Balancing Inclusive Economic Growth and Competition[1]

Special Lecture: Department of Economics

Stellenbosch University

Remarks by

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Thank you for inviting me to give this lecture. I am delighted to be here. This is an interesting year of sorts for me — I joined the Stellenbosch University Economics Faculty exactly eight months ago today.

And it has been an exciting year so far at the Competition Commission (Commission), the public interest guidelines were finalised in June. Last week, the Commission reached a settlement agreement with ArcelorMittal South Africa Limited (AMSA), finalising all pending investigations and prosecutions against AMSA. The agreement included the highest monetary fine (R1.5 billion) levied on a single firm in the history of the Commission.

[1] These remarks are not intended to be exhaustive.

One thing that makes the Commission so special is the dedication and hard work of its staff, my colleagues, some of whom have joined me this evening.

I want to emphasize that today I am speaking on behalf of myself and these are issues that I have found challenging and I hope will challenge and provoke you as well. That said my remarks do not necessarily reflect the views of the Commission or my colleagues.

Tonight, I will address a topical issue that has received international attention recently, inclusive economic growth and competition. I will evaluate its factual and theoretical foundations. I will also consider what competition policy should do to be relevant to the inclusive growth agenda.

I understand inclusiveness to be about the equality of opportunity in terms of access to markets, resources and unbiased regulatory environment. This speaks to the pattern of growth. Economic growth describes the increase in the production of goods and services in an economy which is accompanied by an increase in incomes and jobs. This speaks to the pace of growth. I will return to these concepts later on.

Some of my thoughts tonight are influenced by the book that Commissioner, Tembinkosi Bonakele, Professor Eleanor Fox and I have edited to be published next year, 2017 by the Oxford University Press. The book calls for a broader view of competition policy.

With that introduction behind me, let's me start by making some observations about competition law and inequality.

Competition policy and Inequality

In his recent thought – provoking book on Inequality: What can be done? Professor Tony Atkinson makes the following proposal: "Proposal 2: Public policy should aim at a proper balance of power among stakeholders, and to this end should a) **introduce an explicitly distributional dimension into competition policy**; […]".

The proposal raises a number of questions with regard to the way competition law may square with inequality concerns. Importantly, is the lack of competition one of the causes of the inequality?

In case you were wondering Professor Tony Atkinson is not alone. Professors Jonathan Baker and Steven Salop have also made a similar call and have argued that because market power matters, “an increasing concern with inequality might be expected to call for a competition policy response”.

Market power and inequality

It is sometimes said that distribution does not matter in competition policy, as reflected in the use of the total welfare standard. I disagree. I consider that such perspective is neither descriptively accurate nor normatively appealing. Not only is such a perspective troublesome from an economic and moral view, it is equally and more importantly out of touch with developments in modern economics (in particular advances in information asymmetries and game theory).

Using these developments in economics, many have rightly argued, including Professor Joseph Stiglitz, that the more successful firms may not only be those who are more able to produce products that consumers love and to do so at lower costs; but rather firms that are better able to create and exploit market power, including taking advantage of consumers.

I am persuaded then that a firm like, Microsoft, may have been so successful only to a limited extent because of its technological innovations but more important were its business innovations, which created new barriers to entry and allowed it to first create and then leverage its market power.

Equally, I am persuaded that firms like, Telkom, Sasol, SAA, Media24, AMSA, firms involved in the cement cartel, bread cartel, construction cartel and many others would have long lost their dominance were it not for their conduct which created barriers, reduced competition and enhanced their abilities to exploit customers.

I believe that market power is one of the major sources of inequality. The monopolist's monopoly rents come at the expense of consumers: as monopolies raise their prices, their profits increase while the well-being of consumers and workers decrease. An increase in market power is associated with an increase in inequality. I also believe that inequality leads to poorer economic performance, including lower growth and more instability.

Market power is often associated with creating barriers to entry, and inequality means fewer people have resources to enter markets. The returns from the abuse of market power go disproportionately to the wealthy (the shareholders and the top executives, who are wealthier than the average consumer). Even more concerning is the thought that traditionally, strong unions may have appropriated some of the market power rents but this possibility, today, seems no more than a pie in the sky given the decline of private sector unionisation.

Some commentators have argued **only for** a consumer welfare standard for reasons which include the fact that it is readily administrable and more likely to engender political support. I find this perspective troubling. While the consumer welfare standard helps, it is not justified for reasons based on inequality, and perhaps rightly so, because there are some markets where consumers are wealthy and firms are small or owned by the historically disadvantaged persons.

As you likely know, protecting buyers and their consumer surplus provides a very poor approximation to preventing wealth transfers to those at the top of the wealth distribution.

I agree with the view that overcoming the inequality problem needs a strong embrace of issues of distribution. The key question, however, is distribution to who? Some jurisdictions use the consumer welfare standard but do not consider it distributive.

Fortunately for me, South Africa stands out on this issue in that the pursuit of distributive justice is permissible if not compelled by competition law and its unique responsiveness to issues of distributional equity and fairness. Distribution is to consumers, workers, small firms, firms owned by historical disadvantaged persons and the poor.

Competition policy and growth drivers

Before I talk about what should competition policy do to be relevant for an inclusive economic growth agenda, I would be remiss if I did not point out how competition policy affects economic growth drivers.

As a reminder, competition provides incentives for firms to be more efficient in their use of resources leading to lower costs, lower prices, and higher sales. This effect is increased by competition driving less productive firms out of the market while allowing more efficient firms to expand or new firms to enter.

As a reminder, when productive firms replace less productive ones, overall efficiency in a sector rises. Increased efficiency means that the sector can reduce prices and thus sell and produce more. When the buyers are other firms, the lower price makes these firms more competitive, which in turn enables them to expand. When the buyers are private consumers, the lower prices will imply higher real income and potentially increased consumption.

As you are no doubt aware, competition provides an incentive for firms to innovate in order to differentiate themselves from competitors by offering more attractive products and services. New products can open up new markets and induce economic growth. The behaviour of firms seeking to expand their market share and earn higher profits through increased efficiency and innovation creates economic growth.

Put differently, when customers can choose between different providers, they benefit and so does the economy as a whole. Their ability to choose forces firms to compete with one another. Choice for customers is a good thing in itself, but competition between firms also leads to increased productivity (total factor productivity) and economic growth.

What does the empirical evidence the say on competition and economic growth?

The positive link between competition and faster productivity growth is supported by a wide variety of empirical studies.

For example, Professor Stephen Nickell (1996) finds that the most competitive firms experienced productivity growth rates 3.8 - 4.6% higher than the least competitive. Further, a 25% increase in market share leads to a 1% fall in total factor productivity in the long run.

Professors, Aghion, Braun, and Fedderke (2008) show that mark-ups on prices, which are used as a measure of competition, are higher in South African manufacturing industries than they are in corresponding industries worldwide. They also argue that competition policy (i.e. a reduction of mark-ups) should have largely positive effects on total factor productivity growth in South Africa (in particular, a 10% reduction in the mark-ups would increase productivity growth by 2 to 2.5% per year).

In addition to this evidence that competition promotes growth, there have been many other studies on the effects of competition law itself. However, I think it is important to recognize that competition law interventions rarely target productivity growth directly, instead they focus on promoting competition itself, often measured by lower prices, entry or other consumer benefits, and in doing so, contributes to productivity growth and therefore to economic growth overall.

But there are also other studies of the effect of competition law which use international comparisons of different countries' experiences, to assess whether countries with competition laws (or longer - standing, or more effective competition laws) achieve faster economic growth.

Symeonidis (2008) studies the effects of the UK's 1956 anti-cartel legislation and finds that collusion was responsible for 20-30% lower labour productivity growth over an 8-year period. Clougherty (2010) suggests that increasing competition policy funding by about $60m would result in increased economic growth of 0.84%.

But the distribution of growth matters

While these studies have focused on the rate of growth, I believe that the pace of economic growth is not everything; the pattern of growth also matters.

I believe that the role of competition in driving inclusive economic growth is especially important in times of zero economic growth and fiscal constraints. In such times, default instruments such as macroeconomic tools are insufficient and are restricted by the need for fiscal consolidation. In such times, microeconomic tools such as competition regulation become even more important.

The effect of competition on inequality

While the effect of competition on inequality has not been studied extensively, and has often been assumed to be malign as competition creates winners and losers, Professors Hausman and Sidak (2004) note that poorer and less educated customers in the US pay more for their mobile telephony services than better educated and more affluent customers, even controlling for the level of usage.

Professors Comanor and Smiley (1975) used simple estimates of the prevalence of monopoly profits, together with data on the heritability of wealth, to suggest that in the US, more than half of the wealth of the richest 2.4% of households was ultimately derived from monopoly profits, through inheritance.

In February this year, the World Bank study showed that competition policy in South Africa has brought substantial benefits to households, especially the poor. By tackling cartels in the wheat, maize, poultry and pharmaceuticals markets — goods that amount to just over 15% of consumption basket of the poor in South Africa — it is estimated that these actions have reduced overall poverty by at least 0.40 percentage points. Some

202,000 individuals were made better off and lifted above the poverty line through lower prices that followed the action taken against these four cartels. The savings put an additional 1.6% back into the pockets of the poorest 10 percent of the income spectrum by raising their disposable income. These estimates underscore the importance of competition policy as a complementary measure in combating poverty and reducing inequality.

What should competition policy do to be relevant to the inclusive growth agenda?

I want to argue now that there a number of things that competition policy should do to be relevant to the inclusive growth agenda. I am proud of the Commission's achievements, which are too lengthy to recount here. To offer but brief examples, I will talk to a few.

a) **Effective competition enforcement**

The purpose of competition enforcement is to prevent anti-competitive practices, e.g. the abuse of a dominant position, cartels or other restrictive activities. Cartels or market players with a dominant position have an interest in distorting competition and the ability to do so. Distortions of competition manifest themselves in higher prices and profits, and lower quantities sold. The lack of competition diminishes incentives to innovate and to increase productivity for firms already active in the market, while preventing new firms from entering the market. The more innovation and efficiency incentives are reduced, the more negatively growth will be affected.

A strong resolve to stamp out anti-competitive practices, will ensure cheaper inputs for firms in other sectors and by creating a level playing field among all market participants, this will allow the most efficient firms, including SMEs, to gain market share.

For example, following the uncovering of the cement cartel, there have been many positive outcomes in the cement industry, with evidence that various new cement manufacturers have entered into regions that were previously allocated to other cement manufacturers.

There is also evidence of strong competition in the inland regions where cement manufacturers and independent cement blenders are supplying cement. Sephaku, a relatively new entrant that commenced cement production in 2014, has made a competitive impact in this market by supplying cement to most of the regions. Furthermore, cement importers have grown in terms of their competitive impact, especially in the coastal regions. However, the introduction of provisional anti-dumping tariffs has deterred the ability of imported cement to constraint local manufacturers.

A strong resolve to stamp out anti-competitive practices, will also contribute to the reduction of poverty and inequality by preventing high prices caused by cartels or anti-competitive practices.

My colleagues at the Commission and others have published a large number of retrospective studies of the results of competition actions. For example, Khumalo, Mashiane and Roberts (2014) estimated the precast concrete products cartel overcharge as 16.5 to 28% in Gauteng and 51 to 57% in Kwa-Zulu Natal.

My own work on the wheat flour cartel estimated that in Gauteng province the overcharge ranged from about 10.2% to 3.7%. In the Western Cape, the overcharge ranged from about 35% to 42%. These studies illustrate the importance of protecting competition through the enforcement of the law.

b) Effective merger control

The purpose of merger control is to prevent and remedy only anticompetitive mergers (which are likely to create or strengthen of a dominant position; create or strengthen pro collusive conditions) before any damage is done to prices, innovation, and economic growth.

Effective merger control ensures that markets remain competitive and enables the most efficient firms to grow. Recall for example that in January 2007, the Commission recommended that the proposed merger between Pick n Pay Retailers (Pty) Ltd (PnP) and Fruit & Veg City Holdings (Pty) Ltd (FVC) be prohibited.

The investigation had revealed that, FVC and PnP were close competitors in the retailing of fresh produce. This proposed merger would have likely resulted in the merged entity increasing prices in an anti-competitive manner. Individually these firms were big purchasers of fresh produce from farmers and fresh produce markets and consequently the merged entity's buying power would have been significant, which would have resulted in the harm of farmers and relevant stakeholders along the value chain.

The Commission's recommendation to prohibit the proposed merger between PnP and FVC has largely been viewed as positive in the market for retailing of fresh produce and groceries.

FVC has experienced substantial growth and evolution over the past ten years since the merger was abandoned, which would likely not have occurred if the proposed merger had been approved. This is evident from the increase in the number of stores that FVC has rolled out since 2007, in particular the rebranding and rolling out of the Food Lover's Market brand from only two stores in 2007 to 75 stores by 2016 and the rolling out of 220 FreshStop stores during the same time period.

FVC's growth is also evident through the increase in the number of product lines it offers – increasing from just fresh produce (limited to fruit and vegetables) to a wide range of product lines.

Conclusion

This evening, I have addressed the issue of inclusive economic growth and competition. While my remarks have been influenced by my understanding of the South African competition landscape, I note that these issues are by no means unique to South Africa. I'll conclude my remarks with three short points.

First, competition enforcement should account for inequality concerns by targeting resources towards products purchased by the poor and low income consumers. Greater efforts should be devoted to uncovering prohibited practices, exclusionary and exploitative conduct in markets such as food and agro-processing. The Commission has already implemented a prioritisation policy which led to uncovering cartels in bread (staple food), wheat flour (key input into bread), and maize meal (staple food), among others. However, this could be complemented with expanded budgets for competition authorities. If competition authorities' budgets were increased, these authorities could do more to promote competition and reduce inequality, even without changes in competition law.

Second, inequality might be addressed in individual cases by adopting creative and innovative remedies targeted primarily to benefit the less advantaged and in pursuit of distributive justice. The Commission is already active in not just restoring competition in markets but also crafting remedies with distributional effects to reduce inequality. For example, the Pioneer Foods Settlement Agreement included a discount remedy and a fund to support small businesses.

Finally, concerns about inequality justify an even more interventionist approach to competition enforcement and merger regulation. I am not so naïve as to think that competition law enforcement alone could help address inequality. But I do think that there is also an opportunity to strengthening competition policy outside of competition law.

I believe that we must also continue to be aggressive in advancing our mission to undertake competition regulation for a growing and inclusive economy.

Thank you for your time this evening.