APRIL 2008, RELEASE TWO

GCP
THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

South African Competition Policy in 2008: Key Priorities of the Competition Commission

Simon Roberts

South African Competition Commission

South African Competition Policy in 2008:

Key Priorities of the Competition Commission

Simon Roberts*

In its ninth year of operation, the main priorities of the South African Competition Commission reflect a maturing of the competition regime, as well as a growing recognition of the importance of competitive rivalry in the development of the South African economy. The Commission is much more active in the area of anticompetitive practices and has increased its focus on cartels; it has identified four priority sectors for attention; and it is engaged in substantially strengthening its capacity. These are some of the key changes that emerged from a strategic planning review initiated in 2006. After providing some background on the evolving competition regime in South Africa, I address each of these recent developments.

Background

The African National Congress won the first democratic South African elections in 1994 and embarked on a far-reaching program of reform to address the legacy of apartheid. Competition policy was identified at the outset as an important part of this program given the highly concentrated nature of the South African economy, and its implications for a broad-based growth and development agenda. For example, the largest conglomerate grouping, Anglo-American, was identified as controlling entities

* The author is Chief Economist, South African Competition Commission.

accounting for 43 percent of the capitalization of the Johannesburg Securities Exchange in 1994, and the largest five conglomerates controlled 84 percent.[1] Moreover, several of these groupings were effectively family-controlled. In addition, current and former state-owned enterprises had quasi-monopoly positions in important industries such as steel, basic chemicals, and telecommunications. The conglomerates and the state had driven the apartheid government's development agenda which had focused on minerals and energy-intensive activities and deliberately not on diversified manufacturing and service activities, given the apartheid state's systematic under-education of the black majority.

After an extensive process of consultation and review of competition regimes internationally, the new South African Competition Act was passed in 1998 and came into effect in 1999. The Act provided for the establishment of the Competition Commission and Competition Tribunal, both independent institutions, responsible for investigation and adjudication of complaints and mergers. There is also a specialist Competition Appeal Court. All large mergers are evaluated by the Commission and have to be ruled on by the Competition Tribunal, while intermediate mergers are decided by the Competition Commission and may be appealed to the Tribunal. Small mergers do not have to be notified, but may be assessed by the Commission. Complaints are lodged with the Commission, and the Commission itself can initiate complaints. The Commission refers complaints to the Tribunal that it believes have strong grounds to indicate a contravention of the Competition Act.

[1] *See* MCGREGOR, WHO OWNS WHOM (1999).

As has been widely observed, the first five years of the competition authorities' activities were dominated by merger evaluation. This was largely because the founding legislation of the South African Competition Commission and Competition Tribunal introduced compulsory pre-merger notification (above certain thresholds of combined assets and turnover). Not surprisingly, this meant a heavy burden of work from the outset for the authorities.

Merger activity provided a good basis for building the capacity and reputation of the institution. This has been due to the large numbers of mergers given the pre-merger notification provision in the Act coupled with the well-developed jurisprudence in merger evaluation, which is generally echoed in the South African legislation. There have been in excess of four hundred notifiable merger transactions in most years, with an important proportion being international. Extensive merger hearings in the Competition Tribunal have involved in-depth analysis of the potential anticompetitive implications. The Tribunal rulings on such mergers have built up a substantial body of competition law in this area in a relatively short space of time.

Recent developments, including more attention on anticompetitive behavior, have been driven by three key factors. These factors also underpin the priorities for the next couple of years.

First, recent analyses have highlighted the negative effects of continued extremely high levels of concentration and associated anticompetitive behavior.[2] The importance of

[2] For example, in a 2006 paper, Aghion et al. found high mark-ups in South Africa that were associated with lower levels of productivity growth and employment. P. AGHION, M. BRAUN, & J. FEDDERKE, COMPETITION AND PRODUCTIVITY GROWTH IN SOUTH AFRICA (Harvard University, CID Working Paper No. 132, 2006).

increased competitive rivalry for faster and more broad-based economic growth has also been identified in the South African government's Accelerated and Shared Growth Initiative of 2006.[3] The key role of the competition authorities has been noted by the South African President in successive State of the Nation addresses. In the context of major economic restructuring associated with trade liberalization, anticompetitive behavior may have even greater costs as it reduces mobility and new entry. Moreover, the historic support for capital-intensive and monopolized activities means supra-competitive mark-ups and barriers to entry in products used as intermediate inputs by more labor-absorbing activities (notable in a country in which unemployment rates have been above thirty percent). This applies equally to broadband pricing by the incumbent fixed-line operator as to the monopoly pricing of steel and basic chemicals for the competitiveness of downstream manufacturing.

Second, the Commission's corporate leniency policy (CLP),[4] introduced three years ago, has begun to bear fruit. Even more importantly, the cartels being prosecuted have illustrated the widespread nature of anticompetitive behavior. This is perhaps unsurprising when people realize that the apartheid system, as well as systematically excluding black people from political, social, and economic rights, supported its main constituencies through state-sanctioned marketing boards in almost all agricultural products. This was coupled with high levels of trade protection and subsidized finance. Since the first democratic government swept aside the marketing boards, it has become

[3] *See* Deputy President Phumzile Mlambo-Ngcuka, A Catalyst for Accelerated and Shared Growth-South Africa (ASGISA): A Summary, Media Briefing (Feb. 6, 2006), *available at* http://www.info.gov.za/speeches/briefings/asgibackground.pdf.

[4] *See* Competition Commission of South Africa, Corporate Leniency Policy, *at* http://www.compcom.co.za/resources/Government%20Gazette_111.doc (last visited Apr. 22, 2008).

clear that in many markets private companies merely continued the centralized price determination, and related arrangements such as market allocation, under their own auspices.

Third, recent Competition Tribunal rulings on abuse of dominance have demonstrated the entrenched nature of dominant firms in many areas of the economy and the scope of anticompetitive abuse to extend and protect their dominance and to exert the market power that results from it. These are often firms that developed under state ownership, such as in fixed-line telecommunications, steel, basic chemicals, and air transport.

Priority Sectors

Over the past year, the Commission has developed its position with regard to prioritization. This relates both to the determination of priority sectors and the basis on which specific cases will be prioritized.

There are three main criteria for the wider prioritization of sectors and cases, namely: a) the impact on poor consumers; b) the importance for accelerated and shared growth; and c) the likelihood of substantial competition concerns based on information the Commission gathers from complaints and merger notifications. As the most egregious breaches of the Competition Act, cartels are unsurprisingly a focus in their own right, with the CLP proving effective in increasing their detection and prosecution.

The Commission is taking a more proactive stance in the four selected priority sectors. In each sector, the Commission is reviewing available data and evidence on potential anticompetitive conduct. This may then lead to more specific investigations and

the initiation of formal complaints in what will generally be a multi-year program of work. The sectors identified in 2008 are as follows.

- **Food and agro-processing.** Agricultural markets were amongst the most regulated by the apartheid government. In 1996, two years after the first democratic elections, the government swept aside the "Control Boards" that had governed the marketing and price determination of most agricultural products in the interests of the predominantly white farmers. These farmers had also been supported by tariffs and quotas on imports, and subsidized finance. Co-operatives had also had a very important role to play in the provision of inputs and the storage, processing, and packaging of products. The cartel behavior uncovered in recent years in areas such as dairy products, bread, and maize meal, suggests that the private concerns in agro-processing and food have engaged in far-reaching anticompetitive behavior to the disadvantage of both consumers and farmers. The importance of food to poor consumers and the high levels of poverty in South Africa mean that this has had a particularly negative impact on welfare. Moreover, the impact on the returns from farming clashes with the government's objectives to support entry of black farmers into commercial agriculture and of rural development more broadly.
- **Infrastructure and construction.** An important component of the government's plan to achieve more rapid growth is a far-reaching program of investment in infrastructure. After sustained economic growth over the past decade, infrastructure is now a major bottleneck which is being urgently addressed, led by investments in transport and energy by the major parastatals in these areas. Anticompetitive behavior increases the costs of this state-led investment, as well as raising the costs of investment by private firms more broadly. Internationally, there have been high profile investigations into construction and infrastructure projects, such as by the Netherlands' NMa and the U.K.'s Office of Fair Trading, which have uncovered extensive bid-rigging. The close-knit nature of the South African business community as well as the apartheid legacy of regulation by

government and industry groups suggests that it may well be a problem in South Africa.

- **Banking.** Following mounting concern about the level of bank charges and the arrangements governing the payments system, the Competition Commission launched an inquiry into these issues with an independent panel of experts.[5] Although participation is voluntary, all the major banks have participated in the inquiry. The inquiry report is due in May 2008, at which point the Commission will determine what further steps to take.
- **Intermediate industrial products.** The South African economy is unusual in developing a strong industrial base in heavy industry but relatively weak capacity in more diversified manufacturing. The comparative advantage in capital-intensive intermediate industrial products is despite the high levels of unemployment, especially amongst those with low skill levels. The skewed industrial base is due to South Africa's resource endowment, the cheapest electricity in the world, and extensive support by the apartheid government. Under apartheid, the government sought to develop strategic industries such as steel, but did not want to encourage labor-intensive manufacturing, nor did apartheid support broad-based consumer demand, instead seeking to limit the participation of black people in the economy, including in education and training. The legacy is entrenched dominant industries with a low cost base, but which generally charge local customers on an "import parity" basis even where there are substantial net exports.

It is important to highlight that there is no formal market inquiry provision in the South African Competition Act. Therefore, the focus on these sectors is based on voluntary cooperation and not the power of the Commission to summon information or conduct search and seizure type operations. These powers become available only if and when

[5] For details of the inquiry, including Terms of Reference and submissions, *see* Competition Commission of South Africa, Banking Enquiry, *at* http://www.compcom.co.za/banking (last visited Apr. 22, 2008).

there is evidence to indicate reasonable grounds for suspecting anticompetitive breaches of the Act by identified companies.

Cartels

The Competition Act includes a per se prohibition of cartels; however, in the first eight years of the new authorities there were very few prosecutions. This is surprising given that the South African economy exhibits conditions supportive of collusive behavior. Collective setting of prices and other terms was explicitly sanctioned by the apartheid regime before 1994, but the striking down of these arrangements, together with far-reaching liberalization by the first democratic government, has not led to the dynamic response that was expected.[6] As already noted earlier in this paper, the South African economy is highly concentrated and business and social networks have historically overlapped, specifically in white business. Industry associations have typically operated to lobby government and information appears to be widely shared between firms enabling ex post monitoring of rivals' performance. The concentration of industrial activity in three or four main regions, with long distances between them, also makes market segmentation and monitoring relatively easy.

The 2004 introduction by the Competition Commission of a corporate leniency policy has played a significant role in uncovering several major cartels in recent years. These include alleged cartels in milk and dairy products, bread and milling, and medical supplies for state and private hospitals. Investigations are ongoing in these areas as well as in several products related to construction.

[6] For a review of patterns of continuity and change, *see* N. Chabane, A. Goldstein, & S. Roberts, *The changing face and strategies of big business in South Africa: more than a decade of political democracy*, 15(3) INDUS. & CORP. CHANGE 549-78 (2006).

But, for leniency to be effective, a credible threat that a cartel will be uncovered is required. It is in this context that the Commission has identified sectors and markets where there are strong indications of anticompetitive outcomes for its attention.

Post-Chicago or Mid-Atlantic: Where Does a Small, Open Developing Economy Fit?

In recent years there has been renewed attention internationally on abuse of dominance, including around the European Commission's review of Article 82 of the EC Treaty. This has happened in the context of increasing recognition among economists of the scope for strategic behavior on the part of dominant firms to engage in anticompetitive abuse of their position. In a 2007 paper, John Vickers characterized this as an emerging "mid-Atlantic" consensus which meets the Chicago School critique and identifies rigorous foundations for abuse of dominance concerns.[7] In a 2000 paper, William Kovacic and Carl Shapiro termed it a "post-Chicago synthesis".[8]

The effects-based rather than form-based analysis motivated by this approach has important implications for a small, open developing country such as South Africa. South Africa's distance from other industrial economies and the legacy of state support and protection for many industries under the apartheid regime means that, in general, markets are more concentrated and entry barriers are higher than in other industrial economies. As described earlier in this paper, there are also dominant firms in important industries that do not owe their position to innovation or risk-taking investors, but rather to state sponsorship and support.

---

[7] J. Vickers, *Competition Law and Economics: A Mid-Atlantic Viewpoint*, 3(1) EURO. COMPETITION J. 1-15 (2007).

[8] W. Kovacic & C. Shapiro, *Antitrust policy: a century of economic and legal thinking*, 14 J. ECON. PERSP. (2000).

Taken together, the standards that may be applied in European jurisdictions may also suggest greater concerns in South Africa about unilateral abuse. Furthermore, the negative implications of this abuse for economic efficiency and consumer welfare will likely be greater and more persistent in South Africa. While this may be true at the level of generality, addressing such behavior rests on detailed, case-by-case analysis of the actual conduct and effects to meet the tests set down in the Competition Act. This is the challenge fully recognized by the Competition Commission.

Building the Commission's Capacity

To deliver on its mandate against the major challenges facing it requires the Commission to continually strengthen its capacity for analysis and enforcement. At the same time, the legal and economic consulting fraternities have grown to provide the services required by private parties to cases. And, the increasing attention to competition policy around the world has meant a greater international mobility of competition practitioners. These factors have been reflected in escalating salaries in the private sector, a relatively high staff turnover, and several staff being attracted to competition authorities in Ireland and New Zealand, as well other regulatory bodies in South Africa.

In response, the Competition Commission has focused on building effective knowledge management practices in the organization together with ongoing training and the nurturing of international links that make the Commission an attractive and challenging place for those wishing to advance their career.