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COMPETITION AND POVERTY REDUCTION

Contribution from South Africa

-- Session I --

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-- South Africa --

1. Introduction – competition policy as embedded in society's context

1. Competition policy emerges out of a particular context. It is, in its general character, a reflection of the economic choices that a society makes with regard to the role and bounds of the market mechanism and of the state in the economy.[1] It is also society's response to challenges and issues arising out of a specific historical trajectory. For example, in the United States, the competition regime grew as a counter-point to the abuse of power by trusts such as Standard Oil; in East Asian countries it was introduced within the context of rapid industrialisation driven by the developmental state and in many Latin American countries it was spurred by concerns over inequality.[2] In developing countries, poverty is a key feature of the context.

2. To borrow a phrase from modern political economy, the development and implementation of competition policy can be viewed as an exercise in 'embedded autonomy'.[3] This phrase describes a relationship between state institutions and society whereby the state is embedded adequately in society so as to be responsive to society's needs, but also autonomous from narrow private interests. This formulation can be applied to the experience of competition authorities, as they seek to contribute to the resolution of society's most pressing challenges, such as poverty, whilst taking care not to be overladen with policy goals beyond what is achievable in the realm of competition policy. Embedded autonomy also implies that competition authorities construct their enforcement and advocacy agenda in alignment with society's priorities; doing so in a transparent, rigorous and impartial manner.

3. In response to the questions raised in the call for contributions for the 2013 Global Forum on Competition, this submission will grapple with broad theme of how competition law and policy contribute to poverty reduction. It will reflect on how this has translated into the work of the Competition Commission of South Africa (CCSA) in practice. It will also consider the topic from the 'demand' (the poor as consumers) and 'supply' (the poor as small entrepreneurs and as employees) side as formulated in the call for contributions.

4. Though the need to contribute towards poverty reduction may shape an authority's strategy towards enforcement and advocacy, the causal relationship between competition law implementation and poverty outcomes is complicated by various factors. Though increased competition is expected to lead to lower prices, innovation and also higher rates of participation in the economy; specific competition law interventions can appear to have neutral or even counter-intuitive effects in the market. The effects of enforcement action on a market take time to manifest themselves in pro-competitive outcomes (such as lower prices), making it difficult to attribute market outcomes to competition authorities' interventions.

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[1] Gerber (1994), Constitutionalising the Economy: German Neoliberalism, Competition Law and the "New" Europe, American Journal of Comparative Law, Vol 42.

[2] ibid.

[3] Evans (1995), Embedded Autonomy, Princeton University Press, Princeton.

Market outcomes are also influenced by a range of domestic and global factors, further bedevilling attempts at drawing causality. In the short run, prices may rise or stay the same in spite of anti-competitive conduct being uncovered and penalised. And in assessing the impact of their interventions, authorities rarely consider the effect on poor consumers as a discrete group. Thus to demonstrate the linkage between competition policy and poverty reduction is a difficult and tenuous endeavour, as the bread cartel case study will demonstrate.

2. Poverty in South Africa

5. Poverty appears in different forms across and within countries, and over time. In South Africa, poverty is located within a history of colonialism, which gave way to an apartheid state that systematically 'under-developed' the majority black population. In their recent book, '*Why nations fail*', scholars Acemoglu and Robinson characterise the institutions that governed South Africa's economy and society for centuries during colonial and apartheid times as 'extractive'.[4] The logic of economic management under these dysfunctional institutions was driven by the interests of primary industries (mining and agriculture), which mostly sought to create an elite class of white farmers who faced no competition from their black counterparts, and also to aid the mining industry in generating a class of unskilled black labour to work underground. This dysfunctional mode of governance naturally had implications on the state of competition in the country. Through various legal and policy instruments, competition in the economic sphere was severely curtailed.[5]

6. South Africa is considered an upper middle-income country, with GNI per capita in 2011 at USD 6 960.[6] There is some debate as to the extent to which the living standards of the majority black population have improved since the onset of democracy in 1994. Income measures paint an ambiguous picture, with most studies showing either real income declines or at best modest income growth amongst the poorest households.[7] What is clear is that the rate of poverty has remained high in the post-apartheid period. By 2008, 54% of households lived below the poverty line of R515 (USD121) per month. Applying a higher standard of R949 (USD223) per month, 70% of households were living in poverty in 2008. However, it should be noted that using the oft-cited 1.25 dollar-a-day metric, the ratio of South African households living in poverty is a relatively low 14%.[8]

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4 Acemoglu, D. and J. Robinson (2012), Why Nations Fail, Random House.

5 Networks that straddled the state and business where encouraged by the state. To cite a few examples; agricultural co-operatives were appointed as agents of state control boards and the cement industry was allowed to run a cartel. Recent competition cases have revealed cartels in industries such as concrete pipes, cement, reinforcing steel, scrap metals, flour and bread, illustrating the persistence of these networks.

6 World Bank Development Indicators. http://data.worldbank.org/country/south-africa Accessed 13/01/2013.

7 Leibbrandt et al (2010), Trends in South African Income Distribution and Poverty since the Fall of Apartheid, OECD Social, Employment and Migration Working Papers No. 101.

8 World Bank PovCalNet database. http://iresearch.worldbank.org/PovcalNet/index.htm?2 Accessed 13/01/2013.

Table 1. Poverty trends in South Africa[9]

	Population	Poverty headcount ratio: poverty line R949 per month (USD223)*	Poverty headcount ratio: poverty line R515 per month (USD121)*	Poverty headcount ration: poverty line USD1.25 a day (USD38)**
1993	40m	72%	56%	24%
2000	42m	71%	54%	26%
2008	49m	70%	54%	14%

* at 2008 purchasing power parity dollar values
** at 2005 purchasing power parity dollar values

7. Poverty in South Africa continues to be marked by race, gender and geography; with black, female-headed and rural households experiencing the highest rates of poverty and economic vulnerability.[10] [11] The labour market is also not integrating young people effectively, thus increasing rates of youth unemployment.[12] To develop the capabilities required to transcend poverty, access to opportunity is key. However, in South Africa, it has been found[13] that poverty and inequality is reproduced from one generation to another through lack of opportunity.[14] A child's circumstances at birth; especially whether they are born in a township, informal settlement or rural area, as opposed to an (non-township) urban area; and the education of the household head determine access to opportunity and ultimately its lifetime prospects. This limits the rate of inter-generational mobility in South Africa, despite popular perceptions about the growth of the black middle class.

8. Poverty is one of the most significant challenges facing South African policymakers. There are two key mechanisms that contribute towards poverty reduction; namely private sector employment and government's fiscal policy, as expressed through expenditure programmes such as social grants (income support) and direct provision and subsidisation of services such as water, electricity and housing. The labour market has been unable to provide adequate opportunities to working age adults. Over the past decade, the unemployment rate is stubbornly high at over 24%.[15]

9 Leibbrandt et al (2010).

10 Leibbrandt et al (2010).

11 StatsSA (2012), Income and Expenditure Survey of Households 2010/2011, Statistical Release P01000.

12 Leibbrandt et al (2010).

13 World Bank (2012), South Africa Economic Update: Focus on Inequality of Opportunity.

14 The World Bank defines opportunity as a set of goods and services available to children, such as access to safe water, electricity and education that are critical in determining the opportunities for economic advancement in life.

15 Leibbrandt et al (2010).

Table 2. Unemployment rates by income decile[16]

Decile	1993	2000	2008
1	**49**	**44**	**69**
2	**34**	**44**	**46**
3	**27**	**41**	**47**
4	**22**	**39**	**37**
5	23	34	30
6	19	33	26
7	15	26	20
8	9	21	16
9	4	13	9
10	2	4	5
Overall	**14**	**26**	**24**

9. Social grants and government provision of services has compensated for this lack of economic activity thus providing a crucial safety net and a base for capability development for poor households. Empirical studies suggest that these grants are well targeted, with means testing ensuring that the most important grants are provided to the poorest households. It is estimated that social grants make up more than 70% of household income for the bottom quintile in South Africa, up from 15% in 1993 and 29% in 2000.[17]

10. Ultimately, sustainable poverty reduction will depend on generating wage-earning opportunities in the economy. Competition policy, to the extent that it challenges economic exclusion, lack of innovation and lack of rivalry can play an important role in placing the economy on a higher growth and development trajectory.

11. Lack of competition in product markets for essential goods and services is arguably more harmful for poorer households than for higher income households. As expected, poor households spend a higher proportion of expenditure on essential goods and services. [18] The average South African household spends 12.8% of its expenditure on food and non-alcoholic beverages. In contrast, the poorest ten per cent spend above a third of their expenditure on food and non-alcoholic beverages.[19] The same pattern is repeated with housing, water, electricity, gas and other fuels, where this category accounts for 17.1% of household consumption expenditure for the average household; but accounts for 26% of expenditure for the poorest ten per cent of households.[20]

12. Given the extent to which lack of employment opportunities drives poverty and inequality amongst adults, employment generation has become an important consideration for economic policy. This has influenced how competition law is applied, especially in the realm of merger control. Taken from the perspective of the role of the poor as workers and small entrepreneurs, the tensions between competition policy and poverty reduction have been most apparent, including in the Wal-Mart/Massmart merger discussed below.

16 Ibid.

17 World Bank (2012).

18 Income and Expenditure of Households 2010/2011. StatsSA Statistical release P0100.

19 Bottom decile – 35%; Second decile – 35.2% and third decile 33.9%.

20 Bottom decile – 26%; Second decile – 22.5% and third decile – 22.3%.

3. Competition law and poverty in practise

13. The stated purpose[21] of the South African competition law encompasses orthodox concerns related to efficiency, prices and choice. In addition to this, the statute also articulates the purpose of the Competition Act as promoting competition in order to realise goals related to employment creation and retention, equitable participation in the economy by small and medium-sized enterprises, a broader and more racially diverse spread of ownership and international competitiveness. The Act thus envisages a role for the competitive process in rectifying the distortions and inequities wrought on the economy and society by the *apartheid* regime. These elements of the legislation ultimately relate to the government's economic, development and social policies. This addresses considerations on the 'supply' side (the poor as small business owners) as formulated in this Global Forum.

14. In line with broader economic growth and development concerns, the merger assessment provisions contain public interest considerations. The Commission is required to determine whether or not a merger can be justified on substantial public interest grounds, taking into account its impact on a particular region or industrial sector, employment, the ability of small business or firms controlled by historically disadvantaged persons to become competitive, and the ability of national industries to compete in international markets.

15. Criteria for exemptions also reflect policy concerns related to poverty. In granting exemptions, the Commission should consider whether the practise or agreement to be exempted contributes to the promotion of the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive; the productive capacity necessary to stop decline in an industry or the economic stability of an industry designated by the executive branch of government.

16. In South Africa, the implementation of competition law by the authorities has taken into account the growth and development imperatives of a highly unequal society that is also characterised by high rates of poverty. The Competition Commission's enforcement and advocacy activities are guided by a Prioritisation Framework, which represents the organisation's over-arching strategy.[22] This Framework, adopted in 2008, explicitly incorporates poverty reduction, as it draws on the country's key economic policies that are directed towards the same goal.

17. The Prioritisation Framework directs the Commission to intervene in sectors of the economy that have a big impact on consumers (especially low income consumers) and that determine the enabling environment for business and economic development. The framework is located within the context of the policy focus on labour-absorbing growth to address the high unemployment and poverty levels in South Africa.

18. The Prioritisation Framework identifies specific priority sectors, namely, food and agro-processing; infrastructure and construction; intermediate industrial products and energy; construction services; and banking as focus areas for the Commission's enforcement and advocacy programmes. Cartel conduct, given its well accepted egregious effects on consumers, is also prioritised as an area of investigation. Within priority sectors, investigations are also prioritised depending on criteria such as likelihood of success, evidentiary burden, nature of competition issues (for instance, whether it would be a precedent setting case), resource availability and extent of harm.

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21 Section 2 of the Competition Act no 89 of 1998 as amended, and also the Preamble.

22 Makhaya, Mkwananzi and Roberts (2012), How should you competition authorities approach competition enforcement? Reflections on South Africa's experience, South African Journal of International Affairs, Vol 19, No 1, pp 43 – 64.

19. Proactive measures taken by the Commission in priority sectors include reviewing available information and evidence on potential anti-competitive conduct and screening various markets for signs of potential anti-competitive outcomes. This has assisted the Commission in initiating and in some instances concluding investigations in key consumer and input markets such as poultry, bread, wheat and milling, animal feed, steel, polymers, fertiliser, cement, concrete pipes and bricks. It also resulted in an increase in the number of abuse of dominance investigations.

20. By focusing its energies on identified priority sectors selected on the basis of criteria that include impact on poor households (and industrial development with implications for employment), the Commission has been able to optimise on its resources whilst also contributing towards poverty reduction.

4. Wheat to Bread value chain case study

21. The South African competition authorities' enforcement action in the bread value chain provides a stark illustration of the linkage between poverty reduction and competition policy. In May 2008, the Competition Commission of South Africa produced various scoping reports which highlighted concerns in staple foods. As discussed above, food accounts for a significant proportion of poor households' expenditure. The scoping study occurred against the backdrop of mounting evidence of competition contraventions uncovered by the Competition Commission, including information received between 2006 and 2007 about cartel conduct in the markets for bread baking and wheat and maize milling. Investigations revealed that four major firms dominating the bread value chain had been colluding to set prices and to allocate markets from 1994 to early 2007.

22. These investigations culminated in the imposition of penalties with the most notable being the substantial and unique settlement entered into between Pioneer and the Commission. According to that settlement, Pioneer would:

- Desist from conduct which contravened or might contravene the Act.
- Continue its compliance programme to prevent future contraventions and co-operate with the Commission in its prosecution of others.
- Pay an administrative penalty of R500 million to the National Revenue Fund. In addition, the Competition Commission, National Treasury and the Economic Development Department separately agreed that the Economic Development Department would submit a budgetary proposal and business case motivating for the creation of an Agro-processing Competitiveness Fund of R250 million drawn from the penalty which will be administered by the Industrial Development Corporation.
- Adjust the prices of certain of its products for an agreed period of time (up to six months) so as to reduce its gross profit by an amount of R160 million.
- Maintain its capital expenditure and increase it by an amount of R150 million.

23. These measures were expected to facilitate entry into formerly cartelised markets and to stimulate rivalry in the market as competitors respond to the price reductions.

24. The investigations in the bread case generated wide-spread interest from the South African public, including non-governmental organisations involved in the fight against poverty and the labour movement. Some of these NGOs have sustained interest in the matter, and are now seeking relief for consumers by pursuing civil damages claims against the implicated firms.

25. This case study also demonstrates the difficulties in seeking to draw causation (at least in the short term) between competition law interventions and poverty reduction. In spite of uncovering anti-competitive behaviour in the value chain for such an essential staple food and imposing remarkable penalties and remedies, price outcomes in the market have not met expectations. During the margin reduction period, Pioneer sacrificed over R170m over the period 1 December 2010 to 31 March 2011; R70m on external wheaten flour sales, and R106m on the selected bread products that had been identified as part of the settlement. The remedy sought to go beyond purely punitive measures by offering direct relief to consumers and small bakeries (who procure flour) who had been victims of the cartel.

26. According to information obtained by the Commission from major retailers, Pioneer's major competitors had responded to its price reductions by either reducing the wholesale prices they charged to the major retailers, or by not passing through significant cost shocks experienced prior to and during Pioneer's profit sacrifice period. However, when this period ended, prices for three of the four players increased for both brown and white bread products.

27. Outcomes in wheat flour milling were also similar in that it was difficult to see pro-competitive results in the short term. Yet in this case, there were grounds to suspect that this was due to co-ordinated outcomes being sustained by vertically integrated competitors through information exchange via an industry association. This matter was resolved through recommendations made by the Commission for less problematic mechanisms of information exchange in the market. Regional comparisons across the country also suggest that in regions with high concentration and no entry during the post-cartel period, the main firms have been able to maintain high margins and high market shares.[23]

28. Recent data suggests that price increases in the wheat-to-bread value chain have remained significantly above consumer inflation. Data also suggests that the margins of one of the cartelists have increased to levels higher than during the cartel period. This reversion towards pre-enforcement price trends has drawn questions about the effectiveness of competition enforcement in this market. Nonetheless, in the absence of the scrutiny, penalties and remedies imposed on this market, the counter-factual scenario may actually involve even higher prices and margins.

5. Competition policy, small enterprise development and employment

29. The call for submissions note for this Global Forum acknowledges the ways in which increased competition can present challenges for poverty reduction. Indeed, the transition from a highly concentrated economy to a more competitive one creates winners and losers. Entry by new domestic players or multinationals disrupts supply chains and displaces old modes of production. These dynamics may benefit the poor as consumers, through lower prices, but there are instances where, at least in the short term, intensified competition seems to displace the poor.

30. For instance, in the market for formal grocery retail in South Africa, established corporate retail chains have begun to penetrate formerly un-served market segments by opening new stores in township (predominantly black urban areas) and rural areas. This competition by established retailers for the lower end of the market often leads to the closure of small, locally owned retail stores, with implications for local small business development.

31. The competition authorities explicitly dealt with the nexus between competition policy and small business in *Nationwide Poles*.[24] [25] In this case, Nationwide Poles, a small pole manufacturing firm

23 Competition Commission South Africa Internal Documents.

24 Case number 72/CR/Dec03

complained that Sasol did not supply it with a key input on the same terms as its larger competitors. In its ruling, the Competition Tribunal argued that the Competition Act had the development of small business in mind, as demonstrated by its preamble and, looking back in time, the explanatory memorandum that accompanied it. The “special treatment” accorded to price discrimination, with its own section separate from other abuse of dominance provisions, is also seen as reflecting legislative concern with maintaining accessible and competitively structured markets in which entrants can compete effectively against incumbents.

32. Though the Tribunal did not succeed in its particular use of the public interest arguments in favour of small business in *Nationwide Poles* (where it was arguing for a different standard of showing substantiality where a small business is harmed), its remarks about the potential of competition law to contribute to an enabling environment for small business development retain merit. The Competition Appeal Court, in overturning the Tribunal, was careful to make it clear that its decision did not seek to diminish the ability of small and medium businesses to “use the Act to protect their ability to compete freely and fairly.”[26]

33. As mentioned earlier, the South African regime, attuned to the employment and industrial development challenges of the country, requires the Commission to consider various public interest grounds in the assessment of mergers. These provisions require the authority to determine whether or not a merger can be justified on substantial public interest grounds, taking into account its impact on a particular region or industrial sector, employment, the ability of small business or firms controlled by historically disadvantaged persons to become competitive, and the ability of national industries to compete in international markets.

34. The Commission’s approach to the impact of mergers on employment is based on a case-by-case approach through examining factors that include the skills levels of employees, the regional economy in which affected employees are based and the prospect of re-employment elsewhere. In giving effect to the employment provisions of the legislation, the Commission acts to restrict job losses, and where losses occur to ensure that the affected employees are retrained in a manner that enables them to obtain employment or pursue self-employment opportunities.

35. The entry of Walmart into South Africa, through a partial acquisition of locally listed Massmart, bought the ‘supply-side’ position of the poor into focus. The strict application of competition principles would suggest that this is pro-competitive entry. However, it generated opposition based on supply-side considerations with regards to the impact of the transaction on workers and domestic suppliers.[27] This transaction raised concerns about employment losses and the potential displacement of local producers by imports in the merged entity’s supply chain. These concerns were ultimately resolved through conditions limiting employment losses and the establishment of a supplier development fund to help integrate small South African suppliers into the merged entity’s supply chain.

36. The extent to which the South African competition authorities can interpret their mandate and legislation in favour of poverty reduction remains a matter of contestation between various segments of society. Broadly speaking, those in the labour movement and non-governmental organisations advocate for the balancing act between competition and public interest considerations to tilt far more towards preserving jobs and expanding economic opportunity. The private sector tends to favour a more restrictive approach to

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25 This section relies heavily on Makhaya (2011), The intersection between competition policy and entrepreneurship, Competition News, Edition 41 December 2011.

26 Case number 49CACAPRIL05

27 Case number 73/LM/Nov10

the interpretation of the public interest mandate and is insistent on imposing clear limits on the competition authorities' role in supporting employment, equity and industrial policies.

6. Conclusion

37. The Competition Commission of South Africa, through a transparent prioritisation framework, focuses its resources on those sectors that provide products and services that make up a significant proportion of poor households' expenditure and also those that have been ear-marked by government as important for employment generation and infrastructure provision. The poverty reduction imperative is also reflected in the merger assessment regime, which incorporates public interest provisions that focus the Commission's attention on issues with a bearing on poverty and development, such as employment and small business development.

38. Nonetheless, competition law interventions need to be complemented by wider and consistent application of competition policy across government to encourage entry and effective rivalry in the economy.

39. The nature of poverty in South Africa places employment generation as the key to achieving sustainable poverty reduction. The effectiveness of competition policy as an instrument for inclusive, employment-generating growth depends on effective policies in areas such as access to finance, training, research and development to eliminate other constraints to employment creation.