Market Structure, Market Power and Competition Policy in South Africa: Growth and Employment Challenges

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Overview

South Africa (SA) has a market power and concentration problem. This is so, despite the strong competition regulation institutions. The evidence for the extent of the high levels of market concentration is detailed in my paper written with Thembalethu Buthelezi and Thando Mtani titled "The Extent of Market Concentration in South Africa's Product Markets".[9]

Reducing market concentration towards increasing consumer welfare and promoting an inclusive economy is the Competition Act's most appealing and enduring mirage.[10] The Competition Commission has mounted memorable investigations to uncover cartels, prohibit competition lessening mergers, and to address the abuse of dominance, yet the goal of restructuring the economic order by regulating private enterprise in the public interest has eluded its pursuers. Even the shine of the Commission's greatest triumphs related to the uncovering of cartels[11] - for example, uncovering and successfully prosecuting cartels in products such as bread, flour, maize meal, flat and long steel, wire products, cement, plastic pipes, bricks, concrete products, and construction - dim in the face of criticisms that product markets remain highly concentrated. This is not to say that competition authorities have not discouraged a great number of anticompetitive practices by firms. They have. Yet, we continue to observe the indicia of robust, competitive processes, such as high industrial output, innovation, productive efficiencies, employment, and investment, which are all pointing in the wrong direction.

The root of competition harm is illegitimate market power.[12] Market power can be exercised by a firm as a seller (monopoly) or as a buyer (monopsony). Illegitimate market power harms appear in specific markets, while some others are experienced throughout the economy and include slower overall economic growth and increased economic inequality. The consequences for the future, in terms of creating a growing and inclusive economy in SA, are troubling but before detailing these consequences, it is necessary to first understand the extent of market concentration and why market power is a major issue.

Market structure

For much of its history, SA's product markets and capital ownership have been abnormally concentrated. Simon Roberts (2004) correctly points out that in the past, four conglomerates controlled the majority of economic activity in the South African economy, namely Anglo-American Corporation, Sanlam, Liberty Life and Rembrandt/Remgro. High market concentration has been a characteristic not only of scale-dependent products, but also

[9] The extent of market concentration in South Africa's product markets, Journal of Antitrust Enforcement, (2019) 7 (3), 2019:352–364 (with Buthelezi, T. and Mtani, T.)

[10] South Africa's constitutional transformation gave high priority to the redressing of the racialised economic order of the past. In this setting, a stronger competition regulation system was proposed as a tool to help in that process. The democratic government deliberately made competition regulation its preferred means of regulating private enterprise in the public interest. One objective of competition regulation is to reduce market concentration towards lowering prices and, more generally, promote rivalry and competition.

[11] See L. Mncube and S. Grimbeek, 'A History of Collusion: The Persistence of Cartels in South Africa' in Frederic Jenny and Yannis Katsoulacos (eds), Competition Law Enforcement in the BRICS and in Developing Countries, International Law and Economics (Springer International Publishing 2016); L. Mncube, 'The South African Wheat Flour Cartel: Overcharges at the Mill' (2014) 14(4) Journal of Industry Competition and Trade 487.

[12] Competition policy is concerned with power of market participants to distort competition in a way that is detrimental to society.

of consumer products. Some of the high market concentration may be a result of the legacy of historic privileges, and some of it may be due to scale factors.

Market concentration reflects the number and size distribution of firms in a market, in other words, it measures the structure of a market. Our paper on the extent of market concentration finds high levels of static market concentration. Indeed, when considering the static measure of concentration across the Commission's defined priority sectors, we observe that all priority sectors (which include: information and communication technology (ICT), energy, financial services, food and agro-processing, infrastructure and construction, intermediate industrial products, transport, and the pharmaceutical sector) record Herfindahl-Hirschman Indexes (HHIs) above 2500.[13] The sector with defined markets that have the highest level of concentration is the ICT sector (at 3539), while the financial services sector is found to have the relatively lowest level of concentration (2788).[14]

The finding that the majority of SA sectors are concentrated, accords with various studies that have been conducted on the concentration levels of SA industries. For example, the World Bank points out that SA manufacturing and export markets appear to have high market concentration - just a few firms account for the bulk of the market, including non-mineral exports where the top 5% of firms account for 93% of total non-mineral exports.[15]

Market power

The next relevant question is whether the high level of static market concentration and corresponding market power is a result of legitimate or illegitimate means. One possible (and apt) explanation for the observed high levels of market concentration and corresponding market power is that there is still insufficient deterrence of: (1) anticompetitive collusive conduct, (2) anticompetitive exclusion and exploitation, and (3) mergers, which lesson competition. Illegitimate market power is durable. Firms erect barriers to exclude rivals.

Another possible explanation for the persistence of market concentration is that past privileges, such as previous state support, created large firms with extensive market power. The benefits of these past privileges are likely to be perpetuated by economies of scale, which may act to further reduce the competitive constraints found in a defined market. A firm that attains its dominant position through special regulations or state support is likely to be preoccupied with preserving its position rather than pursuing investment and innovation.[16] One more possible explanation is that those firms that built market power through perhaps state support, have capitalised on this privilege by engaging in extensive lobbying and rent-seeking for regulatory protection.[17] Each of the above explanations can be critiqued, but together they make a compelling case.

For a few markets, a possible explanation is that firms may have engaged in pro-competitive and efficiency enhancing behaviour to expand their market share. This would imply that some firms have obtained their market power through innovation and offering consumers greater value than their rivals. However, only few firms would meet this explanation in SA, given the extent of illegitimate market power.[18]

The causes underlying the persistently high levels of market concentration and corresponding market

[13] The Herfindahl–Hirschman Index (HHI) is the most commonly accepted measure of market concentration. The HHI takes the value of 10,000 in the monopoly case and declines as the level of concentration decreases. Markets with HHIs above 2500 are classified as highly concentrated.

[14] The extent of market concentration in South Africa's product markets, Journal of Antitrust Enforcement, (2019) 7 (3), 2019: 352–364 (with Buthelezi, T. and Mtani, T.)

[15] The World Bank (2014) makes the observation that the concentrated firm export structure is persistent. Over the period 2002–12, concentration increased slightly, with the share of the top 5% of exporters growing from 90% (85% for non-minerals) to 92% (87% for non-minerals). See World Bank, South Africa Economic Update: Focus on Export Competitiveness (2014), South Africa Economic Update No 5 and World Bank, South Africa Economic Update: Promoting Faster Growth and Poverty Alleviation Through Competition (2016) South Africa Economic Update No. 8.

[16] Roberts, S. 2004. Competition Policy, competitive rivalry, and a developmental state in South Africa. In: Edigheji, O. (ed.) Constructing a democratic developmental state in South Africa potentials and challenges. World Rights.

[17] Licensing requirements in some markets are but one example of a type of regulatory requirements that may favour incumbents at the expense of new competitors.

[18] For example, the World Bank (2014) points out that the concentration of South Africa's exports, along with the lack of extensive innovation, is consistent with the country's higher concentration of export market share than that of its peers, and the higher price-cost margins associated with it.

power are not clear. The reason for this is that potential candidate explanations may include some, if not all, of the following: past privileges, the behaviour of incumbent firms' crowding out existing or potential competitors either deliberately or through innovation, efficiencies associated with scale, increases in merger and acquisition activity, the rise of dominant information technology firms, and regulatory barriers to entry such as licensing.

Harms from illegitimate market power

When considering competition harms, the most common approach is to use a partial equilibrium framework. This involves observing at competitive harms within the markets potentially affected by the exercise of market power. From that perspective, the exercise of illegitimate market power is harmful in several ways, among them: (1) wealth transfer and allocative efficiency loss, (2) wasteful rent-seeking, and (3) slowed productivity improvements and innovation in affected markets.[19]

Economy-wide harms from illegitimate market power

Beyond specific markets, the exercise of illegitimate market power is harmful to the South African economy as a whole. The exercise of illegitimate market power may result in slowed economic growth and increasing economic inequality, among others.

Slowed economic growth

Aghion and others 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 SA. In particular, a 10% reduction in the mark-ups would increase productivity growth by 2–2.5% per annum. Higher past mark-ups are associated with lower current productivity growth.[20]

Increased inequality and poverty

Illegitimate market power is often associated with creating barriers to entry, keeping outsiders out of markets and is a major source of inequality. The monopolist's monopoly profits come at the expense of consumers and workers: as monopolies raise their prices, their profits increase while the well-being of consumers and workers decreases. A study conducted by the World Bank (2016) suggests that competition policy in SA brought substantial benefits to households, especially the poor. By tackling the four cartels in wheat, maize, poultry and pharmaceuticals (goods that amount to just over 15% of the consumption basket of the poor in SA), the reduction in the overcharge in prices to consumers is estimated to have reduced overall poverty by at least 0.40% 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 to the poorest 10% of the income spectrum by raising their disposable income.[21]

Therefore, competition enforcement redistributes wealth without incurring the traditional shadow costs arising from taxation and is an actively beneficial form of redistribution for the economy. Competition enforcement redistributes income and wealth, as well as increases efficiency. For this reason, it should be the first choice of policymakers concerned with equity.

Increased joblessness

More competitive economies are more dynamic, creating more jobs but of course there can also be short-term job losses as inefficient businesses close.

Increased corruption

Cartels allow firms to exercise market power they would not have otherwise. An agreement between competitors to fix prices, allocate markets or rig bids is not only anti-competitive, it is also corrupt. It is corrupt because it is a conspiracy against the public. Further, when firms can secure long-lasting economic and political power through their size and lobbying influence, their economic and political power can reinforce each other in a vicious cycle. Market power may give firms the resources to create and exploit political power, which they may use to protect or extend their economic advantages - and then invest some of the resulting rents to extend their political power.[22]

[19] See Market power in the U.S. economy today. Jonathan B. Baker March 2017.

[20] See Johannes Fedderke, Chandana Kularatne and Martine Mariotti, 'Mark-up Pricing in South African Industry' (2007) 16(1) Journal of African Economies 28; Philippe Aghion, Matias Braun and Johannes Fedderke, 'Competition and Productivity Growth in South Africa' (2008) 16(4) Economics of Transition 741.

[21] The World Bank, South Africa Economic Update: Promoting Faster Growth and Poverty Alleviation through Competition (2016) South Africa Economic Update No. 8.

[22] See Market power in the U.S. economy today. Jonathan B. Baker March 2017.