

THE FREE MARKET FOUNDATION

of Southern Africa

progress through freedom

CONSUMER PROTECTION BILL, 2006

Submission by
the
FREE MARKET FOUNDATION OF SOUTHERN AFRICA

BACKGROUND

The Free Market Foundation (FMF) is an independent policy research and educational organisation founded in 1975 to promote and foster a free and open society, the rule of law, personal liberty and economic freedom. It is an NGO financed primarily by membership subscriptions, sponsorships, donations and income from its consultancy company. The FMF produces a wide range of electronic and other publications, and lobbies for a legal, monetary and fiscal environment conducive to high economic growth, empowerment of ordinary citizens and rapid sustainable development (www.freemarketfoundation.com).

Contrary to popular myth, economic freedom does is not generally in the best interests of business and other vested interests, which explains why vested interests spend so much time and money lobbying government for a multiplicity of interventions, subsidies, protections, contracts, franchises, consultancies and other anti-market policies and privileges. The FMF regards personal liberty as both an end in itself and as the proven best way of promoting interests of ordinary people, especially consumers. The world's experience shows beyond reasonable doubt that those consumers who benefit most from economic freedom are, fortuitously, low-income and unemployed consumers, because free competition amongst suppliers and employers increases choices whilst driving prices down and wages up more than any regulatory intervention. Although it is not always clear that privileged elites appreciate this fact, it is well-known to the poor themselves, which is why they migrate lawfully and unlawfully from countries where there is less to countries with more economic freedom.

GENERAL

The FMF welcomes and supports the government's desire to:

- improve consumer protection,
- consolidate of consumer protection law,
- repeal outmoded and redundant laws, and
- advance the social and economic welfare of consumers.

Johannesburg

1st Floor, Norfolk House, Sandton Close 2,
cnr Norwich Close & 5th Street, Sandton
PO Box 785121, Sandton 2146
Tel: +27 (0)11 884 0270 • Fax: +27 (0)11 884 5672
Email: fmf@mweb.co.za

Cape Town

1st Floor, Equity House,
107 St George's Mall, Cape Town
PO Box 805, Cape Town 8000
Tel: +27 (0)21 422 4982 • Fax: +27(0)21 422 4983
Email: fmf.ct@mweb.co.za

Website: www.freemarketfoundation.com

Non Profit Organisation Registration No 020-056-NPO

This submission does not address aspects with which we concur, but only aspect which we fear might undermine the government's objectives, or achieve them at excessive cost, especially to consumers. This submission commences with general observations (Part I) and proceeds to comments on specific provisions (Part II).

The Bill is uncommonly long (nearly 200 pages including schedules) and most provisions raise complex issues each of which justifies substantial analysis and comment. It would take much more time than has been available and a much more substantial document than is appropriate to provide it. Meaningful analysis of an individual provision usually requires more text than the provision itself, which means that a document containing adequate analysis of every substantive provision would be much longer than the Bill itself. Accordingly, this submission is confined to basic issues of principle and illustrative comment on a few provisions.

If, as is normal, other submissions also don't provide thorough analysis of every substantive provision, especially in view of how little time has been allowed for comment, the government will not enjoy the benefit of the sort of thorough analysis called for by Minister Mpahlwa in his Foreword to the Green Paper (<http://www.dti.gov.za/ccrdlawreview/conslawdraftgreenpaper/2ForewordbyMinister.pdf>). This concerns us deeply, as it should the government, because it means that provisions may be implemented which have negative impacts of the kind to which this country and its disadvantaged people should not be subjected. The only way for the government to anticipate and avoid unintended negative consequences is for it to commission a properly conducted regulatory impact and cost-benefit assessment (RIA) – one that is one undertaken in accordance with properly specified criteria, such as genuine researcher independence, comprehensiveness, full quantification and anticipation of secondary effects.

PART I - GENERAL

Over-Regulation Retards Growth and Imposes Excessive Costs on Consumers, Especially the Poor

Minister Mantis Mpahlwa's Green Paper *Foreword* provides an excellent encapsulation of the government's vision for consumers (our emphasis):

Confident consumers are one of the important drivers of competitiveness. By demanding competitive prices, improved product quality and better service, they provide an impetus for innovation and enhanced performance by business. The need to put in place a new framework for consumers must be seen in this context, in the context of the overall strategy to improve the competitiveness of our industry, **rather than as an attempt by government to impose more onerous regulation on the private sector.**

(<http://www.dti.gov.za/ccrdlawreview/conslawdraftgreenpaper/2ForewordbyMinister.pdf>)

Good intentions notwithstanding, aspects of the Bill conflict with the government's objectives articulated by the Honourable Minister. Some of its provisions also conflict with the Bill's principal objective, "to promote and advance the social and economic welfare of consumers ...".

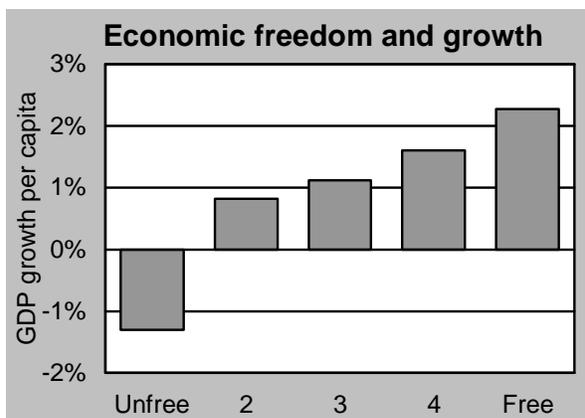
Research comparing policies and their consequences internationally shows how best to promote these objectives. It is clear from the evidence that “social and economic welfare” for consumers and the country in general are promoted most rapidly, effectively and sustainably when markets are relatively unregulated.

There are many excellent studies to this effect, of which we cite just two. Firstly, the definitive index of the degree to which economies are regulated is the annual World Bank study *Doing Business* (www.doingbusiness.org). It is clear from this research that higher levels of regulation coincide with 2% to 3% less prosperity (economic growth). In other words if the South African economy were liberalised as opposed to highly regulated the evidence suggests that the growth rate during the first decade of independence would have more than doubled. At 3% higher growth the average South African’s wealth would double within just over another ten years. Instead the average South African is poorer than they were in 1970 (at constant Rands or US\$), and has experienced only slow and slight growth since transition.

What this means is that by far the most responsible thing government can do for its consumers is to deregulate rather than regulate. The repeal of the antiquated laws listed in § 149 would have achieved this were it not for the degree to which the Bill provides for a new degree of over-regulation.

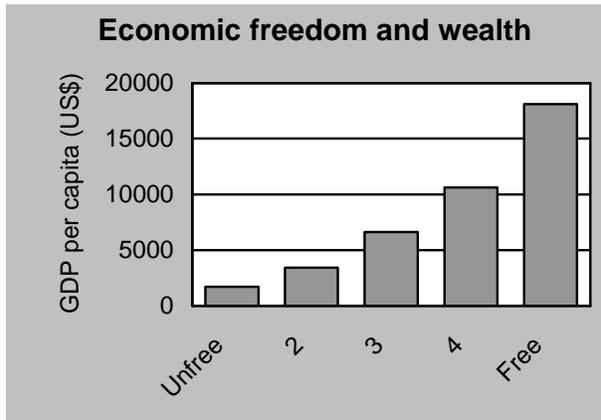
The second definitive research to which we refer is the *Economic Freedom of the World* (EFW) index published annually by the *International Freedom Network* comprising 60 think tanks operating in over 100 countries (www.freetheworld.com). EFW indexes 39 independently published indices of government policy so that countries are ranked in terms of their economic and related policies, from unfree (0) to free (10). The first important point is that on average unfree economies contract (“negative growth”) and free economies grow at rates the government wants to achieve in terms of GEAR and AsgiSA.

The chart (below) shows the world’s countries divided into five groups (quintiles) correlated with *per capita* economic growth, from which it is clear that the least free economies stagnate or decline and the freest economies enjoy high growth rates. This correlation holds regardless of the period for which it is done (since the earliest records in 1970).



The second chart shows that freer economies not only grow faster but are wealthier. In other words the Marxist maxim that the “rich get richer and the poor get poorer” is true

internationally, but, contrary to what Marx expected, it is market economies that outperform those subject with high levels of government intervention.



There are two corollaries of special significance for South Africa. The first is that there is an “acceleration effect” in accordance with which economies grow or decline faster than might be expected purely from their level of economic freedom. Economies decline even if they are relatively free, but becoming less so, and are richly and rapidly rewarded with high growth if they are unfree but moving in the “right” direction. Africa has a growing number of impressive examples, such as Mauritius, Botswana, Mozambique, Uganda and Tanzania. The direction of change is nearly as significant as the state of economic policy.

The second corollary is that developing countries, such as ours, have an “exaggeration effect”, in that they grow or contract much faster than developed economies in response to economic policy and the direction of reform. The world’s most rapidly rising and falling economies are in developing countries, whereas developed countries grow at only slightly lower or higher rates if their economies are less or more free respectively.

SOUTH AFRICA IS NOT A “SPECIAL CASE”

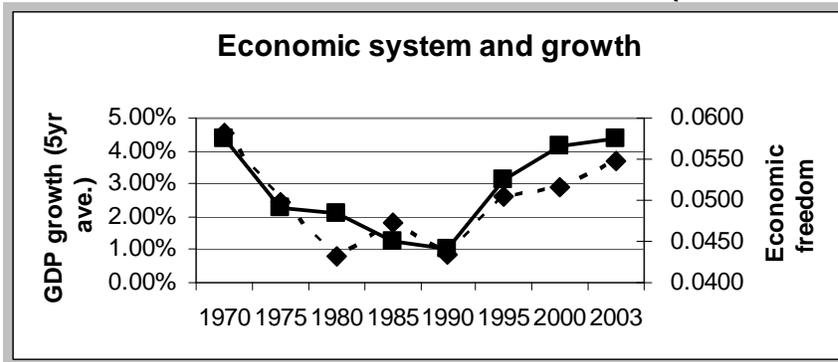
South Africa is no exception. People in all countries fall into the trap of thinking they are a “special case” by virtue of their unique circumstances or history. The ways in which people respond in an economy to policies such as that envisaged by the Bill is a function of being human, and is sufficiently consistent worldwide for the proverbial “bottom line” to be that policies which work best in one country tend to be the same as those that are best for another.

The third graph (below) shows that South Africa’s economic freedom declined during the twilight years of apartheid until transition in 1994. As might be predicted from international experience, growth declined, leaving the average South African poorer after a generation of economic activity. In the early years of transition, the new government, to its credit and despite criticism and resistance, embarked on a bold policy of economic liberalisation for which the country is now being rewarded with rising growth rates and other improving indicators, such as lower inflation, more consumer spending and less unemployment.

In considering this Bill, the government should note that the plateauing-off if the graph suggests that its momentum is in danger of being lost or reversed, which is why it is

particularly important for the government to re-emphasised its commitment to growth through market-friendly policies, as it has done in AsgiSA.

South African Economic Freedom and Growth (1970 – 2003)



After a decade of declining economic freedom and growth during the last years of apartheid, the government in the new South Africa increased our economic freedom rating from 5.3 in 1990 to 6.9 now (after it had declined under apartheid from 6.9 in 1970 to 5.3 in 1990). By 2003 (the latest index), South Africa climbed the ladder from below the halfway mark (70th out of 127 countries) to join the upper third as the world's 38th freest economy.

Considerable political wisdom and resolve is needed to ensure that this Bill does not countermand what has been achieved. There is a real danger that it shift the country further towards over-regulation in the wake of recent highly interventionistic laws, such precursors as the Financial Advisory and Intermediary Services Act (FAIS) and the National Credit Act (NCA).

The Economics of Regulation

We have done sophisticated analysis in response to a request from the ANC on the degree to which individual components in the economic freedom index correlate with prosperity. Most of the 39 components do not make a significant difference individually. In other words, if individual components are removed from the index it becomes clear that each on its own does not appear to be a growth determinant. This means is that a country needs more economic freedom *in general* in order to prosper, and cannot do so by having only some of the “fundamentals in place”.

However, 6 of the 39 components do have a significant impact individually, one of which is the degree to which the economy is regulated by such measures as this Bill. What this means is that the laws of economics are generous to governments in that the consequences of sub-optimal individual policies are forgiven provided policies in general are sound, but there are a few policies which are not so kind to governments; they must get them right if they want to achieve “social and economic welfare” (§ 3).

The reason we provide this evidence, and will, if requested, provide much more, is two-fold:

- Firstly, the government in its macro-economic policy is absolutely correct to regard accelerated growth as its economic policy priority, but it is not always clear that individuals working for it on micro-economic regulation appreciate how much

damage occurs if they succumb to the considerable temptation to over-regulate without due regard to direct and indirect costs, and disastrous secondary consequences – and the importance of the Honourable Minister’s injunction that consumer protection law must not “impose more onerous regulation”.

- Secondly, this Bill does not recognise sufficiently that the best interests of consumers, including their best protection from unscrupulous suppliers, is served by having maximally free and competitive markets – which entail more choice and risk, and the burden of personal responsibility that necessarily accompanies consumer freedom.

BENEFITS HAVE COSTS

Minister Mpahlwa’s *Foreword* goes on to say that the purpose of the Bill is to:

Rid the market of unethical traders and will contribute to the creation of a fair, competitive and equitable environment for all. It also requires us to consider carefully the measures that are put in place to ensure that historically disadvantaged consumers can effectively access their rights and obtain redress when necessary (<http://www.dti.gov.za/ccrdlawreview/consldraftgreenpaper/2ForewordbyMinister.pdf>),

We studied the background documentation to this Bill, and did not find the sort of careful consideration the Minister has in mind. There is, for instance, no situation analysis of the kind that is required for Regulatory Impact Assessment (RIA) purposes. There is no empirical statement specifying the nature and quantity of problems in need of a solution.

Proper consideration requires that problems are properly quantified and alleged facts authenticated. This must be juxtaposed with the extent to which and precise mechanisms by which individual provisions are likely to ameliorate them, and cost that will be occurred (in monetary and non-monetary terms). Only when this has been done is it possible for the government to predict whether overall benefits of the Bill are likely to exceed costs.

There are many provisions where this seems improbable, where the costs of administration, policing, enforcement, compliance and litigation will clearly be considerable without it being clear that there will be sufficient benefits.

The most fundamental law of economics – some would say the only true law – is that “there are no free lunches”, meaning that all benefits have a cost. In the matter of consumer protection it is necessarily always consumers that bear this cost, which is passed on to them in various forms:

- higher prices,
- less choices regarding types of transaction,
- less products and services,
- fewer suppliers competing for their custom,
- less resources at their disposal (by virtue of lower economic growth),
- less protection of important consumer rights (by virtue of resources being applied to peripheral matters),
- less after-sale service, including guarantees (by virtue of exclusions in an attempt to reduce costs in the wake of cost-raising regulation), and

- smaller less viability markets.

Consumers pay all costs

All costs are passed onto consumers, and impact disproportionately on the poor. That is why this Bill, like most Bills, is not likely to face much resistance from business. It is likely to be welcomed “in principle”, and the government will, after ironing out a few wrinkles, be able to announce that business supports it. The readiness of the established businesses community to support increased regulation is simply because (provided all competitors are subjected to the same imposition) they will not be worse off. They will usually gain a competitive advantage over small, emerging and innovative businesses (conveniently labelled “fly-by-night”, “bucket shops” and the like). Their market share, profits and rates of return will not fall, and may rise.

That regulation imposes considerable costs on the economy is clear from the research. It averages twenty times the cost to government. Since profits don’t fall after new regulations are introduced, government must be clear about who pays for consumer protection. The answer is obviously consumers. Adding regulatory costs to business is like increasing any other cost, such as the cost of electricity. The added cost will, like all costs, simply be added to consumer prices.

There is a less obvious impact on consumers than higher regulation-induced prices, namely that increased costs reduce the absolute size of markets, that is the amount of goods and services available to consumers. In short, they are poorer. Businesses which support increased regulation also tend to overlook the fact that they are worse off in contracted markets. This is the problem of the “seen” and the “unseen”: we can see consumer benefits; but not what they are denied to achieve them; we can see company profits but not what they would have been had markets been bigger, we can see what tax government collects, but not what it would have collected had there been more growth.

Legitimate Consumer Protection

What consumers need is protection from being “taken for a ride” rather than from entering into legitimate transactions deliberately and willingly. They do not need the law to make it less rewarding or illegal for suppliers to think of innovative products, services, marketing methods and transactions, or to make fewer offers they may find attractive. Legislation in a free society should reflect the fact that, as the Minister’s Foreword says explicitly, consumers should enjoy freedom of choice in a competitive economy without “onerous regulation”.

Consumer freedom exists only in direct proportion to the extent to which consumers risk making mistakes. Freedom has only one meaning: the right to be wrong, that is the right to do things other people may think should not have been done, and to do things which the doer may subsequently regret. A society in which government strives for zero risk has zero liberty.

PART II – SPECIFICS

Section (§) 3

§3 does not provide for what should be regarded as by far the most fundamental and important consumer right, namely freedom of choice. In the new South Africa freedom as a value and end in itself has been elevated to a status denied under apartheid and aspired to by people across the globe. This section refers, for instance, to the need for consumer “choice and behaviour” to be responsible and informed, but not to the fact that consumers should have the basic right to choose. Consumer freedom may not be mentioned explicitly because the Bill proceeds to curtail it in many provisions. We submit respectfully that this is unfortunate and should be rectified.

The Bill as drafted does not reflect an appreciation of the very important fact that there are two sides to regulation: restrictions on the freedom of suppliers are usually *simultaneously* restrictions on consumer freedom. A provision that suppliers may not, for example, supply a package of goods at a single price (§16) is, equally, a prohibition on the right of consumers to purchase such a package. The reasons why consumers should have such freedom is to enable them to secure lower prices or other benefits, such as consistent after-sales service. If liberated South Africans are presumed to be capable of making important decisions regarding for whom to vote, who to marry, their career, having children, lifestyle, diet, medical care, sexual conduct, religion and so on, they should be entrusted with the right to make much less serious consumer choices.

§16

§16 is an example of where the Bill curtails freedom of contract at the unintended expense of consumers. The main effect of this section will be that consumers will be denied the right and opportunity to secure better deals by entering into transactions of the kind targeted for prohibition. Suppliers will obviously be inclined to give consumers better prices and terms (such as credit), if they can enter into transactions whereby they are guaranteed future business. Consumers should not be denied this opportunity and the benefits of competitive innovation by suppliers. The prohibitions envisaged in this section are like prohibition on bulk discounts, the consequence of which will be to force consumers to make all acquisitions at needlessly high prices and needlessly disadvantageous terms.

The second problem with this section, as with others, is its one-size-fits-all nature. It does not reflect an awareness of a multiplicity of situation-specific contexts where advantageous package deals are available to consumers, such as insurance accompanying mortgages, credit sales or travel, and maintenance agreements or even guarantees accompanying sales of vehicles, equipment or buildings.

The prohibition in §16 (2) (a) is particularly ominous. It prohibits the concept of a “lucky packet”, which sounds trivial but reflects a more profound significance.

§16 (2) (b) prohibits the common international practice of granting rebates. The effect of this section as a whole appears to be the effective prohibition of trade coupons, although these are provided for explicitly later in the Bill.

The Bill is generally well drafted, but in some places, such as §16 (2) (c) the meaning is unclear.

§13

§13 prohibits the dissemination of what is misleadingly called “confidential information”, whereas, by definition, what is envisaged is by no means confidential. Much of it is public knowledge such as people’s phone numbers and addresses in telephone directories, and their financial and other history in court records. In all market economies, particularly in those that are most prosperous, there is an important and active market in consumer information ranging from address lists of consumers who welcome and respond positively to direct marketing, to vital credit information.

We strongly recommend that this section be amended to limit only the dissemination of genuinely confidential information, that is, information provided or gathered in confidence. We point out, however, that there is no need for such a provision since the matter is governed adequately by contract law. What information is and is not confidential should be determined by freely contracting consumers. To the limited extent that legislation is needed, it is more than adequately addressed in the Data Protection Bill.

§14

§14 (2) and (3) envisage a register of pre-emptive blocking and implies that suppliers will, at consumer expense – all costs are passed onto consumers’ – consult the register to identify individually blocked consumers. Apart from these provisions providing no significant benefits at potentially considerable cost it is not clear that they can be implemented in the real world.

§21

§21 (6) has implications we assume are unintended. As it stands the provision would have the effect that a consumer accepting an offer (made by way unsolicited goods) is not bound by acceptance (through payment) in accordance with normal offer-and-acceptance law. The most common and obvious way for a consumer to accept an offer, any offer, and to purchase goods or services is to pay for them. A provision to the effect that consumers may at any time in the future, conceivably years later, recover what has been paid, without needing to return the goods, is extreme and unwarranted. The potential consequences are so bizarre that we assume something different was intended, perhaps that consumers can recover payment if they can prove that they did not realise the absence of an obligation to pay.

This provision and others in the Bill reflects a lack of appreciation for the fact that millions of consumers welcome and regularly purchase unsolicited goods and services offered to them by direct and indirect marketing, from sophisticated consumers to people in the poorest communities. Leading clothing stores, for example, periodically call on wealthy customers in their homes to offer their latest products. Informal contractors call on homeowners offering to fix broken tiles on their roofs, and so on.

§22

§22 creates an inappropriate set of circumstances whereby lawful and legitimate transactions cannot be enforced against a consumer’s estate. There is no good reason for the law to heap unwarranted benefits on heirs at the expense of people who entered innocently, lawfully and legitimately into contracts with the deceased. The matter of deceased estates should be left to the appropriate government department and governed by the laws of succession. This Bill is for the protection of consumers not beneficiaries of deceased estates. If South Africa wants a business-friendly and therefore prosperous

society it should not compromise the certainty with which legitimate business is conducted. As has always happened, administrators of deceased estates negotiate with suppliers and all other people who have rights and obligations regarding the estate.

§23

§23 provides for “consumer’s right to cancel reservations”. It goes on to reflect the reality that there needs to be reservation and cancellation fees in many cases, particularly regarding accommodation, entertainment and catering. The section appears to prohibit potentially important provisions relating to cancellation. Cancellation, may, for example, result in considerable loss or damage and it should therefore be lawful to contract accordingly.

§23 (4) exempts a deceased’s estate from legitimate liability incurred by a consumer. It is not clear why the legislature should want to do so. Why should heirs benefit at the expense of suppliers because a consumer dies? Existing law of succession is perfectly sound according to which heirs take over most rights and obligations of the deceased.

§27

§27 makes it obligatory for the prices of goods to be displayed. This has been a requirement of South African law since the 1960s if not before, and was re-enacted in government notice 413 of 1977. The law has never been enforced for the simple reason that it is entirely impractical. This was pointed out and predicted to the apartheid regime. A few years ago we contacted the Department of Trade & Industry and asked who in the department was responsible for the law. After much delay, we were told that no one in the department was aware of its existence.

Paradoxically, laws requiring marking of prices would, in the unlikely event of them being enforced, impact negatively on the two opposite extremes of the market, the highest and lowest income groups. The fact is that small and informal businesses do not and never will display prices (in most contexts). Prices at the lower end of the market are established and known to all concerned by virtue of custom and prevailing market conditions, which sometimes vary enormously from day to day and hour rot hour, such as the current price of foodstuffs purchased daily for the purposes of resale on the same day.

At the other end of the market, places such a fashion boutiques and jewellery stores do not display prices because it is considered infradig.

The marking of prices on goods law is superfluous and should, after many years of neglect, be accepted as moribund and abandoned.

§28

§28 (5) (c) should apply only to persons in the employ or under the direct control of a supplier.

§31

§31 presupposes a more sophisticated economy than exists in South Africa. This is the danger of importing laws from the world’s richest countries or being guided by their consultants. This section is self-evidently unworkable in the majority of South African communities, which are in historically (and still predominantly) black areas, such as rural areas and “townships”.

§31

We wonder if §36 takes sufficient account of the reality of some markets. We suspect that suppliers in travel and entertainment markets, for example, routinely and legitimately run “specials” in the full knowledge that they are likely to be “sold-out”. Airlines, for instance, especially discount carriers, try to have 100% occupancy.

§44

The objective of §44 is not obvious. Is not clear, for instance, how this applies to dozens of transactions where the rewards concerned are contingent on a future event, such as a suspensive or resolutive condition, a perfectly normal contracts. Here the consumers may be principal losers. They can get better terms, lower prices and/or income from such transactions – millions want and do – and the section seeks to deny them this right and opportunity. The section should be scrapped and the matter left to the laws of fraud and contract.

§46 (2) (b) (iv)

§46 imposes costs which will be passed onto consumers, where benefits are unlikely to exceed costs.

CONCLUSION

As stated above, we comment only on a representative sample of provisions. Many that follow impose costs that will be passed onto consumers in the form of higher prices, less choices and smaller markets. §61, for instance, prescribes “good quality”. Quality is itself a product which consumers should be free to purchase or decline. Low-income consumers in particular ought to be free to buy poor quality goods and services at lower prices, such as used goods, and even goods in atrocious condition, because they are affordable. Often the poor want to buy cheap goods they can repair. What matters is if consumers getting poor quality have been cheated, which should be left to freedom of contract (in the absence of fraud).

Every provision in the Bill which has the effect of giving consumers real benefits has the effect of raising the price they must pay or harming them in other ways. Every such provision should be carefully re-examined with a view to deciding whether the government really wants to impose such costs and restrictions of low-income consumers; whether the trade-off is really worth it. Needless to say, the Bill will get support from the minority of consumers (who are from middle and upper income groups) for the simple reasons that they envisage and can afford expected benefits. But their support will be based on a failure to appreciate that every benefit comes at their expense. They may also not appreciate that supposedly cost-free benefits they expect usually have disproportionate implications for the poor.

In the circumstances, we urge the government to concentrate on repealing moribund laws, and to take this opportunity to free the market, as the Honourable Minister envisages, of excess regulation, so that there can be higher growth, more wealth for consumers, and more consumer freedom and choice.

Submitted by:
The Free Market Foundation of Southern Africa
Ref: Eustace Davie and Temba Nolutshungu
011-884-0270

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