HOW COMPETITION AUTHORITIES CAN ENABLE ECONOMIC TRANSFORMATION TO REDUCE INEQUALITY: SOME EXAMPLES FROM AFRICA

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I. COMPETITION: THE MISSING LINK BETWEEN ECONOMIC TRANSFORMATION AND POVERTY REDUCTION IN AFRICA?

Economic transformation – the process through which resources move from lower to higher productivity activities – is key for economic growth and poverty reduction, particularly in Africa. Shifts from lower to higher productivity activities lead to more and better jobs, higher labor incomes and capital returns, ultimately lifting the poor out of poverty and reducing inequality. However, in Africa, the rate at which growth has translated into poverty reduction has been lower than in other regions, and this is partly explained by constraints in the process of economic transformation.[2] Based on the latest comparable household statistics across 27 Sub-Saharan countries, productivity growth in the agriculture sector (the sole source of income for 42 percent of households) has been relatively sluggish, and productivity in the new sectors to which labor has moved (mainly services and trade) is not as high as in other countries.[3]

Weak competition limits the potential for economic transformation to create better jobs and higher incomes through productivity growth. In fact, competition is one of the main factors that affect both productivity growth within a sector and the ability for market players to enter other sectors that have higher productivity. Cartels and monopolies reduce incentives of existing firms to compete, innovate and enhance productivity. Market foreclosure practices together with government rules that strengthen dominant firms or discriminate against more productive firms discourage entry into high-productivity economic activities. Meanwhile, a lack of competition in key input markets lowers productivity growth of downstream firms that rely on those inputs.[4] Empirical evidence from a study into product market competition, productivity and jobs in South Africa found that (i) markups had generally risen between 2010 – 2014, largely driven by larger firms that have higher pricing power; and (ii) firms that faced lower competition (measured by their pricing power), had lower productivity growth, lower employment, and lower wage growth.[5]

Competition in African markets is relatively weak: economic factors are exacerbated by the lack of effective enforcement of competition rules and the existence of government rules and practices that impair competition based on merit. According to the Global Competitiveness Report 2019, 71 percent of African countries rank in the bottom half of coun-

2 World Bank, Making Transformation Work for the African Poor (2017), mimeo. See also Paci P. & M. Tuccio "Why is growth less poverty reducing in Africa?" (2016).

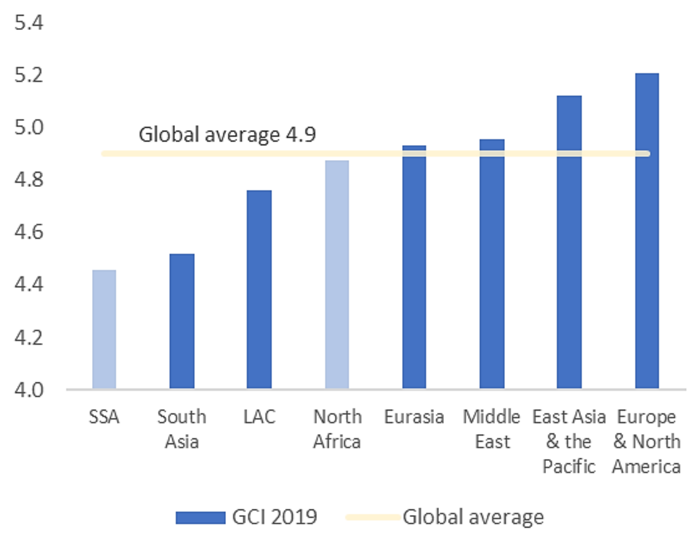
3 *Ibid.*

4 For a summary of studies on this effect see World Bank– OECD, "A Step Ahead: Competition Policy for Shared Prosperity and Inclusive Growth" (2017).

5 Dauda S., S. Nyman, & A. Cassim "*Product market competition, productivity and jobs: the case of South Africa*," (forthcoming 2019).

tries globally in terms of domestic competition.[6] For example, according to Bertelsmann Stiftung's Transformation Index ("BTI"), which is derived on the basis of expert assessments, African countries rank lowest globally on the extent to which: (i) rules prevent the development of economic monopolies and cartels; and (ii) the extent to which the fundamentals of market-based competition have developed. African markets also often display features that can make them more prone to anticompetitive practices, such as small market size and relatively high concentrations. Indeed, previous studies on the Africa region have found that weak competition in input markets like fertilizer and cement has had adverse effects in these markets, which are key to driving economic transformation and the creation of better jobs (see Box 1).

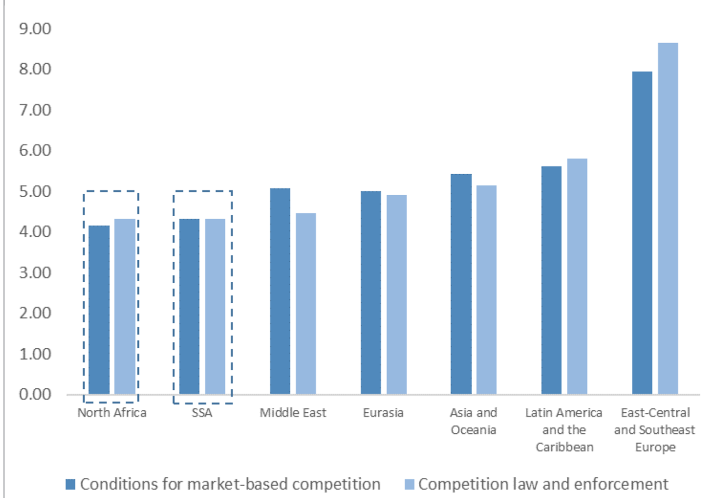
Figure 1: Global Competitiveness Index – Competition in Services



Note: Measured on a scale of 1 to 7, with 7 representing higher intensity of competition in services (includes professional, retail and network services). SSA stands for Sub-Sharan Africa.

Source: WEF GCI (2019)

Figure 2: Market-based Competition and Competition Policy Enforcement by Country Group



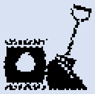
Note: Measured on a scale of 1 to 10, where 10 denotes the best conditions for market-based competition and the existence of comprehensive competition laws that are strictly enforced, respectively. SSA stands for Sub-Sharan Africa.

Source: Bertelsmann Stiftung (2018)

6 This draws on perception-based indicators from the World Economic Forum's Global Competitiveness Index (WEF GCI), which ranks countries in terms of the components that constitute their global competitiveness based on a survey of a representative sample of business leaders in their respective countries as well as public data sources.

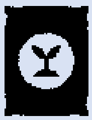
Box 1: Examples of Competition Issues in Key Input Markets in Africa

Cement



Average cement prices in Africa were 183 percent higher, on average, than the world price of cement at the end of 2014. Even if prices in African countries were only around 10 percent higher than a competitive level, African cement consumers could be overpaying by more than $2.5 billion a year due to a lack of competition (with $1.4 billion of that in Sub-Saharan Africa).

Fertilizer



Retail prices of fertilizer in Africa are significantly above prices in the Black Sea and Middle East regions. A review of ten African countries - which included Ethiopia, Ghana, Kenya, Burkina Faso, Mozambique, Nigeria, Tanzania, Rwanda, South Africa and Zambia - found that urea prices at retail outlets averaged $712 per metric ton, well above average retail prices in the Middle East ($472 per metric ton) and in the Black Sea Region ($424 per metric ton).

Even when controlling for income levels and transport costs, prices of goods and services consumed by households in urban Africa are 20 to 30 percent higher than in other main cities around the world.[1] This result could stem in part from a lack of competition within value chains.

1. Nakamura et al (2016); World Bank. 2016. Breaking down barriers: unlocking Africa's potential through vigorous competition policy. Washington, D.C.: World Bank Group

II. IN THIS CONTEXT, WHERE DO WE START?

In order to boost pro-poor economic transformation, actions to promote competition have to focus on those sectors where the poor are involved as producers, entrepreneurs or employees. Considering their importance for economic transformation and poverty reduction, we will define these core sectors as:

1. Agriculture (encompassing subsistence agriculture and production of cash crops) - where the poor are typically small producers.

2. The "third" sector – where the poor are typically small entrepreneurs but could also be employees (including small retailers, small providers of tourism services, as well as small goods producers).

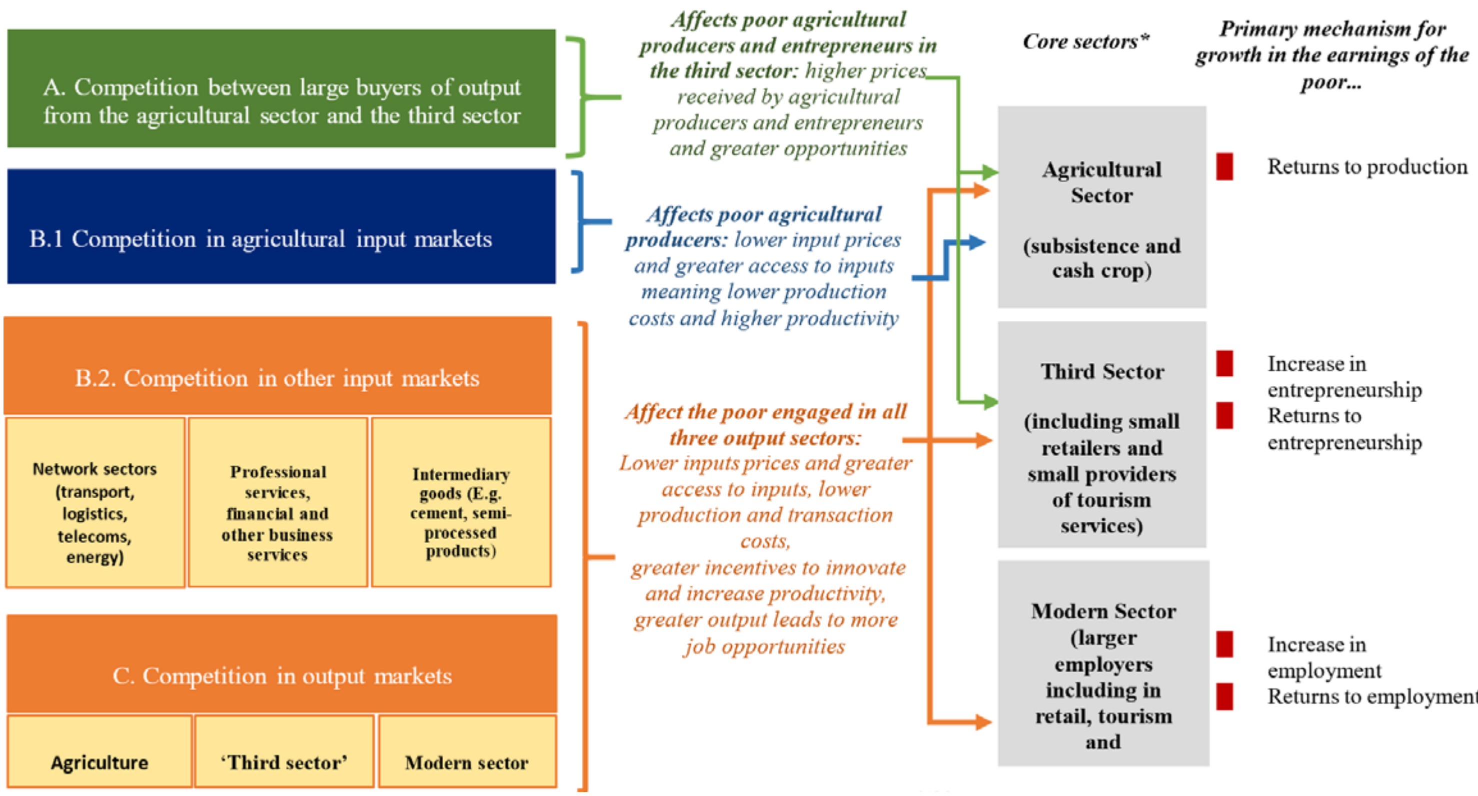
3. The "modern" sector – where the poor are typically salaried employees (including larger retailers, large tourism businesses, and large manufacturers).

The earnings of the poor are then affected by (i) the level of competition *in these core sectors themselves*, (ii) the level of competition in markets that are used as *inputs in those sectors*, and (iii) competition among *downstream buyers* of products produced by the poor in these sectors.

Governments in Africa are taking concrete actions to boost competition. This has happened through three categories of actions: (i) enforcement of antitrust laws against abuse of dominance and anti-competitive agreements, and merger control, (ii) measures to open markets and implement sectoral policies that enable contestability, firm entry and rivalry, and (iii) measures to ensure competitive neutrality and prevent non-distortive public aid support. Over time more countries have adopted and increased the effectiveness of competition legal frameworks: 36 countries, covering over 85 percent of Africa's GDP, have competition laws and 26 of those have competition authorities in operation. And pro-competition principles have been integrated into sectoral and economy-wide policies. For example, Ethiopia has recently decided to open up its telecommunications market to competition, and regulatory impact assessment frameworks in Kenya and Zambia now include an evaluation of effects on markets and competition.

The activities of competition authorities cover all these areas of advocacy, policy advice and enforcement, and affect the three core sectors. In these three core sectors, competition authorities have to date been focused relatively more on inputs sectors that are vital to the poor as small producers or entrepreneurs (B.1 and B.2 in Figure 3), for example in agriculture inputs, telecommunications, and transportation. Recently, however, there has been a move towards intervening in markets that buy from the less well-off, such as in retail and agricultural markets (see A in Figure 3 below). Boosting competition between downstream buyers would result in higher prices received by agricultural producers and entrepreneurs in the third sector. In the modern sector, the link to poverty has typically come from the consumer welfare side. However, in certain cases in the modern sector, mostly related to mergers, competition authorities have addressed certain aspects that are directly related to employees in those sectors, often through use of public interest provisions.

Figure 3: Summary of how Competition can Increase Earnings of the Poor Across Sectors



Note: Authors' own elaboration.

III. MOVING BEYOND CONSUMER WELFARE: HOW DO COMPETITION AUTHORITIES CREATE BETTER CONDITIONS FOR PRODUCERS AND ENTREPRENUERS IN THE PROCESS OF ECONOMIC TRANSFORMATION?

A. Actions to Boost Competition Between Large Buyers of Output from the Agricultural Sector and the Third Sector

Competition among downstream buyers increases the incomes of entrepreneurs and producers in upstream output markets. Buyer power – either due to collusion or restrictive government interventions that reinforce dominance – generally depresses prices for small agricultural producers. Competition authorities are tackling this by introducing abuse of buyer power regulations, advocacy, and enforcement mechanisms to increase competition among downstream buyers. Kenya has introduced abuse of buyer power provisions in the Competition Act, with the latest amendment adopted in 2019. The move was a response to a high prevalence of delayed payments for supplies by agricultural producers and small enterprises, with these arrears amounting to an estimated KES 40 billion (approximately U.S.$400 million) as of 2017 and contributing to a high micro, small and medium enterprise ("MSME") mortality rate. South Africa recently introduced new provisions on buyer power into its competition law with the explicit objective of promoting greater participation in the economy by small enterprises by addressing the way that dominant firms interact with these players as their suppliers.[7] Although these provisions are more related to unfair trade practices, they are similar in nature to provisions regarding small and medium enterprises ("SMEs") enforced by competition authorities in Japan and Korea.

Besides adjusting competition laws, competition authorities and other government institutions have taken decisions in benefit of small producers. In Zambia, farm-gate prices for cotton reportedly increased after price-fixing among ginners was detected by the Competition and Consumer Protection Commission (the "CCPC"). In Rwanda, in 2012, the government adopted a competitive bidding process for green-leaf tea by two state-owned tea factories. As a result of this initiative, the country's 60,000 tea farmers saw their incomes increase by an average of 35 percent and is expected to have a strong impact on jobs. This pro-competition reform took in place when the country had a competition law but no competition authority to advocate for competition. In Madagascar, when the vanilla marketing board was replaced as the only buyer of vanilla by more competitive domestic vanilla traders, there was a large positive effect on the purchase price paid to vanilla farmers, lifting about 20,000 individuals out of poverty. Since then, the Competition Commission of Madagascar has started operations and there is more work to be done in agricultural value chains to ensure competition among traders and exporters allows the benefits of international trade to flow to smallholder farmers.[8]

B. Actions to Boost Competition in Input Markets

Competition in agricultural inputs drives returns for smaller agricultural producers and therefore anticompetitive behavior in these markets (such as fertilizer, seeds, and pesticides) inflicts particular harm to low-income producers. Globally, the existence of international cartels in the fertilizer sector raised prices of chemical fertilizers by 17 percent on average during 1990–2010.[9] Global export cartels, such as the Belarus Potash Company export cartel, could increase final consumer prices of potash in Sub-Saharan Africa by at least 29 percent assuming a simple pass-through.[10] The price of potash fertilizer for 2011–2020 under a Canadian cartel arrangement has been projected to be double what it would be under a competitive scenario.[11] While such global export cartels have posed a problem for enforcement action under national competition regimes, competition authorities have been active in domestic fertilizer markets, with Zambia investigating a cartel case in fertilizers, and Kenya's competition authority (the "CAK") conducting a fertilizer market inquiry to identify barriers to competition and starting an enforcement action. In South Africa, structural remedies were imposed by the Competition Commission to restore competition after a case of anticompetitive conduct in the fertilizer market. Analysis indicates that the intervention led to new entry, increased customer choice and price competition, as well as estimated customer savings ranging between R1 billion and R10.5 billion.[12]

In other cases, a lack of appropriate regulatory frameworks creates barriers to competition in agricultural input markets. Starting the process of harmonization of the seed regulatory framework in East Africa led to savings of U.S.$49.1 million for farmers and boosted demand for certified seed in Kenya, Tanzania, and Uganda between 2000 and 2008. Similarly, governments in West Africa through the Economic Community of West African States ("ECOWAS") have also been working to harmonize seed and fertilizer rules and quality control procedures to increase farmer choice and reduce prices.

Competition in transport and distribution sectors shapes earnings for the poor in the agricultural, third and modern sectors. Breaking up anti-competitive practices in international shipping services would reduce transport prices for goods shipped to the United States from developing countries by 25 percent and lead to cost savings of up to U.S.$2 billion.[13] Several countries have sanctioned international shipping lines involved in the shipping cartel, with South Africa being one of the only countries in Sub Saharan Africa to investigate and impose fines on at least two shipping lines with one receiving leniency for cooperation. A lack of domestic competition in intermediate sectors, including transport and distribution services, can hinder the transmission of domestic and international price signals to producers, which would otherwise

7 Preliminary results of the Competition Commission's retail market inquiry in South Africa found that certain characteristics of the formal grocery retail segment were conducive to unequal bargaining power between supermarkets and suppliers.

8 Porto, Chauvin, & Olarreaga (2011); Part Three: Strengthening Competition To Stimulate Growth And Job Creation in: Stocker, Harivelo, Nantenaina, Cyril, Minosoa (2019). Madagascar Economic Update : A New Start? (English). Washington, D.C. : World Bank Group.

9 Connor (2012).

10 World Bank Group (2016).

11 Jenny (2012).

12 Sunél Grimbeek, Godknows Giya & Qhawe Mahlalela, "The impact on competition in the fertiliser industry after the Sasol divestiture of blending facilities in 2010," 2017.

13 Fink, Mattoo, & Neagu (2002).

drive reallocation and diversification. The Competition Commission of South Africa is currently conducting a market inquiry into the public passenger transport sector, including understanding market conditions in the minibus taxi and commuter bus segments which are key for transporting low-income commuters to their place of employment. The Competition and Fair Trade Commission of Malawi has also carried out competition assessments for road, air and water transport.

Competition in other input markets shapes earnings, particularly for entrepreneurs in the 'third' sector and for employees in the modern sector. Competition authorities have used both advocacy and enforcement powers to boost competition and allow for entry in key inputs markets. Independent bakeries in South Africa were harmed by price-fixing among major bread manufacturers who overcharged by 7–42 percent on the price of wheat flour.[14] A cement cartel in the SACU region raised cement prices for South African customers by up to 9.7 percent. Enforcement action by the South African competition authorities to end a regional cartel in cement prevented overcharges on the price of cement of 7.5–9.7 percent, saving downstream firms some (U.S.$79–100 million) a year in input costs. The breakup of the cartel was followed by the first new greenfield entry in the sector for 80 years. As well as offering lower retail prices than the incumbents, the new entrant was projected to create 400 direct permanent jobs and 3000 indirect jobs. Malawi's Competition and Fair Trading Commission in collaboration with the Common Market for Eastern and Southern Africa ("COMESA") prevented the establishment of import barriers to cement that would have otherwise prevented the benefits of entry of regional players in a market that was highly concentrated. The Egyptian Competition Authority also recommended easing the entry of imported steel rebar, including reducing customs tariff to zero, relaxing the regulated specification, shortening the administrative procedures from 30 days to 1 day. Consequently, the import share climbed in one year from 1 percent to 23 percent, and prices decreased by 49 percent from 2008 to 2010.

Telecommunications and mobile financial services are other important inputs that have had a transformative effect in Sub Saharan Africa. In Kenya, antitrust enforcement has curbed the exercise of significant market power by the dominant mobile payment services provider, Safaricom, and increased incomes for small agent enterprises. Following this antitrust case in 2014, there was 9 percent fall in agent exclusivity compared to 2013, along with a 10 percent rise in the profitability of agents overall and a 45 percent increase in rural areas. Collaboration between the CAK, the Central Bank and the Communications Authority to develop and implement system interoperability rules is expected to benefit more than 30 million customers with consumer prices set to decrease. In Zimbabwe, the competition authority investigated the mobile financial services market and engaged in advocacy efforts to boost competition in the sector. The investigations confirmed abuse of dominance in the sector, after which the competition authority engaged other sector regulators to address the issue, resulting in a reduction in the cost of mobile financial services and increased access to mobile payments.

Furthermore, reforming regulations that restrict competition in domestic services (telecoms, energy, professional services, and transport) has been found to increase value add and productivity growth of downstream sectors that use those services. In Italy, the removal of price floors and other restrictions on legal services led to greater productivity.[15] The Polish government succeeded in reducing restrictions in 250 professions and eliminating those in 71 professions, which is expected to reduce excessive costs and other barriers linked to entry into regulated professions and contribute to price decreases and employment growth in the long run. In Africa, many rules (or loopholes in the rules) still allow for professional associations to fix minimum prices or enter into other collusive arrangements. For example, in the case of Kenya, following the CAK's rejection of an exemption request to fix minimum prices for accounting services, a law was passed to allow for it. Meanwhile, in Zambia, allocation of construction public contracts through a professional association cannot be prosecuted given a loophole in the competition law.

C. Actions to Boost Competition in Output Markets

Barriers that protect firms in the three core sectors may reduce entry and incentives to achieve productivity gains, and thus inhibit the creation of more and better jobs. In Zambia, actions by the competition commission prevented the exclusion of potential micro-, small-, and medium-scale entrants from the saw-milling market. The CCPC recommended a competitive process of allocating softwood licenses for both existing and potential sawmill applicants, resulting in entry of 500 small-scale saw millers and creation of an estimated 5,000 direct jobs. Within the same sector, the CAK prevented the loss of close to 7,000 jobs provided by 149 sawmills through advocating for pro-competition licensing, which was implemented by the sector regulator. Similarly, the Egyptian Competition Authority advocated with the Ministry of Trade and Industry to reopen licenses for new integrated steel plants that had been blocked for several years, leading to four additional licenses being awarded that would ultimately lead to job creation.

14 Mncube (2013).

15 Pellizzari & Pica (2011).

Another specific feature of competition law enforcement in Africa is the inclusion of public interest concerns in the analysis of mergers. These provisions have allowed competition authorities, for example in South Africa, Kenya and Zambia, to include conditions so that job losses are minimized in the short term after a merger. Nonetheless, this has raised concerns on whether this over-expands the role of competition authorities into labor issues and potentially encourages political interference.

Overall, reforms that increase competition in product markets tend to boost employment in the long term and/or on aggregate largely by expanding output and export opportunities.[16] In Kenya, advocacy action by the CAK helped to remove barriers to entry which almost hindered the development of a new high-value export crop and increase in the returns to farmers. A condition that incumbent tea factories must provide a "no objection" before a license may be issued to a new factory potentially hindered entry of new tea factories, but following CAK's intervention, an investor subsequently established a tea factory which is now exporting to firms in Japan and China. This also allowed smallholder farmers who switched to the specialty tea to realize a 230 percent increase in the price paid per kilo for their product. Reforms have allowed private investments (now there are more than 7 licensed processors) and enabled domestic and foreign investors to develop this high potential export crop that could significantly increase productivity, employment, and farmer income as well as diversify Kenya's export crops.

IV. CONCLUSION

In summary, responding to the needs of the economy, competition authorities in Africa are taking actions that support pro-poor economic transformation, leading to lower inequality. In addition to enforcement actions, authorities carry out market enquiries and advocacy actions to boost competition in key input markets and markets where the poor sell. And even in contexts without a competition framework and enforcement authority, governments integrate pro-competition principles in their rules. Looking into the future, competition authorities could be seen as facilitators of pro-poor economic transformation which should raise their profile in the development and growth agenda.

16 A review of this evidence can be found in World Bank - OECD. "A Step Ahead: Competition Policy for Shared Prosperity and Inclusive Growth," (2017).