiscal subsidy or corporations in which both the state and private investors share in ownership, or they have been fully privatised.

While this may provide quick relief to the fiscus, it frequently provides little direct comfort to the consuming citizenry, extravagant promises of efficient and cheap services notwithstanding. The corporatised entity often remains a licensed monopoly and even when the government commits itself to competition through licensing new entrants, the erstwhile SOE invariably enjoys any number of massive advantages over its rivals.

In short the long-suffering citizens graduate from public monopoly to private monopoly and can often be forgiven for feeling cheated. Certainly a great many, even the majority, can be forgiven for recalling that whereas in the past all had to do with the same cheap, albeit shoddy service, now it seems that only the rich and conveniently located are able to enjoy any access to the new technologically superior service. And it is precisely these considerations that give the best of reforming governments, precisely those that are committed to the welfare of all of its citizens, reason for questioning the wisdom of a reformist path. As it is, globalisation has heavily circumscribed many of the traditional mechanisms of redistribution. Now in the wake of corporatisation and privatisation, governments find that they are not even capable of utilising the instrument of state ownership to provide these basic commodities to their citizens and voters. And because these goods and services are not only basic elements of the consumption package but critical components of an effectively functioning economy, it is not only redistribution that suffers but economic growth as well.

I want then to spend a few minutes looking at some random lessons from our experience of privatisation and the role of newly established competition authorities and sectoral regulators in making a post privatisation environment work, both for the end consumers of these basic goods and services as well as for the firms that rely on cheap and efficient energy, communications and transport. I find it very difficult to identify a recipe specifying the role that competition authorities should play in ensuring the successful introduction of competition into natural monopoly type sectors. So much depends on the particular characteristics of the country in question – the size of the public sector, the timing of privatisation initiatives, the maturity or otherwise of the regulators and the competition authorities. So I make no claim other than that these are some of our experiences and hope that they will offer some insights to others.

Firstly, the precise timing and mode of a privatisation will have a major impact on the post-privatisation state of competition. The competition authorities should be sensitive to this and should be advocating competition-friendly modes of privatisation. What this means is that, while, as competition authorities, we should constantly point out that the old model for providing basic goods and services, the monopoly SOE, is an unlikely long-term solution, we should equally reject ideologically-driven pro-privatisation approaches that refuse to acknowledge the complexities of a large privatisation exercise and the profound damage that an ill-timed and poorly executed privatisation may do, not least to the competitive structure of key markets.

Hence, in South Africa we have an electricity utility that provides a relatively efficient and inexpensive service. While the utility has been corporatised and is primarily motivated by profits, it has had imposed on it a reasonably clear public sector mandate regarding the roll out of electrification to under-provided rural and urban areas. The utility has managed to meet its public sector mandate, while simultaneously providing an inexpensive and relatively efficient service within commercially acceptable norms. It also has a reasonable relationship with its regulator, a body only established some 8 years ago.

But strains are beginning to emerge. Arguably, over the past several years the utility has been able to draw on the cushion provided by excess investment in generating capacity in the relatively distant past. However, this is being quickly absorbed and new investment is now urgently required. This inevitably means a re-examination of the ownership model including vertical disintegration. Tensions with the regulator over pricing decisions have also arisen as the utility attempts to lay the basis for raising the large amounts of private capital needed for new investment. Hence, while the future does not necessarily portend smooth sailing, our policy makers have at least had time to examine the best way forward, they are going to be able to draw on lessons learned from other domestic and international privatisation initiatives, and there is already a reasonably credible post- privatisation infrastructure, critically including an established and credible regulator, in place.

My point is simply that it was not necessary to privatise our electricity regulator on day one. And our government was well advised to follow the pragmatic path that it has taken. When confronted by this situation the best approach is to carefully lay the groundwork for the introduction of competition that will inevitably come, the better to ensure a truly competitive market in time or, at least, a regulator capable of simulating competitive conditions.

Our experience in telecommunications contrasts with that in electricity. Here the part privatisation of our fixed line monopoly appears, if anything, to have entrenched the monopolistic structure of this critical market. Indeed, the part-privatisation model employed in this sector that has resulted in the state owning 70% of the telephone utility, with a further 30% plus much of the management responsibility in the hands of a multinational telephone company is probably the worst structure into which to introduce competition with a new entrant having to contend with an alliance of a SOE and a powerful private operator. Matters are helped none by the fixed line monopoly also being the largest shareholder in the largest mobile phone network.

In short, competition authorities should reject the rhetoric of pro- or anti- privatisation and should reflect their superior understanding of the operation of markets by their support for cautious pragmatism in approaching any specific privatisation.

Secondly, while caution and conservatism should govern the approach of sophisticated competition advocates to large privatisation initiatives, they should be uncompromising in their efforts to ensure that licensed monopolies do not successfully leverage their dominance into markets in which they do not enjoy the protection of their license.

While this may seem small fry compared to the big-ticket telephone or electricity markets, the fact is that most of the large utilities are vertically integrated behemoths whose activities extend deep into the markets of their suppliers and customers and, if unchecked, may do a great deal of damage to a series of important ancillary markets while the world is focused only on their core market. One small example but there are literally thousands: our state owned television broadcaster began to insist that private filmmakers contracted to make programmes for viewing on its various stations had, in their production, to utilise the studio facilities of the state broadcaster. This injunction brought forth howls of protest from private film making facility owners who insisted, quite correctly, that while the SABC's license conditions allowed it to dominate the airwaves, it accorded them no such right in the market for film making facilities. The competition authorities put a stop to this leveraging of monopoly power.

Leveraging of monopoly power by licensed monopolies seems to be an important area of intervention by competition authorities. As I have already said the damage that may be caused by these massive procurers of goods and services may be considerable. It is also an area where the jurisdiction of the competition authorities relative to the regulator is often, though not always, relatively clear. And it affords the competition enforcers the opportunity of being seen to be vigilant in relation to licensed monopolies even if, at the same time, they are obliged to acknowledge some of the difficulties inherent in resolving competition problems in their core markets.

Thirdly, I think that competition authorities should be vigilant in monitoring the activities of corporations that used to be in the hands of the state but that have long since been privatised. The fact is that the reach of the state into areas of direct provision used to be considerable. Our government has, in its various incarnations, owned holiday resorts, small regional airlines, steel mills, chemical complexes and fertiliser plants to name but a few. Most of these have been long since privatised and, for the most part, into relatively competitive markets in which they have either thrived or disappeared. But others have retained – and even extended – their dominant position in their markets. The competition authorities need to be particularly vigilant in relation to these enterprises. This is, of course, not a simple matter. These usually rank among the country's 'national champions' controlled by well-connected senior management who do not take kindly to the attentions of a fledgling competition authority. But, equally, they are as often egregious monopolists whose activities generates considerable hostility from their long-suffering suppliers and customers.

The existence of these corporations may well be an argument for giving the competition authorities powers to remedy anti-competitive market structures even in the absence of a particular conduct-based cause of action. In our statute 'excessive pricing' is specifically identified as an instance of abuse of dominance. There is, as yet, no definitive interpretation of the meaning of this potentially far-reaching and controversial abuse, but, it too, may come to be particularly effective in respect of 'super monopolies' which usually have their roots in state ownership or license.

Finally, there are vexed jurisdictional questions that need to be given early attention if the 'natural monopolies' are to be effectively regulated. I used naively to think that the murky jurisdictional boundaries between the responsibilities of the competition authority and the sectoral regulators was a uniquely South African problem. I have come to learn that this is something that afflicts all jurisdictions partly because there are genuinely grey areas between what are properly construed as licensing issues – and thus the province of the regulator – and competition issue – and thus potentially the province of the competition authority. However, while these grey areas cannot be wished away and will invariably involve a substantial degree of resource sapping litigation, unnecessary jurisdictional conflict should be avoided at all cost. Not only is it a vast feeding trough for the law profession, one that consumes the time and money (and the credibility) of the competition authorities, it is also the basis for forum shopping and other mechanisms designed to evade the attention of any regulators, whether competition or sectoral.

In South Africa, the competition statute has economy-wide application in respect of all competition matters. But for the grey areas mentioned above, one might be forgiven for thinking that this would serve to resolve jurisdictional problems. But it does not because other, prior acts, extend jurisdiction over competition matters to sectoral legislators. Strictly speaking these Acts should have been amended at the time of the introduction of the Competition Act but as anyone who has been involved in a legislative drafting process will tell you, this is very unlikely to happen. The upshot is that there is concurrent jurisdiction as between the sectoral and competition authorities in respect of many of the key 'natural monopoly' sectors – telecommunications, airports, sea ports and many other services. We have recently amended the Act in order to provide a mechanism for exercising concurrent jurisdiction.

Given the ubiquity of this problem, we should try and learn from each other in this area although it is reasonably clear that the difficulties in resolving this problem are often political rather than technical and, where technical, involve overcoming extremely difficult, possibly endemic, co-ordination problems in government. I would though tentatively suggest that there are two necessary conditions for resolving the problem:

- Ø The competition authorities should have jurisdiction over all competition issues. In other words no other regulator should have responsibility for evaluating a merger on competition grounds, or for promoting competition, or for defending competition against anti-competitive conduct.

- Ø Secondly, all branches of government that are actually or potentially responsible for regulatory legislation need to be fully appraised of the competition statute and its reach. I get the impression that some of the most crippling jurisdictional problems stem from genuine error rather than a calculated grab for turf. This can only be overcome by a clear advocacy programme within the ranks of government itself.

We must accept that the consequences of anti-competitive conduct in the key basic goods industries are particularly visible and widely diffused. For the competition authorities to be involved in arcane, protracted jurisdictional battles in this area will prove highly damaging to the credibility of the entire competition enforcement system.

In summary then our experience suggests:

- Ø Privatise in order to introduce competitive markets and, wherever possible, resist privatisation until the institutional conditions are in place to ensure competition;

- Ø Take an uncompromising stand with respect to 'natural monopolies' leveraging their dominant positions into ancillary markets;

- Ø Vigilantly monitor the activities of former SOEs that have managed to retain their dominance and consider measures that enable the competition authorities to remedy anti-competitive structure;

- Ø Give the competition authorities sole jurisdiction over all competition matters and prioritise eliminating concurrency in the exercise of this jurisdiction.