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Towards an Optimal Competition Policy in South Africa: Post Chicago and the Developmental State

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TOWARDS AN OPTIMAL COMPETITION POLICY IN SOUTH AFRICA: POST CHICAGO AND THE DEVELOPMENTAL STATE

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Abstract

In this paper, we consider recent developments in economic theory in order to gauge their implications for competition policy in South Africa when account is taken of the actual economic and market conditions. We argue that it may be optimal for competition policy to be systematically biased toward an anti-competitive role by dominant firms given these conditions. To avoid over enforcement, competition authorities will have to undertake the necessary analysis, on a case-by-case basis. We conclude that South Africa's competition policy is at the heart of development and by extension of a developmental state. If the desired outcomes of the Accelerated Shared Growth Initiative for South Africa, the National Industrial Policy Framework and ultimately the objectives of a developmental state are to be realized, then it is optimal for competition policy to be complemented by these strategic policies.

JEL: L11, L40, L50

Keywords: competition policy, industrial policy, developmental state, abuse of dominance, competitive rivalry

1. Introduction

Economists have recently pointed out that the size of an economy, the levels of concentration, and the barriers to entry as well as the history of state support are all relevant in pursuing an optimal competition policy. This has been accompanied by the increasing recognition in competition policy circles of developments in economic theory which demonstrate the scope for strategic behaviour on the part of firms with large market shares to engage in exclusionary conduct. Observing how recent developments in economic theory, particularly agency theory, game theory, transaction cost theory and information theory, have greatly improved our understanding of competition policy. Laffont (1998) notes that competition is an unambiguously good thing in the first-best world of economists and that world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, a benevolent court system to enforce contracts, and a benevolent government providing lump sum transfers to achieve any desirable redistribution.

¹ * Competition Commission South Africa and ** The Presidency, South Africa; The views represented here are solely of the authors and do not necessarily represent those of the Competition Commission or The Presidency.

South Africa is far from this ideal world and thus competition policy needs to reflect actual conditions on the ground. The basis for this assertion is that the essential focus of competition policy in developed countries is the promotion of allocative efficiency and reduced prices for consumers. Considering South Africa's quest for economic development, this focus is too narrow and static. The central objective of a developmental state is the promotion of long term economic growth. It requires dynamic rather than static efficiencies. This suggests that in a world of incomplete and missing markets, unfettered competition may be sub-optimal given South Africa's 1994 heritage of a stagnant economy with high levels of concentration. In this paper we therefore argue for an optimal degree of competition which entails sufficient competitive rivalry to reduce inefficiency but does not deter the propensity to invest.

This paper is organized as follows: Section II describes the developments in economic theory and their implications for competition policy in South Africa. Section III argues that competition policy and industrial policy are mutually reinforcing while Section IV analyses the relationship between competition policy and the developmental state. Section V concludes.

2. Developments in economic theory²

A leading authority on competition policy recently noted that "When the Chicago school got going in the 1950s, the field of industrial organization was a very informal branch of economics. There was not only little mathematical or other formal modelling. There was little in the way of theory. The Chicago school's contribution was to apply simple price theory to the commercial practices described in the leading antitrust cases" (Posner, R.A 2005). The Chicago school challenged the naive view of competition policy based on simple models of imperfect competition, associating market power, large market shares and abusive conduct with the typical behaviour of monopolists and consequently the historical bias in US antitrust in favour of protecting small firms. The school questioned the logic of much of unilateral abuse in terms of both the ability and the incentive for such abuse.

Note that while questioning the ability of firms to exclude rivals for any period of time due to the contestability of markets and the development of new and improved products, the school's biggest challenge was whether a firm had the incentive to do so. This is the argument that there is only 'one monopoly profit' to be made. For instance, where a monopolist in one product may seek to tie-in

² This section draws from Mncube, L. 2008. "What are implications of the 'post Chicago synthesis' for competition policy in South Africa? ." *Paper presented at the Third European Conference on Competition and Regulation, Cresse: "Competition Policy: Procedures, Institutions, IPRs", 4th an 5th July 2008. Athens, Greece.*

consumers to purchase a related product, and where a monopolist in an upstream product has an exclusive supply arrangement with a downstream producer or vertically merges with a downstream producer and forecloses downstream competitors. There is only one monopoly profit to be made from sales of either the tied products or from the downstream product embodying the upstream input. In both cases the monopolist can extract the full monopoly profit through pricing of the product in which it has a monopoly position without exerting leverage, either horizontally or vertically.

In other words, in the Chicago school framework there is no actual incentive for firms to behave anti-competitively, and so the Chicago critique concluded that antitrust actions were actually prohibiting arrangements which were efficient and pro-competitive. For example, according to Posner (1976), exclusive vertical arrangements such as exclusive territories are not harmful market allocations but efficiency-enhancing means of preventing dealer free-riding on the marketing investments of manufacturers. Following McGee (1958), price-cutting is not predatory, but the root of competition. A firm with a large market share maintains such a share through its superior efficiency and innovation.³ The broad sway of this position in the USA means that unilateral abuse cases are rarely successful and have to demonstrate that the behaviour is output restricting and not just that it harms competition 'on the merits' or normal and effective competition (Fox, E 2003).

For all its important insights the Chicago school limited most of its analysis to either monopolistic or perfectly competitive markets. The critique posed by Chicago school and the more rigorous answers that have resulted from improved theoretical work underpin the 'post-Chicago synthesis'.⁴

2.1. The post Chicago synthesis

When game theory and strategic behaviour, together with the effect of imperfect information on contracting became standard tools in industrial organisation, the post Chicago synthesis studied more complex market structures and introduced welfare considerations to derive sound normative implications.⁵ Under these conditions there are clear incentives for firms to engage in anti-competitive behaviour to protect and extend their market power. In the above case, this can underpin exclusive dealing or vertical integration by a monopolist. The post-Chicago synthesis thus identifies a number of situations in which vertical foreclosure is a rational anticompetitive strategy used to restore market power in the upstream market, as a defensive leveraging strategy to deter entry in the long run and to

³ See Landes, W. M and R.A Posner. 1981. "Market Power in Antitrust Cases." *Harvard Law Review*, 94.

⁴ See Kovacic, W. E and C Shapiro. 2000. "Antitrust policy: a century of economic and legal thinking." *Journal of Economic Perspective*, 14.

⁵ Game theory refers to the rigorous analysis of situations of inter dependent decision making, explicit analysis of dynamics (game not one shot) while contract theory refers to the rigorous analysis of how agents can and do construct contractual arrangements, generally in the presence of asymmetric information.

monopolise the downstream market (see, for example, Salop and Scheffman (1987) and Rey and Tirole (2006)).

The insights also apply to strategic behaviour to deter entry. Consider the following simple game between a potential entrant and an incumbent firm. First, suppose the entrant decides whether or not to incur the sunk costs necessary to enter the market. Next, the incumbent decides whether to accommodate entry or engage in predation. Suppose further that the entrant will make positive profits if the incumbent accommodates entry but will lose money if the incumbent engages in predation. Following the Chicago School critique and viewing the problem as a one-shot game, predation is not profitable. The threat of predation is also not credible.⁶

It is useful in this context to reflect on the seminal work by Milgrom and Roberts (1982) and Kreps and Wilson (1982) who demonstrate the power of reputation and signalling to support credible predation, and rely heavily on the presence of asymmetric information. The core of predation based on reputation is that the predator signals the willingness to engage in predation (for example, predatory behaviour may signal low marginal cost). Fudenberg and Tirole (1986) show how predation can also work by disrupting the ability of the entrant to determine whether remaining in the market will be profitable. Modern economic theory establishes that predation can be profitable for an established monopolist in a variety of plausible situations.

For example, a dominant firm has an incentive to behave in ways which suggest it is low cost, when it may not be. It also has an incentive to develop a reputation for fighting rivals and entrants to entrench its position, even though on the face of it this is not rational. These incentives both rely on there being barriers to entry, without which there is no durable market power. With imperfect information there are good reasons to believe entry barriers are more significant and may be of a strategic nature (see also Geroski and Jacquemin on the durability of monopolies, cited in Fox, 2003). The post Chicago synthesis therefore takes into account asymmetric information and uncertain time horizons in attempting to formalise the intuition that predators can develop a reputation that will not only drive the current prey from the market but deter others from entering.⁷

⁶ It might be the case that the entrant will fight for a long period of time before exiting, or perhaps accommodation is quite profitable for the incumbent which implies that the opportunity cost of predation is high. The only sub game-perfect equilibrium is for the potential entrant to enter the market and for the incumbent to accommodate entry. The idea that a sequential game has to have a Nash equilibrium not just at the outset but at every sub game is called sub game perfection.

⁷ In the context of tying and bundling, Carlton and Waldman (2002) explain how such arrangements can be anti-competitive in raising barriers to entry and so preventing the monopolist's position from being undermined. If there are two goods, A and B, where the monopoly exists in good A but where there are competitors (actual and potential) in good B due to lower barriers to entry, the monopolist has an incentive to exclude the competitors in B. Following the reasoning in some of the various Microsoft cases, this incentive exists where the creation of competing substitutes to the monopoly in good A is easier to do by firms that are already established in good B. By excluding competitors in good B the threat of entry into the monopolised market for good A is reduced.

These theoretical developments effectively meet the Chicago critique. The synthesis refers to the progress from the answers to the critique to an effects based standard for evaluation of abuse of dominance which requires careful analysis of the competitive dynamics and firm behaviour in a given market. To sum up this brief review of the different approaches to competition policy, it is not surprising that the results of the post-Chicago synthesis are systematically biased toward an anti-competitive role by firms with large market shares. Since, it recognises the scope for strategic behaviour on the part of firms with large market shares to engage in exclusionary conduct such as aggressive pricing, threatening or undertaking overinvestments in complementary markets, imposing exclusive dealing contracts or bundling goods with the sole purpose of deterring entry and stifling innovation. We argue hereafter, that given the actual conditions on the ground in South Africa, it is optimal for Competition policy to err on this side.

2.2. Implications of the post Chicago synthesis on competition policy

The potential and incentives for anti-competitive abuse of dominance depend on the situation in individual markets. And, to the extent that conditions in the European Union may be different from those in the USA, due to higher levels of concentration or monopolisation (as highlighted by Vickers, J 2007), the same is true to a greater extent in a country such as South Africa. This was reflected in the South African Competition authorities's approach to the large merger between Mondi Limited and Kohler Cores and Tubes a division of Kohler Packaging Limited.⁸ These considerations mean that the size of an economy, the levels of concentration, and the barriers to entry as well as the history of state support are all relevant for the optimal competition policy to be pursued (Gal, M.S 2003).

The presence of concentrated market structures can be expected to have adverse impact on price and output levels of many goods and services, with knock-on effects where they are also inputs in production. Low levels of competitive rivalry, with entrenched dominant firms, also have negative implications for dynamic efficiency, product development and other non-price dimensions of competition. In the South African context Aghion et al. (2006) and Fedderke and Szalontai (2005) find such effects, with high anti-competitive mark-ups associated with poor productivity performance and employment growth.

⁸ In this case the Competition Tribunal explicitly accepted the recognition of circumstances in which vertical transactions may be problematic, including making reference to the insights from game theory and 'post Chicago' theories of anti-competitive harm. The Competition Tribunal's prohibition of the merger was upheld by the Competition Appeal Court. In its judgment the Competition Appeal Court cautioned that: *"The assessment of harm has to be analysed within the specific framework of the Act [South Africa Competition Act].....Thus care must be taken before an uncritical borrowing of the traditional anti-trust economics theories, as developed in the United States of America, encrust the process of interpretation of our Act. Unlike much comparative competition law, the Act specifies among overall its purpose of the maintenance of competition, that small and medium size businesses have an equitable opportunity to participate in the economy and that there be promotion of a greater spread of ownership, in particular to increase the ownership stake of historically disadvantaged persons"*

Competition law enforcement in South Africa has historically been weak. The state has created monopolies and used protection from competition widely as a policy instrument. The scale of concentration has been and remains considerable. South Africa has powerful state owned enterprises in the transport, telecommunications and broadcasting and energy sectors. Some like Mittal SA and Sasol are now in private hands while others like Telkom are partially privatized. Telkom, for example, has dominated the fixed line telecommunications sector since 1994 and this is unlikely to change in the near future. To cement Telkom's dominance, government awarded Telkom a five year monopoly in 1996 in return for extending access to previously disadvantaged areas and due to delays in the licensing of the Second National Operator (SNO), Telkom currently enjoys a *de facto* monopoly.

Put differently, many firms which occupy dominant positions in South Africa have not necessarily obtained their place through superior efficiency and foresight in the market place but because of direct or indirect state protection. As a result, the background context of competition policy in South Africa is different from the US and Europe. The fact that monopolies are due to decades of state protection and not successful competition on the merits could lead to different approaches even if the cases are similar.⁹ This means that there is a need for active enforcement. Public enforcement is also critical in ensuring that concentrated nature of the South African markets does not lessen or prevent competition given the weak state of organisation of the consumer constituency. Furthermore, because new entry has been stifled in many sectors of the economy, it is optimal for the South African competition authorities to err on the side of encouraging entry, by adopting a post Chicago approach to competition policy which looks at the actual conditions on the ground.

3. Competition and industrial policy

The argument so far is that competition authorities should err on the side of encouraging new entry. One critique of this argument is that it relies on theories that reveal why certain practices may be anticompetitive under certain conditions and may lead to false positives, that is, over-enforcement. For South Africa, this will depend on the ability of the competition authorities to undertake the necessary analysis, on a case-by-case basis, in order to address conduct with very harmful effects. Another important question which is also central to this paper, relates to the kind of policies considered as optimal for South Africa. By this we mean should the state allocate scarce resources to promote competition, or should it rather favour selected sectors which contribute the most to a particular set of desired, long term, developmental goals? But treating the two choices as substitutes could hide the fact that the two can be complementary and in the case of South Africa ought to be.

⁹ See Fingleton, J 2003. "De-monopolising Ireland." *In: 2003 EU Competition Law and Policy Workshop: What is an abuse of a dominant position, European University Institute, Fiesole.*

For instance, competition policy promotes the allocative and technical efficiency of economic activity on the basis of equality of opportunity to participate in markets whereas, industrial policy promotes dynamic efficiency in achieving favoured outcomes through supporting a favoured economic agent. While it may seem as if there is a potential conflict between the two types of policies in that enforcement of competition policy may limit the policy space necessary for achieving the goals of industrial policy, this need not be because South African competition policy is not inherently opposed to dominant firms but only recognises their scope of strategic behaviour to engage in exclusionary conduct or abuse of dominance. In other words the extent to which the potential conflict manifests itself as incompatibility or in a form that strengthens the interaction of competition and industrial policies depends on the details of their design and objectives (Brooks, D.H 2007).

Industrial policy is less likely to achieve satisfactory results when it is not accompanied by active enforcement of competition policy. Where tensions exist, South African competition policy has been designed and implemented to accommodate these challenges. Measures to promote the goals of industrial policy do not have to restrict competition. These include among others measures to support growth and achieve social goals such as public expenditures on infrastructure and education and creation of an investor-friendly business environment.

3.1. Competitive rivalry, industrial policy and industrial development

Apartheid industrial policies left South Africa with a highly skewed industrial structure and dominant firms in key sectors. These firms had developed significant capabilities on the back of state support, under state ownership or state protection from competition. Their behaviour and orientation today in many respects determines the development of whole sectors of industry. This historical trajectory of industrial development means key sectors are monopolized or dominated by a very few firms with market power. The high concentration and low rivalry leads to high pricing, poor service levels and low innovation levels. In addition, the existing dominant firms are able to create barriers to entry so as to harvest high rents as long as possible.

A number of implications flow from the challenges facing competition policy in smaller and developing economies such as South Africa. Fostering competitive rivalry means not just preventing exclusion but addressing strategies that undermine effective competitive discipline. The counterargument illustrated by the US authorities is that competition should not seek to protect particular competitors (who may not be efficient) but competition (see Fox, 2003). This has been echoed in the South African Competition Appeal Court in its decision overturning the Competition Tribunal's ruling against predatory pricing by Sasol of creosote. But, effective competition is an active process which requires firms to be able to grow their market and offer attractive propositions to customers. As highlighted above, the strategies of

the dominant firm may involve favouring some downstream competitors over others. And, the substantial preventing or lessening of competition test in the Act does not necessarily mean firms exiting the market, but being inhibited from being effective competition.

Such an approach suggests assessing the dynamic nature of competition – in the form of possible entry and growth of competing entities. This applies also to industries characterised by tight oligopolies, especially if enhanced by long-standing arrangements, conventions, or understandings. Small competitors may seem insignificant, but ultimately could be playing a very important role in the outcomes of such markets over time. Where cartels have been uncovered and prosecuted but the industry conditions remain the same then there is a reasonable likelihood of collusion continuing in other ways, without necessarily explicit coordination. Again, such outcomes can only be sustained if there are ways of restricting entry that would otherwise be attracted by the supra-competitive margins. An example of such challenges for the impact of competition policy in South Africa is in baking and milling where cartels have recently been uncovered by the Commission. The question which naturally arises is whether conduct and outcomes have changed as a result of the cartels being prosecuted.

The general point is that in smaller economies provisions against anti-competitive behaviour may require stronger enforcement. And, ensuring effective competitive discipline may require greater attention to the nature of inter-firm rivalry and dynamic efficiency effects in competition policy. As discussed above, developments in industrial organization over the past two decades have highlighted how, under conditions including imperfect information and sunk costs, it can be possible for dominant firms to entrench their positions through their strategic behaviour and not through their superior innovation or product development. As Geroski and Jacquemin (1984) cautioned ‘when, however, small asymmetries can be solidified into dominant positions that persist, the inequities they create become institutionalized, creating long-term problems in the performance of the economic system which cry out for policy attention’.

The promotion of innovation and large investments, as well as trade liberalisation have been the main goals of industrial policy in South Africa. In some cases industrial policy has targeted specific sectors, such as specific programmes for the auto and clothing & textile sectors. (Roberts, 2007 and Mohamed and Roberts, 2007, as cited in Roberts, 2008). The auto industry stands out as being where a programme specifically aimed at altering the incentives facing firms has led to greatly increased investment, output and exports, alongside maintaining levels of employment.

Furthermore, Roberts (2008) argues that generally industrial policy has not taken competitive rivalry into account, nor has it been related to the specific characteristics of different industries or sectors. Where incentives have been provided, it appears that firms have not been held to clear conditionalities

or performance targets, nor has government sought to use rivalry as a mechanism to induce firm effort towards industrial development goals. Instead, Roberts (2008) maintains, government has placed faith in moral suasion (such as in the commitment by Mittal to agree on a 'Developmental Steel Pricing Policy' with the Department of Trade Industry) and an overall emphasis on improving productivity through liberalization and a reduced government in the economy. But, notwithstanding important changes in conglomerate structures, liberalization has generally meant that firms best able to take opportunities in a liberalized environment are those with developed capabilities from the support they received under apartheid, thus compromising the effectiveness of industrial policy.

Because industrial policy focuses on the long run growth this suggests that competition policy should flexibly accommodate industrial policy. In their dynamic interaction, the balance between competition and industrial policy may change over time with different emphasis at different stages either by design or by circumstance. Large international conglomerates add an extra dimension to the balance between industrial and competition policy objectives. The entry of conglomerates into the market usually increases competition, at least in the short run.¹⁰ But if this entry takes place through mergers or acquisitions then this increases concentration in an already highly concentrated market. Furthermore, if the increased concentration leads to abuse of a dominant position in the market, then an active competition policy restores efficiency.

4. Competition policy and the developmental state?

Democratic South Africa chose, within a market economy, to use the state machinery as a vehicle to mobilise all economic players around pro-poor growth, employment creation and fighting poverty and exclusion as well as reducing inequality. Utilising the state apparatus to drive a certain development agenda characterises a developmental state.¹¹ The need for a developmental state is informed by the legacy of underdevelopment shaped by South Africa's unique history. The current state of the economy and of industrialization is a consequence of the discovery of minerals, apartheid policies, sanctions and the import substitution regime.

South Africa's 1994 heritage included a stagnant economy, high and growing unemployment together with high levels of concentration. It was an economy highly dependent on minerals and energy-intensive activities but which were not vertically integrated into the economy, and much of industry was

¹⁰ To the extent that these entrants bring new managerial or production techniques and technology; access to international supply chains, markets, and finance; and benefits to domestic consumers, labour, and suppliers of other inputs, they tend to be viewed favourably.

¹¹ A developmental state is one whose "politics have concentrated sufficient power, autonomy and capacity at the centre to shape, pursue and encourage the achievement of explicit developmental objectives, whether by establishing and promoting the conditions and direction of economic growth, or by organizing it directly, or a varying combination of both" (Leftwich in Taylor 2006, 2).

inefficient, having been dependent on state support and protection. The challenge of more diversified growth and development faced low skills levels, small markets, virtually non-existent black entrepreneurial class, massive racial and regional inequalities and exclusion for the majority of the population (Hirsch, A 2005).

Though progress has been made and there has been sustained economic growth over the years, major concerns exist with both the level and the nature of growth, specifically with regard to employment creation, and with levels of concentration, uncompetitiveness and broad based inclusion and participation, hence the even greater drive for a strong and effective developmental state. However, despite liberalization and a reduction in state support for heavy industry favoured by the apartheid regime, most sectors of the economy remain highly concentrated with recent research highlighting the extent of anti-competitive mark-ups and their negative implications for productivity and employment (Aghion et al. 2006).

However, as the post apartheid state has pursued industrial policies designed to stimulate economic growth through greater reliance on the market system, this has led to concerns about the role of competition policy. On one hand, competition policy should reflect the realities of the international marketplace where competitive advantage stems from process and product innovation while utilizing recent economic theory and jurisprudence from competition authorities in industrialized countries who have been enforcing and interpreting different versions of competition policy over a longer period of time. On the other hand, competition policy also should reflect the conditions that prevail in South Africa such as minimal technological base, small, concentrated and somewhat isolated domestic market with a history of being an activist state characterized by public ownership of industry and protection from competition. For these and other reasons, South African competition policy has developed not to become a simplified version of extant antitrust regimes.¹²

An optimal competition policy for South Africa has to be intertwined with industrial policy if it is to move the developmental trajectory in favour of more labour-absorbing activities. This in itself is central to broader based and more inclusive development. Competition policy is important in making sure that firms along the production chain do not abuse their dominance and that historically disadvantaged

¹² . The South African Competition Act of 1998 (in section 2) identifies its purpose as being '*to promote and maintain competition in the Republic in order-*

- *to promote the efficiency, adaptability and development of the economy;*
- *to provide consumers with competitive prices and product choices;*
- *to promote employment and advance the social and economic welfare of South Africans;*
- *to expand opportunities for South African participation in world markets and to recognise the role of foreign competition in the Republic;*
- *to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and*
- *to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.'*

These objectives include a range of goals in addition to efficiency and consumer welfare.

entrepreneurs can respond to incentives to start and sustain viable firms. Increased entry and greater participation does not necessarily arise from competition policy. This needs to be complemented with active policies to facilitate entry, such as the provision of finance, effective skills development and business support. Information provision is an important part of business support, as is ensuring access to ancillary services.

Competitive rivalry can also act as a powerful force in firms delivering on specific development objectives. Firms can also be encouraged to compete for incentives and support from the state, with competitive rivalry ensuring that government can withdraw support and re-allocate it if the conditions for the support are not being met. Competitive rivalry is thus important for the policy tools to place the economy on a more dynamic developmental path, as well as being an integral part of the development trajectory itself in terms of individuals and firms being able to participate effectively in the economy and be rewarded for their effort. All of the above consolidate the fact that central to the effective workings of a developmental state are competition institutions that promote the public interest and ensure that there is an efficient economy whose resources are employed as efficiently as possible.

In Asia, experiences with industrial policy, and the desires for its goals, have been shaping the debate over competition policy for a longer period of time. The insight from these countries is that competition policy, which places greater weight on short term concerns but is increasingly considering long run effects, and industrial policy appear to be converging in their goals. As a result, more and more of these countries are finding that carefully crafted, industrial and competition policies can be mutually reinforcing (Brooks, D.H 2007). But, the point is not to transplant the model of any particular country rather that the standards applied by, and priorities of, the competition authorities are based on the actual conditions of the economy and in South Africa's case, the small, very concentrated and skewed economy.

In an attempt to set the country on a growth trajectory, the state has designed industrial policy, competition policy and other strategic policies to take into account short run goals such as greater employment or improved income distribution, but the emphasis is ultimately on long term growth and development. This is motivated by the fact that faster growth may lead to greater competition. For example, the Accelerated Shared Growth Initiative for South Africa (ASGISA) attempts to make it possible for the country's economy to grow at 6% which is the desired minimum growth rate required if government is to halve poverty and unemployment by 2014. ASGISA identifies barriers to entry and limits to competition amongst other binding constraints in the economy. While the recent National Industrial Policy Framework (NIPF) builds on and complements ASGISA by attempting to transform the economy and unleash the country's productive capacity.

Economic development requires structural transformation, structural transformation is path-dependent.¹³ This means that coordination failures may limit the ability of markets to identify and achieve the most socially beneficial long term development path of activities. Hausmann and Rodrick (2006) point out that unless purposeful action is taken to move towards new activities, countries may not be able to overcome the market failures that affect the process of structural transformation and for this reason industrial policy is a central part of any development strategy. In the case of South Africa, at the centre of enabling increased productive capacity is an industrial strategy supported by competition policy that aims to enable entry and facilitate more vigorous competitive rivalry as well as the ability to identify potential growth points, bottlenecks and effective incentives among others.

Seen from this perspective, competition authorities have a central role in enabling programmes such as ASGISA and NIPF to be effective. Moreover there are numerous examples of how concentration in key sectors makes it difficult for the economy to respond to stimuli put forth by the developmental state. South African experience with competition policy has shown that decisions and conduct of firms with large market shares in any sector shape economic outcomes. While others have questioned whether the state has a strategy to engage with this conduct and its implications beyond the approach of ensuring a 'business friendly' investment climate. The NIPF recognises the need to do so, but it remains to be seen whether this will be effectively followed through in practice.

At a minimum a developmental state presupposes the ability and aim of collecting and analysing information on the trajectory of the economy in order to anticipate the likely outcomes and the impact of different government strategies to alter that trajectory. In this regard, an under-emphasised strength of competition authorities is their ability to uncover the competitive dynamics and outcomes in a given market through powers of information gathering and analysis (Roberts, S 2008). Perhaps such understanding of firm behaviour is essential to government's strategy for engagement with business. However, the remedies at the disposal of the competition authorities cannot ensure more dynamic competitive rivalry. They can address ways in which dominant firms abuse their position to extract rents and entrench their monopoly power, but more competitive outcomes depend on complementary policies to support active rivalry. In other words policies such as NIPF and ASGISA need to be complemented with competition policy for the objectives of a developmental state to be realized.

5. Conclusion

In summing up we draw on the lessons from this paper. First and foremost, for small and somewhat isolated industrial economies with high levels of market concentration, such as South Africa, unilateral

¹³ Since new activities take advantage of existing capabilities (such as particular labour skills) that were developed for other activities.

conduct is particularly important simply because there is a greater likelihood of there being a dominant firm in any given sector when factors such as scale economies and barriers to entry are taken into account. We have argued for an encouraging entry-based competition policy focused exclusively on eliminating or limiting governmental, natural, and artificial barriers to entry. Encouraging new entry promotes the competitive process, limits rent seeking opportunities, and furthers the process of being a developmental state. An entry-based competition policy can provide the foundation for a developmental market economy wherein competitive pressures hone production efficiency and stimulate appropriate product and process innovation fundamental to international competitiveness and economic growth. At the heart of this argument is the proposition that while entry is the essence of competition, there needs to be thorough case by case analysis of conduct given the actual market and economic conditions in South Africa which is predicated on the post Chicago synthesis.

Second whereas competition policy yields efficiency benefits induced by competitive rivalry in contestable markets, industrial policy can fill in the gaps in a developing market economy by coordinating markets where developments in one market depend on developments in another and by maximizing the net benefits of other externalities. South African competition authorities therefore have the responsibility of ensuring greater rivalry. At the same time they ought to ensure that the stimuli provided by ASGISA and NIPF yields the greatest possible returns in terms of growth, employment creation, poverty reduction and industrialization. While they appear to be on the right track and proactively investigating various priority sectors as identified by ASGISA and the NIPF for possible anticompetitive behaviour. It remains to be seen whether the competition authorities will play a greater role in policy formulation because of their vast and intimate knowledge of the economy.

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