TT Mboweni: Central banking, competition and concurrent jurisdiction

Address by Mr TT Mboweni, Governor of the South African Reserve Bank, at the Annual Competition Conference, Johannesburg, 29 March 2001.

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1. Introduction

Good evening ladies and gentlemen. I thank you for inviting me here this evening to address this conference at a time when competition policy and enforcement are rapidly increasing in prominence throughout the world. This is indeed a stimulating time for you as you grapple with the challenges that confront you. It is perhaps unusual for a central banker to be addressing an anti-trust conference such as this one. At first glance, the worlds occupied by the Reserve Bank and the competition authority are at opposite ends of the economic policy spectrum. Whereas the central bank is characteristically identified as the guardian of macro-economic stability, the competition authority is concerned with regulating micro-behaviour. This includes investigating and adjudicating business practices and ensuring that the structure of the economy promotes competition and facilitates access.

The importance of the microeconomic sphere cannot be under-estimated. I have mentioned in the past that microeconomic reforms are important in driving the South African economy forward. President Thabo Mbeki noted in his address at the opening of parliament earlier this year, that we have reached the necessary level of macroeconomic balance and stability. He observed that the time was right to focus on the critical microeconomic issues, more particularly the public sector.

2. Complementary functions

A deeper look at the functions and broad objectives of the Reserve Bank and the competition authorities reveals that we share more than is apparent at first glance. We use significantly distinct instruments, but we share a common objective to be attained through our regulatory functions and regulatory tasks – that of promoting growth and enhanced economic opportunity.

Since the central bank cannot realise its key objective of securing financial stability in the absence of soundly functioning financial markets, it has a critically important regulatory function. The Bank has to ensure that the institutions that play a central role in the financial markets understand and abide by the rules that are necessary for the effective functioning of the market.

A case in point was three years ago, when the international economy was hit by the Asian crisis. Many policymakers and analysts insisted that the economic fundamentals of some of the worst-hit Asian countries were sound and bolstered by strong monetary and fiscal policies. Interestingly, some of these countries had experienced high growth and strong foreign capital inflows up to the crisis. However, upon deeper scrutiny, it became apparent that the authorities responsible for macro-economic policy had neglected their regulatory role. It is now widely recognised that inadequately framed and enforced rules, what are now widely called governance problems, and an inadequate regulatory structure underpinned the crises in the countries that once earned the title of the Asian Tigers. From this conclusion, it is obvious to see why the International Monetary Fund's reaction was to focus on regulatory reform in the aftermath of the crisis, and significantly, this focus continues today. The most recent example is Turkey, where an economic crisis has highlighted the pressing need for the restructuring of state banks, a point the authorities are taking in hand and acting upon.

The rules monitored and enforced by both the central banks and the competition authorities are amongst the key pillars of the regulatory framework which are necessary to ensure the effective functioning of an economy. The competition authorities and the financial regulators are mutually responsible for regulating the structure of markets and the behaviour of the market participants. While we both respect the markets, we also realise that, like all other institutions, they require clear and predictable rules for their effective functioning and they require an agency that is able and willing to enforce those rules. The criteria that we use in our regulating function naturally diverge because our immediate objectives are different. But many of the features that are essential to the effective functioning of a central bank are equally necessary for an effective competition authority.

3. Pre-requisites for effective functioning

Two of these shared features are technical competence and independence. Anybody who has worked in a regulatory agency – be it a central bank, a competition authority or a sector regulator – will recognise the immense technical complexity of the work these agencies undertake. We need to attract the kind of staff and inculcate the kind of ethos that produce work of the highest technical quality. If our decisions are to provide certainty to investors and confidence to the society at large, they must be rooted in solid and reliable data reinforced by cutting edge analysis. The pressure to produce state-of-the-art regulation is intensified by the fact that regulators should never imagine that one rule, or one mode of interpretation, is good forever. Regulators work in a dynamic and rapidly evolving environment and their work and policies must be able to reflect this. Regulators must ensure that their rules are respected but they must take care not to become too rule-bound, and in so doing lose sight of the purpose served by the rules. It is relatively easy to provide either certainty or flexibility: to provide both presupposes unusual levels of competence and confidence on the part of the regulator.

Regulators also need to be able to take decisions fearlessly and independently. Much is said about the importance and the necessity of central bank independence. Those who worry about this seem to be primarily concerned about the central bank's relationship with government. They are concerned to ensure that the central bank should not deploy the powerful levers at its disposal simply to assure the short-term popularity of the government of the day. The Constitution determines that the Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice.

Although the instruments of a competition authority are less direct in their effect than those at the disposal of a central bank, the authority will also have to maintain a necessary distance from the public authority if it is to carry out its regulatory task successfully. But it is also important - maybe more important - to maintain independence from the powerful private interests that would seek to influence the way in which a competition authority exercises its functions. I will not review the shortcomings of some of the previous behaviours in the area of banking and financial market regulation – they are well known and we are still grappling with the fall-out. Suffice to say that we are both dealing in an area where powerful, well-resourced private interests will spare no expense in attempting to sway their regulator. This is a complex area because one must certainly be willing to listen to the regulated; but listening to them should not compromise the ability to make independent decisions.

4. The proposed merger between Standard Bank Investment Corporation and Nedcor

I will now turn to a recent example that shows both the dynamic environment in which the Reserve Bank and the competition authorities operate and the interaction between the two bodies. The proposed merger between two of the country's four biggest commercial banks, Nedcor and Standard Bank Investment Corporation, provides such an example. However, it must be pointed out that the situation exposed what may be called a regulatory gap in the regulatory frameworks of the two agencies. This gap is subsequently being addressed.

The Reserve Bank received an application from Nedcor to acquire a majority shareholding in Standard Bank Investment Corporation on 30 November 1999. In this situation, as in others, the regulator must remain objective and not act as a matchmaker or precipitate a trend. In section 37 of the Banks Act the application for a merger and the framework of merger considerations are subject to a formal process which aims to remove as much of the subjectivity as possible. The duty to consult with other regulatory bodies is of paramount importance.

In any application of this sort, section 37 of the Banks Act requires a decision to be made by the Minister of Finance, after the Registrar of Banks has made a recommendation, subsequent to consultation with the Competition Commission. The Registrar also has to engage the two banks in discussions, consult with other domestic and international regulators, and consult with the Governor and Deputy Governors of the Reserve Bank. Further, the Banks Act prescribes that the competition authorities must be consulted on competition issues in an application of this nature. However, prior to the amendments to the Competition Act, which came into effect in February this year, the Act did not apply to applications "subject to or authorised by public regulation". Further, section 54 of the Banks

Act says that no arrangement involving a bank and no arrangement for the transfer of the bank's assets and liabilities, or a part of them, can be legally executed unless the consent of the minister of finance is conveyed through the Registrar. This section does not contain a provision requiring consultation with the Competition Commission.

In applications like these, the Minister of Finance has to be satisfied that the proposal is not contrary to the interests of the public, the depositors, and the bank concerned or to its controlling company. The Minister of Finance rejected Nedcor's bid based on the grounds, among others, that South Africa's already highly concentrated banking sector would be compounded by the merger; the size of the merged bank would affect the banking authorities' ability to contain systemic crises; and the potential social costs, such as job losses, outweighed the efficiency gains of the merger. The Minister of Finance took into account the recommendations of the Registrar of Banks and the Competition Commission, which had both opposed Nedcor's bid on the grounds of pub lic interest.

In this case, the Supreme Court of Appeal ruled that the Registrar and the Minister of Finance had sole jurisdiction over share acquisitions in banks and banking mergers. As a result of this judgement, the Department of Trade and Industry made certain amendments to the Competition Act. It deleted the provision that the Competition Act did not apply to acts authorised by public regulation. Further, the Minister of Finance has the power to exclude the Competition Commission's jurisdiction by issuing a notice.

5. Concurrent jurisdiction

The amendments established a concurrent jurisdiction between the Competition Commission, the Registrar and the Minister of Finance. This concurrent jurisdiction has to be managed with an applicable agreement, according to section 31A, which was inserted into the Competition Act. These agreements must be negotiated with the various regulatory authorities within the relevant industries to "coordinate and harmonise the exercise of jurisdiction over competition matters". But in the case of bank mergers, the Competition Commission's powers are qualified further with the provision that the Minister of Finance is, if he deems it to be in the public interest, entitled to assert jurisdiction over these transactions.

In the light of this regulatory gap and the amendments to the various laws that arose as a result of it, the Competition Commission and the Reserve Bank's Bank Supervision Department met on 9 March this year to begin drawing up a Memorandum of Understanding. This Memorandum would set out how the agencies would proceed under the concurrent jurisdiction framework. Only issues of broad principle were discussed but it seems clear that the Bank Supervision Department will perform its duties in terms of the Banks Act as before, including consultation with the Competition Commission. The Competition Commission would then perform its duties in terms of the Competition Act. Share acquisitions in banks or mergers between two or more banks may legally then only proceed once all the approvals have been granted. Although the principles of the agreement have been fleshed out, the Memorandum of Understanding has not yet been finalised and efforts are ongoing to thrash out the mechanics of the cooperation. We believe this Memorandum of Understanding is a matter of urgency.

This agreement is important for a number of reasons. Among them, that the operations of the regulatory authorities with jurisdiction over the banking sector must in themselves be regulated. Given the importance of the banking sector to the country's economy and financial system, the work and interaction of the various regulators must be set down in an orderly, predictable fashion, so as not to compromise the different interests that arise. And of course, the operations of the regulator must at all times be shaped by the very objectives it is trying to achieve. Among these are to ensure that banks are safe and sound, to ensure that the bank's customers have faith and confidence in the bank and the banking system, and to ensure that banks operate efficiently and effectively.

6. Competition and the economy

It is of course not only the regulatory function that the Reserve Bank and the Competition Commission have in common. The competition authorities and the central bank are both concerned with economic regulation, with regulation that produces desired economic outcomes. Whereas the Bank's interventions are at the macro end of the spectrum, the competition authorities are concerned with interventions in the micro-economy. But both are essential and it is an appreciation of this that accounts for my frequent reference to the importance of microeconomic reform. At the risk of oversimplifying the matter, if we at the macro-economic end provide the stable platform without which growth will not occur, then it is the micro-economic interventions that put in place the key incentives that guide the investment decisions by individual firms, that ensure that the pattern of investment will not only be able to realise the necessary commercial returns but that will also ensure optimal social returns.

Our respective actions and interventions will often be scrutinised against these economic criteria. You will often be judged publicly by those who believe that what is good for them is good for the economy. In fact, this is frequently not the case and some of the sternest tests of your independence will come from those cases where you are forced to defend your actions against those who argue that your actions, by undermining the interests of important firms, are, thereby, harming the economy.

In this light I have been interested to read some of the responses in the media to the competition authorities' activities. Some of these critics are concerned that your activities are not sufficiently geared to the need to build 'national champions'. They are concerned that the price worth paying for the attainment of international competitiveness is the dominance of world class companies in our small economy and that merger regulation somehow repels foreign investors. This is asserted time and again, despite evidence to the contrary. Hence, we know – and Michael Porter's work on Japan is interesting in this regard – that success in international markets is heavily influenced by the extent of competition in the domestic market. It stands to reason that companies that are able to extract monopoly profits in their domestic market will have little interest and, often, little ability to face up to the arduous business of penetrating competitive international markets.

We know that foreign companies find this a difficult market to penetrate precisely because of the high levels of monopolisation. Surely vigorous merger scrutiny is not likely to hit foreign investors who have no presence in this market – on the contrary they will be the ones encouraged to invest by anti-trust merger regulation. In particular, robust anti-trust enforcement will facilitate those previously excluded by the high levels of concentration and by practices that have served to reserve markets for the privileged few.

7. Competition and prices

The regulator's role in ordering a market defined by competitive forces is as much a necessity for the economy and economic stability as is competition itself. Competition enforces a strict discipline on the price formation process. Random price shocks arising from the dominant position of a single supplier in the market are largely prevented through increased competition. Although such price shocks are not inflationary in the strict sense of the word, they do help to perpetuate an "inflation psychosis" because they influence consumers' expectations of future inflation. What usually happens in the aftermath of a one-off price shock, is that the overall price level rises and that during the adjustment process, the actual inflation rate is higher than it would otherwise have been. The rands in consumers' pockets will buy less as they then experience a decline in their purchasing power, all other things being equal. An inflation spiral may unfold if they are compensated for this loss in purchasing power by pay rises, for example.

The immediate price effect of a random shock cannot be controlled by the central bank. For instance, no level of interest rates will be sufficient if a monopoly supplier lifts the price of its product. However, such a one-off price increase can have a knock-on effect and drive up the prices of all other goods if monetary policy-makers are not sufficiently vigilant.

By raising the level of competition in the economic system, one important source of random price shocks is reduced or eliminated. And a major obstacle in the way of a successful counter-inflationary monetary policy will be removed. This is important because, as you know, we adopted the inflation targeting framework for monetary policy in February last year. This means that we target inflation primarily but must also take into consideration the variables that impact on inflation. In terms of the target, CPIX, which is the headline consumer price index excluding mortgage costs, must average between 6 and 3 percent in the year 2002.

8. Conclusion

I have made a real effort to speak to diverse constituencies and stakeholders within the economy, to have them understand why the Bank adopted the inflation targeting framework and why the Bank is sometimes obliged to take decisions that appear to conflict with some of their short-term interests. I firmly believe that we can not carry out our task effectively if the general population is not informed about the framework of our decisions.

The competition authorities, the Reserve Bank and other institutions must be cognisant of the socio-economic factors that dominate the South African landscape as well as be guided by their primary objectives. I note that your legislation allows for elaborate efficiency defenses both in the case of mergers and even in the case of restrictive agreements. Exemptions are permitted for practices that can be shown to promote exports, small business and black economic empowerment. These all represent critical social and economic goals and they may, on a case by case basis, necessitate a departure from strict anti-trust enforcement. But you are entitled to approach requests for exemption with a certain degree of skepticism – after all the best tonic for export growth and for the promotion of access to the economy is, in most cases, likely to be competition itself rather than exemptions from the competitive process.

I wish you well. Thank you.