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Excessive Pricing and Industrial Development

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Market power in upstream industries

- History matters – we care about where firms are able to entrench dominant positions and exert market power, especially where this is inherited
  - All assessments of the SA economy over last 20 years have identified concentration and weak competition as a problem, and this is legacy of apartheid policies
  - Especially relates to minerals based industries
  - *SCI* decision demonstrates how prior state support also entrenches dominance in adjacent markets
- Has industrial policy come to terms with the interests and power of such firms and the implications for the economy?
- Competition law is possible mechanism to address the conduct of such firms
- Abuse of dominance provisions in Comp Act are about addressing the legacy of existing entrenched positions, disciplining the exertion of market power
- Regarding beneficiation – about removing discrimination against local industry
- Coordinated approach is required where industrial policy, regulation and competition policy play complementary and mutually reinforcing roles

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Why downstream manufacturing matters

- Manufacturing is important for inclusive growth, multiplier effects
- This requires bringing together production capabilities, a conducive environment such as competitively priced inputs, access to finance and appropriate technology
- Industrial policy: transfer of natural resource advantage to the growth of downstream, higher value-adding and labour intensive industries
- In middle-income countries manufacturing growth leads GDP growth; in South Africa it has lagged and non-resource based industry is *especially* poor (just 1.6% pa from 1994 to 2013)
- Clear link between behaviour of upstream firms and the costs of downstream firms

Plastics sector

- Labour absorbing, which grows at rapid rates in industrialising countries,
- SA underperforming peers despite being one of lowest cost producers of basic input required in the form of feedstock propylene for key polypropylene material
- Though not the only factor, the cost of polymers is by far the largest cost (40-60%) and impact on price competitiveness
- Depressed margins in sector compromises firms' ability to invest in up-to date equipment → vicious instead of virtuous cycle

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Excessive pricing & IPP: CC vs SCI case

Why was the case brought?

- The product is important for downstream industry
- Sasol enjoys a monopoly position due to it being a former SoE, leveraged this position in polypropylene
  - SCI's monopoly position in was not "earned" by risks and investment
  - There are significant barriers to entry
  - Priced in line with EPP in the 1990s, IPP from 2000's
  - SA net exporter of polypropylene
  - Low cost advantage a result of past decisions and state support
- Tribunal Decision
  - IPP in this case is the exercise of market power
  - Sasol's prices should be reflective of low costs, cost advantage must be passed on to downstream, particularly because of how cost advantage was acquired
  - SCI's conduct led to lost opportunities for innovation and development for the domestic manufacture of downstream plastic goods
  - Remedy-SCI cannot discriminate by location of customers
- Tribunal imposed penalty but the damages (transfer from customers) are likely higher and amount to billions

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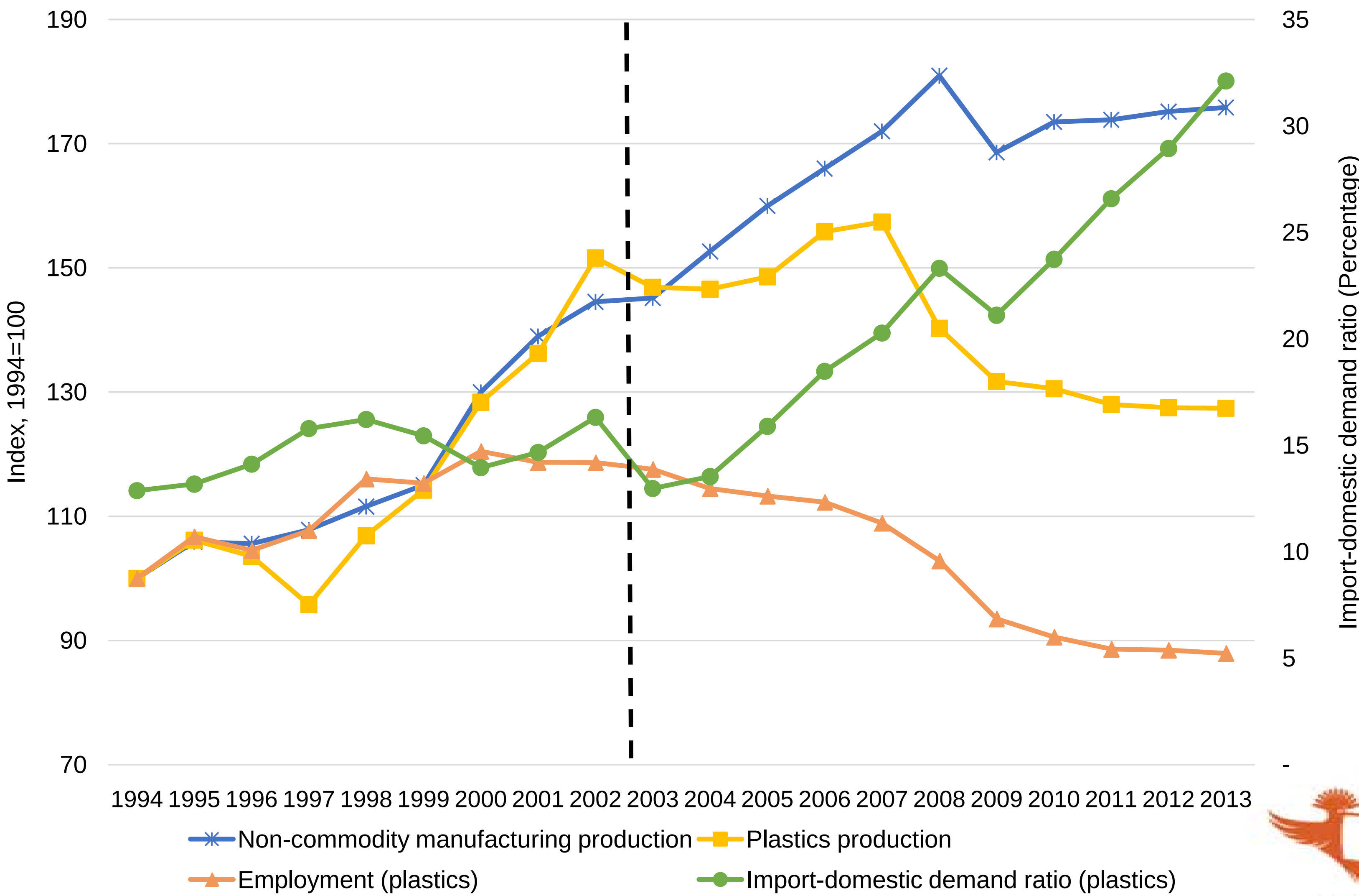
Performance: Turning point in the performance of the plastics sector? 1994-2002 grew at 6%, 2002-2013 contracted by 1%pa, 13000 jobs lost



Non-commodity manufacturing: Manufacturing excluding Basic chemicals, Coke and refined petroleum products, other chemicals and man made fibres, basic iron and steel, basic non-ferrous metals

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Common Misunderstandings

Perceptions	Comment
Beneficiation is a misplaced objective, downstream buyers should not be subsidised by suppressing prices below export prices	PP case: local customers *disadvantaged* relative to exports; challenge is in ensuring export prices
Domestic P > Export P, is common feature of commodity markets	Not necessarily the case e.g. coal, iron ore and maize – prices are at or below export prices, where SA has large exports
Beneficiation does not equal net gains for SA, heavy industry is large contributor to tax revenue	Status quo means profits kept upstream, if downstream industry grows so does tax base, tax revenue and employment
Intervention in upstream markets will disincentivise investments	Upstream pricing dis-incentivises downstream investment. Interventions limited to the nature of the company, its position and acquisition of that position
Previous state support no longer relevant, money has been paid back	Effect of support in certain industries has been the creation of entrenched dominance that has endured into the current times