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Contribution from South Africa

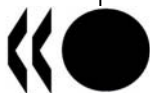
-- Session I --

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THE REGULATION ON RESTRICTIVE COMPETITIVE BEHAVIOUR BY PUBLIC ENTERPRISES

--South Africa--

1. Background

1. The South African state, in common with most developing countries and a great many developed countries, pursued an active industrial policy in order to create the basis for industrial development. A wide range of instruments were employed as part of this industrial policy including direct state investment and ownership, tariffs and other protectionist measures, tax holidays and subsidies, procurement requirements and government supported mergers. It is probably a fair, if somewhat sweeping generalisation, to say that where basic industrial and commercial inputs were concerned the favoured instruments were direct government investment and tax subsidies, while where consumer goods were concerned tariffs were the instruments of choice. Direct government investment has underpinned dominant firms – ‘national champions’ – in, inter alia, steel, petro-chemicals, fertilisers, and large swathes of transport from fuel pipelines to passenger air transport. The South African state also invested in many industrial enterprises through the Industrial Development Corporation, a large industrial development finance institution established in the 1940s, that has also exercised a major influence on policy designed to support industrial development. In addition, in common with almost all countries, the state owned utilities in telecommunications and electricity.

2. We very briefly describe the evolution of state involvement in major industries before reviewing more recent debates around the role of industrial policy in South Africa and setting out the challenges that previous state support for industry poses for competition policy. Finally we sketch briefly some of the elements of what we believe are an effort to reduce the tensions which may arise between competition and industrial policy.

2. Evolution of state involvement in major industries

3. In the 1980’s and 1990’s, the South African government, again in common with many of its counterparts in the rest of the world, embarked on a process of economic liberalisation that included a lowering of tariffs and other barriers to international trade as well as the privatisation of important state owned enterprises, most notably those involved in petro-chemicals and steel. The first of these, Sasol Limited (“Sasol”), is now a significant multinational while the latter – Iscor Limited – has been absorbed into the ArcelorMittal South Africa Limited (“ArcelorMittal”) steel empire. Sasol and ArcelorMittal, the erstwhile state created and owned enterprises, dominate a great many of the critical domestic markets in which they participate. Other South African national champions – notably the dominant fixed line telephone company, Telkom SA Limited (“Telkom”), and the monopoly provider of electricity, Eskom Holdings, are still owned by the state.

4. The alcoholic beverages market is a clear example of a state sanctioned anti-competitive private agreement to support the creation of national champions in the beer and wine and spirits market. Here, in the 1970’s the state ignored the views of the Competition Board, a largely advisory body that preceded the contemporary competition statute and institutions, and allowed a market sharing agreement which, to this day, underpins dominant firms in each of the beer and wines and spirits markets,

3. Recent debates around the role of industrial policy in South Africa

5. Support for industrial policy has been maintained despite widespread dissatisfaction with the conduct of the state owned enterprises (“SOEs”) and former SOEs, those corporate entities that are justifiably characterised as South Africa’s ‘national champions’. Industrial policy over the past decade or

so has sought to pursue different objectives in the form of a more diversified and labour absorbing development path, and it has not used extended state ownership to achieve this, while there has also been far-reaching trade liberalisation. But, the established position of large former SOEs has enabled them to continue to benefit from state support such as tax holidays for major investments. At the same time, government has been largely ineffective in counteracting these interests. For example, South Africa's telecommunication charges are generally agreed to be amongst the highest in the world and the population and the exceptionally energy intensive mining and minerals processing sectors have recently had to bear the brunt of serious shortfalls in electricity capacity. Both entities are subject to relatively new, under-resourced and relatively weak regulatory bodies.

6. The former SOE's, notably Sasol and ArcelorMittal SA, have been at the centre of several significant abuse of dominance investigations and several successful prosecutions. While it is wholly possible to argue that state investment was necessary for the establishment of these basic capabilities that underpinned a deep level mining and, later, a manufacturing economy, in their current incarnation these national champions are strongly associated with inefficiency and with abusive conduct, both exclusionary and exploitative. By way of example ArcelorMittal has been successfully prosecuted by a large gold mining company for contravening the excessive pricing prohibition in the Competition Act 89 of 1998, as amended ("the Competition Act" or "the Act") and Sasol was successfully prosecuted for discriminatory pricing in contravention of the Competition Act although the latter decision was overturned by the Competition Appeal Court. Telkom's monopoly was extended in exchange for a commitment to roll out fixed line telephone services to the rural and other low income areas – although it partly honoured the roll out commitments, it did so at prices too high for the newly connected consumers to afford and so before long the rate of disconnection exceeded the rate of new connection.

7. A product of the period of economic reforms – although with diverse roots and influences extending significantly beyond the imperatives of economic liberalisation – was a much strengthened competition policy regime, which included the promulgation of a new anti-trust statute in 1998 as well as the establishment of sector regulators in the telecommunications, energy and selected transport markets. While the reforms do evidence growing respect for market principles, the continued support for industrial policy, support which has been strengthened by the current global economic turmoil, has meant the possible tensions between these policy fields have been the subject of recent policy debates and analysis. These have highlighted the importance of dealing with the impact of anti-competitive conduct for South Africa's economic development and, as such, the complementarities between industrial and competition policies. Sector specific policies of the Department of Trade and Industry for sectors such as metals, machinery and plastic products have also highlighted the negative impact of supra-competitive pricing of basic material inputs.

8. Support for industrial policy, specifically including national champions, is manifest in certain of the provisions of the Competition Act itself. Hence the promotion of employment, competitiveness and small and medium-sized enterprises feature alongside more orthodox consumer welfare objectives as explicitly stated 'purposes' of the Competition Act¹. The objective of supporting small and medium-sized enterprises played a significant role in the Tribunal's decision in the matter of Nationwide Poles CC v Sasol Oil (Pty) Ltd. In this matter Sasol was found to have contravened the Act's proscription of price discrimination. In its decision the Tribunal noted that it was required to take account of 'an industrial policy that places the development of SMEs at the centre of attempts to improve the workings of the market mechanism².' Although this decision was overturned on appeal, in its decision the Competition

¹ Note that the purpose of promoting international competitiveness provides that a purpose of the Act is 'to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic'. (our emphasis)

² 72/CR/Dec03 - Nationwide Poles CC and Sasol Oil (Pty) Ltd

Appeal Court supported the Tribunal's view that the Act required that the competition authorities take note of 'the need to ensure that small and medium businesses are able to use the Act to protect their ability to compete fairly and freely³.'

9. The insertion of industrial policy objectives in the Competition Act extends beyond the general purposes of the statute.

10. Section 10 of the Act provides that the Competition Commission may exempt a firm from the application of the chapter of the Act which proscribes anti-competitive agreements and abuse of dominance if the agreement or practice contributes to the promotion of exports, to the competitiveness of small businesses, to changes in productive capacity necessary to prevent the decline of an industry, or to the economic stability of an industry designated by the Minister of Trade and Industry. Note that only the Competition Commission is entitled, with a right of appeal to the Competition Tribunal, to grant an exemption. The Minister has no decision making function with regard to applications for exemption.

11. While the number of exemptions granted is small, as might be expected a number of those that have been granted do indeed promote the core industrial policy objective of international competitiveness, if not competition, although it is not immediately apparent that any of these exemptions severely compromise competition. Indeed even when granting an exemption the Commission attempts to carefully design the exemption so as to maintain competition to the greatest extent possible. However, clearly in order to have qualified for exemption the exempted conduct would have to constitute a contravention of the Act. For example, the Commission conditionally exempted a geographic market sharing agreement between Qantas (the Australian airline) and South African Airways (also a state owned 'national champion') on the grounds that the exemption promoted exports and allowed for a change in productive capacity necessary to stop decline in an industry⁴.

12. The merger provisions of the Act similarly require the competition decision maker to take account of industrial policy objectives. Hence when deciding a merger the relevant competition agency – the Tribunal in the case of mergers above a specified threshold and the Commission in respect of those falling below the threshold – is required to decide whether the merger is likely to give rise to a substantial lessening of competition, and then, regardless of the outcome of the competition evaluation, to determine the transaction's impact on a specified number of public interest grounds, which include the standard industrial policy objectives such as the transaction's likely impact on region or sector, on the ability of small businesses to become competitive, and on the ability of national industries to compete in international markets.

13. It is important to note that the relevant competition authority is the only decision maker, including in the assessment of the public interest impact of the merger. Neither the Minister nor any other executive structure is entitled to override the competition authorities' decisions. A ministry or department of state may make representation to the Commission and the Tribunal and, on several important occasions, have done so, but the decision making prerogative resides solely with the competition authorities. This, and the fact that the competition evaluation precedes the public interest assessment, ensures that, while the industrial policy objectives are seriously treated, they are assessed by competition professionals through the lens of the competition evaluation. This may help explain why, although the public interest assessment has occasionally resulted in the imposition of a condition (usually centred on the employment impact), they have never been dispositive in the decision whether or not to approve or prohibit a merger.

³ 49/CAC/Apr05 - Sasol Oil (Pty) Ltd and Nationwide Poles CC

⁴ Government Gazette No. 30805, 29 February 2008

14. In short, the insertion into the competition statute of industrial policy objectives alongside orthodox consumer has not materially compromised the attainment of the core competition objectives. Nor, we believe, does this place our work outside of the mainstream of competition enforcement and adjudication. Evoking international competitiveness and scale economies in merger assessments, whether under the guise of public interest or efficiency, is standard practice in most jurisdictions with which we are familiar. The critical difference between our practice and many, if not all, other jurisdictions, is the explicit inclusion of social and industrial policy objectives in the competition statute, the transparent manner in which the public interest is weighed against the competition impact, and the fact that it is the competition authority, rather than a minister of state, that is the decision maker even on public interest matters.

15. This is not to say that the inherent tension between industrial policy and competition policy has been eliminated, particularly in those instances where industrial policy seeks to selectively promote the interests of particular enterprises. Indeed the current economic crisis has, if anything, strengthened the hand of those who support a leading role for the state in the attainment of economic objectives. Nor is this surprising – for those competition fundamentalists who have consistently denied the prevalence or impact of market failures, the financial crisis is clearly a salutary lesson. However, the financial crisis has ineluctably become the basis for all manner of economic actors to demand state support and intervention in favour of national firms. Certainly in South Africa it has become the basis for demanding state support for a range of enterprises and sectors whose woes owe more to decades of state protection and its handmaiden, inefficiency, than to the impact of the economic downturn. Faced with the opportunism that underpins these demands for support, the competition authority can do little other than use its advocacy tools and its public profile to warn of the dangers inherent in undermining market processes and to warn against a conveniently distorted interpretation of the concept of market failure, one that views every unsuccessful firm or sector as the victim of market failure rather than of inferior products and supra-competitive cost structures.

4. Efforts to reduce the tension between competition policy and industrial policy

16. However, the South African authorities are attempting to take a more positive and constructive approach to industrial policy, than that of the market fundamentalist ‘nay-sayer’. We sketch briefly some of the elements of what we believe are an effort to reduce the tension between these important fields of economic policy:

17. Firstly, there are unquestionably industrial policy instruments and programmes that are, at worst, neutral with respect to the attainment of competition policy objectives. These are industrial supports that are far from market and that are directed at strengthening generic industrial capabilities as opposed to those that privilege particular firms. Human resource development and general support for research and development are clear examples of this. Where support is extended to particular enterprises it should be done as the outcome of a competitive and transparent process in which the criteria for support are clearly specified. The criteria should emphasise the prospective recipient’s prospect for future success rather than need. Furthermore, industrial policy support should always be accompanied by a clearly specified exit strategy for the provider of support. It is imperative that the competition authorities participate actively in the debate surrounding industrial policy and that they advocate for competition-friendly industrial policies.

18. Secondly, it is imperative that the competition authorities do not conduct themselves in a manner that suggests that they are anti-big business. Indeed it is important that their work evidences the incontrovertible truth that has taught generations of anti-trust enforcers that the overwhelming majority of mergers do not raise competition concern and that the merger process is an important aspect of the process of economic restructuring process. Similarly its prosecutorial strategies and decisions must give

expression to the learning that holds that many vertical agreements and, indeed, instances of unilateral conduct are efficiency enhancing.

19. Third, the credibility of the competition authorities rests on being effective in addressing anti-competitive conduct and rigorously evaluating mergers that raise competition concerns. This is particularly the case in economies with conditions for sustained cartel conduct and abuse of dominant positions. Recent cases of cartel conduct in various food products have demonstrated how the far-reaching liberalisation of government controls in 1996 was undermined by private regulation by the food processing companies. The support for market oriented economic policies requires vigorous enforcement against such conduct. In this regard, it is important to recognise that small markets are particularly vulnerable to anti-competitive unilateral conduct. Hence there is a legitimate role for the competition authorities in ensuring that entry barriers are as low as possible and that SMEs are able to survive. The ‘protection of competition not competitors’ mantra rings hollow where a great many markets are characterised by the absence of competitors and hence competition. It has been suggested that industrial policy should, wherever possible, avoid supporting dominant firms but should rather focus its attention and resources on second tier firms and new entrants. It is of course possible that second tier firms remain at that level because their offerings are inferior to the first-tier firms. But it is also highly conceivable that certain of these firms are stuck in the second tier because of the structure of the market and the conduct of its dominant participants. Where the conduct of the dominant firms is impeachable then vigorous prosecution must follow, but where the dominant firms are privileged by non-competition events and policies of the past – for example a previous history of state ownership – then there is a prima facie case for directing assistance at those that have not been beneficiaries of this historical privilege.

20. Fourthly, the competition enforcer would be well-served in this debate by a prosecutorial strategy that is clearly seen to be generating positive outcomes from an efficiency and poverty alleviation perspective. For example, the South African Competition Commission, has identified bid rigging in public tenders as an important priority area, and under that rubric, construction and civil engineering as markets that require close scrutiny. The context for this is a government economic policy that has identified public investment in infrastructure as a pillar of its growth strategy and that is committed to massive infrastructural spend in support of the 2010 FIFA World Cup. By focusing on bid rigging, the competition authorities are demonstrating the positive contribution that competition policy can make to a pillar of the state’s economic and industrial policy.