

Monopoly and competition policy

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Foreword

In this *Monograph* Professor Reekie provides a brief but comprehensive overview of a policy that has become the subject of much heated debate recently. The government has announced its intention to revise existing legislation on competition and monopoly. In the meantime, numerous political statements have referred to “unacceptable levels of concentration” in South African industry and large companies may be forgiven for believing that they have been found guilty of offenses that as yet exist only in the minds of a few politicians. Some wonder whether new legislation will be written to support pre-determined verdicts. The resulting uncertainty is detrimental to future investment and much-needed economic growth.

Monopoly and Competition Policy has been written for the layman who wants to know more about this important issue. Professor Reekie points out that the first anti-monopoly laws were aimed at preventing English monarchs from selling monopolies to raise money. The USA’s Sherman Act (1890) was the first attempt to regulate those firms deemed to be privately created monopolies. Both the act and the principle on which it was based have been controversial ever since, and the courts’ interpretations of the law changed considerably over the years as the economic consequences of earlier decisions became apparent. Elsewhere, notably in Britain and South Africa, attempts to regulate so-called private monopolies in the “public interest” floundered because of differing interpretations of what constituted the public interest. The result was demonstrably inconsistent rulings.

Professor Reekie questions whether structural factors such as size, integration or diversification of firms can ever be used as reliable indicators of negative behaviour. He also warns that the South African government, in framing new competition law, must be careful not to impose costs and constraints on local firms that will make them uncompetitive on world markets.

Our present industrial structure is the result of conditions imposed on the economy in the past, including high tariffs, race-based legislation, exchange controls, years of double-digit inflation, the existence of numerous state industries protected from competition, and high levels of regulation. Once all these policy measures and impediments are removed, the structure of firms will change in response to the new competitive environment and the firms’ behaviour will be disciplined by the market, making intervention probably both unnecessary and counter-productive.

The aim of legislation regarding monopoly and competition policy, Professor Reekie concludes, should be solely to protect consumer welfare, and enforcement should be characterised by consistent application of sound economic principles. This would lead to more predictable and appropriate rulings, which in turn would create a more stable business environment. Since unwarranted inhibition of entrepreneurial activity eventually translates into a loss of consumer welfare, this monograph is in the final analysis a voice in defence of the interests of the consumer.

The views expressed in this *Monograph* are those of the author and are not necessarily shared by the members or staff of the Foundation.

Eustace Davie
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The author

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W Duncan Reekie

1

A historical perspective

Introduction

South African competition law is of relatively recent origin. It is embodied in the *Maintenance and Promotion of Competition Act* (Act 96 of 1979) which came into operation in January 1980. Prior to that date the 1955 *Regulation of Monopolistic Conditions Act* had been passed but its provisions had been both parsimonious and little used.

In contrast to the relatively short life span of competition policy (which is essentially a negative instrument used by the state to tell businessmen what they cannot do, positive industrial policy instructing or encouraging businessmen to choose actions has a longer and less ambiguous history. The government owns several nationalised or parastatal corporations (e.g. Eskom, Telkom, the Post Office, Transnet, the Land Bank, Armscor, Denel and the IDC). It also owns equity through the Industrial Development Corporation (IDC) and the Small Business Development Corporation (SBDC). The IDC was formed in 1940 to foster the development of allegedly high-risk industries towards which private investment, it was argued, would not be attracted. (This was also the reason given for the establishment of ISCOR in 1927 as a nationalised iron-and-steel firm, although iron and steel production did not begin with ISCOR. Prior to World War II the United Steel Corporation, among others, was producing significant volumes of steel, while in the post-war period Highveld Steel and Middleburg Steel are major producers of specialised steel products).

The IDC continues to hold 300 million ISCOR shares. It also holds 170 million shares in SASOL (the now partly privately owned oil-from-coal giant) which was originally established for politico-strategic reasons. Another 'strategic' investment of the IDC is the Atlantis Diesel Engine company; other holdings include joint ventures (sometimes to induce investment, sometimes to rescue ailing firms) with foreign or domestic firms. Examples of these include organisations such as Safmarine (shipping), Alusaf (aluminium), Richards Bay Minerals, Siemens and Foskor (fertilisers).

The IDC's rationale, of course, has always been somewhat ambiguous. On its foundation in 1940 there was no evidence that investors were unwilling to expend large sums of capital on projects of high risk with a long pay-back. At that stage, however, investors simply believed that the mining sector rather than manufacturing was where the country's comparative advantage lay. The IDC's existence can, nevertheless, be argued for on either 'infant industry' or 'strategic' grounds. It is also seen by some as having the portfolio management experience and expertise to indulge both in nationalisation and in sectoral selection and encouragement, the latter falling under the general rubric of 'industrial policy'.

There is then a dichotomy in actual or intended government policy towards industry. There are agencies such as the IDC and nationalised firms that have substantial administrative discretion. But there is also the Competition Board, whose objective under either the 1979 Act, or any probable succeeding legislation would be somehow to confine such discretion if exercised by management in private industry. The purpose of this *Monograph* is to examine the latter part of this dichotomy and comment further on its appropriateness, particularly with regard to monopoly, merger and restrictive practice legislation (I have already discussed the former aspect of the policy split in FMF *Monograph* No.10, *On Industrial Policy*).

Early history, natural rights and utilitarianism

Ambivalence towards monopoly has a long history. In England, Queen Elizabeth I and earlier monarchs could grant exclusive trading rights and privileges relating to specified commodities or new sources of imports. When in need, they sold monopolies to augment revenues (for example for soap boiling in London). Parliament resented this practice and in 1623 passed the *Statute of Monopolies* which made it unlawful.

The case against *government-awarded* monopolies was reinforced by natural-rights philosophers such as John Locke (1623-1704) and Thomas Jefferson (1747-1826), who argued that the individual's inalienable right to life, liberty and property implies the right to enter into any voluntary, mutually acceptable exchange and to retain any property arising from such a trade. Consequently it is wrong to interfere with such transactions, and equally wrong to outlaw or regulate voluntary contracts, such as particular forms of business organisation, since that would impinge upon the natural right of individuals to do with their own property as they saw fit.

Legislation banning the monarch from awarding monopolies (preventing others from trading) is therefore consistent with this natural-rights view of an economy. Anti-monopoly laws as we know them today – discouraging certain types of voluntarily-created business enterprises or agreements – are inconsistent with this concept.

By the eighteenth century government-created monopolies were unusual and generally required special Acts (as for land purchase to dig canals and build railways). In ordinary trade and industry, parliament in the UK neither created monopolies nor did anything to prevent private citizens from creating them if they could. The only constraint on private monopolies was the common-law doctrine on “restraint of trade”, which held that it was legal to draw up a contract in restraint of trade, but such a contract was unenforceable in court.

Adam Smith in the *Wealth of Nations* (1776, p.145) agreed with this legal stance and with the natural rights view that contracts voluntarily entered into should not be outlawed. He also hints, however, at why government might move from awarding monopoly privileges to intervening in business activity:

... people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary.

While Smith's argument coincides with a natural-rights view, the most commonly quoted part of it is the first sentence suggesting that free-market exchanges may not be in the wider public interest. Groups of sellers may collude, prices may be raised, higher profits be earned, but the hapless consumer must either do without the goods or pay more. In aggregate, producer and consumer are worse off. Thus utilitarians such as Jeremy Bentham (1748 – 1832), who argued for ‘the greatest happiness of the greatest number’ conclude that government should intervene in the market process.

The utilitarian view that the subjective values and costs of individuals can be added together in some objective way may be disputed. Nevertheless, utilitarianism and the ‘public interest’ is a powerful argument as to why privately-created monopolies (and not only governmentally-granted ones) should be regulated or controlled.

Revolution in industry – and in economics

Smith's writings preceded and Bentham's coincided with the Industrial Revolution, when factory production was substituted for cottage industry technology. With what must have seemed bewildering speed for the people of the time, ever larger organisations emerged in industries such as railroads, iron and steel, and oil, as entrepreneurs took advantage of the cost savings available from managerial, technological and financial economies of scale.

Professor Frankel (1969, pp.36-7) has given a graphic description of financial economies in the South African context. Describing the rationale for the large mining-finance houses – which sponsor individual mines – he claims that without the group system “it is very unlikely that the industry could have been developed”.

In opening a new gold mine, the magnitude of the economic and engineering problems were such that the venture, in order to insure the distribution of the risks ... had to be sponsored by large ... companies ... The original share capital bearing the maximum risk, came to be entirely subscribed by one or more of these ... houses ...; it is not until a later stage, when mining operations have produced sufficient information to make a closer valuation of the prospects of the mine possible, that investment buying by the public takes place...

In the USA what became known as ‘trusts’ appeared in a wide spectrum of industries. Sometimes managerial errors occurred and the creation of large corporations proved to be inefficient. Giantism could be a high-cost form of organisation and, when it was, the firms collapsed under their own weight. Who today remembers US Leather, National Wallpaper, Standard Rope and Twine, or National Starch?

Many, however, were successful and therefore highly visible. From the end of the US Civil War consumers began to benefit from the lower costs and lower prices brought about by large enterprises. As goods became more accessible with the spread of the railroads, small localised businesses were suddenly exposed to the competition of impersonal, distant, larger and lower-cost rivals. Farmers, too, saw their incomes fall as their selling prices dropped during the nineteenth century’s last decades. And since most farmers were also locked into fixed debt repayments, this led to falls in their real incomes.

Thus two important lobbies – small businessmen and farmers – who could appeal to the general US philosophy favouring diffusion and decentralisation of powers were opposed to the trusts and to large (and often distant) business in general. This, coupled with one other factor, the concept of “perfect competition”, resulted in a century of anti-trust legislation which has only recently been reevaluated.

The concept of “perfect competition” first appeared in 1881 in Edgeworth’s book *Mathematical Psychics*. It would form part of the basic toolkit of many economists for the next century, though Edgeworth’s original definition would be refined and honed considerably.

Perfect competition is a state in which an apparent form of socially optimal structure of firms exists. The situation may be undesirable or unattainable, but it has the advantage of providing a yardstick for industrial or competition policy legislation.

From the theory of perfect competition, anti-trust legislators developed the Structure : Conduct : Performance paradigm (SCP).

In essence, this assumes that firms strive to gain large market shares in order to maximise profits. The striving by each holds each in check and encourages the holding down of prices and costs. But if one or a few firms succeed in gaining high shares, they can set prices higher, thus permitting inefficiency and unfairly redistributing income and wealth. These costs, of course, can be offset by economies of scale or increased innovation. This argument is summarised in the box below.

It is only a small step further to argue that monopoly profits increase with concentration (indeed, in the past many empirical data were provided to support this view) and that industrial structure should therefore somehow be controlled.

Structure Perfect Competition and/or low concentration levels	→ Conduct Price : cost ratios close to unity with consumer	→ Performance Allocative efficiency prices are kept in line valuations and productive efficiency (costs are held down)
Monopoly and/or high concentration levels	Price : cost ratios departing from unity	Inefficiency and possible monopoly profits

A century of anti-trust: USA, UK and South Africa

Anti-trust law made its first modern appearance in America's 1890 *Sherman Act*.

The first major compulsory divestiture of assets under the Act was in the 1911 Standard Oil case. Size *per se* (not a 100% market share with a single seller) was judged to result in net harm to the general welfare. Little economic analysis was carried out during the case and 'guilt' was determined by corporate structure alone, not by economic performance.

In later cases size *per se* was not the initial criterion for condemnation. The 'rule of reason' was applied. In the 1911 Tobacco case a trade-off was made. The court decided that economic performance had improved (due to corporate size), yet ordered dissolution nonetheless.

The 1920 US Steel case continued the slight swing away from condemnation of size *per se*. The court did not order dissolution. It claimed the firm had not exploited its market power and had therefore committed no offence.

In the 1945 Alcoa case, however, size was again condemned. Judge Learned Hand accused Alcoa of 'doubling and redoubling its capacity' before others entered the field. Alcoa had to agree to compete less aggressively with those government-owned aluminium firms due to be sold off after the war. (In effect, consumers would then have to pay more for what they wanted from existing large firms while awaiting supply increases from other firms). These decision do not carry the stamp of rigorous economic reasoning. What they *do* reveal is a populist unease with big business irrespective of benefits provided to society.

The negative attitude to existing structure, or size *per se*, was also applied to mergers or potential structure in the *Clayton Act* of 1914. The *Celler-Kefauver Anti-Merger Act* of 1950 was even more restrictive. It initiated the 'incipiency doctrine' whereby a merger which need not itself result in a monopoly would be banned because any succeeding merger would consequentially be closer to producing one. The 1952 proposed merger between Brown Shoe and Kinney Shoe (which would have resulted in a joint market share of only 5%) was prevented for this reason. Again, the lawyer's concept of monopoly was far removed from the economist's strict 'single seller' definition.

The 1982 AT&T case resulted in dissolution by consent. Twenty-two regional telephone and cable companies were sold. This, however, was the last anti-trust divestiture in America. Furthermore, the AT & T case represented less the historical unease over size and more the desire to break up a government-protected, regulated industry. The case was closer to a UK-style privatisation than to a turn of the century corporate breakup.

This change in US thinking was even more dramatically illustrated in the same year when the IBM case was dropped by the authorities after 13 years of litigation. Most of the government's complaints were that IBM had reduced prices and increased output, which McGee (1988, p.476) points out are 'not exactly the stuff of which real monopolising and consumer injury is made'. This decision marked a watershed in American legal attitudes towards big business. Since then, US legislation has been more rigorous in its application of economics.

An understanding of why this change occurred is crucial to a correct appraisal of what effective competition is. Chapters 2 and 3 below provide some of the necessary background for this purpose.

It took 60 years for anti-trust policy to cross the Atlantic to the UK (1948). The following reasons have been put forward for the delay include:

- i There was no overt and dramatic merger movement in the 1880s and 1890s as there was in the USA. “Buccaneering” equivalents of Carnegie (steel), Rockefeller (oil) and Morgan (banking) did not exist.
- ii British firms had to compete in export markets, and against imports. American business – partly due to tariffs, partly to self-sufficiency – was apparently less exposed to competition, so the need for regulation was apparently greater.
- iii Academics and politicians saw little mileage in anti-trust legislation. One party was interested in reform through socialism, others were concerned with issues such as social welfare, Imperial trade preference, the ‘Irish question’, and the South African War and its aftermath.
- iv Later, in the Depression years, economic policy concentrated on mitigating the slump. Remedies included abandonment of free trade and encouragement of industrial rationalisation. The time was not right for policies that discouraged mergers and corporate growth.

The 1944 *White Paper on Employment Policy* took a different view. It argued that competition would hold down post-war inflation, and that exhortation to the monopolists of labour (the trade unions) to restrain wage demands (i.e. the price of labour), was unlikely to be successful if business was not also controlled in some fashion.

This, coupled with disillusionment with nationalisation within the Labour government, resulted in a swing towards anti-monopoly legislation as an alternative. The *Monopolies and Restrictive Practices Act* was passed in 1948.

UK legislation is conduct-oriented rather than structure-oriented. In other words, a firm or groups of firms will be condemned if behaviour is deemed to result in some specific ‘abuse’ detrimental to the public interest. This need not be associated automatically with market dominance (although a 33% market share, not a single-seller situation, was enough to trigger off an investigation).

Therefore, British policy is often alleged to be more pragmatic in intent than the US equivalent. The British approach emphasised the concept of the ‘public interest’, while the US stressed the ‘market setting’.

But the ‘public interest’ is difficult to determine. Professor GC Allen (a former member of the Monopolies Commission) argued that the guidance provided by the Act as to the public interest “consisted of a string of platitudes which the Commission found valueless. It was largely left for the members to reach their own conclusions by reference to the assumptions, principles or prejudices which their training and experience caused them to apply to economic affairs” (1968, p.16). Only after the passing of the *Fair Trading Act* 1973 did anti-monopolies policy explicitly specify that ‘competition’ should be regarded as a goal. Even there, however, the public interest was included and the Commission had to take account of ‘all matters which appear ... in the particular circumstances to be relevant’. Nevertheless, the goal of competition did make judgements susceptible in principle to the rigours of economic analysis.

The 1973 Act, moreover, revised the definition of ‘monopoly’ (from the legal viewpoint) from a 33% to a 25% market share – far from the economist’s single-seller situation.

Charges of inconsistency in the UK approach have been made as often as has praise been given for its pragmatism. For instance:

- i British Oxygen’s return on capital of 23-25% was deemed ‘unjustifiably high’, whereas the Molins Machine Company’s 36% was deemed acceptable;

- ii Turner and Newall's drop in profitability from 42% to 13% was condemned as indicating inefficiency, while Kellogg's fall from 70% to 37% was approved of on the assumption that the decline would continue;
- iii Lucas, with 95% of the car dynamo market, escaped censure, whereas Roche, with 60% of the tranquilliser market, was argued to have abused its position – thus implying structure is unimportant;
- iv The two main detergent firms were condemned for entry-detering levels of advertising in the powder market, in which they held a 96 percent share. Their (higher) advertising expenditures in the liquid detergents market, in which they held a 66 percent share, escaped censure – thus implying structure *is* important.
- v Lonrho was permitted to acquire SUITS (a Scottish company owning House of Fraser and so Harrods' shares) despite pleas that the takeover would damage the career prospects of Scots based in Scotland. A year later Hong Kong and Shanghai Bank's bid for the Royal Bank of Scotland was rejected by the Monopolies and Mergers Commission for just this reason.

The list could be extended, but suffice it to say that economic trade-offs were rare and what was deemed to be 'in the public interest' in the UK was as unpredictable as what was deemed to be 'reasonable' in the USA. Historically at least, rigorous use of economics was as rare in the UK after 1948 as in the USA after 1890.

In South Africa, with its colonial linkages, factors similar to those operative in the UK delayed legislation. While there was antagonism towards 'trusts', it was essentially ethnically based and directed against either English speakers or their sub-groups.

Economists such as Frankel emphasised that the groups (or trusts in American jargon) increased the availability of capital in the economy by facilitating new saving and investment (see p.4). More

efficient forms of risk-bearing – such as the mining-finance houses – were like new forms of production. Innovations of any sort not only replace existing goods and services, but increase the total income of the community by opening more productive investment opportunities.

The mining houses, however, have now become conglomerates, and not only is mining controlled (not owned) by a few dominant corporations, but so too are many other industries, often by the mining-finance houses themselves. As a result, large South African firms are being scrutinised from both ends of the political spectrum. The recently established (in historical terms) Competition Board stated in its *Second Annual Report* (para 9):

Oligopolies ... can (cause) prices to congeal at unduly high levels, while conglomerates can distort competition by ensuring market support for their members at the cost of more efficient outside firms ... these ... should be under constant scrutiny so that possible abuses can be detected and ... corrected in the public interest.

The *Fourth (1983) Annual Report* took a similar position. Paragraph 14 explained why:

... conduct is never unrelated to market structure ... both are of the utmost importance for ... implementation of competition policy.

In typical SCP fashion, these two reports argue that concentration leads to high prices, inefficiency, and income maldistribution from consumers to producers. Moreover, this maldistribution has greater political implications in South Africa than elsewhere, since most consumers are black and most producers are white. That is why ANC member Albie Sachs (1990, p.167) argues that anti-trust policy is of more importance than nationalisation:

Blacks have effectively been excluded as significant actors in the spheres of finance, production and services. Backed directly and indirectly by the law, whites have exercised unconscionable degrees of monopoly control; training has been manifestly unfair, and racially-based restrictive practices have abounded ... The application of anti-trust legislation (to the major conglomerates) ... could in fact have implications more dramatic than a drive towards nationalisation.

The Competition Board's reports have therefore often displayed the strengths – or weaknesses – which characterise the UK and US judgements. The 'public interest' is the 'final criterion' for evaluation. In 1982 the chairman of the Board defined this as 'the interest of consumers, producers and traders as well as the broad national interest'. The national interest in turn was defined as achieving:

... economic growth, the efficient utilisation of resources, an acceptable pattern of income distribution, a desirable general price level and equilibrium in the balance of payments.

This has led unsurprisingly to unpredictable verdicts. The definitions embrace groups whose interests do not necessarily coincide, as well as economic targets which may be mutually exclusive.

For example, in the Alcoholic Beverages report the beer industry's structure, dominated by SA Breweries, was condemned. A dissenting member did, however, argue that the appropriate market for examination should include wine since the products are close substitutes, the presence of each product precluding monopolistic exploitation of consumers by the other.

Again, in the Soft Drinks Industry report, Coca-Cola's large market was applauded as a consequence of 'normal business practices'. Elsewhere in the report the firm was condemned for awarding additional discounts to tied houses in Soweto and Kliptown. Presumably this is abnormal practice.

Current issues

There is, then, despite the lengthy history of monopoly and competition policy, no consensus on the matter. In the USA reinterpretation of the law has resulted in more rigorous judgements, at least since the early 1980s. In the UK and South Africa, significant rewriting of current legislation is imminent. How should future rules be drafted?

This paper attempts to provide some guidance. In the next section the rationale for competition policy is presented. The public interest is defined from the viewpoint of the consumer. Competition is seen to be a process which should not be inferred simply from structural statistics. And it is argued that markets for goods, while important, should not be analysed in isolation from the markets for capital and for votes. Once the market for votes is accounted for we will discover why the seemingly innocuous phrase "public interest" has been so damaging in UK and South African competition policy history. Pressure groups, part of the public, can be more effective in lobbying support than consumers, the general public.

Chapter 3 examines specific structural issues such as size, integration and diversification of industry. Three further reasons (to those addressed in Chapters 1 and 2) are provided for exercising caution in legislative drafting. First, the small South African economy cannot and should not be treated by lawmakers in the same way as other larger economies. Second, economic theory is hard pressed definitively to predict negative behavioural effects from any of these structural conditions. Finally, and not trivially, it is difficult to select measures of either structure or behaviour which unambiguously demonstrate harm to the public interest from either an actual or potential structure.

Chapter 4 examines restrictive trading practices. Issues such as price discrimination, price parallelism, collusion, and other real or apparent anti-competitive behaviour patterns are discussed.

Finally, some concluding thoughts are offered which, it is hoped, will aid both the drafter of new competition legislation and those who apply it. Harvard industrial economist Joe Bain wrote (1969, p.512):

... the application of the law, in the sense of discovery, identification, and treatment of firms or industries that are in violation of its provisions, should be predictable, impartial, and so far as possible relatively automatic – as distinct from being unpredictable, discriminatory, capricious or heavily influenced by administrative discretion.

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Competition policy and its rationale

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.

Adam Smith (*The Wealth of Nations*)

The power of demanding or refraining from demanding is “consumers’ sovereignty”.

W H Hutt (*Economists and the Public*)

Efficiency and consumer welfare

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.

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*. Bork (1993, p.91) claims 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.

Economic theory shows us that a multiplicity of small firms in conditions of perfect competition and producing a homogeneous product (a totally unrealistic and undesirable situation) must achieve overall efficiency. That same theory shows what a single seller (a monopoly) must do in order to maximise profits – again the notion is unrealistic in practice. Alternative, real-life forms of industrial structure lie in between, and here conventional theory – even at an advanced level – is ‘little more than a guess’ about how firms will and do behave (Bork, p.92). Nevertheless, the polar theories are uncluttered, powerful and, even if imprecise, sufficiently adequate in their simplest forms to aid in prediction and explanation and so in policy formation.

Evaluating consumer welfare

It is only when the theories are musclebound and policy-makers are unable to adapt them to the realities of how competition works that they become obstacles rather than aids to successful competition policy. To illustrate their value (and their weaknesses), consider the following five models:

i Harberger

Competition policy aims at achieving overall efficiency. To understand consumer welfare in this context we must understand the concept of consumers’ surplus. Consumers’ surplus is the

value (or utility) consumers gain from buying goods which is over and above the total price they pay the supplier. It arises because although they pay the same price for each unit, including the last unit bought, all earlier units provided greater satisfaction. (This is explained by the two economic laws, the law of diminishing marginal utility and the marginal equivalency principle of consumer equilibrium which states that the marginal cost – price paid – must equal the marginal benefits obtained.) Geometrically, in Figure 1, buying from a monopolist at price P_m , consumers will voluntarily buy Q_m , pay a sum of money in total equal to the rectangle $P_m \times Q_m$, and receive also the consumers' surplus shown.

However, if the industry had been perfectly competitive the price would have been lower at P_c equal to unit costs. The consumer surplus triangle would have been much greater. Monopolisation has resulted in a higher price being paid (P_m not P_c) and lower quantity bought (Q_m not Q_c). has been reduced. Part of the consumer surplus triangle has been shifted to producers as excess profits (not a direct concern of monopoly policy since this is a transfer from consumers to producers, who will in turn be consumers in their own right of some other good or service). But part of it is totally lost to society as shown by the deadweight triangle. This resource misallocation is the concern of competition and monopoly policy.

The first writer to research deadweight loss was Harberger (1954). Over the period 1924-28 for the USA he estimated it at 0.08 per cent of national income. Nobel Laureate George Stigler (1956) concluded that this, if true, was so small that economists would be better employed fighting 'termites' than combating monopoly.

Figure 1

ii **Williamson**

However, the monopolised industry may get the benefits of more efficient production techniques, and so lowered costs (Figure 2). In this case the net welfare gain or loss to the economy is the difference between the two shaded areas. Fewer real resources are used to produce Q_m than otherwise. The excess resources are released to increase output elsewhere. Oliver Williamson (1968) therefore argued that in judging a merger (or a forced unbundling) policy makers must ask whether the cost savings (or increases in the divestiture case) which will result will be greater than the loss of consumer surplus, and *vice versa*. Bork (1993, p.108) points out that in many cases – in fact in ‘most mergers’ and also in the practice of ‘price discrimination’ – the positions and shapes of the lines on the diagram (i.e. business practice) will be such that only cost savings will arise, price will be unchanged and so no deadweight loss will occur, only a net gain.

Figure 2

iii **Leibenstein**

An alternative argument is that inputs are not used as efficiently in monopoly. Leibenstein (1966) argued that X-inefficiency will exist (this is simply a fancy name for what is called inefficiency in everyday life). As a consequence of increased costs, firms – to maximise profit at new cost levels – may even have to raise price further than P_m to P_m^1 (See Figure 3). Output will be still further reduced and the deadweight loss triangle further increased. Excess profits will be less because of the presence of X-inefficiency, and for policy purposes that rectangle be added to the increased triangle to obtain the welfare loss from monopoly (scale effects have been excluded from the Figure).

Figure 3

Leibenstein’s arguments depend on the notion that in departing from perfect competition there is a loss of competitive discipline and pressure on both managers and workers which results in their indulging in higher-cost, less efficient behaviour. Leibenstein has come under criticism from a variety of writers. Indeed here we have a good example of the confusion of terms. (‘Perfect competition’ from first-year theory is not the same as ‘competitive discipline or pressure’. Perfect competitors in fact are under very little pressure, they simply accept passively a market price. Real-life firms of whatever size have to struggle to raise capital, satisfy shareholders, search for a price at which they can maximise profits without attracting new rivals, and develop new and better products so that they can continue to exist and to attract and pay high-quality managers and workers. A firm which cannot do these things cannot maintain its share price on the capital market. Takeover is as sure-fire a way to go out of existence as bankruptcy. Both exert discipline, yet both are assumed away in the simple equilibrium of perfect competition. On grounds such as these, a Nobel Laureate (George Stigler) queried the ‘Existence of X-Efficiency’. Nevertheless there remains plausibility in the argument of another Nobel Laureate (John Hicks) that monopolists would, if they could, live a ‘quiet life’.

iv **Tullock**

There is, however, another reason why the deadweight loss triangle may be too small an estimate of the welfare loss from monopoly. Tullock’s (1967) argument (contrast Figures 1 and 4) is that if a successful monopolist can extort the income transfer of excess profits from his customers, then such a large prize is worth the investment of large resources. Indeed, the prize is greater than indicated in the Figure (which is for one period only), and stretches into perpetuity. Customers likewise will be interested in, and willing to make investments in, activities preventing the transfer.

Even once established, a monopoly will attract continual efforts to break it down, and further investments will be incurred to protect it. In short, the Tullock rectangle, rents, must be added in whole or in part to the Harberger triangle. The rents (which already exist) will attract 'rent-seeking' costs or investments either to protect their existence in the hands of the producer or to transfer them back to consumers or new entrants. The rent-seeking costs simply aid in the transfer of wealth or income, they have nothing to do with its creation. In principle it is worthwhile for firms to incur rent-seeking costs up to a level just short of the value of the rents themselves.

v **Littlechild**

There is worse. There is an additional argument against the waste of rent-seeking behaviour which competition policy authorities must be aware of. They themselves are part of the bureaucracy which rent-seekers (producers or consumers) will try to 'capture'; in other words, they themselves can be a cause of rent-seeking behaviour. The only sure way to eliminate rent-

seeking is to eliminate potential rents, and the only way to eliminate rents (compare Figure 4 and Figure 1) is to eliminate the excess profits – but to do so without the regulatory activity which can lead to rent-seeking – in short, regulation by free competition and market entry, not regulation by law.

But can free competition and market entry arise without regulation? Littlechild (1981) argued affirmatively. The whole concept of Figure 1, he claims, is often misguided. Competition, in Littlechild's view, should always be regarded as a process, not a state of equilibrium (even economic theorists should discard the static version of perfect competition). Profits, then, are never, as in Figure 1, 'excess', but rather are the outcome resulting from entrepreneurship. Alert entrepreneurs have grasped the opportunity of innovation (technological, organisational, marketing or whatever) and have offered a product to consumers. The demand curve is there only because entrepreneurs have drawn the attention of consumers to the possibility of obtaining Q_m at P_m . The relevant alternative, the yardstick for comparison, is not Q_c at P_c . Perfect competitors in equilibrium would never have noticed the possibility of change, the opportunity for profit. The relevant alternative is for the good not to have been supplied at all. Thus the very fact of production and sale implies a net social gain equal to the profits plus consumers' surplus to which production and consumption give rise. However it is measured, deadweight loss is, says Littlechild, an irrelevance.

Figure 4

Who evaluates – consumer or bureaucrat?

Although Littlechild and Tullock come at the issue from different perspectives, together they highlight the problem of outsiders (bureaucrats and politicians) measuring 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. The latter have no property rights in the gains created from exploiting a profitable trade, nor do they suffer directly the costs of error 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, as Tullock showed, 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 small 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 decisions can be lobbied for or against. The ‘losers’ from faulty policy are invariably consumers and taxpayers. The reason for this is that any one policy will appear to them to have a very low cost as the cost is dissipated across consumers at large and is therefore not highly visible. Thus they tend not to organise in opposition since the incentive to individuals to do so is weak. However, to the beneficiaries of the policy (providers of labour and capital in the industry concerned), the benefits are both visible and worth organising for to obtain or retain. 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 than the likelihood that a small group of producers will organise to obtain the policy outcome favouring them.

Lastly, policy can be shown to have perverse results. The status and success of bureaucrats are often measured by the resources at their disposal. Thus the creation, maintenance and expansion of policy is a ‘good thing’ in its own right for a civil servant. The politician, motivated by power and the desire to stay in office, will readily concur. The ‘benefits’ (e.g. ‘lower prices’, ‘preserved jobs’) from competition policy can easily be pointed to. Political support can be gained. The costs, in terms of alternative job opportunities lost which could otherwise have been created, or goods and services lost which could otherwise have been produced with the resources so used, are invisible and cannot be identified. It is not surprising that activist competition policies have an impressive record of failure and of inconsistency.

The safest conclusion for South Africa would be that there is a role for policy which aims at making markets work. It should do this by deregulating product and labour markets and at removing government-imposed entry barriers to industries and occupations. Nationalised enterprises should be privatised by restoring the rights of ownership to the citizens of the country. Displaced workers in declining industries can then be given training vouchers to be used for retraining in areas of their choice. And continued and expanded commitment to international free trade would make for a more competitive economic environment at home.

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3

South African industrial structure

This chapter examines South African industrial structure. It then looks at the empirical debate that has occurred to ascertain if deadweight loss exists and consumer harm occur as a result of South African structure. As in the rest of the industrial world, the evidence here suggests little cause for concern. Indeed, much of the concern is misdirected. Finally, the issue is again raised of how regulators can measure economic harm if they cannot understand either consumer benefit (as non-consumers) or (as non-producers) the meaningful competition required to gain consumer approval.

Concentration and ownership

It is frequently argued that South African industry is highly concentrated. This assertion has two dimensions. First, there is the issue of oligopoly in any given product market. The South African economy has a small number of large conglomerate companies (by local standards) which results in a wide array of otherwise unrelated markets being dominated by subsidiaries of the same six or seven large groups. Secondly, the formal capital market (i.e. the Johannesburg Stock Exchange) is also highly concentrated in that control (not necessarily ownership) of over 80 per cent of the capitalised value of all listed companies is concentrated in the hands of only six groups (two of which are mutual insurers).

Given the apparent concentration of economic control in the hands of a few conglomerates, it is worth recalling a number of points. First, the South African economy is relatively small. Therefore, in industries where large scale is necessary, large companies are unavoidable and the number of firms in such industries will be small. Secondly, politically motivated disinvestment reduced the number of overseas companies willing to be seen operating in South Africa. Disinvestors sold their operations to domestic firms, so increasing concentration both within the market sector concerned and at an aggregate, cross-economy level.

Furthermore, concentration in the past has very often been further politically induced, either indirectly or directly. For example, tax breaks enabled life assurance companies to offer policy-holders after-tax incomes at a more beneficial rate than the saver could obtain by investing directly in corporations or unit trusts. This no doubt is one reason why South African individuals hold more life assurance cover per capita than their European or North American counterparts.

Interest payments are not deductible as expenses against income (as in North America), other than investment income. Thus job-related housing-bond subsidies were encouraged which diverted individual wealth holdings from corporate investment towards the financing of domestic residences. Also, until the 1990 Budget, dividends were effectively taxed twice, albeit partially: company tax was levied on profits, and personal income tax at the recipient's marginal rate was then payable on two-thirds of the dividend. This encouraged profit ploughback. Existing firms then grew even larger because their growth was subject only to a diluted capital market test.

Furthermore, since the early 1960s (with only a brief interlude in the early 1980s) exchange controls have made overseas expansion by domestic firms relatively difficult. Indigenous expansion, often by diversification, further increased aggregate concentration.

Thus government's use of economic policy indirectly encouraged large firm size and small numbers of rivals.

Concentration is therefore, a matter for concern for both political and economic reasons. There is a strong case for asking the Competition Board to examine the degree and cost of unnecessary state intervention and to discover the extent to which, over the years, these have caused high levels of concentration in certain areas of the economy.

But the concentration of control may also be efficiency-induced. In a recent paper Professor Brian Kantor of the University of Cape Town (FMF *Briefing Paper* No.16, *Corporate*

Restructuring and Competition Policy) pointed out that the evolution of the pyramidal structure of the South African economy can partly be explained on the one level by the allocation of economic control (not ownership) to those groups of managers judged by shareholders to be the most competent; and on the other by the wish of owners to retain control by the pyramidal mechanism (disallowed by law in the USA and the UK). This results in a high concentration of control in South Africa and in other countries with similar legal frameworks such as Switzerland and Sweden. In Scandinavia and Switzerland a similar small number of efficient management teams have emerged which, as in South Africa, dominate the relevant national stock exchanges. The added dimension in South Africa is that the control concentration is racially biased (whites as opposed to blacks) just as historically, but no longer, it was linguistically biased (English-speakers as opposed to Afrikaans-speakers).

This racial bias prompted several black spokesmen to argue that 'white' businesses (for example the large retailers) should not be allowed to operate in the traditional black townships, and that purchasing policies of large procurers such as government and the conglomerates should be legally compelled to favour black entrepreneurs, notwithstanding any disadvantageous price differentials. These types of policy proposals seem likely to become ever more overt, albeit, as is so often the case, they appear to favour producer interests (i.e. emergent black businessmen) rather than the interests of consumers (black or white) and providers of finance (black or white) – since, after all, most black consumers would choose to buy from the cheapest stores irrespective of ownership, and most black savers (contractual or otherwise) would choose to invest in media offering the highest returns (usually companies or financial institutions loosely, but incorrectly defined as 'white business').

Indeed, as Frankel pointed out, the mining finance houses were a financial market place innovation in their day and they were the first to evolve into complex pyramid structures. The exploration company was effectively controlled by the operating company, which in turn was linked to a holding company ultimately controlled by the finance house. All four tiers were usually quoted on the JSE so that investors could choose to own shares in whichever level best suited the degree of risk they were prepared to bear. As time passed, and especially as the regulatory and political constraints of the 1960s to 1980s came into play, the pyramids themselves tended to become interested in a wide range of other industries.

Tight control of some of the companies within the groups can be achieved with an ownership stake in the parent company of less than 5%. This controlling share usually represents a large proportion of the wealth of the controlling families. The mutual life insurers Sanlam and the Old (SA) Mutual typically own a much larger stake, about 30% or more of their group companies. The pyramids began as owner-managed firms. Successful ventures expanded by reinvesting profits and by attracting outside capital from banks and more rarely from minority partners. Since the controlling founders have the power *inter alia* to determine the salaries they pay to managers and to themselves, outsiders have little protection and trusting partners are hard to find. Outside shareholders have to rely on the desire of the controlling shareholders to maintain their reputations as custodians of other people's wealth. However, their investments are usually safe as a reputation for fair play and good management on behalf of minority partners is essential if capital for further expansion is to be raised on favourable terms.

There are few limits to the expansion of successful firms other than their ability to raise capital. For the few firms with controlling shareholders of great achievement, prospects and good reputations, raising additional share capital need not prejudice their control. Though control becomes less secure as outsiders come to own 50% of the shares, this barrier may be easily circumvented by the issue of low-voting or no-voting shares where regulations permit. Where regulation inhibits this, a holding company could be formed to hold a 51% controlling stake in the operating company. The original controllers would keep 51% of the holding company and sell 49% to outsiders. Outsiders would then own 49% of the operating company directly and half of the remaining 49% or 25% indirectly. They would therefore own and receive 74% of the dividends from the operating company without being in any way able to control its management.

In the US, UK and South Africa, unlike for example continental Europe, the issue of non-voting or low-voting shares was made difficult by laws and stock-exchange regulation. But South African entrepreneurs were able to achieve exactly the same results with the consent of majority partners by forming holding companies, cross-holdings and voting trusts. They did this to maintain control while raising extra capital for expansion. At times the aim of the expansion was to diversify the holdings of the key operating company, whose wealth had become too dependent on the original single line of business activity. The controllers thus became the controllers of a conglomerate, without giving up control.

Nobody is forced to invest in tightly controlled companies. Any purchase or sale is at a market-determined price. As with all share investments, such transactions come without guarantee. Only time can tell whether the trust placed in the controlling shareholders and in their abilities as controllers of managers and as managers of assets is justified. Though a few South African family-controlled groups have been trusted in this way and have been able to expand without giving up control, they represent exceptions, not the rule. (A fuller discussion of this thesis is presented in Barr, Gerson and Kantor 1995.)

Clearly care must be exercised to the extent that regulations have resulted in concentration of control (in the private and state sectors), deregulation and privatisation will deconcentrate. To the extent that pyramid structures are efficiency induced (as Frankel and Kantor argue), then divestiture policies could have heavy costs for consumers.

Structure and performance

South African political attitudes to big business reflect the ambivalence of history as did 'trust-busting' US President Theodore Roosevelt:

'Th' trusts' says (Roosevelt) 'are haejous monsther built up be th' enlightened intherprise iv th' men that have done so much to advance progress in our beloved country', he says. 'On wan hand I wud stamp thim undher fut; on th' other hand not so fast'.

Source: Finley Peter Dunne's fictional Irish immigrant – philosopher Mr Dooley summarising President Roosevelt's views. (Cited in Scherer, 1980.)

America's ambivalence continues today. As was seen, statute law is tough, yet its implementation and interpretation is either inconsistent or has lapsed. European ambivalence is built into the legislation where case-by-case investigations or 'abuse' are more common than simply attacks on structures *per se*. Flexibility to interpret alleged 'abuse' unfortunately lends itself to inconsistency.

This ambivalence has its roots in common sense, as Mr Dooley emphasised. It also has roots in the problem of how, if at all, deadweight loss should be measured. And, very importantly, the structure : conduct : performance model (SCP) which underpinned much anti-trust activity in the US and Europe from the 1940s through to the 1960s has been found to be inadequate.

WG Shepherd (1985, p.2) summarised the SCP paradigm (see the diagram on p.6) as follows:

1. In every market firms try to attain and exploit large market shares as they attempt to maximise their profits.
2. When these firms' strivings hold each other in check, no firm is able to capture a large market share. The result is a healthy process of competition, which holds down prices, forces firms to be efficient and stimulates innovation.
3. But if one or several firms do attain high market shares, they can usually get extra profits by setting prices above costs and restricting output. Their *monopoly* power can impose social losses by causing inefficiency, a retarding of innovation and unfair shifts in income and wealth.

4. These costs of monopoly may possibly be offset, in part or in whole, by benefits from scale economies or an *increase* in innovation. (Emphases in original.)

It is but a small step from a model of this kind simply to argue that monopoly profits will increase with the concentration of the market. Joe S Bain (1951) was among the first to spell out this relationship explicitly. He argued that successful *collusion* between firms would approach or result in joint monopoly profit maximisation. The ability to collude would increase with concentration and so, other things being equal, monopoly profit rates could be expected to increase with concentration as collusion became progressively more successful. This statement, of course, rests on the implicit and unproven assumption that it is cheaper to police collusive agreements when firms are fewer in number. If they are few, then such small numbers, accompanied by high profits, are viewed, possibly incorrectly, as proxies for the degree of collusion and monopoly profit.

What *empirical* evidence is there to support the view that price : cost ratios are greater in more concentrated industries? (Chapter 4 examines the *theory* of collusion in greater detail.) Is there any evidence to suggest that if such higher margins exist they are due to the desire of firms in concentrated industries to maximise joint profits? The premise that there is a link between concentration and monopoly profit rests largely on quantitative studies published during the 1950s and early 1960s, primarily using US data (and in the 1970s using UK and European data). Nearly all the US investigations used data from the 1950s excluding Bain's pioneering work, which was based on statistics drawn from the latter part of the 1930s. Bain divided his sample into two halves, most and least concentrated. He found a statistically significant difference between rates of return. This conclusion stimulated further research which at first tended to confirm that there is a link between concentration and successful collusion.

The American economist L Weiss (1971) cited a further 23 similar studies which had been published by 1969. Most of these seemed to reveal a weak but nonetheless positive relationship between the two variables. Weiss concluded that 'practically all observers are now convinced that there is something to the traditional hypothesis ... I doubt that we need many more general concentration-profit studies'.

Two later papers by Yale Brozen (Chicago) and one by Harold Demsetz (UCLA) did, however, cast doubt on the empirical relationship between concentration and profit rates. These papers have often been cited as the starting point of 'the new learning' on concentration. In fact no one explicitly asked why high profit rates persisted over time until Brozen did in 1970. He argued that *if there is successful collusion* in concentrated industries, then the above-average *profits should persist over time*. The above-average profits would represent a non-competitive equilibrium; that is, no forces would operate to disturb that situation. On the other hand, if Bain's findings represented disequilibrium, they simply reflected states of transition. Brozen suggested that *profit rates in industries with above-average returns would decline* and those in industries with below-average returns would rise. For one, there would be new entrants in the industries with above-average returns, obviously attracted by higher profits. Capacity growth and supply increases would result in price falls, and rates of return would converge on the average. Conversely, capacity would contract and rates of return rise in industries with below-average returns as some firms would be driven to the wall and others would leave. Brozen found that most of the industries in Bain's sample did indeed perform in the manner he suggested (i.e. industries with high profits at a given point did experience declines in profits over time, and vice versa).

Brozen's findings proved unexpected and puzzling to many. In particular, he faced the challenge that he had examined industries which were concentrated during the period of the original studies, but which had ceased to be concentrated during the period of his replications. To the extent that this was true, Brozen argued, there is little cause for concern since, if the SCP model does hold true at any point in time, then market forces will themselves deconcentrate the industries and reduce the monopoly profits flowing from collusive behaviour.

The initial problem remains. Why should all concentrated industries tend simultaneously to have higher profitability as the evidence suggests? Is it because of collusion by a few large firms?

Demsetz (1973) approached the problem from another angle. The earlier studies linked monopoly power and concentration by suggesting that fewness in the number of firms in the industry facilitates collusion to restrict output and raise price. Demsetz argues that *there are reasons other than collusion for expecting a positive correlation between concentration and profitability*. An association between market concentration and rates of return should be expected from any workable incentive system that rewards superior performance.

Superior ability in lowering cost or in improving products, be it the consequence of luck, entrepreneurial or managerial foresight or the presence of scale economies, may well increase profits and draw sales from the unsuccessful towards the successful and efficient firms. Thus, concentration and profitability could be associated for reasons totally unconnected with collusion and contrived scarcity. In a word, they arise from efficiency reasons. Such situations may (and Brozen's work suggests do) erode with the passage of time as new entrants or existing competitors emulate or improve upon the activities of the successful firm. But unless the short-term monopoly rewards (price : cost ratios above unity) are significant in both amount and duration, there will be no incentive for firms to be efficient, to conduct themselves in ways which would gain those rewards.

Higher profits and increased market share are specific to the firms that perform well in terms of productive efficiency or innovation. Other firms in the same industry which do not satisfy customers by producing appropriate products of the appropriate quality at low costs of production do not share in such higher profits. Demsetz argued, however, that if the only source of higher profits is in fact collusion, then all firms in a particular market should share in these profits. The issue then becomes one of discovering the sources of profitability in concentrated industries.

We can do so by examining the association between concentration and rates of return for those firms that are relatively small in their respective industries.

If there is collusion, it will benefit all firms in the industry. Superior efficiency, however, will benefit only those firms that can more readily attract customers. Demsetz's results (relating to the United States) failed to reveal the predicted benefits that small firms would derive from collusion in concentrated markets. Smaller firms in concentrated industries were actually no more profitable than smaller firms in other industries.

The SCP paradigm is no longer undisputed. This is a remarkable change from just 25 years ago when Weiss argued that further testing was no longer required. Indeed in sharp contrast, Weiss now doubts that any more concentration-profits studies could even be published, but for a much different reason as shown by the following exchange from a special Department of Justice (US) seminar (cited in Hazlett, 1986):

Leonard Weiss. I used to believe that the concentration-profits data provided a meaningful statement, and so I didn't go a lot further in my search for data. I no longer do. I think Demsetz and Peltzman have won that battle.

William Shepherd. I don't agree with Leonard that Harold Demsetz and his Chicago colleagues have won this battle. The tide of debate is mainly in the other direction; Chicagoans have just raised interesting, but by no means conclusive, questions about concentration. And they haven't given any significant evidence against the positive relationship between profits and market share.

Leonard Weiss. Oh, it's conclusive. A large proportion of our colleagues won't believe the concentration-profits relationship. They look at them as very equivocal results at this stage.

Voice from the Audience. The relationship may reflect scale economy as well as monopoly power.

Leonard Weiss Well, scale economy, superior management, or superior product or all kinds of things. *As a result, I don't think you can publish a concentration-profits article any more* (my emphasis).

South African data provide (on a static basis) results similar to those of Bain. But when the figures are neutralised for scale, efficiency and innovation, the Demsetz revisionist view also holds here. Small firms in concentrated industries do not appear to derive monopoly benefits from sheltering under a monopoly-contrived price (Leach 1992 and 1997).

This is a particularly interesting point. Concentration of ownership and control in South Africa (witness Anglo American, Sanlam and Old Mutual) is far higher than in the United States. It seems, however, to have made for superior efficiency. The performance of senior managers has been doubly monitored by the concentrated shareholders, who have had a clear interest in doing so. In the United States more diffuse ownership has tended to promote monitoring by takeover, which has resulted in considerable increases in share value, a clear indication of previous managerial incompetence. What are the implications for the SCP (Structure : Conduct : Performance) paradigm? One is that it is redundant. A second less extreme view would suggest that the relationship runs in the reverse direction not $S \rightarrow C \rightarrow P$ but rather from $P \rightarrow C \rightarrow S$.

Superior efficiency or innovative behaviour, superior management and/or successful exploitation of scale economies draw sales from the less successful to the more successful firm. Concentration of industry (large market share) is a direct result of this effective competition.

Such positions can and will erode with the passage of time as new entrants or existing competitors emulate or improve upon the activities of the successful. On the other hand, if the successful continue to satisfy consumers they will maintain their dominance.

The whole SCP model on which anti-trust policy has been based for most of the century is in question. Good-performance (efficiency) leads to consumer-attracting conduct (prices and products) which leads to concentrated markets. Provided there are no governmental barriers to new competition such as tariffs, parastatal monopolies, professional cartels or other statutory protection devices, market forces will reward successful firms and will by themselves deconcentrate any industries where inequitable monopoly profits exist.

This 'new learning' is influencing anti-trust policy worldwide. But it is not really novel. It is simply a resurrection of the natural-rights approach to trade and exchange. This assumes that private property is respected, owners are motivated to use their property more productively than would any third party, and the monarch or state is denied the authority to infringe such rights by granting monopoly power or sole-seller authority. A sole seller should exist only if he is selected voluntarily by consumers because he meets consumer wants better than any alternatives. Immediately someone else can better satisfy such wants, a monopoly vanishes. To exploit such a position by monopoly pricing – without government restraints such as tariffs, professional codes of conduct or nationalised firms – simply attracts imitators who would undercut the monopolist. The combination of monopoly profits and absent government is as attractive to entrepreneurs as honey to bees.

To recap, successful firms acquire increasingly large market share. Markets therefore become concentrated because of *conduct* (pricing, innovation, successful satisfying of consumer wants) which reflects efficient *performance* (in terms of productive efficiency and the holding down of costs relative to what is produced).

However, even this is not enough. Profits, the reward for efficiency, would then attract *entrants*. This would in turn de-concentrate the industries (as successful entrants would result in a larger number of firms). At the same time actual entry, or even the threat of entry would exert pressure on price : cost ratios, so reducing profits. This is likely to happen even if attempts at entry do not succeed. The motor industry is an example of successful entry. (Toyota and Nissan entered in the 1970s at the expense of Leyland and Chrysler who eventually withdrew altogether in the early 1980s.) The beer industry is an example of the second point. The following quote from the Scottish economist Tom Wilson should not be forgotten:

“Perfect Competition” is not a norm and the fact that it has been taken for one is a remarkable example of the way in which we can mislead ourselves with our own emotive terminology. Indeed the expression “perfect competition” has probably done more to darken counsel than any other in modern economic literature ... (Wilson, 1962).

Few industries are ‘competitive’ in the professionally precise jargon of the economist. Static market analysis frequently reveals the presence of monopoly or oligopoly. A more dynamic approach, however, may well show fierce rivalry between market members, a rivalry and degree of competition which enhances the consumer’s power of choice. If consumers use this power by revealing their preferences in the market-place, then those firms that fail to respond may well find their commercial health jeopardised or their market share adversely affected.

Economists often seem loath to accept their own acknowledged advances. It is over forty years since Schumpeter (1950) emphasised that the competition ‘which counts’ is not traditional price competition but rather the continuous and universal search for substitutes, for replacing the less desirable by the more. The substitution begins with consumers seeking to distribute their incomes to their optimal benefit, and proceeds through to producers striving to replace less sought-after products by more sought-after ones and by substituting better ways of producing for less effective ways. The essence of this competition is consumer choice and the response to changing consumer preferences by competing firms:

... the competition from the new commodity, the new technology, the new source of supply, the new type of organisation ... competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the output of existing firms but at their foundations and their very lives ... (Schumpeter, 1950).

But, and it is a big ‘but’, barriers to competition erected by regulators and lobbied for by vested interests can thwart this process. And the barriers to and distortions of competition in South Africa are legion. Efficient competition policy should direct its attention to these, not to structural variables unconnected with performance.

Implications for monopoly and merger policy

The tough *per se* approach of US legislation is in limbo for good reasons. Article 86 of the Treaty of Rome deals with ‘abuse of dominant position’. The very wording allows for greater flexibility than a *per se* approach. What is dominance? What is abuse? It is difficult to establish a boundary between acceptable behaviour and abusive behaviour.

Indeed the scope for error in both European and American approaches is great. Empirical and theoretical evidence suggests the *per se* approach is simply wrong. Yet detailed regulation (or flexible interpretation of law) depends for its success on the ability of a few people (who may be captured) to judge what is best for consumers. Promoting competition by removing regulatory barriers is probably the better approach. Market competition will then generally outperform the boldest regulator – not least because of its ability to surprise.

Governments can prevent mergers, encourage them, or insist on divestiture. There are strong economic arguments which suggest that when the government does engage in such activity it will often do the wrong thing.

Consider first merger prevention. The ‘failing company’ defence (as in the takeover) is often difficult to employ if the failing company has not, at the time of the proposed merger, failed enough. Mergers can be regarded as a civilised and efficient alternative to bankruptcy and voluntary liquidation. But, especially if a large firm is doing the acquiring, the *prima facie* reason will often appear to regulators to be one of merely increasing market power. Perhaps if mergers were not so actively discouraged there would be fewer bankruptcies. (In South Africa the ‘failing company’ defence has been successfully and correctly employed before the Competition Board, for example

by Rainbow in its takeover of Bonny Bird in the broiler chicken market, and by Nedbank in its acquisition of Finansbank.) To assess the true situation, the market that should be examined is not only the market for the goods in which the merging companies trade but also the market in 'corporate control' (whether this be the JSE or pyramidal holding companies). If this market is imperfect, then managers can deprive owners of higher income from their shares for substantial periods, either through inefficiency or by pursuing non-profit maximising objectives. If it is working well this cannot happen, otherwise the share price of the firm will decline relative to other firms in the same industry. In so far as low share price reflects poor management, it also indicates what the share price could be if efficient management was installed. As a consequence, a merger or takeover attempt will occur in order to transfer the inefficiently utilised assets into the hands of those who can manage them more effectively. The potential capital gain in the share price will be the attraction that initiates this event.

Now consider merger encouragement. If the market in corporate control is working smoothly, then mergers to gain scale economies, and the extra profits which go with them, will take place without government encouragement. If such mergers do not occur, then imperfections in the market for corporate control are enabling inefficient managers to pursue courses of action that are not in the best interests of their shareholders or of the nation as a whole.

In the case of forced divestitures or unbundling these arguments are merely inverted. If the market in corporate control (the stock exchange or a pyramid) is working smoothly, then unbundling to gain the lower costs of reduced administration or X-efficiency, or to gain the additional benefits of managerial nimbleness, will automatically and smoothly take place as owners seek to increase their wealth without government encouragement. If such divestitures do not take place the cause is probably to be sought elsewhere (as, for example, in exchange controls inhibiting the overseas use of moneys received from asset sale at home).

This raises two questions. Is the market in corporate control working well? If not, should not the attention of government agencies be devoted to that market rather than the markets in products? Certainly, if it is working smoothly then there is much less need for government interference, and there are reasons why such interference may be more harmful than helpful.

This argument can be clarified by asking two further questions. First, who loses most from poor decisions? If two firms refuse to merge or demerge in order to gain lower costs, then their joint output is produced at a higher cost in resources than it need have been. This is a social loss, but it is borne *entirely* by the owners of the firms in their lower incomes (we ignore tax losses to government from higher profits, and social losses due to output reduction and higher prices). Alternatively if, say, a conglomerate merger takes place in order to save costs but, in the event, managerial judgement is proved faulty and costs rise, then again the loss is borne solely by the owners of the firms who made the mistake in the first instance.

Secondly, who has the information to make pro- or anti-merger decisions which will be closest to optimal? The answer is and must be those most intimately involved with the situation, namely the members of the industry itself. They have considerably more knowledge of a firm's and industry's cost and demand conditions and prospects than any outsider. This holds for both horizontal *and* vertical merger situations, since knowledge of customers and/or suppliers is part of a manager's stock-in-trade. (Highly specific and publicly unavailable information may be open to official government eyes, but this will be exceptional.)

In other words, it is the members of the industry who have the most to lose from poor merger or demerger decisions and therefore who have the greatest incentive to take correct ones. Outside legislators, however benevolent, have neither the incentive nor the ability to take the optimal decision. And rent-seeking and capture theory shows that the assumption of benevolence must also not be made lightly.

This discussion depends on the smooth operation of the market in corporate control. What actions need to be taken to improve the workings of this market should it prove to be imperfect? The answer lies with information. Information on a company's current and prospective performance should be easily accessible. If the market in corporate control is working well there is little need for

either merger encouragement or discouragement by government. Merger prevention is required only for mergers motivated by a desire for market power outweighing scale economies or benefits from removing inefficient management.

Competition policy cannot be based on knee jerk reactions to structures of markets (concentration) or structures of firms (pyramids and conglomerates): it needs to be rigorous. Only through rigorous analysis can we begin to understand the complexities of industrial rivalry and the market process – how in the market-place for goods and services, or in the market for ownership and control, the consumer is being served. In Chapter 4 we examine other reasons why populist reactions to business behaviour (in particular, allegedly collusive behaviour and what are sometimes called restrictive practices) can be based on false inferences.

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4

Collusive and restrictive practices

Current South African policy -- a brief review

The *Maintenance and Promotion of Competition Act* of 1979 enables the Competition Board to examine three main aspects of business, namely monopoly situations, acquisitions and restrictive practices. Its definition of a monopoly situation is broad:

... a situation where any person, or two or more persons with a substantial economic connection, control in the Republic or any part thereof, wholly or to a large extent, the class of business in which he or they are engaged in respect of any commodity.

So too is its definition of acquisition:

... the acquisition by the holder of a controlling interest in any business or undertaking involved in the production, manufacture, supply or distribution of any commodity, of such an interest --

- (a) in any other business or undertaking so involved; or
- (b) in any asset which is or may be utilised for or in connection with the production, manufacture, supply or distribution of any such commodity, provided such acquisition has or is likely to have the effect of restricting competition directly or indirectly.

However, the “acquisition” definition is more precise in that it relates to “restricting competition”. The definition of “restrictive practice” is also helpful, and again the criterion required for implicit condemnation is the restriction of competition. Restrictive practice means:

- (a) any agreement, arrangement or understanding, whether legally enforceable or not, between two or more persons; or
- (b) any business practice or method of trading, including any method of fixing prices, whether by the supplier of any commodity or otherwise; or
- (c) any act or omission on the part of any person, whether acting independently or in concert with any other person; or
- (d) any situation arising out of the activities of any person or class or group or persons,

which restricts competition directly or indirectly by having or being likely to have the effect of --

- (i) restricting the production or distribution of any commodity; or
- (ii) limiting the facilities available for the production or distribution of any commodity; or
- (iii) enhancing or maintaining the price of or any other consideration for any commodity; or
- (iv) preventing the production or distribution of any commodity by the most efficient and economical means; or
- (v) preventing or retarding the development or introduction of technical improvements or the expansion of existing markets or the opening up of new markets; or
- (vi) preventing or restricting the entry of new producers or distributors into any branch of trade or industry; or
- (vii) preventing or retarding the adjustment of any profession or branch of trade or industry to changing circumstances.

It took three years (as demonstrated by the Board’s *Annual Reports*) for the Board to tilt its interpretation of its definition of monopoly to a structural rather than a behavioural one. The same

period saw the “public interest” concept added in such a way that consumer welfare ceased to be the ultimate yardstick of whether or not a monopoly situation was to be condemned.

The *First Annual Report* of the Competition Board (1980, para 11) highlighted points regarded as crucial. The minister of Economic Affairs was quoted thus:

- (a) ... preservation of the free market system ... is the cornerstone of our ... economic life [and]
- (b) ... the preservation of healthy competition ... [is] an important condition ... [for] economic development.

To achieve these ends the Board was established to help implement the 1979 *Maintenance and Promotion of Competition Act* to:

- (a) ... provide for the maintenance and promotion of competition;
- (b) ... [prevent] or control restrictive practices;
- (c) ... [prevent or control] the acquisition of controlling interests in businesses and undertakings; [and]
- (d) ... [control] matters connected therewith (para 12).

In short, market concentration (smallness of firm numbers and largeness of firm size) was not included in the board’s terms of reference. Within a year, this constructive approach to competition and sober approach to big business had altered. The *Second Annual Report* (para 9) said:

Oligopolies ... [can cause] prices to congeal at unduly high levels, while conglomerates can distort competition by ensuring market support for their members at the cost of more efficient outside firms. Clearly, these oligopolies and conglomerates should be under constant scrutiny so that possible abuses can be detected and, where necessary, corrected in the public interest.

The Board’s *Third* (1982) and *Fourth* (1983) *Annual Reports* took similar positions (paras 16-17 and 12-13 respectively) and the latter (para 14) explained why:

Market conduct is never unrelated to market structure ... [so] both are of the utmost importance for the efficient implementation of competition policy.

Thus South African competition policy in its very early years was designed to take account primarily of the newer thinking in industrial economics, which downplayed the importance of structure as a criterion. However, after 1982, structure, in contrast to the more permissive policy abroad, emerged as a key criterion for investigation.

Moreover, although not detailed in the original Act, the Board came to view the “public interest” rather than the consumers’ interest as the “final criterion” in judging a monopoly or a merger. It has proved difficult for the Board, however, to agree on what the public interest is. This makes its judgements unpredictable and creates uncertainty for consumers and producers alike. One chairman of the Board (Dr D Mouton, in 1982) defined it as “the interest of consumers, producers and traders as well as the broad national interest”. The national interest in turn was defined as achieving

... economic growth, the efficient utilization of resources, an acceptable pattern of income distribution, a desirable general price level, and equilibrium in the balance of payments.

In practice, when the Board has tried to apply this criterion its verdicts have not been consistent. This is not surprising since (as noted on pp.23-24) the definitions embrace groups whose interests

do not necessarily coincide, and economic goals which may be mutually exclusive. Not only are the Board's reports sometimes inconsistent in how they interpret the public interest, but even in the same report members of the Board may express disagreements in minority reports.

The mechanistic structuralist approach towards monopoly did not survive long. The second chairman, Dr S Naude, argued for a less structurally constrained approach, though he also emphasised the "public interest" as a criterion. He stressed that effective competition was independent of market structure: "It could include both the extremes of atomistic competition ... and the oligopolistic market structure with a few large dominant firms." He went on to define effective or workable competition as "a market situation that (a) holds the essential benefits of competition such as freedom of entry ... a choice for buyers and the inability of sellers to impose terms (including prices) on buyers; (b) is practical, i.e. workable; and (c) can be reconciled with the public interest". In 1986, Dr Naude noted the counter-revolution that had taken place recently in US policy and ascribed it to, *inter alia*, the increased influence of economic analysis. He quoted a leading US anti-trust jurist, Judge Robert Bork, who expressed the "hope that the process will continue until this body of the law becomes completely economically rational".

At present in the 1990s, however, it appears as if the economic analysis which is applied is based on both approaches, which have quite different policy implications. The Competition Board still has some way to go in applying consistent criteria in its decisions and recommendations. This policy ambivalence was highlighted by the approach adopted towards restrictive practices, also in 1986. *Per se* prohibitions of certain agreements were introduced as additions to the 1979 Act (including resale price maintenance, horizontal price collusion and collusion on conditions of supply). Exemptions could be granted if it could be shown that the agreements were in the public interest, whereas generic restrictive practices in the original Act were "restrictive" only if they restricted competition as defined, not simply because they existed *per se*. As noted earlier, restrictions against the interests of consumers can certainly occur – the point is, either they do not persist or else they arise because they are, in fact, means of lowering costs and therefore prices to consumers. *Per se* prohibition denies consumers the opportunity to discover if this is true.

Now, in the mid-1990s, a major review of South African policy is contemplated, prompted by political, structural and populist concerns. If economic and consumer-interest criteria were regarded as the only relevant considerations, such a root-and-branch examination would not be necessary. Before concluding in Chapter 5 with our own recommendations for reform, we examine some of the concerns already detailed on page 49 from the *Second Annual Report*. (Namely prices which are held at "congealed" levels and "market support" for conglomerate members by use of discriminatory practices.)

Parallel and uniform prices

To some theoreticians uniform prices are a result of collusion and are to be expected because of concentrated industrial structures. This theory does not stand up to examination.

"Parallel pricing" is the practice by which two or more sellers set their prices at or about the same level and change them at or about the same time and by the same amount or proportion. The important matters that need to be established are whether this form of behaviour is competitive and/or if it can be expected to have consequences which may be detrimental to the public interest as measured by consumer welfare. Areas in the 1990s where this has been of concern to the Competition Board include cement prices, bank interest rates and cellular phone rates.

In the perfect competition of elementary theory no individual seller is able to influence the market price. Market price is determined impersonally by the interaction of the total supply of the product and the total demand. The individual seller is a "price taker" in that he or she cannot influence the price by his own actions. It is in this sense that these markets are customarily described as perfectly competitive. Sufficient conditions are a large number of sellers (and indeed of buyers), all of substantially similar size, standardisation of different sellers' products, and a high degree of knowledge of market prices among sellers and buyers. These conditions prevail in various commodity and financial markets. In such markets the price charged by all sellers will be uniform.

No individual seller will be able to charge more than the market price or will wish to charge less than that price, whatever his own costs. Changes in demand conditions in the market, or in the costs of all or a significant number of sellers, will result in prompt change in the market price since all sellers will find it to their advantage to charge the price at which total supply and total demand are balanced in the new condition. The fact that sellers' prices change at or about the same time and by the same amount in these circumstances would be evidence of a highly competitive situation. Moreover, with the further condition that entry of new sellers into such markets is easy, there would be no reason to expect the rate of profit to deviate for long from the minimum necessary to attract investible funds, given the risks involved. We can call this rate of profit the "competitive" or "normal" profit. Observed profit rates in such markets may display fluctuations and may not correspond to the normal rate at any one time. But there can be no long-run tendency for profit rates to remain above the competitive level.

In a situation of economic – not legal – monopoly (a single seller), there will also be a uniform price since there will be only one price and one product. The decision-taker in such a situation has a more difficult job in setting price than the "price-taker" of perfect competition. He or she cannot accept the market price (since there isn't one) but must choose by more or less informed trial and error what is believed to be the wealth-maximising price. Selection of a price above or below that level will result in a wealth loss. Furthermore, there can be no presumption that the wealth gained by selling at the (unknown) optimal price will be at a level above "normal profit". Provided others can readily enter the industry (provided it is a "contestable" market), the monopolist's wealth-maximising price will be constrained and his capital will earn only the competitive rate of return. Contestability requires not large numbers of firms, but only easy and low-cost entry and exit. An incumbent monopolist cannot charge a high price and succeed in earning returns above the competitive norm in a contestable situation. He will instead be subject to competition from a new entrant, so destroying the monopoly. Alternatively, the threat of such entry, or the effect of actual hit-and-run entry, will be such as to bring price and returns down to the competitive level, leaving the economic monopoly intact.

Concern about monopoly arises when entry is barred in some way – say by government regulation. The incumbent can then charge a higher price, earn higher returns, and provide consumers (because of the higher price) with lower volumes of the commodity than they would otherwise purchase at more competitive levels. In addition, any spur to tighter efficiency or innovation may be blunted.

Uniform or parallel prices can thus be regarded as the competitive norm whether a diffuse or a single-seller structure is considered. Similarly, returns or profits can be regarded as appropriate in either situation (with the added requirement of contestability in monopoly).

It is when we turn to markets which are not characterised by a large number of sellers that we may encounter a practice which gives rise to concern, that is, collusive parallel pricing. Industries with relatively few sellers, or in which a few sellers dominate the market, are generally termed oligopolistic. In modern economies a considerable number of markets are oligopolistic. The distinctive feature of oligopolies is that a major decision by one seller will have a significant effect upon the other sellers and that the reactions of those sellers will in turn affect him. Recognition of these interdependencies may deter the individual seller from self-interested price changes which must be made at the expense of competitors. Instead, pricing policies may be co-ordinated with the aim of balancing the interests of all the sellers as a group. Price changes may then be initiated only when there is good reason to expect that all sellers will benefit, whether the change is upwards or downwards.

In short, the sellers may try to act in collusion, tacitly or explicitly, as if they were an economic monopoly. This is often termed collusive or cartel behaviour. Decisions are taken with group welfare in mind, rather than being prompted by a rivalrous desire to get one step ahead of the competitors. The belief is that *pro rata* share of profits resulting from group wealth-maximising behaviour will be greater than would accrue if individualistic, but self-defeating, motivations dominated. The social costs of noncontestable monopoly would therefore accrue. In fact, as

opposed to belief, firms will collude only if the expected benefits are greater than the expected costs. The costs of collusion may prevent any attempt to collude. An attempt to collude may fail and, indeed, typically will fail as discussed in the following paragraphs. Moreover, even a successful collusion will be far from perfect and so the colluding firms will still fail to act as if they were a monopoly.

These assertions are now examined more closely. George Stigler won the Nobel Prize for his work in industrial economics, not least anti-trust analysis. His view of cartels was that they are either tacit or explicit agreements which, because of rivalry, seldom last. “They are gentlemen’s agreements: where they seldom are or long do.” Collusive parallel pricing is understandable but it will not persist (see Stigler, 1966). There are several strands to the argument.

- a) Individual firms will always have an incentive to chisel or cheat on any explicit or implicit price agreement.
- b) Such cheating will quickly be noticed and responded to by competing price reductions (leading to non-collusive uniform prices providing normal returns).
- c) To guard against chiselling firms may set up monitoring mechanisms (of each other) or allocate shares of market or territories for exclusive use. This is costly and/or agreement may be difficult. The less likely outcome is agreement (e.g. efficient firms do not like feather-bedding inefficient ones, each likes a “fair” share of profits and “fairness” is difficult to define) the more likely is cartel breakdown.
- d) Cartel breakdown by chiselling (price rivalry) is also more likely the higher is the ratio of fixed to total costs in an industry. Given a relatively high burden of fixed costs, a “voluntary” diminution of the flow of cash revenues (by “agreeing” to high uniform prices and claiming to forego chiselling) may create financial difficulties. This is particularly true in times of market depression – or its supply-side corollary, capital outlay growth.
- e) Further, cartel breakdown through cheating (price rivalry) is also likelier in a rapidly growing industry. If demand is rising fast, other things equal, the likelihood of being instantaneously spotted cutting price will appear to be less. The impact on rivals’ current outputs need not now be negative – you may merely slow their rate of growth. Rivals, of course, each reason in the same way, and the collusion crumbles.
- f) If existing firms do not cheat and pull prices down to lower (but still uniform) levels, then as in contestable monopoly, new firms will enter and achieve the same result. Indeed even the threat of their entry can have this result. (Again, as in monopoly, the situation must be contestable, and entry easy to activate.) As with perfect competition and contestable monopoly, uniform parallel prices and the profits derived therefrom simply represent convergence on the competitive norms.

This analysis can be applied to most if not all so-called collusive areas of industrial practice. Collusion may be an instinctive behaviour pattern for many businessmen but competitive forces rob them of their ability to indulge it. Award government protection, however, and new forms of competitive behaviour, new rivals, new entrants, and ‘cheating’ by existing competitors can be ruled out by law. Consumers need reflect only on the cartels protected by government to see how easily they could be better off. (Medicines and petrol prices are only two examples of the results of outmoded distribution channels protected by government; Clicks may not employ dispensing pharmacists and Pick ’n Pay may not cut petrol prices.)

Favouring associated firms

The charge that large pyramidal or conglomerate firms selectively favour associated companies for monopolistic reasons is very unlikely in theory. Judge Bork in his analysis of anti-trust in the USA points out that “it is impossible for a firm actually to sell to itself for less than it sells to outside firms because the real cost of any transfer ... includes the return that could have been made on a sale to an outsider. No matter what the bookkeeper writes down as the transfer price, the real cost is the

opportunity foregone.” (If I am a dressmaker buying in fabric at R50, selling completed dresses at R100, and I give a new dress to my wife, my cost is R100, not R50, no matter what figure I put in my books.) Subsidising associated firms, if it occurred, would be self-deception, involving sacrifice of returns, and merely providing encouragement to the associate to operate at an uneconomical rate. (See Bork, 1993, p.228.) Cross-subsidisation cannot increase existing returns, nor can it enhance any above-normal or monopolistic returns. As Judge Bork points out (p.229), above-normal returns can be abstracted only once from the value chain and as we have already seen, firms cannot, unless protected by government in one way or another, act as if they were monopolists in any event.

Bork (p.229) demonstrates this by looking at an integrated manufacturer and retailer. If each tries to maximise profit by restricting output, the result will be a price higher and an output smaller than the monopoly point. (My own text, *Managerial Economics*, 1995, contains several pages of rules managers can apply in their own interests to avoid this unhappy outcome.) The rationale starts by looking at a monopoly manufacturer selling to competitive retailers. The manufacturer will set output and price so that consumers will be charged the monopoly price after retailers have added their costs, including a normal return. The manufacturer will not want retailers to earn more (since that would be foregone profit), nor will he want them to earn less, since then retail investment and so throughput would ultimately decline to the manufacturer’s detriment. Similarly, if retailers earned more and so expanded, the manufacturer would be paying for unwanted retail services.

If the manufacturer takes over the extra retail sector, the demand he faces and costs he would incur will be unchanged. His profit-maximising output decision will thus also be unchanged. There is only one monopoly profit.

Predation

The only other reason for fear of monopolistic abuse by cross-subsidisation is predation: that is, the intent to drive independent firms out of business either by a direct price war or by selling inputs to associated firms at such low prices that the associates can indulge in a price war. After a successful price war prices can be raised to monopolistic levels. If this is the case, of course, it immediately suggests that firms so accused cannot be currently abusing their market positions (monopoly returns can be abstracted only once in the value chain). Once achieved, any subsequent vertical relationship could be examined for abuse in due course. *Ex post* analysis, however, is not very helpful for policy makers before the event. Again, appeal must be made to both theory and precedent. The idea of future abuse (predation) as the intent is very unlikely. To succeed predation requires losses by both victim and predator today so that the predator can maintain higher prices tomorrow, earning above normal profits for long enough to recover both of these losses. Entry by new rivals or chiselling by existing firms would easily defeat the project.

Restrictive practices and price discrimination

In both the USA and the UK restrictive practices, collusion and “anti-competitive” devices were either deemed illegal from the days of the original *Sherman Act* (1890) or, in the case of the *Monopolies and Restrictive Practices Act* (1948) at the very least, subject to investigation. The UK legislation was strengthened by the *Restrictive Trade Practices Act* 1956 which deemed that all agreements between firms (not just the ‘legal’ monopolies which held 33 percent [later 25 percent] of the relevant market) had to be registered officially and were presumed to be against the public interest unless the non-criminal Restrictive Practices Court deemed them to be acceptable against a list of prescribed criteria (which included a final, ‘catch-all’ public-interest yardstick).

The two main additional pieces of US legislation are the *Robinson-Patman Act* 1936 and the *Federal Trade Commission Act*’s ban on false and misleading advertising which resulted in major (but indecisive) investigations in the 1970s. The *Robinson-Patman Act* was passed because of perceived weaknesses in the *Clayton Act* 1914 which prohibited price discrimination which ‘substantially’ lessened competition or tended ‘to create a monopoly’. The *Clayton Act* excludes from this prohibition discrimination owing to differences in grade, quality or quantity of the good sold; discrimination which makes ‘due allowance’ for differences in cost; and third, discrimination

‘carried out in good faith’ to meet a competitor’s price. Small traders were not protected since the quantity clause provides an easy escape; moreover the courts refused to apply the law when the discrimination resulted from the pressures of large traders on their suppliers. These issues became increasingly apparent with the advent of large-scale retailing during the 1920s and 1930s. The Depression coincided and the problems of small- and medium-sized buyers were compounded by the tendency of manufacturers to shade prices and give less than overt rebates in the face of declining demand. The trend towards government approval of cartelization at that juncture of history was embodied in the National Recovery Administration in the USA and the *Robinson-Patman Act* was passed against that background.

Its main purpose was to prevent powerful retailing groups from obtaining ‘undue’ favours from their suppliers relative to small- and medium-sized traders. It prohibits the charging of different prices to different purchasers of ‘goods of like grade and quality’ if the effect ‘may be substantially to lessen competition or tend to create a monopoly ... or to injure ... competition’. Another section renders it illegal for a buyer ‘knowingly to induce or receive a discrimination in price’. The refunds allowed relate to perishability, obsolescence, ‘due allowance for differences in the cost ... resulting from the differing methods or quantities’ specific to the transaction in question, and/or that it was done ‘in good faith to meet an equally low price of a competitor’. Neale (1960, pp.252-3) summarizes the case law history of the Act’s application as follows:

[it] will be met with frank unbelief. The idea that a manufacturer may break the law by granting a wholesaler’s discount to a wholesaler who also runs retail shops, or by selling goods direct to retailers at a price higher than one of his wholesalers may be charging, or by beating an offer made to an important customer by a rival manufacturer or even by matching the offer unless he is satisfied that his rival can justify his low price by cost savings ... may simply seem incredible.

But incredible or not, that is the US law. The muddle is inevitable given the conflicting objectives of the Act. It is attempting to protect small business against price disadvantages on the one hand, while simultaneously attempting to combat price discrimination as anti-competitive.

The difficulty industry has with the law is illustrated by the ‘good-faith’ price-matching defence. To succeed, the seller must show that the matched price is itself lawful. This necessitates knowledge of the competitor’s own price and cost structure – but in a classic Catch-22 if he shows he has such knowledge he may be prosecuted for conspiring to restrain trade under the *Sherman Act*. Further confusion is caused by the phrase ‘price differences’ which is used in the legislation, not ‘price discrimination’, which is a technical term indicating disproportionality of price : marginal cost ratios. Thus identical prices with different costs (uniform price discrimination) cannot be touched by the legislation.

In 1980 the US Department of Justice recommended repeal of *Robinson-Patman*, as well as the section of the *Clayton Act* which it had amended. But to date this has not happened. In the interim it has fallen into disuse but prior to 1980 it certainly had anti-competitive effects by deterring firms from engaging in selective price-cutting (which is one main reason why economists argue cartels cannot survive absent government regulatory support). Essentially the Act is concerned more with protecting particular competitors, rather than competition.

A case study: Pharmaceutical pricing in South Africa

In a 1994 study entitled *Uniform Pharmaceutical Pricing*, Ernst R Bendt, concluded (p.20)

Uniform pricing provisions should be recognised for what they are: anti-competitive policies designed to protect a diminishing segment of the increasingly price-sensitive retail marketplace. Public policy should ...(be) encouraging more price flexibility, not less.

The South African government's *National Drug Policy* (Department of Health, p.8) takes the opposite view. It argues for a "single exit price" (jargon for a uniform manufacturer price) for apparently "equivalent transactions" and favours a "transparent" pricing structure for private sector purchasers in South Africa. Recently the Department of Health announced that it wishes in addition to see the conventional mark-up of a fixed percentage on retailer purchasing price (plus a nominal dispensing fee) replaced by a fixed fee for professional services.

Uniform price legislation would go far beyond current Competition Policy in that first, it would be directed at particular market practices, not at *abuse* of particular practices. The *abuse* criterion in the *Competition Act* would examine current or proposed market practices in the light of their ultimate impact on consumer welfare. For example, does the current or proposed practice strengthen and improve the efficiency of the existing retail sector? Does the practice encourage innovation in the existing distribution chain which would be to the benefit of the consumer (in terms of lower final prices or a better service)? Does the practice facilitate or hinder the development of more efficient means of purchasing and paying for products by the consumer or others acting on the patient's behalf, such as the managed care arms of medical schemes? Does the practice facilitate or hinder the widest possible distribution of the product in areas of the economy where conventional outlets are scarce or conventional medical scheme cover is unavailable or hard to come by? Does the practice facilitate or discourage innovative methods of monitoring pharmaceutical consumption such as total disease management, pharmaceutical benefit management or drug utilisation reviews either pre- or post-consumption by patients? Does the practice facilitate or discourage innovative distribution methods such as direct mail, health maintenance organisations, preferred providers of medicines, or entry by large-scale retailers in either CBDs or hospitals?

Clearly if a blanket rule (such as uniform pricing or a fixed fee-for-service) is applied it can have deleterious or beneficial effects on the consumer welfare depending on circumstances. The legislation will then be either difficult to apply, complicated to draft or produce many and often unpredictable distortions. "Abuse" legislation is then more appropriate; and abuses can be dealt with on a case-by-case basis and with a proper definition and understanding of competition consistently borne in mind.

Uniform price legislation would make it illegal to negotiate discounts on prescription medicines with retailers who can offer services to manufacturers that justify discounts. Uniform prices should be opposed as a form of price controls. They are inconsistent with the goal of strengthening competition in the private health-care sector and would curtail company pricing flexibility – a flexibility which has been important in causing reductions in ex-factory price levels in recent years, and which in turn, despite many artificial rigidities in the distribution chain, has resulted in lower prices paid by patients to many previously unavailable forms of medicine distribution systems. Retail pharmacies, leading proponents of uniform pricing, are among the many businesses that now find it essential to offer discounts to their customers.

The *National Drug Policy* also argues for *transparent* pricing structures. But transparency *per se* is neither desirable nor undesirable in the public interest. For example, high (but transparent) price levels are undesirable. Fixed transparent mark-ups in pharmacy have been deemed to be anti-competitive (by the market place as discounts have eroded them over the last decade -- see *Competition Board Report 52*). Transparent fixed-fee-for-service has also been deemed undesirable in other areas of health-care provision (the *Medical Schemes Amendment Act 1989* removed the legal requirement).

Appropriate or competitive transparency is where buyers, whether patients, medical schemes, pharmaceutical benefit managers, managed care groups or others, can easily obtain information on alternative services of lower price suppliers. This results in lower prices and better services as higher cost, less satisfactory suppliers are forced to cut prices to gain or retain business.

Inappropriate or anti-competitive transparency, such as guaranteed margins or fees, discourages this rivalry and preserves and conserves existing high prices and distribution modes.

The Competition Board (*Report 4*, p.61) writes:

... codes of conduct, 'fair trade' rules and 'open trading' systems, or whatever they may be called, tend to maintain prices at overly high and rigid levels (and) ... (it) is an intriguing fact that the powerful manufacturer and the weak trader both champion these systems.

The preference of some traders for anti-competitive transparency to avoid rivalry has been discussed. Why would manufacturers prefer a uniform price? The Competition Board (*Report 4*, pp.10 and 62) notes that *price discrimination by manufacturers* (the converse of a uniform price for equivalent transactions) "*is indispensable in the public interest*". The preference of large manufacturers for an anti-competitive transparent pricing structure is understandable. Marketing, product design and sales efforts are easier to use in the guaranteed absence of price rivalry. They are less easily countered, less readily noticed when used and discourage the promotion of, or market entry of generics on a pure price basis.

"Secret" rebates do not remain secret for long and any rebate is soon matched. This is how competition avoids prices congealing at high levels. The need to avoid price uniformity and not to regulate against price discrimination is therefore indeed "indispensable". But the attractiveness of avoiding price competition is only one reason the Competition authorities see price discrimination in this light. Other arguments against an anti-competitive transparent, uniform price include the desirability of providing cross-subsidisation to different sectors of the market which vary in their ability to pay. (This equity argument partly explains the low price charged to public-sector buyers, and to dispensing doctors servicing patients for a single, all-inclusive (and low) consultation fee. Total industry output is therefore increased. Of course the phrase "price discrimination", like the phrase "perfect competition" is emotive. It also misleads. As pointed out in Chapter 1, the issue is consumer welfare.

The most common theoretical charge of abuse in any monopoly situation is that firms can *reduce output* and so raise price. However, price discrimination (in pure theory) is one business practice where it can be shown unambiguously that the ability to practise it either simply enables the same output to be reallocated to different market segments (an equity or income distribution issue) or that it can permit firms to *increase* their output. Pure theoreticians, therefore, would concur with the Competition Board that price discrimination is, if not indispensable, at least benign. Enforced uniform pricing, on the other hand, would at best have no impact on quantity (but a negative one on equity) and at worst would be malign in its impact on quantity.

The National Drug Policy (NDP) wishes to enforce an anti-competitive transparent, uniform price, for "*equivalent transactions*". That wording was used first by the Minister for Public Enterprises in Government Notice No. 1136 on 24th June 1993, in terms of the *Competition Act*. The intention of the Notice was the same as that of the NDP, namely to make it

unlawful ... to sell ... medicines ... in a manner which ... discriminates between buyers ...
by applying dissimilar prices ... to equivalent transactions.

The NDP (as proposed government policy) is thus in broad agreement with the then proposed policy of the government before the 1994 election. Notice 1136 was intended to apply under existing Competition Policy legislation. It was appealed against by some but not all manufacturers. The Appeal has currently lapsed. Would the Appeal stand under existing or proposed Competition Policy legislation?

To answer that question is difficult, but three factors make it likely that the Appeal would succeed if put before the Board. These are:

- i. The definition (appropriately) is similar to the formal theorists' definition of price discrimination. That is, to cite Professor George Stigler it is:

the sale of technically similar products at prices which are not proportional to their marginal costs.

We have already seen how price discrimination is approved of theoretically as indispensable, how in practice it has encouraged competition, how it results in competitively transparent price reductions and in competitively transparent shifts in buyer behaviour as they exercise preferences by shifting from one distribution channel to another. Both definitions (Stigler's and that of the Notice) show also that price discrimination is identified by examining ratios (price : cost), not by examining price alone. Thus identical prices can be discriminatory if costs differ. This is why the phrase "equivalent transaction" is necessary.

- ii The Notice emphasised that differences in price are "justifiable" if they are required "to provide for the cost or *probable cost* in the manufacture and/or distribution of the medicine". The policy problem here, as both economists and the drafters of the Notice understand, is that costs are subjective. When the manager of a firm takes a decision only he/she knows the benefit he/she is foregoing – the cost – of the decision. Hence the use of the adjective "probable".

To illustrate one difficulty with uniform prices for equivalent transactions, ask "what is equivalent?" A manufacturer may wish to raise his share of the market. Should he price at the same level today to two different distribution channels if he anticipates one channel has a much higher growth potential tomorrow? If he believes the one channel has a more efficient (lower cost) method of reaching the patient and can expand more rapidly tomorrow than the other channel, how can he encourage that for his own (but also the final patient's) benefit? The answer is to price *ahead of demand* by lowering price to the channel with high potential – a common business practice but one with *prima facie* evidence of unjustifiable price discrimination. Yet closer inspection, taking account of *probable costs*, might render any price differences "justifiable".

Implementation of the Notice on Appeal would, therefore, be difficult since (i) it is attempting to ban a practice the Board accepts in principle as "indispensable" and (ii) it would be difficult to ascertain in practice if any price differences (or uniformities) uncovered represent or do not represent price discrimination as defined both by theoreticians and the Minister in the Notice.

- iii The third reason, paradoxically, is due to the current state of flux of competition policy. It is uncertain whether the redrafted policy will follow an "American" or "European" pattern, or alternatively retain the existing South African mode, at least on specific issues. As far as price discrimination is concerned, however, the three bodies of competition policy or law adopt a similar approach:

(a) USA: The 1936 *Robinson-Patman Act* prohibits the sale of goods at different prices to customers intending to sell onwards to final consumers, with limited exceptions (see p.58). This precedent would appear to be a paradigm for the uniform price proposed in the NDP. However, as we have seen, the Act has proved unworkable, un-enforceable and impossible to interpret. The US Department of Justice has recommended its repeal on these grounds and on grounds that if enforced it would be detrimental to competition. Its repeal is continually opposed by lobbies of small-scale retailers but *de facto* the Act has simply withered away. The consensus of legal and economic opinion is that next to the Act's repeal, benign neglect is the optimal approach from the viewpoint of the public interest and of the consumer. There is little in American precedent to encourage the proponents of uniform pricing for equivalent transactions.

(b) UK: The United Kingdom Monopolies Commission in 1971 produced a multi-industry report entitled *Parallel Pricing*. This too provides no support for proponents of uniform pricing, indeed the reverse. Firms, it argues (para 9), often prefer to compete in ways other

than price “because the cards of non-price competition are less easy to trump”. That, of course, may or may not be in the consumer interest. But (para 67) each case should be examined to ascertain, for example, if coordinated pricing policies (to say nothing of mandated ones such as those proposed in the Notice and by the NDP) *inhibit expansion* of market shares by sellers of products or *modes of distribution preferred by consumers*; or if departures from published prices by way of discounts etc. (para 74) weaken anti-competitive, collusive or conservative behaviour; or whether differences in cost levels, managerial aspirations, market shares, expectation of future growth or management styles impact more heavily on price coordination patterns than does a desire to restrict output or lead a quiet life. If price competition is minimised, the Report continues, excessive costs can be built into given prices, the incentive to satisfy the final consumer and gain his/her patronage by lowering price may be weakened, and inflationary pressures may be strengthened due to an inability to pass on cost increases in a coordinated fashion (particularly if only one price controller or watchdog has to be convinced rather than a multitude of consumers or their agents with an ability to switch custom – which is an impossible arguments for firms to counter after it has been put forward and acted upon).

(c) SA: In South Africa price discrimination falls under Section 1 (b) of Act No. 96 of 1979. That is, it could be deemed to be a restrictive practice operating against the public interest. If so, it can legitimately be banned by the Minister. If not, it is then regarded as a legitimate business practice or method of trading. Take *seriatim*, the seven criteria laid down by the Act to determine whether or not a practice is restrictive and against the public interest are:

- i does it restrict production or distribution?
- ii does it limit facilities available for the same?
- iii does it enhance or maintain the price?
- iv does it prevent production or distribution by the most economical means?
- v does it prevent or retard technical improvements or the expansion or opening up of markets?
- vi does it prevent or restrict entry into any branch of trade?
- vii does it prevent or retard the adjustment of any profession or trade to changing circumstances?

In each case the answer is negative.

i In theory, price discrimination expands or maintains output, it does not restrict it. In practice it has been used to gain access to additional and novel distribution channels – health maintenance organisations, dispensing doctors, direct mail distribution, preferred provider pharmacies etc – and these expansion modes have probably been used to a greater extent than they would have been had conventional community pharmacists not been prohibited from expanding through normal commercial means because of the regulatory ban on corporate ownership.

ii Price discrimination has done the reverse of limiting facilities for production and distribution (in the face of the ban on pharmacy corporate ownership which has limited facilities).

iii Price discrimination has resulted in the newer modes of distribution demanding discounts, and both the new and the older modes of distribution passing discounts on to reimbursers. It has not maintained or increased price. Ex-factory prices indeed tend to have declined, while conventional retail markups and wholesale margins result in South

African factory exit prices being among the lowest in the world when calculated as a proportion of the final price paid by patients.

iv Price discrimination has not resulted in distribution through uneconomical modes. Rather it has encouraged sellers to seek out alternative modes to the outdated retailing pattern of small-scale, individually owned community pharmacies which are banned by law from operating under an ownership by other than that of a pharmacist.

v Price discrimination has encouraged innovation in pharmaceutical distribution, not retarded it – dispensing doctors, mail-order pharmacists, and preferred provider organisations promoted by innovative groups such as Mediscor are just a few examples.

vi Price discrimination has not restricted entry into any trade. Rather the reverse is true. Doctors qualified by competence, if not function, to dispense have done so, and pharmacists have entered into agreements as preferred providers, and also moved into direct mail as a consequence.

vii Price discrimination has encouraged, not retarded, the adjustment of the retail pharmacy profession to changing circumstances.

In short, by all criteria price discrimination fails to meet the yardstick of a business practice operating against the consumers' interest.

Furthermore competition policy authorities must not forget Adam Smith's dictum with which we began (p.3). While people of the same trade are motivated to meet together to raise prices, Smith emphasises that the state should do nothing to facilitate such assemblies 'much less to render them necessary'. Yet an insistence on publicly posted uniform prices for the pharmaceutical industry's sales into the private sector of the health care market, and the use of the sealed bid tender system for pricing in the government sector both encourage collusive behaviour. In the former overt collusion is made easier and cheating is simpler to detect and to punish. In the latter collusion is encouraged because the costs of not colluding, i.e. loss of an all-or-nothing contract, are much greater than they are in a more normal sales relationship.

A final question remains. Has the evolution of pharmacy distribution in the last decade been optimal from the viewpoint of the consumers' interest? The answer is no – not because of price discrimination, however, – that has generated price and cost reducing developments – but because of the ban on corporate ownership imposed by the 1974 *Pharmacy Act* – which has retarded such developments.

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5

Envoi

Competition policy in South Africa is in a state of flux. New legislation was drafted and withdrawn. The existing legislation (essentially the 1974 Act) remains in place, and although new legislation is promised by the end of 1996, it is likely to be implemented only in mid-1997.

Public opinion about what Competition Policy is or should be is also in a state of flux. Influential opinion-formers range from those who are simply anti-big business to those who would take a pragmatic stance, issue by issue, to those who adopt a Panglossian approach that whatever is, must be optimal. Some argue that existing policy is sensibly flexible. Others believe the allegedly “rigorous” American anti-trust laws should be translated to South Africa, while still others would have South Africa model itself on the more “behaviourally” oriented approach of some European legislators.

There are many fallacious and internal inconsistencies in the arguments being put forward in the debate. For example, the anti-big business lobby overlooks the fact that a “big” firm in South Africa may simply appear big because the market is so small. A smaller firm in that context may simply be inefficient. Those who argue for the “rigorous” American anti-trust system are referring to the rigours of forced divestiture or trust-busting but judgements of that sort have not been made in American courts for some 70 years, and the last attempted case of that kind, IBM, was rejected in 1981 after 13 years of litigation.

In fact, in the last quarter of the century the USA has indeed proved to be “rigorous” in its application of its laws, but its “rigours” have not been in the stiffness or harshness of judgements and sentences, but rather in the rigorousness with which it has applied economic analysis in its procedures and arguments prior to arriving at conclusions. (Former US Solicitor General Judge Robert Bork, in the 1993 edition of his 1978 book surveying 100 years of US legislation, provides case-by-case support for the thesis that economic reasoning has pervasively and surely become the yardstick by which the Anti-trust Laws are applied.)

However, 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 US.)

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 exist in the UK (for investigative purposes) when market share hits 25 per cent (originally 33 per cent). However, the “presumptions” implying definitions of abuse would be mechanistic. Fourie *et al* (p.23) argue that a “clearer definition of abusive behaviour” would enable “enterprises to organise their conduct accordingly”.

It is of course possible to provide clearer definitions. Yet the essence of competition is that entrepreneurs do the unpredictable in order optimally to meet consumer requirements. Presumptions and definitions may simply exclude *ex ante* certain types of behaviour which, *ex post* would be interpreted as competitive. Alternatively, a code of presumptions of dominance or abuse might, in

the long run, be simply ignored (as is *Robinson-Patman*) although in the short run it will have significantly damaged competition.

Similarly, under restrictive practice legislation vertical restraints and price discrimination would probably be banned *per se* (p.24). But we have already seen that to practise vertical restraints is usually irrational for a profit-maximising businessman, whilst price discrimination tends to be neutral or expansive in terms of output.

However, the Fourie *et al* proposals do not warrant further examination as the draft bill based on their working paper was rejected by the Minister of Trade and Industry in late 1995. Work was begun on a redraft in 1996.

In the meantime, it was announced in *Business Day* on 15 July 1996 that the task force formulating the new legislation had recommenced its work for a third time. Their most recent working document reported on in the press highlights the dichotomy the policy-makers face. It argues 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 dilemma. Early US anti-trust judgements were whimsical and unpredictable, varying with the dominant politically appropriate view. Later US judgements have been tackled from an economic point of view. This most recent South African document veers towards that approach and states that competition law should promote

...consumer welfare and economic efficiency by preserving the freedom of economic action of market participants. One will need to consider whether it is necessary to target excessive conglomeration and/or enterprises ... in a monopoly situation, what factors are relevant in deciding whether a merger restricts competition to a substantial extent, and under what circumstances mergers that restrict competition ... or result in market dominance ought to be condoned.

If this stance is adopted by the politicians, then the 1979 Act will be little amended in intent, albeit physically it may be substantially rewritten. If the political decision swings the other way then the current concern will continue.

Conclusion

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 to building up a coherent body of decisions and of guidelines for them should be made. This will give assurance of as much consistency founded on economic analysis and experience as can be made. In effect little amendment of the original 1979 Act would be required. Even the Board’s view of concepts such as the “public interest” occur seldom in the existing legislation but have rather accumulated over the years in Annual Reports. If these views are correct they will stand, if not they will depreciate in the face of later economic arguments.

Some earlier Reports of the Board may not have received the attention they deserve. As a consequence inconsistent judgements have been given. Inconsistency, however, can be corrected. Inappropriate drafting of inflexible presumptions cannot.

That South African Competition Policy is imperfect is not questioned. That the overall objective of the Act – *Maintenance and Promotion of Competition* – requires rejection is unacceptable. Rather what is 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 Board should be expected. This will result in more predictable and more appropriate Board verdicts, whilst previous errors will be corrected in the light of better understanding.

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 nationalised industries and parastatals). And *per se* illegalities in business behaviour which have

been declared in minor amendments to the 1979 Act can be questioned as to their appropriateness and consistency with the overall objective of promoting competition in the principal Act.

As Judge Bork emphasised (p.422), a competition policy that opts for openness of markets reflects the ideal of equality of opportunity. Those who argue for a structuralist approach to anti-trust and for *per se* declaration of behavioral illegalities are more concerned with the small and less efficient, i.e. they have a preference for equality of outcome. Economic rigour demands that policy concern itself with the smallest economic unit of all, the individual consumer and his or her welfare.

References

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