

Is this how the DTI views “competition”?

Background

The Department of Trade and Industry’s draft document on *Competition Policy* purports to present a coherent attempt to relate the dominance of monopolies and conglomerates in the economy to “the public interest”. The broad aim, explicitly stated in the opening paragraph of the executive summary, is “to spur public debate about how competition policy can contribute to the restructuring of the economy”. While the apparent intention to adopt an overall approach to interrelated structural features of the economy is laudable, the suggested methods of improving competition could impact negatively on the objectives of competition policy properly understood.

The core issue is the definition and scope of the “public interest” concept, which the document seems to suggest conforms to international norms and practices. The proposals incorporate a variety of constituents and objectives, including development, macroeconomic and trade objectives, as well as policies designed to enhance black empowerment and redress the apartheid legacy.

The policy recommendations incorporate a revision of present legislation through a monopolies law directed at restrictive practices and the “abuse” of corporate dominance. Such procedures would be pre-emptive as well as “compelling disinvestment or exit from certain markets”. The document claims that the new *Guidelines* put forward “combine features that will be attractive to stakeholders who emphasise market discipline, just as much as to those who consider the state capable of more direct intervention in markets”. This may be so, but it is partly because the *Guidelines* are so all-embracing and eclectic that they are internally inconsistent and contain mutual exclusivities.

Competition policy in South Africa, and elsewhere, has often foundered on the “public interest” rock. These two words can be interpreted in ways which depend mainly on the values and predispositions which their interpreter brings to them. Competition policy, to the contrary, is a technical term on which economists may differ, depending on their technical paradigms, but which can be discussed and debated technically. However, it is difficult to have an impartial debate on a *pot pourri* of the “good things” contained in an unconstrained definition of the public interest. There is a danger that the *Policy Guidelines* could pass into competition law because concerned critics are unwilling or unable to reject the desirable – but (in the context) inappropriate – objectives outlined in the guidelines document.

The Notion of the Public Interest

The conflation of objectives under the broad heading of the public interest is perturbing. Firstly, the normal criteria frequently found in the considerable international literature on the topic – in terms of the effects on consumers, producers, labour etc receive scant attention in the document analysis. The variety of objectives incorporated in the specifically South African version of public interest as defined in the document can also be contradictory.

As acknowledged in the *Document*, there are highly concentrated industries that have grown to positions of dominance as a result of efficiency. A curbing of their (efficient) activities through the proposed legislation could be detrimental or damaging to the future growth prospects of the economy as a whole. Prospective local as well as foreign investors could well be deterred from investing if there is an inkling of unknown and unpredictable reaction by the envisaged Monopolies Board. A brake on the activities of certain large firms could adversely affect exports, corporate tax revenue, and hamper possible spin-off demand for the products of small and medium scale enterprises as well as, in certain cases, adversely impacting on empowerment and affirmative action.

The problem with the shopping basket set of criteria contained in the guidelines is that there are so many vague and subjective aspects that they do not provide a workable yardstick. Alternatively, the competition watchdog organisation could apply the aforementioned imprecise and impractical criteria to any targetted large organisation and subject it to divestment if one or two of the criteria are not met even though the organisation has met all the others. This uncertainty is not conducive to an investment-friendly, growth-enhancing environment.

Competition and the International Environment

The argument in the *Document* in Chapter 4 concerning the relationship between monopolies and the foreign sector is also confusing. The *Document*, (citing the 1997 UNCTAD World Investment Report for 1997), argues that, as far as foreign investment is concerned, the highly concentrated/monopolistic structure of the South African economy served to deter foreign investors from investing in South Africa in the post-sanctions environment. If this were true, how can we account for the investment that has taken place – before, and even during the sanctions era? Also, why did international conglomerates with market capitalisation far in excess of local conglomerates limit their investment in South Africa? The reality of the situation is that, while the determinants of such investment are highly complex, foreign investment is primarily reliant on economic growth and a secure environment. To blame market dominance by a few major players for the lack of investment is simplistic.

The naivety can, of course, be explained by the source of the UNCTAD comments – foreign investors themselves. Self-seeking business managers are never loath to encourage government to reduce entry barriers (for themselves) if that means weakening the market standing of existing competitors. If the existing competitors are large, indigenous firms that have achieved their market status through efficiency and not monopoly abuse, the negative effects could be significant.

The assumptions regarding the mainly adverse relationship between monopolies/ conglomerates and the lack of exports are also erroneous. As is common knowledge, many of South Africa's principal exporters happen to be tied into conglomerate structures. The demand function for exports is complex, depending *inter alia* on the exchange rate, local demand, relative prices, efficiency in production, transport costs etc. and not on market dominance alone – which indeed could be consequence not a determinant.

The Mercantilist Dominance of Industrial Strategy over Competition

In para 4.3.4. the *Document* argues that there are “tensions and synergies” between Competition Policy and Industrial Strategy. There is no doubt in the minds of the *Document's* authors how these tensions are to be resolved. They “will be managed” (4.3.4) by “the provision of overall objectives” (4.3.4.1.), and making competition policy a “key pillar” of industrial strategy (4.3.4.2) and “within the framework” of both the strategy and the overall objectives the new “authority” – now quaintly described as “autonomous” will conduct its activities (4.3.4.3). If this is not sufficiently clear the *Document* repeats the point in para 7.3.1. There will be a “more precise definition ... of the policy structures ... and government policy... political choices will be exercised in the mandate extended to our industrial strategies and *from there*, to our competition authorities” (our emphasis).

This is not the place to examine the government's industrial strategy in detail. Suffice to say it is regarded by many as of key importance, its objectives are heterogeneous, often internally inconsistent, and indeed coincide with most of the potpourri of objectives contained in the current *Document*. To that extent they are self-reinforcing and so, as claimed, there are hypothetical “synergies”. In practice South African “industrial strategy” is far removed from competition policy as understood by economists. Overall industrial strategy is monitored by NEDLAC and in particular

its trade and industry chamber. NEDLAC's goals include promoting growth of and decision-making participation in the economy. "Consensus" should be sought for pending legislation and in all pertinent areas such legislation (including Competition Policy) must come before NEDLAC for consensus approval. Consumers, of course, are not, indeed cannot be participants.

The process is cumbersome. The Institute of Race Relations (*Business Day*, Oct. 1, 1997) is concerned that NEDLAC's "hours of talk" between the various "social partners" has "acted as a brake". In particular they attribute this to the presence of organised labour in NEDLAC "which represents a fraction of SA's economically active population and whose views flatly contradict the interest of ... unemployed people and entrepreneurs ...". They go on, "(t)he hard truth is government is going to have to take on COSATU to implement GEAR". And yet it was COSATU which successfully promoted the industrial strategy project (ISP) to its current position – an overriding one as we have seen – in official government policy.

At the other end of the spectrum is David Lewis, one of the initiators of the ISP project and also an author of previous discussion documents on competition policy. In *Business Day*, September 12th 1997, he defends NEDLAC as a democratic exercise in "decentralisation of power to civil society". Earlier in his discussion Lewis contradicts his own case. NEDLAC is about decentralisation of power. Yet, he argues, while macro-economic policy "lends itself to centralised policy-making," issues such as "labour market policy (and) industrial policy ... do not even permit the illusion of centralised determination". The reasons Lewis gives for this rejection is that the "active connivance" of participants is required since even "if we leave aside normative notions of democracy, the sheer quantum and quality of information that government requires ... necessitates detailed interactions with society. To imagine it can be achieved solely through Parliament is ludicrous". Quite so.

Lewis, therefore, argues for the additional layer of NEDLAC. His case can be readily extended from amazement at the quantum of today's information required to make decisions. That information or knowledge is divided between different people, and much of it is pertinent to and usable only by individuals "on the spot". Further, tomorrow's relevant information is even more dispersed, speculative and diffuse, due to changing tastes and technologies. Add to the problem of the division of knowledge over space and time the need for incentives to both appropriate it and use it, and to prompt alertness to what might be, then an additional institution to Parliament is clearly required. Whether Lewis is right in his view that NEDLAC is that institution is another matter.

Economists asked to define the institution as described, would answer – "this is a market with competition".

Other Contradictions in the Document

The *Document* cites a variety of socio-economic objectives as part of the broad public interest criteria. These incorporate redistribution, labour interests and black economic empowerment. Relying on competition policy to achieve these objectives is again overambitious. There are more specific (and hence more effective) policies that could be attempted. In fact, an indiscriminate, ill-defined and subjective competition policy could exacerbate and contradict attempts to deal with these issues.

A fundamental gap in the *Document* is a lack in analysis as regards the multiplicity of reasons that could account for the high levels of monopoly concentration in South Africa. Possible explanations are: investment sanctions, small-sized domestic purchasing markets, excessively high protective policies that preceding governments introduced to encourage local manufacture, the natural evolution

of successful corporations, and a natural attrition in competing companies as economic recession tended to deepen.

A change in both the domestic and world economic environment throughout the 'nineties' has nullified some of the above explanations as to why monopolies have persisted in the more recent time period.

The *Document* is vague in addressing the issue of the composition of the so-called tribunal that will be entrusted with the task of monitoring monopolies. It seems that the DTI will act as the administering body. Beyond that, and given the wide-ranging set of objectives incorporated in the "public interest" concept, there are so many divergent interest groups that the tribunal will run the risk of becoming unmanageable and dysfunctional. Costly litigation will inevitably arise. A full-time watchdog inspectorate will have to be employed – and as experiences elsewhere have shown, that is no guarantee of consistency or predictability of judgement when the terms of reference of the inspectorate embody the amorphous overriding goal of taking into account the public interest broadly defined.

Finally, the *Document* does not take into account the comparative international experiences with competition policy in other countries and the regulatory institutions involved in economies that have been more successful in generating a more competitive environment.

The issue of labour practices in an "uncompetitive" environment also need to be addressed. Do monopolies/conglomerates actually pay lower wages than unregulated small and medium scale enterprises? What is the impact on wages and employment of the activities of monopolistically organised labour unions? Empirical work is required on this aspect. Also, what of important issues like expenditure on Research and Development, skills training etc? Are small and medium scale enterprises going to be subject to the same subjective criteria as their large counterparts in regard to these aspects?

Efficiency and Consumer Welfare – or Development?

Consumer welfare is greatest when society's resources are allocated in the economy so that consumers are able to satisfy their wants as far as technological and physical constraints permit. In this way the wealth of the nation is maximised. Competition policy's aim should be to help bring about this result.

There may be occasions when government wishes to achieve other objectives (e.g. to redistribute income or wealth, to promote the interests of historically disadvantaged people, or to encourage environmentally friendly production or consumption) but such alternative goals are not the objective of competition policy. Anti-trust authorities may note such goals, but they are in the bailiwick of other legislators.

The *Document*, para. 9.1.3. does not accept this view and stresses that it is critical that all government policies – including competition policy – are aligned so as to reduce the uneven "development" of society. Those who "bear the main burden" (para 9.1.3.) include "women, children, the elderly and (the) disabled".

This special pleading makes it difficult to argue the case objectively without appearing to be antagonistic to, or indifferent towards, women, children and others. Commentators must deny that indifference and must emphasise that it is competition which maximises a country's income and provides the wherewithal to distribute that income more generously to such groups.

Society's total wealth depends, of course, on achieving overall efficiency in the production and distribution of goods and services. This overall efficiency is composed of *allocative efficiency* and *productive efficiency*. Judge Bork notes that the "whole task of anti-trust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare". Allocative efficiency is achieved when resources are used in industries or for tasks where consumers value their output most. Productive efficiency is achieved by most effectively using resources in particular firms.

The Tough Technical Task

Economists understand both the theory of maximising and of assessing economic efficiencies. They also understand the problems non-economists (bureaucrats and politicians) have when they try to measure consumer welfare.

Politicians and bureaucrats, no less than anyone else, pursue their own self-interest. Moreover, they do so in an institutional environment which makes it all too likely that their benefit will be at the expense of the public as consumer.

First, there is the role of *information*. The price mechanism provides consumers and businessmen with the information about shortages and surpluses that they need for their decisions. They also have the incentive to gather this information, which government officials do not have. Civil servants have no property rights in the gains created from exploiting a profitable trade, nor do they suffer directly the costs of errors in misdirecting the flows of capital or labour. They will not be alert to the best opportunities and will be less likely to exercise caution in making unpromising decisions. Regulators can therefore be presumed to make damaging and harmful decisions much of the time.

Then there is rent-seeking, that is, the use of government power by interest groups and individuals to obtain special privileges for themselves. Successful rent-seekers gain above-market returns by successfully lobbying government for favours. Lobbies representing particular interest groups such as established firms, trade unions or professional groupings are likely to have a disproportionately large influence on government, whereas the interests of large groups, especially consumers, are likely to be under-represented.

Competition policy issues can be lobbied for or against. The 'losers' from faulty policy decisions are invariably consumers and taxpayers, as any one policy will appear to them to have a very low cost because the cost is dissipated across consumers at large and is therefore not highly visible. Consumers and taxpayers consequently tend not to organise in opposition to policy decisions since the incentive to do so is weak. However, to the beneficiaries of policies (providers of labour and capital in the industries concerned), the benefits are visible and worth organising for, both to obtain or to retain them. Since all (or most) will reason this way, the likelihood that large groups such as consumers will organise effectively to counter partial and selective so-called competition policies targeted at benefiting specific producers, is much less likely than that a small group of producers will organise to obtain the policy outcome favouring them.

The *Document's* contexts, as already discussed, unfortunately exemplify these arguments.

Conclusions

The *Document* indicates that government opinion about what Competition Policy is or should be is in a state of flux. Its arguments range from the anti-big business lobby to those who would take a pragmatic stance, issue by issue. It claims to be international in approach. This would apparently

meet the requirements of those commentators who over recent months have argued that the allegedly rigorous “American” anti-trust laws be transferred to South Africa. Still others have urged that the South African model be based on the more “behaviourally” oriented approach of some European legislators.

Unfortunately, rigorousness in the use of economic analysis is not what many South African commentators mean when they use the word “rigour”. By and large they mean tough attitudes to break-up, and an “incipiency” approach to merger, as illustrated by the original working paper on future South African competition policy by Fourie, Lewis and Pretorius (1995, p.22). They wrote: “One option would be to judge dominant enterprises on the basis of their structure alone, without reference to their conduct”. (This is the approach followed in the U.S.) Although this approach, misleadingly labelled American, is still popular in some quarters, Fourie *et al* (p.23) proposed instead the “abuse approach”. Abuse could be defined as “exploitative”, “exclusionary” and “structural”. The abuse would be one of “dominance”, and “presumptions” would be required in any new legislation to define “dominance” or the market-share level at which investigation would be triggered. Some commentators have called that the European approach. Certainly “presumptions” of legal monopoly have existed in the UK (for investigative purposes) when market share hits 25 per cent.

It is certainly possible to provide clear definitions. Yet the essence of competition is that entrepreneurs do the unpredictable in order to meet consumer requirements. Presumptions and definitions may simply exclude, before the event, certain types of behaviour which, after the event, would be interpreted as competitive. In the short run this damages competition, while in the long run it reduces national wealth.

The Fourie *et al* proposals were, however, rejected by the Minister in late 1995. Work was begun on the current *Document* in 1996. It was announced in *Business Day* on 15 July 1996 that the task force charged with writing this current *Document* had argued that government must take a political decision as to whether the legislation should have “an exclusive economic focus or should serve political and social goals”. This is the apparent dilemma. It should not be. The task force argued that competition laws should promote “...consumer welfare and economic efficiency by preserving the freedom of economic action of market participants”.

The argument put forward by the task force is clearly receiving little weight. If it had, then the 1979 Act would require very little amendment in intent, although it could be substantially edited and the authorities provided with greater implementing powers. What is required is not the impossible (and undesirable) – namely that all aspects of monopoly control should be expressed in universally applicable laws and regulations. Rather, the aim should be confined to promoting competition. A sustained effort should be made to build up a coherent body of decisions and of guidelines for these decisions. This would give assurance of as much consistency founded on economic analysis and experience as possible. Even concepts such as the “public interest” can – *in context* – be defined by cumulative decisions or rulings over the years. If the views are correct they will stand, if not they will depreciate in the face of later economic arguments.

Inconsistent judgements may naturally be given but inconsistency can be corrected in later court decisions. Inappropriate drafting of inflexible presumptions cannot.

That South African Competition Policy is imperfect is not questioned. Yet the view that the overall objective of the 1979 Act – *Maintenance and Promotion of Competition* – requires rejection, is unacceptable. What is preferably required is a regular and more consistent application of economic

principles. Cross-referencing and frequent consultation of existing precedents and works of analysis by the Competition authorities should be encouraged. This will result in more predictable and more appropriate verdicts, whilst previous errors will be corrected in the light of better understanding.

Perhaps government (and business) resources can then be put to better use examining anti-competitive structures and practices in state-protected industrial or professional environments (including the parastatals and organised labour), in an endeavour to ensure that markets work for the benefit of society as a whole.

References & Further Reading

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