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Walmart / Massmart Merger

Submission by the Free Market Foundation

It is unclear from the Portfolio Committee advertisement to what end it is calling for submissions.

In this submission, we make the following assumptions:

1. The Portfolio Committee in particular and the legislature in general has no ability, by virtue of the constitutionally entrenched separation of powers, to interfere with the Competition Tribunal's decision regarding the Walmart / Massmart merger.
2. The Portfolio Committee may legitimately investigate and consider issues of general relevance to parliament's law-making function.
3. This enquiry affords the Portfolio Committee and the legislature an opportunity to clarify the legislature's position on competition law.

In the circumstances, we assume that the Portfolio Committee's objective is to assist it and the legislature in its essential and exclusive function as law-maker.

The formulation of policy as opposed to law is not clearly delineated as an executive or legislative function. Typically, policy is developed within the executive branch of government in accordance with the separation of powers, and proposed legislation is submitted to the legislature for the performance of its legislative function. The legislature may, in theory, establish its own policies and legislate accordingly. In practice this happens only to a limited extent, namely the extent to which bills before parliament are adopted, amended or rejected, usually in the light of evidence submitted to Portfolio Committee hearings.

This submission therefore is not a submission on what should have happened under existing law in the Competition Commission or the Competition Tribunal, but a submission in support of the legitimate mandate of the Portfolio Committee to consider existing and proposed legislative policy.

It is also a submission to encourage the Portfolio Committee and the legislature to remedy some of the negative perceptions that the process may have created, rightly or wrongly, amongst local and international role-players, especially investors.

These potentially negative perceptions include:

1. The perception that what ought to be the single most important constituency and interest in competition policy, namely consumers, were, for practical purposes, unrepresented and to a greater or lesser degree ignored or compromised. The saying that when elephants fight the grass gets trampled applies to the Walmart / Massmart merger. The vocal and visible parties were narrow vested interests: Walmart, Massmart, their competitors, unions representing existing employees, and government departments. What was conspicuously absent were such interests as consumers, workers in other sectors, the unemployed, and beneficiaries in other sectors that would enjoy increased spending made possible by savings brought to the economy by the merger. The broader and amorphous “public interest” or “national interest” are terms loosely bandied about without meaningful or definable context. As has been well demonstrated in economic literature, such terms are so devoid of coherent content as to mean whatever anyone wants them to mean, which is why they are used in support of every conceivable policy proposal.
2. The perception that competition law is a legitimate weapon to be used by competitors against each other is particularly unfortunate. There is a serious danger in South Africa that competition law becomes a means of avoiding competition rather than competing. The purpose of competition policy ought not to be the protection of those who cannot compete successfully from those who are more competitive in the market place. This enquiry affords the Portfolio Committee an opportunity to make this clear and to stress that the primary purpose of competition policy is that competitors must compete by appealing to consumers and that it is consumers who should have access to competition policy if circumstances harm their interests. If consumers, for instance, vote freely with their rands for a given supplier, competition policy should not become a means of forcing them to sustain less preferred suppliers. The sole purpose of competition policy should be to identify and remove genuine obstacles to market entry, innovation, and the like. This enquiry affords the Portfolio Committee an opportunity to consider the extent to which government policies that do not come under competition policy scrutiny are anti-competitive. These include entry barriers and subsidies, red tape which discriminates against small and emerging business, and, as far as retailing is concerned, restrictive application of zoning laws in some jurisdictions.
3. The perception that South Africa is willing to consider protecting uncompetitive businesses from foreign investors is, perhaps, the single most negative perception that the Competition Commission’s enquiry has generated. The Portfolio Committee and the legislature could make it clear that they want a competitive and globally relevant economy, especially as a member of BRICS, and to that end welcome foreign investment; that it is not South African policy to protect uncompetitive local businesses from globally competitive local and international businesses.
4. The perception that it is a legitimate function of competition policy to consider an open ended range of issues such as labour, small business promotion, protectionism, foreign investment, and so on *ad infinitum*, is inconsistent with the intended purpose of competition policy as it is generally understood. In this case, it is particularly instructive that the position adopted by the Competition Tribunal is anomalous in that it has prescribed anti-competitive conditions in favour of local suppliers and labour. In doing so it has, arguably, trespassed into the explicit domain of other government departments and agencies. Such other government departments and agencies have dedicated mandates and expertise regarding job creation, labour relations, protectionism, small business promotion, and so on. If anything, the competition authorities should find themselves in conflict with protectionist policies rather than advancing them. They should be the countervailing watchdog in favour of competition whereas institutions in other contexts are charged with curtailing it when other anti-competitive national priorities prevail.

The Free Market Foundation, as its name implies, espouses a market that is free of excessive government interference. As is clear from all recognised pro-free market literature back to Adam Smith’s *Wealth of Nations*, through such luminaries as Hayek and Friedman, to such modern exponents as Sowell and Buchanan, **the essential purpose of markets is to serve the interests of consumers.**

Protagonists of free markets are not, contrary to popular mythology, fronts for the interests of business, whether big or small. As the great exiled South African free market economist, William Hutt, put it, the objective of a free economy is “**consumer sovereignty**”. One of his protégés, Raymond Ackerman, founder of Pick n Pay, applied Hutt’s economic theories in order to create the extraordinarily successful Pick n Pay group. Building on Hutt’s consumer sovereignty idea, Raymond Ackerman coined the phrases the “consumer is queen” and the “consumer is always right”. Emulating the philosophy of Hutt and his father, the current CEO of Pick n Pay, Gareth Ackerman, said with reference to the Walmart / Massmart merger that it would have been absolutely wrong for the deal to

have been turned down. Since there is probably no retailer in South Africa that is theoretically more threatened by the merger than Pick n Pay, Gareth Ackerman's position of principle is particularly instructive. According to the Ackermans, and all free marketers, **consumers and only consumers should decide who stays in business.**

One of the great myths is that consumers are weak. On the contrary, **consumers are not only sovereign, but ruthless.** They hire and fire the world's largest conglomerates with every consumer choice they make, whether considered or whimsical. The biggest corporations spend billions doing "consumer research" and "market research", and running elaborate advertising campaigns, in a desperate attempt to appeal to sovereign consumers. The assumption that consumers are ignorant and uninformed has the unintended consequence of leading to legislation, intended to "protect" consumers, that in fact removes the right of consumers to decide for themselves how to spend their money and to what terms to agree.

If the Walmart / Massmart merger hearings have lessons for the Portfolio Committee they must surely be that it was not just freedom of enterprise that was at risk, but the rights and interests of consumers. What the opponents of the merger were essentially arguing for was that consumers should not be offered more choices at preferred prices.

This analysis must not be misinterpreted as being a critique of the Tribunal's ruling. On the contrary, it is understood that the conditions laid down by the Tribunal are those which were suggested by Walmart / Massmart. Apart from the R100m supplier development fund, it is understood that the other conditions would probably in any event have been what would follow the merger. It is nonetheless appropriate to consider two of the arguments against the merger. Namely:

1. That jobs would be lost.
2. That increased imports would harm local industry.

These are old and seductive arguments. They have been refuted many times by economic theory and hard facts.

The argument that jobs might be lost is, stripped of its pretty packaging, an argument against efficiency. It is essentially an argument that the same job could be done by fewer people. It is not necessarily true, of course. But let's assume that it is. If we assume that the Walmart / Massmart merger would result in precisely the same outputs produced by fewer people, would we have a case against the merger? The obvious answer is no. All human progress occurs to the extent that human beings find ways of being more productive, that is of equivalent units of human endeavour producing units of greater value. If the job-loss argument had any validity it would mean that we should never have allowed vehicles to replace ox-wagons or planes to replace sailboats. We should also not have allowed electric motors to replace horsepower, and we should not have allowed horses and cattle pulling wooden ploughs to replace human power. A moment's reflection makes it clear that the argument is anachronistic and ahistoric, and devoid of any logical substance.

What we want in South Africa, in the national interest, is for everyone to find ways of getting the same job done with less people. As far back as the 1700s, Adam Smith pointed out that if the Luddite assumption that greater efficiency causes unemployment was true, the pin industry alone would have rendered the entire British population unemployed. The number of pins made by pin-making machines was such that if pins were still made by hand, the entire working population would have been required to produce the same number of machine-made pins.

What must be asked when there is a fear of job losses through a Walmart / Massmart merger, is how it will affect the country as a whole. The answer is to replace a static analysis with a dynamic analysis that looks at the "big picture". Assuming the worst, that the Walmart / Massmart merger results in, say, 50% of existing employees being laid off, and no improvement in consumer choices or lower prices, what will happen to the workers who are laid off? The first and most obvious answer is that they will be available for alternative employment including self employment and employment by Walmart / Massmart competitors (who are best placed to take advantage of their skills). They will indeed join the pool of unemployed South Africans, but it is a myth to think of the unemployed as an amorphous or generic whole. Job seekers are a complex and diverse range of people with specific skills and geographic localities.

Additionally, Walmart / Massmart will have savings or profits in direct proportion to laid off workers. Those savings or profits will be ploughed directly back into the South African economy. Assuming all other things to be equal (*ceteris paribus*), the number of jobs thus created will be precisely equal to the jobs lost. In other words, in the absence of evidence to the contrary, it must be assumed that layoffs as a result of the merger, if any, will be precisely equal to jobs created by it.

The real world is, of course, not that simple. The number of new jobs may be more or less. Economic theory does not allow for confident predictions of which it would be, but it does mean that we know with certainty that layoffs do not necessarily entail an absolute loss of jobs.

What is likely to happen in reality is fortunately more optimistic than merely “heat gained equals heat lost”. The assumption that there will be no improved output is unduly pessimistic. It is much more probable that any layoff will coincide with lower prices and increased choices for consumers. All workers are also consumers. The first benefit for the “working class” will therefore be lower prices and better choices.

The savings consumers make are spent by consumers on something else. This is the famous economic insight of the “seen” versus the “unseen”. We see lost jobs and consumer savings, but we do not see new jobs and additional consumption. No-one knows what consumers will spend their savings on. Whatever it might be, there will necessarily be job creation as a consequence. The number of jobs thus gained might well exceed the number of jobs lost, if any, due to the merger. It can probably be said with a high degree of certainty that the merger will result, by virtue of the dynamic nature of economic processes, in the country having a net gain in employment rather than a net loss. From a consumer perspective, there will undoubtedly be net gains. **Consumers will be better off, which should be the principal criterion of competition policy.**

The second issue raised above is imports. The superficial seductive argument is that Walmart / Massmart’s international nature will result in the merged enterprise increasing the ratio of imports. It was argued that this could force its competitors to also increase imports. If this were true, it would be an admission by competitors that they are inefficient and uncompetitive, in which case the best thing that could happen to them is to subject them to the merger. A more plausible assumption is that they are already operating according to what is the economically optimal mix between local and foreign sourcing.

That argument aside, the concern about foreign imports raises a fundamental myth, namely that imports occur at the expense of local industry. This myth has been soundly refuted by economic theory and hard facts many times over many decades. The first and most obvious point of economic reality is that imports can be purchased only with revenue earned from exports. In other words, imports are the reward for having successfully and competitively exported, or having orders for exports. It is easily forgotten that there is no inherent virtue in having “foreign exchange reserves” or an “export surplus”. the sole purpose of wanting foreign exchange and exports is in order to maximise imports. If South Africa were to do no more than export and accumulate foreign exchange, it would be to the conspicuous detriment of the country. Far from wanting to minimise imports and the expenditure of foreign exchange, the national goal should be to maximise them. We need to be in a position to spend as much foreign exchange and to import as much as possible.

The only way in which Walmart / Massmart, or anyone else, could increase imports, is by virtue of someone else increasing exports. Any restriction on Walmart / Massmart’s freedom to import, is a restriction on South Africa’s exporters. Import restrictions directly punish our competitive industries, which have the ability to export, and reward our uncompetitive industries, which are incapable of exporting and can sell locally only by virtue of being protected from their own lack of competitiveness.

From a **consumer perspective**, restrictions on imports are an assault on lower prices and increased choices. If consumer rights are to be protected at all, high on the list should be the right to free choice and low prices. The best, if not the only, way to protect that right is to allow international competitive industries to develop and be rewarded by earning foreign exchange. The foreign exchange they earn is the foreign exchange Walmart / Massmart and other importers buy in order to import. The best way to harm consumers is to protect suppliers who charge higher prices for less preferred goods and services. Foreign trade mythology is one of the great enemies of consumer rights. **The main objective of competition policy ought to be to promote and protect the right of consumers to choose.**

Please note that the FMF would like to make an **oral submission**.

We also attach two papers on competition policy FYI.

Leon Louw
Executive Director