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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Competition and Inflation – Note by South Africa

30 November 2022

This document reproduces a written contribution from South Africa submitted for Item 12 of the 139th OECD Competition Committee meeting on 29-30 November 2022.

More documents related to this discussion can be found at
www.oecd.org/competition/competition-and-inflation.htm

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Introduction

1. The global economy has been subject to a number of several economic shocks since the onset of the Covid-19 pandemic which have resulted in higher levels of price inflation, in particular food price inflation. In the past year, crop failures due to extreme weather events, supply chain disruptions and rising global oil prices have spurred a sustained wave of price inflation which has placed households under considerable pressure, especially lower income households.
2. The onset of the pandemic demonstrated that competition authorities have an important role to play in periods of economic crisis, including periods of high inflation. The Competition Commission of South Africa (“CCSA”) is of the view that authorities need to be more proactive against foreseeable shocks and conduct. This includes the role of market power (temporary or permanent) in driving inflationary forces in many markets through 'rocket and feather' conduct whereby manufacturers, wholesalers and retailers use the pretext of known rising costs to inflate prices more quickly and by more than cost increases (the rocket), and reduce them more slowly than necessary once the shock is over (the feather) to profit from the crisis. This has required the creative use of other tools, such as the active monitoring of critical markets, firm-level advocacy, guidance on the boundaries of acceptable conduct, accelerated investigations and consent agreements to correct behaviour.
3. This submission sets out the views of the CCSA on the issue of competition and inflation, along with examples of the type of work that is being undertaken to respond to the high inflationary environment.

1. Relationship Between Competition and Inflation

4. The South African economy is highly concentrated across numerous value chains largely because of support for national champions to displace imports in the face of sanctions during the Apartheid era. The persistence of the high levels of concentration is the subject of research by the CCSA, with an assessment using merger filings as the basis for justifying the strengthening of enforcement tools in the recent amendments to the Competition Act 89 of 1998, as amended (“the Act”). More recently, the CCSA released a Concentration Tracker report titled “*Measurement of Concentration and Participation in the South African Economy: Levels and Trends*”¹ which used information from over 80 industry associations, regulators and government departments to depict the levels and trends in concentration of 178 markets across all sectors of the economy. This research is used to understand concentration and potential competition issues across the economy and serves as an aid to prioritisation and context to investigations. That report specifically identified high and growing concentration across many food value chains.
5. The CCSA generally accepts that there are likely to be some genuine cost drivers behind periods of inflationary pressure in different parts of the economy. However, the

¹Competition Commission of South Africa. 2021. Measuring concentration and participation in the South African Economy: Levels and Trends. Available online: <https://www.compcom.co.za/wp-content/uploads/2021/12/Concentration-Tracker-Main-Report-1.pdf>

CCSA is of the view that inflationary outcomes may be exacerbated by exploitative and opportunistic behaviour of firms in concentrated markets. This is because publicised accounts of cost inflation create the expectation that prices will need to go up, but the lack of transparency creates an opportunity to put prices up higher or faster than costs justify. Similarly, the lack of transparency may result in more persistence in inflation once costs start declining. This is commonly referred to as the “rocket and feather” effect. Therefore, whilst firm conduct may not be the primary driver of high inflation, it can exacerbate a bad situation.

6. The CCSA’s experience in dealing with a series of economic shocks since the beginning of the pandemic, including periods of high inflation, has shown that these concerns are well-founded. Our findings in much of the research and investigations shows that some firms do exploit economic turbulence to pass through higher than justified price increases and are slow to bring these down once conditions stabilise.

7. The CCSA is of the view that competition policy has an important role in fighting these sources of additional or incremental inflationary pressure, even if it cannot usefully address the general underlying cost pressures. In doing so, inflation may be lower than otherwise and not persist for as long, providing relief to consumers and potentially sparing some of the side-effects of more blunt instruments such as monetary policy. Competition policy is also well suited to such a role given its jurisdiction over the entire economy and strong enforcement tools.

8. More broadly, the CCSA view is that competition policy is one of the tools that can contain inflation generally given that enforcement and the deterrent effect this has on pricing. Effective enforcement on cartels and abuse of dominance, including excessive pricing, collectively does impact on containing inflation.

2. Action Taken in Response to High Levels of Inflation

9. Given the success and wide media coverage of the CCSA’s enforcement against price-gouging during the pandemic, there is a high expectation from the South African public, media and government that the CCSA will be active in monitoring and investigating inflationary shocks to determine that these are not being driven by opportunistic behaviour. This is because these high-profile investigations have shown that price increases have not always been warranted by the underlying cost increases, resulting in a degree of scepticism by the public when faced with price hikes. As a result, trade unions, NGOs and civil society leaders routinely use the media to call for the CCSA to investigate price hikes from basic foodstuffs to airline fares. In addition, Cabinet has issued statements welcoming the oversight role that the CCSA plays, such as that of 8 June 2022²:

“2.5. Cabinet also welcomed the decision of the Competition Commission to closely monitor prices of essential food items, particularly the provision that businesses should justify their price increases.”

10. Given the high expectations, the CCSA is obliged to monitor the source of inflationary pressures and to investigate where there is a reasonable basis to suspect that margins are being opportunistically increased beyond cost justifications by firms anywhere in the supply chain. The CCSA appreciates that addressing these after the fact provides no actual relief for consumers or levels of inflation even if it punishes the firm. For this reason,

² <https://www.gcis.gov.za/newsroom/media-releases/statement-cabinet-meeting-wednesday-8-june-2022>

the CCSA has adopted a strategy of proactive and highly publicised monitoring, strong direct and media advocacy along with swift investigation when problems are identified to resolve them quickly either through prosecution or settlement. Our experience is that these measures may be effective in creating a deterrent effect and altering behaviour quickly where firms have not exercised restraint.

11. The examples provided below on food and airlines illustrate the strategy clearly. In particular:

- First, they provide clear guidance to business through the media or direct engagements on what conduct is not acceptable and how the CCSA will assess price increases in their market. Typically, this is that price increases must be justified by cost increase and therefore margins may not expand. However, in some cases absolute Rand margins rather than percentage margins are advised on. This creates business certainty to guide those firms that seek to remain compliant and prevent exploitative price increases rather than trying to fix them once they occur.
- Second, to engage in active monitoring and to publicise that fact along with reporting to the public on that monitoring. This is essential if there is to be credibility to the threats of action if business step out of line, and to be accountable to the public in fulfilling the mandate. This has taken various forms across markets including using public data to monitor increases at different points in the value chain or benchmarking to see if price increases are out of line.
- Third, to act on the monitoring information where there is a reasonable basis to suspect a price increase that is not justified by costs, or in response to complaints by the public. Investigations are the only means to create transparency and certainty as to firm conduct as it provides the CCSA with powers to request financial information on costs, prices and margins for different products. The exercise of this power also aids in providing a deterrent effect as firms are aware that the CCSA may initiate or receive complaints of price increase. Prosecuting contraventions similarly reinforces that deterrent effect apart from remedying the conduct itself. The CCSA has also been creative in the settlement processes, willing to accept undertakings and behavioural change if rapidly agreed, along with formal consent agreements.

2.1. Food Inflation Monitoring and Enforcement

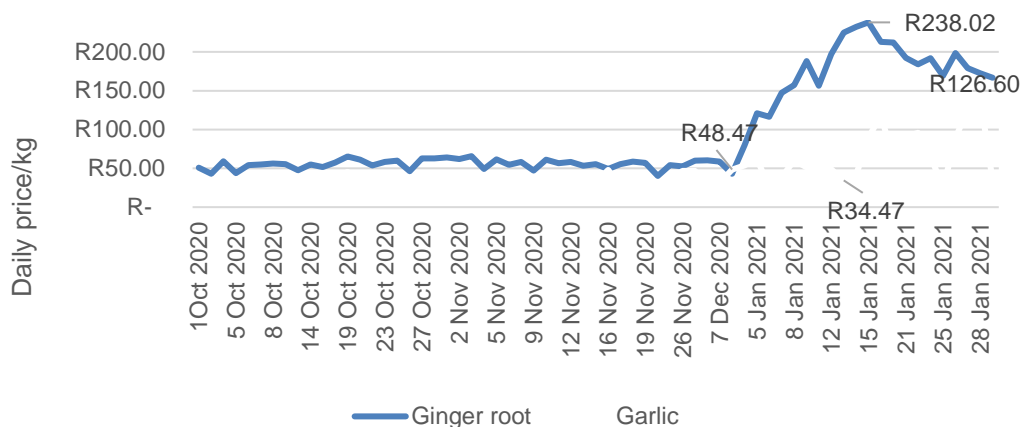
12. In 2020, the CCSA began actively monitoring essential food prices to understand the effect of the Covid-19 pandemic and the ensuing economic crisis on food markets. A series of essential food price monitoring reports (EFPM Reports) published in 2020 and 2021 pointed to concerning price behaviour and market dynamics in food markets that may lessen, impede, or restrict competition in food markets. In a country characterised by high poverty levels, ensuring the proper function of essential food markets and value chains is an important aspect of protecting the spending power of vulnerable consumers. In particular, the CCSA found that food markets can over-react to shocks with quicker and higher price increases than justified, which are frequently slow to reduce once the shock has passed.

13. The CCSA's approach to food price monitoring is to draw on publicly available data and public sentiment to spot potentially problematic patterns at an aggregate level which may require a more detailed assessment or engagements with specific market players. The data sources that the CCSA has drawn on to date include daily fruit and vegetable prices from municipal markets; commodity prices from the South African

Futures Exchange (SAFEX); retail prices used by the national statistics agency (Statistics SA) to compile the consumer price index; and wholesale prices used by Stats SA to compile producer prices index. The combination of commodity prices, wholesale prices and retail prices enable the CCSA to construct a time series of margins at each level of the value chain.

14. An early application of this approach was to the price of ginger and garlic during the height of the Covid-19 pandemic in 2020/21. The CCSA received several complaints from the public regarding the price of garlic and ginger, which in some instances increased by 300%. This was confirmed by the daily price data published by the Johannesburg Municipal Market. The figure below shows that the price of ginger (per/kg) increased by nearly 400% in the first two weeks of January 2021. The price of garlic (per/kg) increased by 267% from 13 January 2021 to 27 January 2021. Municipal market data can be a proxy for wholesale prices. The cause of this shock was a global spike in Covid-19 infections alongside a failure in the Chinese ginger crop with the South African crop only harvested in May.

Figure 1: Garlic and ginger prices from 1 October 2020 to 29 January 2021



Source: Johannesburg Municipal Market

15. The CCSA's engagement with retailers found that while an increase in demand combined with supply constraints explained some of the retail price increase, the absolute margin being applied to ginger, and garlic had also increased. In essence, retailers had determined an appropriate percentage margin for garlic and ginger for the typical cost price to recoup shelf space and other retail costs. However, maintaining that percentage margin when costs increased multiple times resulted in excessive absolute margins being applied which overly compensated for the shelf space which was not increasing at the same cost inflation. Furthermore, concentration and the prior existence of exclusive lease arrangements coupled with a scarcity of garlic and ginger provided the retailers with the ability to raise absolute margins which were not competed away. This intervention resulted in retailers committing to cap absolute margins until the market normalized.

16. As the global economy emerges from the pandemic, inflation and particularly food price inflation have eroded consumer spending power. Globally, food inflation has been driven by several factors such as rising input costs and supply challenges in Eastern Europe. High concentration levels throughout the food value chain have also been identified as a potential contributor.

17. Like much of the world, South Africa's inflation rate has reached levels last seen a decade ago. The latest figures published by Statistics SA, showed that food and beverage inflation in September 2022 was 12.3%, significantly higher than the overall inflation rate of 7.5%.³ Within foods and beverages, the price of oils and fats accelerated the fastest at 29.0% on an annual basis. While the price of bread and cereals increased by 19.3% while meat price inflation and vegetable price inflation came in at 9.9% and 10.6% respectively. Fruit prices were stable, and inflation fell modestly by 0.2%.⁴

18. In light of successive and above average increases in the price of oils and fats and the ensuing public outcry, the CCSA's August 2022 EFPM Report focused on the drivers of cooking oil prices including the role of market power along the value chain. The preceding report, published in March 2022, noted that the Eastern European conflict would exacerbate existing price increases given the region's importance as a major producer and exporter of sunflower oil and oilseed.

19. Our analysis began with unpacking the sunflower oil value chain. Sunflower oil accounts for the majority of South African cooking oil consumption and is the basis of most edible fat products. Therefore, it is a suitable proxy for understanding the market dynamics that influence the price of oils and fats. The CCSA's Concentration Tracker Report previously found increasing levels of concentration throughout the sunflower oil value chain from the primary input, sowing seed, to the manufacture and distribution of the finished product, refined sunflower oil.

- Regarding sowing seed, the CCSA had previously found that 52.2% of locally approved sunflower seeds are owned by Pioneer / Pannar, which was created through a merger between the South African Pannar Seed and Pioneer Hi-Bred, a United States based seed producer.
- Sunflower seed farming has also become more concentration with the number of commercial farmers falling from 1604 to 1389 from 2015 to 2019.
- At the processing level of the value, the top five seed crushers (who make crude oil) processed 80.7% of sunflower seed for human consumption in 2020, up from 76.9% in 2015. The largest crushers in South Africa are also downwardly integrated and refine their own crude oil which marketed under various brand names including the private labels of South Africa's largest retailers.

20. The analysis focused on the contribution of sunflower seeds to the wholesale and retail prices of sunflower oil. South Africa is a net importer of oilseeds, therefore domestic sunflower seed prices have historically tracked international price trends. For the analysis the CCSA used the spot price of sunflower seeds traded on SAFEX; the average retail price of 750 ML of sunflower oil collecting by Statistics SA to compile CPI (consumer price index); and the average producer price of 20 L of sunflower oil collected by Statistics SA to compile PPI (producer price index).

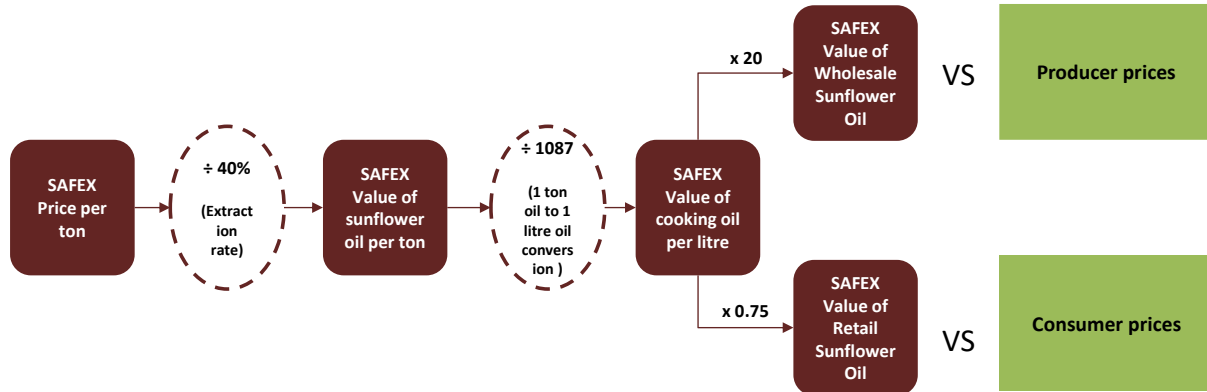
21. The first step of the analysis was to calculate the seed value of the retail (750 ML) and wholesale (20 L) of cooking oil. The CCSA then calculated the seed-to-retail and seed-to-producer spreads of sunflower oil. These spreads are simply the difference between seed value of 750 ML of sunflower oil and the actual retail price and the seed value of 20 L of

³ Statistics South Africa. 2022. P0141 Statistical Release - Consumer Price Inflation September 2022. Available online: <https://www.statssa.gov.za/publications/P0141/P0141September2022.pdf>

⁴ Statistics South Africa. 2022. P0141 Statistical Release - Consumer Price Inflation September 2022. Available online: <https://www.statssa.gov.za/publications/P0141/P0141September2022.pdf>

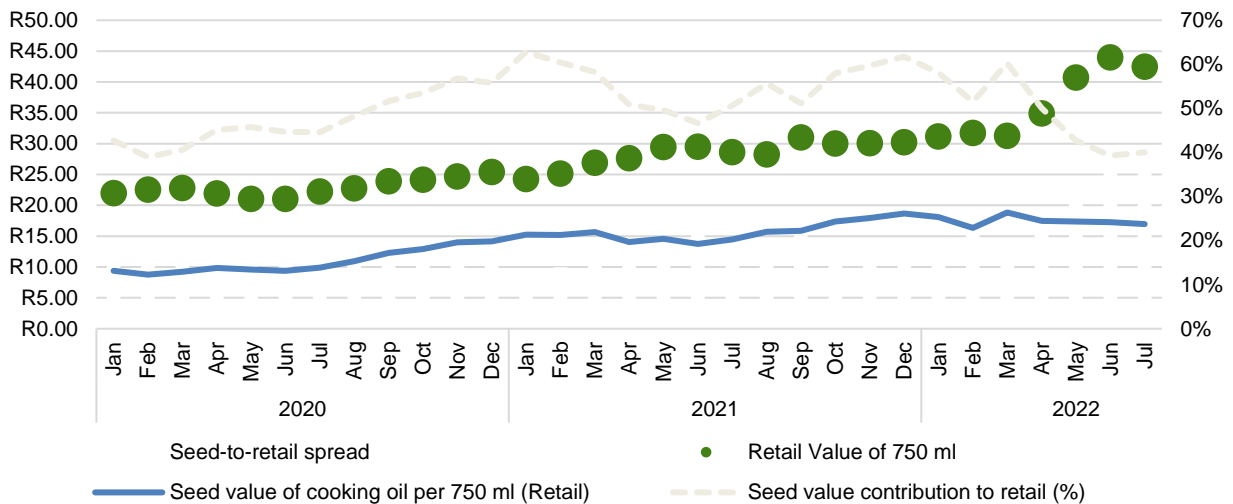
sunflower oil and the actual wholesale price. The method is summarised in the figure below:

Figure 2: Method for calculating SAFEX Values of wholesale and retail sunflower oil quantities



22. The analysis of retail prices found that cooking oil price increases were not driven by the price of sunflower seeds, but other costs and margins that form part of the retail price paid by consumers. This was evidenced by the significant widening of the seed-to-retail spread as shown in the figure below. The contribution of sunflower seed prices to retail prices fell steeply from about 55% to below 40%.

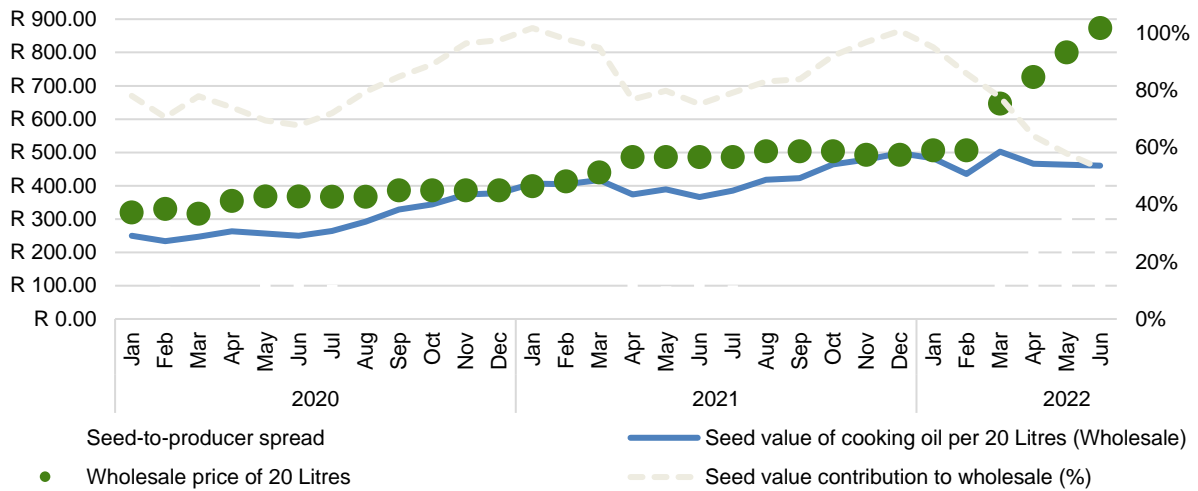
Figure 3: Retail pricing pattern of cooking oil from January 2020 to July 2022



Source : Stats SA Grain SA, SAFEX

23. As sunflower seeds are a larger productive input for producers, they account for a greater share of the producer price of sunflower oil meaning that the seed-to-producer spread is proportionally lower than the seed-to-retail spread. The analysis nonetheless showed a dramatic widening of the seed-to-producer spread beginning in January 2022. As a result of this widening, the contribution of sunflower seeds to the producer price fell from above 90% to below 60% by June 2022.

Figure 4: Producer prices of cooking oil from January 2020 to June 2022

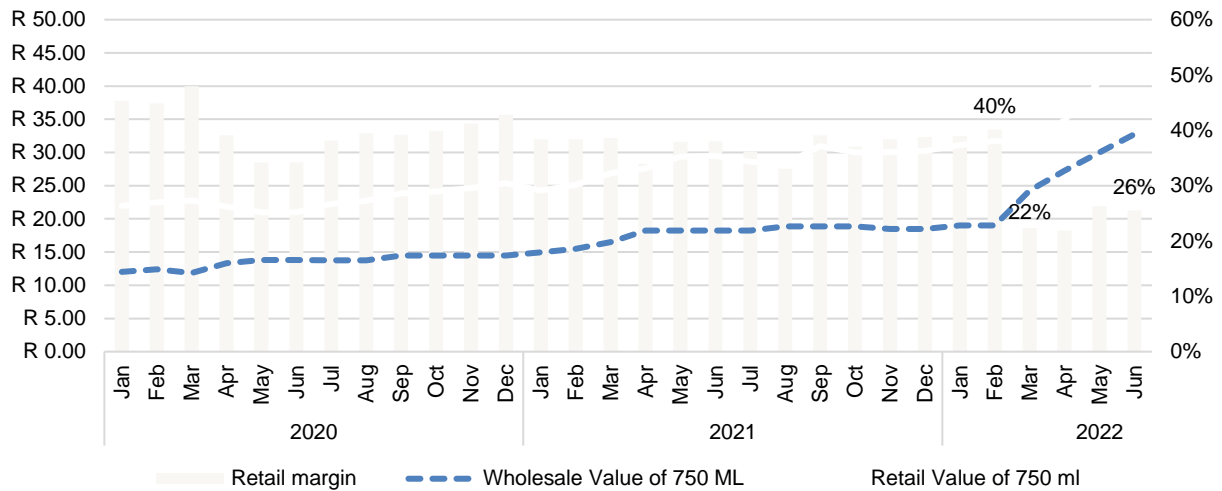


Source : Stats SA, Grain SA, SAFEX

24. To account for the fact that processor often purchase their seed requirements and keep them in storage or use futures contracts to hedge against price increase, the CCSA replicated the preceding analysis with seed prices lagged by two months. At the retail and wholesale levels the finding as to wider seed-to-retail and seed-to-producer in 2022 continued to hold.

25. Lastly, the CCSA sought to understand the interaction between retail and producer prices by analysing the aggregate retailer margin applied to sunflower oil. This is simply the difference in the wholesale and retail value of 750 ML of sunflower oil. As shown below, the retail margin was quite volatile in 2020 and 2021. However, it fell from 40% in February 2022 to 22% in March 2022. This showed that while retail price increases were reflective of wholesale price increases, the increases from producers of sunflower oil appear to have been partially absorbed by retailers.

Figure 5: Retailer margin from January 2020 to June 2022

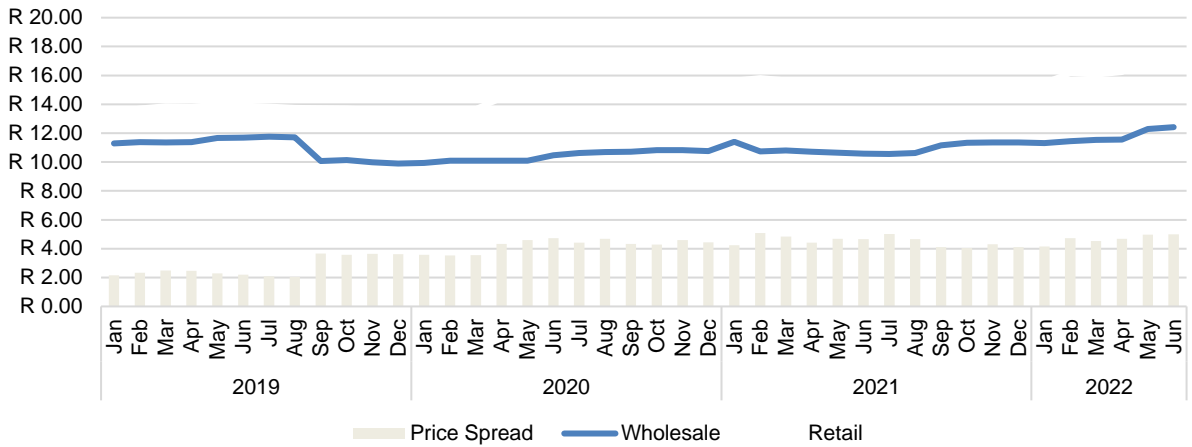


Source: Stats SA

26. There are several reasons why the price of sunflower oil may have increased to the degree shown above. These include increased transport, energy costs, a weaker currency, and disruptions of global supply chains. However, given the levels of concentration at the processing and retailing levels of the value chain, opportunistic pricing in the wake of a global disruption in the oilseeds market may also have played a role.

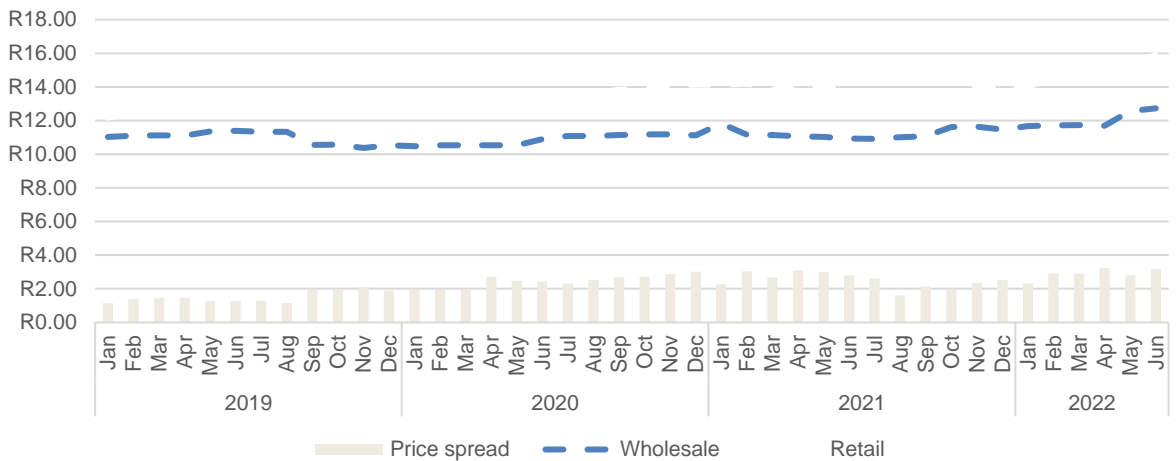
27. A comparison of the wholesale and retail price of bread, also part of the August 2022 EFPM Report, found the retailer margin applied to white and brown bread had widened. This widening was caused by a steep decline in the wholesale price of bread that occurred around August / September 2019, but that was not passed on by retailers to consumers. This trend appeared to have continued into 2022 as the retail prices of bread have increased by more than the wholesale prices. The retail price of brown bread increased by 12% compared to the 10% increase in the wholesale price. For white bread, the retail price increased by 13% whereas the wholesale price increased by 9% in 2022. In percentage terms, the retailer margin on white bread (16%- 29%) was generally higher than on brown bread (9% - 20%). This suggests that retailers view brown bread consumers as more price sensitive than white bread consumers.

Figure 6: White bread (700g) prices from January 2019 to June 2022



Source: Stats SA

Figure 7: Brown bread (700g) prices from January 2019 to June 2022



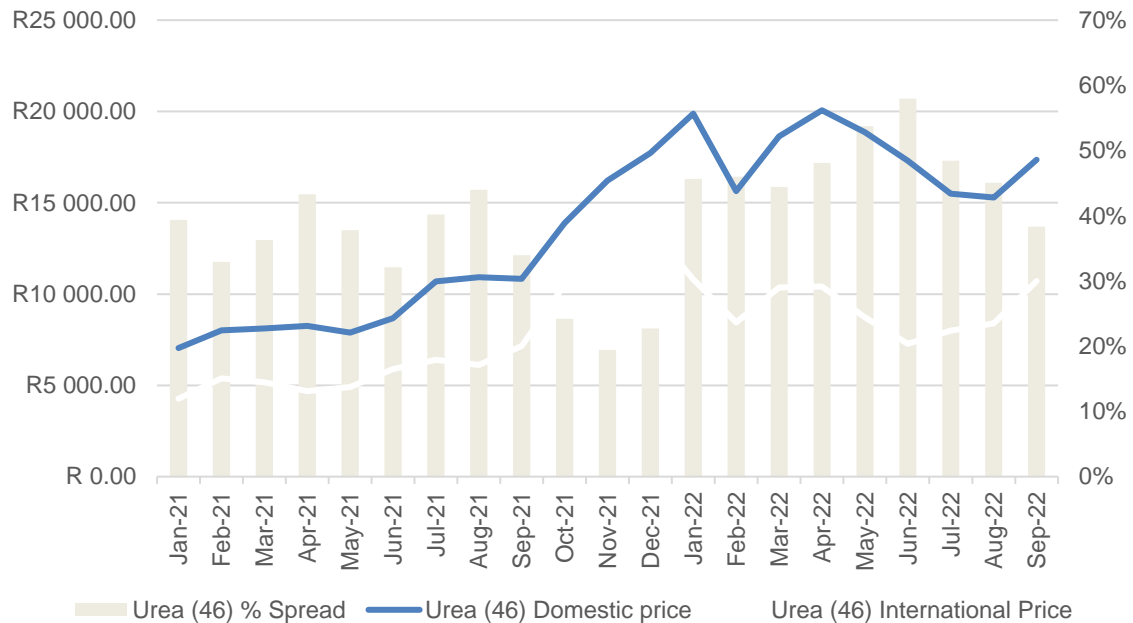
Source: Stats SA

28. The bread examples above are likely demonstrative of asymmetric pricing or rocket-and-feather effect where prices respond quickly, like a rocket, to upward pressure, but slowly, like a feather, to downward pressure. Our analysis of food markets has extended to key agricultural inputs such as fertilizer, which appears to be exhibiting the same rocker-and-feather phenomenon. Most of the urea fertilizer that is used in South Africa is imported and as such the domestic price tends to track the international price. Several countries instituted export bans on fertilizers to secure supply against the backdrop of rising gas prices. Gas is the main energy source for nitrogen fertilizer production, which includes urea.

29. The graph below shows the international and domestic price of urea with the percentage difference between the two prices. While the spread was volatile in 2021, it has clearly increased in 2022. In January 2022, the international and domestic price of urea decreased, but the domestic price reduction was not as steep as the international price resulting in a widening spread. The spread widened from April to June 2022, suggesting a similar interplay between international and domestic prices. However, domestic prices

have fallen from June 2022 while international prices increased until August 2022 when both prices started to rise once more.

Figure 8: Difference in domestic and international urea price from January 2021 to September 2022

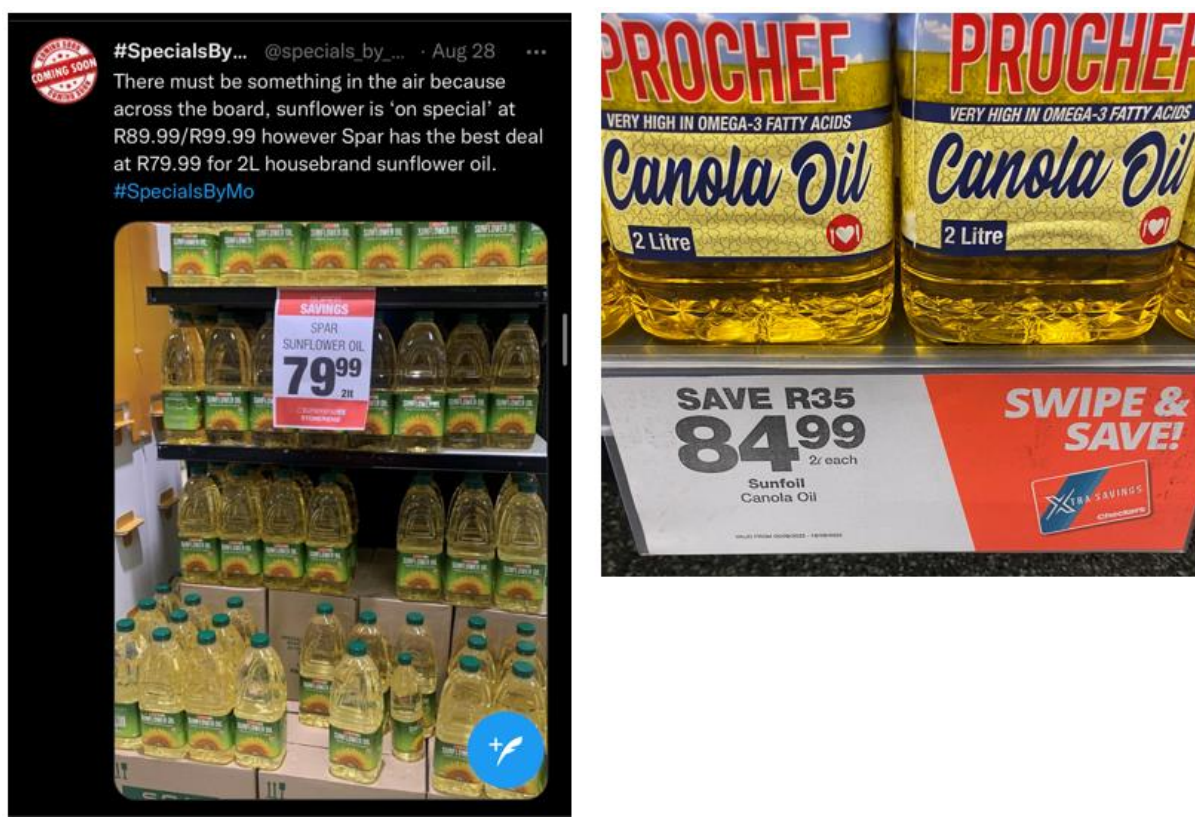


Source: GrainSA Input Reports

30. Following the CCSA's enforcement action against price gouging during the peaks of the Covid-19 pandemic, there is an expectation from the public and government that the CCSA probe deeper into price increases to ascertain whether there has been price abuse by retailers and or food manufacturers. Whilst public data is a useful source of information to monitor and identify potential candidates of exploitative conduct, a proper assessment cannot be performed using publicly available information, which is aggregated and does not speak to costs. On the basis of these findings, the CCSA has initiated an investigation against major producers and retailers of sunflower and other cooking oils. This investigation also includes maize and wheat products. To date, the CCSA has requested price and margin information for all cooking oils, bread, maize meal, pasta, flour, edible fats, bread, and rice products sold by retailers and manufactured by producers. Cost related information where there are initial indications of problematic behaviour has also been requested.

31. However, to simply the release of the EFPM research report and the associated media publicity can also result in some immediate behavioural adjustments as some of the tweets revealed around the pricing of cooking oil on the weekend after the release of the report. The monitoring and analysis along with the publicity also empowers retailers to question suppliers of these essential products, or for consumers to question retailer behaviour. Forcing behavioural change or empowering others to do so is an effective form of enforcement for temporary periods of price inflation.

Figure 9: Social media reports of steep cuts in the price of cooking oils following the release of the EFPM Report on 24 August 2022



2.2. Airline Industry Fare Inflation Advocacy and Monitoring

32. The CCSA has been closely monitoring developments in the domestic airline industry since the start of the pandemic when many airlines came under financial strain due to travel restrictions that were imposed to curb the spread of Covid-19. During this period, state-owned SA Express and Mango airlines were grounded, leading to a substantial decrease in seat demand on key routes. While there were fewer airlines operating domestically and internationally, the limited demand meant that there were no concerns over abuse of market power. As demand picked up, more airlines resumed flights and capacity grew faster than demand, which continued to keep a cap on pricing and abuse of market power.

33. However, in March 2022, the South African Civil Aviation Authority suspended Comair (Pty) Ltd (Comair) from flying. Comair's subsidiaries Kulula.com (Kulula) and British Airways accounted for almost 40 per cent of seat capacity and all flights were immediately cancelled. The CCSA made known its intention to intervene in the market should the remaining airlines use this situation to hike airfare prices and cause harm to consumers. The CCSA specifically warned that it would not hesitate to 'act swiftly and decisively if there is evidence of price gouging'.⁵ The CCSA also provided strict guidance to the airlines of what would constitute gouging, given that the last seats on remaining flights would already be priced higher. Such guidance was that adding new high priced fare buckets or reallocating seats to the higher fare buckets on existing flights would be

⁵ <https://www.iol.co.za/news/competition-commission-warns-airlines-against-exploiting-travellers-with-unfair-price-increases-1d79c1af-6c6f-4585-8f47-c83c73d00fb2>

considered as exploiting the situation. The suspension lasted only five days, after which Kulula and British Airways were able to operate again.

34. Two months later, Comair announced that, due to funding difficulties, it was suspending all its flights with immediate effect, removing the seat capacity from the market once more. The CCSA met with the leadership of the major airlines the same day the announcement was made to engage with them regarding appropriate behaviour to avoid price gouging emanating from the supply shock (including reiterating the guidance that was provided previously) and to explore means to bring more capacity into the market quickly.⁶

35. Whilst the engagements appeared fruitful, persistent complaints around increases in fares resulted in the CCSA investigating the domestic airlines for excessive fare inflation in the context of a capacity shortage. The airlines indicated that some price inflation was unavoidable due to the substantial increase in the jet fuel price driven by global events coupled with refinery closures for maintenance in South Africa. In the context of a large underlying cost driver increasing, and the inability to separate fare inflation from exploitative conduct using public data, the CCSA acted on the complaints and took forward the investigation. As with essential foodstuffs, public data is inadequate to properly assess the real situation on costs and margins, whereas an investigation enables the CCSA to get full transparency on whether prices are increasing at a rate faster than costs, with the result of an expansion in the margins. The investigation also means that airlines are aware that the CCSA has full transparency on their costs and margins, and therefore it can also serve as a deterrent to any exploitative behaviour whilst the investigation is under way. That investigation is ongoing.

36. This is only one example where the CCSA has exercised its discretion to proactively engage the industry in an effort to address and prevent market distortion. The CCSA will continue to intervene in markets and pick the most appropriate and effective enforcement tools from its arsenal to deal with economic shocks.

3. Conclusion

37. The deep global crisis resulting from the Covid-19 pandemic forced competition authorities to innovate, shifting investigative techniques to a proactive and rapid response approach, as well as to embrace different understandings of abuse of (temporary) market power. It is important not to forget those lessons as we shift to different types of economic crisis with similar detrimental effects on consumers. The CCSA has done so in continuing to use different tools in addressing incremental inflationary pressures brought on by temporary market power in a general inflationary environment.

⁶ <https://www.citizen.co.za/business/competition-commission-warns-airlines-against-price-gouging/>