Competition Policy in South Africa – Where has it come from and where is it going?

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The little that I know about investment analysts tells me that despite the broad-ranging title that I have been given for my talk you are probably concerned with a somewhat narrower topic – competition, or, as it is often called, anti-trust, law, rather than competition policy is, I suspect, your interest, and, within that, I would imagine that merger regulation is your principal concern. Competition policy is considerably broader ranging than competition law – it is, if you like, to the economy, what the constitution is to the polity. It lays out the parameters of the relationship between the state and economic citizens and between economic citizens themselves, in a manner somewhat akin to the way in which the constitution regulates the relationship between the state and individual citizens and between individual citizens themselves. Clearly however competition law is a subset of competition policy so that it is not possible or desirable to discuss the one in isolation from the other.

So where then does the concern with competition policy and law originate because clearly while competition policy has always been an important branch of theoretical and applied economics it has, in recent year assumed a new urgency and a new dynamism?

This is simply explained by the massive expansion of markets. The most dramatic evidence of this is in the countries of the former Soviet bloc where administrative determination of economic processes was ended literally overnight. But it is no less significant in most developing economies where the state has, over a wide front, drawn in the boundaries of its participation in the economy and in a great many industrialized countries where a range of critical economic activities previously dominated by the state – telecommunications, public transport, etc – have, by political decision or technological advance, been opened to the private sector. And, indeed, in cross0border trade, where the reduction in trade barriers has accelerated and deepened the penetration of markets. And all this continues apace – liberalization of economic life in China, the collapse of state owned airlines, the decision of a country like Britain to allow foreigners to purchase domestic broadcast licenses, the liberalization of telecommunications markets in developed and developing countries are a few random examples of the continuing penetration of markets into hitherto uncharted territory and accounts for the abiding significance of developing policy with respect to competition and its regulation.

Why 'competition and its regulation'? Why not simply view competition – as some do – as the very antithesis of regulation and celebrate it for that reason, as the triumph of market forces over administrative intervention. Why re-introduce regulatory oversight over the resurgent and insurgent market forces?

None of you will have any difficulty in understanding why a state-licensed monopoly must be regulated. All South African citizens have experienced the shortcomings of state owned monopolies that were and, to a significant extent, continue to be relatively unregulated, proverbial laws unto themselves. This has been true of public transport, of electricity generation, of telecommunication services. The current government has made considerable advances in introducing modern regulatory oversight of these activities – for the most part still dominated by the state – but my reading is that, without significant exception, the demand here is for stronger, more effective regulation rather than further deregulation. There is, in other words, widespread recognition that where, as a result of government policy, market forces do not operate and where regulation is ineffective, the services that we receive are expensive and inefficient.

By the same token most of us have also experienced the consequences of simply handing over state owned monopolies to private interests, of simply exposing protected monopolies to the market. A few of these fail, and this is generally no bad thing – but this only tends to happen in those relatively rare situations where there has long been an active market beyond the walls of the protected monopoly. More likely the erstwhile state owned enterprise flourishes but frequently at tremendous cost to the domestic economy, particularly to domestic consumers. Even where the sector is opened up to competition, either through the issuing of new licenses or 'free entry' the erstwhile monopoly generally proves adept at excluding or limiting new entrants, thus retaining its dominant position. Indeed, the only interests that tend to benefit from the privatization of state monopolies into unregulated markets are the managers of these enterprises who acquire effective control over vast assets paid for by the taxpayers of their countries.

This was not always so readily appreciated. In the late 80's although one could find no end of economists in the World Bank willing to advise developing and emerging states to reduce, through privatization, their role in economic activity, few were interested in debating the intricacies of competition law. This seemed to be an arcane preoccupation of a small number of developed countries - indeed the US was, for the most part, alone in viewing competition law as a cornerstone of economic policy.

However this lack of interest in competition law changed very quickly once governments – in both developing and developed, emerging and mature market economies – actually began accepting all this advice, actually began withdrawing from the economy. They quickly discovered that what the retreating states left was a vacuum, a vacuum that was filled not by a benign invisible hand pointing in the direction of efficient outcomes, but one that was rather filled by private concentrations of economic power, if anything less able and willing to promote economic efficiency and consumer welfare than the erstwhile state owned enterprises whose mantle they had assumed.

In short the newly deregulated, privatized economy did not resemble a Silicon Valley heaven nearly as much as a Moscow hell, an environment that was not only extremely hard for those obliged to live and work in it, but one that was extremely unattractive to investors and, so at odds with the basic requirements for dynamic competition and economic growth. The state had retreated and the market had advanced but a key ingredient was missing. On reflection, what was missing was a set of rules, or, at a deeper level, what was missing was the appreciation that the

market is an institution like any other and, like any other institution, it requires a set of enforceable rules that regulate the conduct of its participants – rules regulating the governance of corporations, rules regulating financial and other accountability, rules regulating the relationship between owners and employees, and, what we are talking about here, rules that regulate the manner in which competitors interact with one another. In the anxiety to label market economies 'free', what had been forgotten was that these 'free markets' were in fact governed by a complex set of rules, some of which were enshrined in statute, others of which were established in court, and still others of which resided in strongly held custom and convention. But all of them had rules. Indeed over the same period we have been presented with some sobering evidence of what happens even in those societies with long established rules and conventions when the rules break down – Enron is but one example of the importance of rules.

This caricature represents fairly accurately where the renewed interest in competition policy and competition law comes from. It has ensured that, whereas at the beginning of the 'nineties, about 15 countries had adopted competition laws, by the end of the decade approximately 90 had done so and many of the original 15 had taken steps to strengthen their competition laws and institutions. Last month the members states of the WTO commenced negotiations that will probably lead to the development of a treaty to govern competition in international markets.

Each country has got there via its own particular set of imperatives – hence the EU was driven to strengthen its competition regime because of its role in forging the common market; Indonesia introduced its competition law because it was compelled to do so by the IMF; in South Africa, on the other hand, the law enjoyed popular backing derived from a longstanding and widely held concern that key product markets are both highly concentrated and incontestable. Equally obviously each national law reflected the key priorities and concerns of the societies from which they emanate. But what they had in common was that they all responded to a growing recognition, first, that markets led to economic outcomes superior to those attainable through administrative direction of the economy; but, second that, in order to realize their considerable promise, markets had to be subject to effective regulation.

But 'why', you may well ask, 'should competitive markets, be subject to regulation?' It is easy to understand why licensed monopolies should be regulated; it is also understandable that a privatized monopoly, given its first mover advantage, its superior capital base and networks built up under the protection of its monopoly privilege and its well established links in government, may require a transitional degree of regulation to ensure that it does not prevent new entry. However, new technologies and well resourced entrants have successfully opened up the most competition-hostile markets – telecommunication and passenger rail transport for example – and, in any event, there are thousands of markets in which the state is not and has never been present. Why should these be regulated?

The answer to this question can be presented in varying degrees of complexity. Let me offer this answer: the incentives that a competitive market offers to providers of goods and services to produce better, cheaper commodities also incentivises the destruction of the competitive process itself. And once competition has been destroyed, all the dynamic incentives that produced the triumphant firm are reversed and replaced with the incentive to restrict output and raise price, to innovate less, to enjoy the quiet life and to ensure, above all, that prospective new entrants are

excluded from the hallowed turf occupied by the monopolist. The task of competition regulators is to ensure that the process of competition does not destroy the very basis of its own existence.

In short, firms confronted by competition have a powerful imperative, indeed the most powerful imperative driving the market economy, to eliminate their competitors.

When this drive to better the competition translates into producing superior products at lower prices it will not only be tolerated by competition law, it will be positively encouraged. This – lower prices and superior products through innovation – is after all the promise, the very stuff, of competition.

However, when this powerful incentive translates into colluding with one's competitors or into practices designed to foreclose entry by new competitors, then the competition authorities will step in and prosecute the perpetrators of these anti-competitive practices.

And, if this incentive translates into the merging of competing firms, or the acquisition of a customer or supplier, then the competition authorities will investigate and, in those rare circumstances in which it is established that the transaction is likely to prevent or substantially lessen competition, the transaction will be prohibited or have conditions imposed that are designed to ameliorate the impact on competition.

Having listened to all this, you may well ask 'but why merger regulation'? Why, in other words, try and regulate the structure of the economy when there are laws to ensure that those who participate in the various markets – whether concentrated or not – conform to pro-competitive conduct?

First, it is not possible, or desirable, to regulate all aspects of conduct. Hence nothing prevents a monopolist, or, in the parlance of our legislation, a dominant firm, from charging a monopoly price. Indeed, provided that entry barriers are sufficiently high and that the monopolists pricing strategies did not encourage new entry, a monopoly price is precisely what would be charged. In regulated sectors where there is a licensed monopoly monopolistic conduct is overridden right down to the regulator setting the price. But I think that everyone would agree that it would be highly undesirable for the competition authority to assume the role of a price setting agency. Thus in order to forestall the necessity for excessively interventionist regulation such as price setting, the preferred strategy is to prevent, wherever possible, the emergence of anti-competitive structures, where these structures arise through mechanisms other than the provision of superior products. The alternative mechanism in question is through merging with a competitor and so mergers that give rise to anti-competitive structures are proscribed.

Secondly, despite legal proscription of anti-competitive conduct it remains extremely difficult to check this behaviour. Anti-competitive conduct either takes the form of practices – such as horizontal collusion – that simulate monopoly or, where a dominant firm is already in place they take the form of exclusionary practices, practices designed to force competitors out of the market or to prevent them from entering or growing in a market. The returns to the firm from monopolistic behaviour are extremely high and so the incentives to engage in these practices are

considerable. That is why in the USA and other countries individual executives participating in monopolistic conduct go to jail and firms are subject to swingeing fines. But even then they still do it. We have seen how difficult it is to bring a restrictive practices case to trial – we have seen the massive resources of large firms deployed in order to prevent competition authorities from carrying out their mandate. This is why merger regulation is so important – rather constrain, through merger regulation, the rise of structures conducive to monopolistic conduct then imagine that they can be easily controlled after the fact. There is no room for romanticism here – we have, in South Africa, considerable recent evidence of the contempt with which the executives of major corporations treat their own shareholders. Imagine how little restraint they feel in relation to their customers or, particularly, their competitors.

Don't get me wrong: I certainly don't advocate giving up on conduct regulation. Merger regulation on its own will not prevent the emergence of monopoly, nor does it affect existing monopolies. But the cost of foreswearing merger regulation would be very high indeed. It would place an intolerable burden on enforcement and this is why the profile of merger regulation has risen in the activities of competition authorities across the world.

However, our critics respond, even if there is point in merger regulation, the cost of error is very great because mergers, the argument continues, are necessary if our firms are to achieve the minimum efficient scale necessary to compete on international markets. In a small economy this will frequently mean that we must permit dominance of the domestic market but the returns, it is argued, will be counted in the exports gained.

I should say at the outset that those who propagate this argument never explain why it is economically efficient or socially desirable for domestic consumers to subsidise exports, why we should be willing to impose higher prices on our own consumers in order to gain exports. But I won't even go there because the basic premise that correlates scale and international competitiveness is, for the most part, false, particularly when the scale argued for equates to domination of the domestic market. Indeed, the evidence shows time and again that the most successful players in international markets are those that are steeled by competition on their domestic markets. This is not surprising. Why should a firm subject itself to the rigours of penetrating international markets when it can achieve acceptable returns simply by increasing its prices on an uncompetitive domestic market? South Africa has never lacked for firms that have dominated the domestic market, but these firms have, for the most part, been markedly unsuccessful in penetrating international markets. This is not because these firms are too small. It is precisely because of the degree of protection that South African firms have enjoyed in their domestic market – protection from international competition by tariff barriers; protection from domestic competition by their dominance over the domestic market. This does not promote international competitiveness; it militates against it.

This is not to say that arguments for mergers that rely upon achieving scale economies or other efficiencies are always invalid. The Competition Act recognizes this by providing for an unusually elaborate set of efficiency defences. Whenever we decide that a merger is anti-competitive we are required to try and identify countervailing pro-competitive efficiency gains. In fact a recent decision of the Competition Tribunal allowed a merger to monopoly in one part of the metal fabricating sector precisely because it accepted the efficiency arguments advanced.

But, in general, we are bound to treat scale arguments skeptically when they are used to justify a merger that will lead to domination of the domestic market. One example among many will suffice to show why. When the erstwhile Competition Board was asked to review the proposed merger of SASOL and AE&CI it was told that scale considerations and their impact on international competitiveness dictated that we allow the merger to go ahead despite the fact that the merged entity would have dominated several important markets. The most important market at issue was the explosives market. It was clear that this was the jewel in AE&CI's crown, the asset that SASOL sought, above all, to acquire. The two companies also, between them, controlled ammonia production in South Africa.

What did we find on closer examination of the evidence? First, far from being a small domestic market, the South African market for explosives is the largest in the world. Where explosives are concerned we are not a small economy. It will not surprise you to learn that all the major mining companies – with the exception of the AAC, AE&CI's owner – opposed the transaction. Moreover, explosives are, for obvious reasons, not internationally traded. So there is, from the perspective of export competitiveness, no point in building a massive explosives plant whose capacity exceeds the size of the domestic market even if this leads to lower unit production costs because explosives cannot be exported. There were no gains for international competitiveness arising from the merger. Indeed had the mines landed up paying more for monopolized explosives, it is likely that their international competitiveness would have suffered. In truth the merger was driven by more prosaic, predictable objectives: AAC wanted to exit from its non-core activities. It found that the highest bidder for its explosives interest was, surprise, surprise, its largest competitor which was willing to pay a premium because of the market domination that would have accrued to it as a result of the merger. On the other hand, the Competition Board was happy to allow the firms to merge their ammonia plants – scale considerations seemed important because the market was truly international. But the firms chose not to do so despite Competition Board authorization. Why? Because they were not really interested in the scale economies achievable in ammonia production. They were rather after the market domination that the explosives merger would have created.

I want to deal with one final issue, and that concerns the public interest issues that we are required to factor into our merger decisions. We are required to consider the impact of the transaction on employment, on a region or sector, on the competitiveness of small firms and firms owned by historically disadvantaged entrepreneurs, and on international competitiveness.

Let me say at the outset that I have no problem with a statute obliging those who go into a merger to factor into their decision the impact on employment or other public interest matters. If this requirement in our act has already influenced business behaviour against transactions that would lead to uncertain private benefits but certain social costs then that is, in my view, a highly positive outcome. But at the same time you should be aware that, to date, no transaction has been determined on grounds of public interest alone. That is, we have never allowed an anti-competitive transaction because of its positive impact on public interest; and we have never prohibited a pro-competitive transaction because of its negative impact on public interest.

I do not however deny that this is a difficult area. However we should acknowledge that there is no competition regime in the world that does not take account of public interest criteria of this variety.

The most common approach used in balancing competition and public interest considerations is

to allow a political authority, the Minister, to veto, on public interest grounds, the decision taken by a competition authority on competition grounds. I prefer that the responsibility for the decision making remain unified. For one authority to take the competition decision and the other to take the public interest decision strikes me as highly undesirable. It certainly invites massive lobbying. By contrast there is in our system an open, transparent process to which all concerned parties have access. Decisions are not taken on the basis of privileged access to the decision maker. There is an elaborate system of appeals and reviews. And, I must stress, the way in which the Act frames the investigation, ensures that the public interest decisions are made through the lens, through the filter of a competition analysis. We always have to first decide the impact on competition. Having gone though this the discovery of a sufficiently strong countervailing public interest factor would almost inevitably conduce to imposing conditions on the merger, conditions designed to salvage competition (where an anti-competitive merger is saved by its positive impact on public interest) or conditions designed to protect the public interest (where a pro-competitive merger is condemned by its negative impact on public interest). This is the advantage of holding a single authority responsible for the whole evaluation.

In summary then, our concern with competition law emanates from recognition of the powerful, positive incentives embodied in the functioning of effective markets. It is designed, in common with competition laws elsewhere, to ensure that our market remains effective, to ensure that the process of competition is not undermined by the competitive process itself, by, in other words, the accumulation of private economic power that occurs through the competitive process. Merger regulation is a key aspect of competition law – in fact by helping to maintain competitively structured markets merger regulation limits the necessity for invasive intervention later on. The suggestion that the size of our domestic market dictates that we adopt a generally permissive attitude towards market dominating mergers does not hold water. Where the argument is valid the Act allows ample opportunity for raising efficiency defences and a positive impact on international competitiveness must be considered in the public interest evaluation that we are mandated to undertake. Public interest considerations have not played a determining role in our merger decisions to date. However, it is wholly appropriate that they be incorporated into a merger evaluation. Our act is structured in such a way as to make transparent the difficult process of balancing competition and public interest consideration and to ensure that these are filtered through the core objective of the Act, the maintenance and promotion of competition.