

  <p>Australian Competition & Consumer Commission</p>	<p>Australian Economic Forum</p> <p><i>Is Competition a myth?</i></p> <p>23 September 2011, Sydney Rod Sims, Chairman</p>
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When I saw the title for this session I was immediately attracted. “*Australian industry structure - Is competition a myth*” can facilitate a broad discussion of great relevance to Australia and on which I am keen to participate both today and in the future.

In my view effective competition is the key driver of both productivity and innovation, and therefore prosperity. With low levels of Australian productivity currently under the spotlight the status of competition and competition policy in Australia should be near the top of the public agenda.

When there is talk of competition policy I immediately think of two aspects. First, the traditional anti trust focus, reflected in, say, the criminal cartel provisions as well as sections 45, 46 and 50 of the Competition and Consumer Act. These deal with agreements and mergers that substantially lessen competition, and the misuse of market power.

Of course, competition policy is more than the traditional anti trust issues; indeed, these essentially protect the competition we have. Competition policy is also about microeconomic reform that takes competition into new areas and which can include the appropriate regulation of monopolies where competition is not possible for one reason or another.

Today I will answer the question posed by making three observations.

Firstly, competition is not a myth in the sense that Australia has achieved a great deal since 1974 when we saw the enactment of the Trade Practices Act (TPA) and the establishment of the Trade Practices Commission.

Second, while much has been achieved, more needs to be done. My friend Fred Hilmer, when he was asked to speak at a recent ACCC regulatory conference, suggested the recent poor Australian productivity performance might be linked to the fact that we have moved our focus away from the role of competition in delivering efficient outcomes. I agree with his analysis.

Third, where competition is clearly a myth, especially in the areas of infrastructure provision where there are monopoly providers, economic regulation is the complement to competition. Economic regulation can, of course, only be a second best solution to an effectively functioning marketplace. However, a natural monopoly providing essential services is going to provide greater benefit to consumers, and the economy as a whole, under a transparent and carefully specified regulatory regime than it will if left to its own devices to preside over a market of one seller and many individual buyers.

I will now address each point in turn.

1. Competition is not a myth and we have achieved a great deal since the enactment of the Trade Practices Act 1974

The 1974 Trade Practices legislation was the culmination of what can only be considered a difficult reform path. In 1965 there was, for example, an attempt to introduce rigorous trade practice legislation but the reforms were watered down in the face of substantial business opposition. The 1965 Act prohibited just two practices – collusive tendering and bidding. A company needed simply to register an anti-competitive agreement with the Commissioner of Trade Practices in order to avoid legal sanctions. By 1974, there were more than 14,000 such agreements on a secret register.

Prior to the 1974 legislation the Australian Industries Development Association, the then peak business body, made submissions on the Trade Practices Bill. It began – “Is Australia ready for the Trade Practices Bill 1973? The answer is, not in its present form”.

The submission went on to challenge what we now understand to be a fundamental clause in the legislation - that a corporation shall not in trade or commerce engage in conduct which is misleading and deceptive - asking what did it mean and was it necessary at all?

The 1974 Act was clearly a significant change. It sought to prevent certain anti-competitive conduct and safeguard the position of consumers in their dealings with producers and sellers, and the position of businesses in their dealings with other businesses.

It was, however, introduced into an economy that was still highly protected from international competition and one where government's role was significant.

The period of stagflation (1973-1983), of simultaneously increasing unemployment and increasing inflation, brought to an end a 'golden age of growth' and what seemed like Keynesian certainty. The long period of expansion had created an overheated economy which was seriously compounded by a massive increase in oil prices. In this troubled period a shift of thinking began to occur towards looking to market solutions.

Indeed, there was a questioning of whether Australia was benefiting from the continuation of centralised wage fixing, continued tariff protection, government ownership of trading enterprises such as Qantas and the Commonwealth Bank as well as rigid regulation and government ownership in the transport and the public utility sectors. Until the mid 1970s, infrastructure services were generally provided by government departments who had a statutory monopoly.

In the early 1980s we had the floating of the dollar and financial deregulation. These reforms increased Australia's exposure to the international economy and highlighted the many other rigidities in the economy.

In the late 1980s Australia began wide-ranging structural reform which I was proud to be part of in the Department of Prime Minister and Cabinet. Tariffs were reduced, industrial relations were liberalised and changes began in many sectors.

The late 1980s, for example, saw the establishment of independent regulation of the telecommunication sector followed by the introduction of limited competition in the early 1990s and full competition after 1997.

The idea that competition between electricity generators could occur gradually took hold and there were the early moves to establish a national electricity market.

In response to rail budget deficits and concerns about the efficiency of intercity rail freight operations, Australian governments agreed in 1991 to establish the National Rail Corporation to provide an interstate rail freight carriage service. Indeed, at the time we complained that Queensland Rail did not include its rail freight assets but that was fortunate in retrospect as QR National is now Pacific National's main competitor.

In the early 1990s there were the first moves to introduce Australia-wide truck user charges and establish the then National Road Transport Commission to begin the move to uniform transport regulation, a journey we are still on.

There were also early moves to liberalise aviation, coastal shipping and the Murray Darling Basin water market. I could go on.

In the early 1990s Mike Waller (currently chair of the Sustainability Victoria and a member of a number of other boards) and Peter Harris (now Secretary of the Department of Broadband, Communications and Digital Economy) came into my office and suggested a wide-ranging review of competition policy. The idea was to institutionalise the gains from the above early reforms and ensure the TPA was also brought up to date with the latest thinking. The then Prime Minister was keen and we called Fred Hilmer to see if he would be willing to Chair the review.

The resulting report, now of course referred to as the Hilmer review, effectively provided a comprehensive blueprint for the implementation of National Competition Policy (NCP).¹ The maxim upon which NCP was based was that the presumption should be in favour of competition unless a public-interest detriment can be proved.

From this set of reforms the ACCC, of course, was established and a more encompassing national approach to competition policy was put in place. This included:

- extending the competition provisions in the TPA so that they applied to activity by unincorporated and State and Territory-owned businesses (in addition to corporations and Commonwealth-owned businesses)
- review by governments of all legislation that restricted competition
- reform of the structure of public monopolies to facilitate competition
- the provision of third-party access to significant infrastructure facilities. This reflected the conclusion in the Hilmer Report that, in order to introduce competition in some markets, it is necessary to regulate access to facilities that exhibit natural monopoly characteristics and to which

¹ Australian Independent Committee of Inquiry, *National Competition Policy* (Report, AGPS, Canberra, 1993) (Hilmer Report)

businesses require access in order to compete in upstream or downstream markets

- price oversight of government business enterprises
- competitive neutrality between government and private businesses when they compete; and
- sector-specific reforms in a number of areas including energy and telecommunications that built on the earlier work.

The NCP reforms cemented a major change to Australia as competition was introduced into formerly sheltered areas of the economy and the TPA was extended to cover almost the entire economy.

The 2004 OECD economic survey of Australia singled out the National Competition Policy reforms as playing a central role in Australia's economic success story, claiming that in "the last decade of the 20th century Australia became a model for other OECD countries".² More recently the 2010 OECD survey suggested that the Australian economy had been one of the most resilient in the OECD during the global economic and financial crisis in part because "structural reforms in competition, product and labour markets in the 1990s made the economy more resilient"³

For the ACCC, the major changes of the NCP have been followed by a series of both incremental and step changes to the Act. Our expanding responsibilities cover mergers, cartels and other anti-competitive conduct, consumer protection and product safety, adjudication, regulation of markets with entrenched market power due to their natural monopoly characteristics, enforcement of water trading rules and a role in relation to copyright remuneration.

The most recent changes to the ACCC's role sees the advent of Australian Consumer Law that reinforces a relationship between competition policy and consumer protection that has for too long been under-emphasised.

Both competition and consumer policies are important for well-functioning markets. Consumers need to be well informed, to be able to assess the information they receive, and to be able to act on that information to drive competition. A single national consumer law has now replaced multiple state laws and the ACCC has new investigation powers and remedies.

So my first point today is that competition in Australia is not a myth. Australia's competition regime stands proudly amongst the world's best and competition or effective regulation exists in many areas of the economy.

2. While much has been achieved, however, considerably more needs to be done to increase competition in the economy

Every year the ACCC holds a major regulatory conference and last year Fred Hilmer was invited to speak. Fred's figures on the percentage changes in

² OECD Survey of Australia 2004, Policy Brief, January 2005, page 2

³ OECD (2010), OECD Economic Surveys: Australia 2010, OECD Publishing, page 22

growth in multifactor productivity showed that, while there had been a significant increase for the period 1991 to 2001 there has been declining productivity growth since the early 2000s.⁴ Many explanations can and have been put forward to explain such a decline.

Fred's argument was that productivity improvement depends on enablers (for example, a more skilled workforce) and incentives (for example, competition policy). Our current approach emphasises enablers over incentives. Drawing on recent international studies and assessing Australia's own policy performance, Hilmer argues that incentives are more important.

While a focus on enablers is worthwhile, renewed emphasis on incentives, particularly competition, is clearly needed if productivity performance is to be improved.

As we know, Australia avoided the worst effects of the global financial crisis. During the early period of the crisis, when the future was uncertain a dialogue occurred between competition bodies in a number of countries about the potential impact on competition policy of an economic downturn. This was in response to the re-emergence of arguments for the old protectionist policies that were repackaged to protect a range of self-interests.

It was notable how quickly failures in one area of the economy were used to argue more broadly for a dampening of the forces of competition in the other parts of the economy.

As the Australian economy was opened to trade in the 1980s, pressure was placed upon the tradeable good sector to be more competitive. A key focus of NCP was on infrastructure and utility reform because, without efficient infrastructure services, the tradeable good sector could not compete in the international economy. We need to continue this argument today as pockets of protection are likely to result generally in higher costs and lower quality products and the weight of these inefficiencies will have to be carried by the rest of the economy.

So how do we sit now in relation to competition policy?

In the traditional TPA arena when faced with the question "Australian industry structure – is competition a myth?" many would focus on the grocery, petrol and electricity sectors. I do not think anyone can see competition in these sectors as a myth, but some important market power does exist and these sectors do require particular focus.

In groceries the recent media concerns seem mainly to do with the effect of the market power of Coles and Woolworths on upstream suppliers; but there also needs to be a focus on consumer outcomes. With petrol it seems little understood that Australian city prices essentially reflect international parity prices; in many smaller markets, however, there may be competition concerns. It is also little understood that electricity price rises have generally

⁴ 2010 ACCC Regulatory Conference, Frederick Hilmer, *Learning from success - Competition Policy and Productivity*.

Available on the ACCC website at

<http://intranet.accc.gov.au/content/index.phtml/itemId/1192781>

been driven by rising network costs, but there may be important instances of market power that need attention.

The question is whether the current Act is up to the challenge. I think it is but, as I have said elsewhere, the ACCC will be taking a strong interest in the many oligopolistic markets that we have in Australia to ensure market power is not misused and, indeed, to avoid any increase in that market power. If we find that any changes in legislation are needed, we will say this.

Some of the issues in these sectors, of course, also go beyond the CCA and go to issues of, for example, planning policy.

It is in the area of microeconomic reform, however, where there is clearly potential. Whenever policy is examined we need to ask whether the proposed changes will promote increased competition and the appropriate incentives for behaviour.

For example, even in the infrastructure sector alone, where much has been done, we can ask:

- do we have the right incentives for road use?
- are pricing signals sufficient to drive appropriate road/rail investment choices?
- can more public services (eg road maintenance) be put to competitive tender?
- is it sensible to introduce some competition into urban water supply?
- are there sufficient incentives for demand management in electricity?
- are the incentives faced by publicly owned energy, water and transport companies better than those that would be faced by well regulated private sector companies?

My second point, therefore, is that there is much more scope to raise competition to the forefront of our national debate and to our thinking in each major reform area.

3. Where competition is a myth - a monopoly is going to provide greater benefit to consumers and the economy as a whole under a transparent and carefully specified regulatory regime than it will if left to its own devices

Promoting competition and effective regulation are complementary functions. The ACCC aims to promote effective competition, and has a complementary regulatory role where markets do not, or cannot, have the foundations for effective competition. When faced with monopoly assets, for example, competition law (the old Part IV and Part V of the Act) is manifestly deficient in yielding good community outcomes.

Economic regulation seeks to encourage efficient outcomes that would be expected within a competitive market. That is, it seeks to encourage the

regulated business to provide the services that customers want at a price that reflects the cost of producing them as efficiently as possible.⁵

I have recently been voicing my concerns about some of the rules in place for regulating the energy market. The poles and wires used to deliver energy to consumers make up 40–50 per cent of the retail price and are currently the main source of rising electricity prices. While network costs rose because of the need to replace ageing infrastructure and to meet rising peak demand, they have risen more than they should have.

It is, of course, essential to provide commercial returns to network businesses to fund the investment needed to meet energy demand, replace equipment that has reached the end of its life, and maintain reliable networks. But we also need to be sure that consumers pay the minimum necessary to meet the costs of safe and reliable supply.

During 2011, the Australian Energy Regulator (AER) examined the rules under which the networks are regulated and concluded that the rules do not strike an appropriate balance between efficient investment and fair charges for consumers. The AER will be shortly proposing a rule change to the Australian Energy Market Commission (AEMC) to redress this imbalance.

It is the role of the independent economic regulator to seek to encourage the regulated business to provide the services that customers want at a price that reflects the cost of producing them as efficiently as possible. This is the AER's rationale for proposing a rule change for energy regulation to the AEMC.

This is also the ACCC's rationale for taking a different position from the findings of the Productivity Commission's (PC's) current draft inquiry report into the Economic Regulation of Airport Services.⁶ While I have a tremendous respect for all that the PC has done and does, on this one issue of when and where not to regulate, I must respectfully take a different position.

The PC's draft report finds that Brisbane, Melbourne, Perth and Sydney airports – and to a lesser extent Adelaide Airport – have "sufficient market power to be of policy concern". It recognises that efficiency losses may result if that power is exercised.

The exercise of market power can result in detriment to Australians in a number of ways.

Firstly, high prices (or low quality) can result in inefficient under-utilisation of airport infrastructure and services, including by consumers, business travellers and tourists. Secondly, firms with market power may inefficiently under invest, so that demand for their services will exceed supply, leading to further potential for increased prices. This can also lead to underinvestment in

⁵ Arguments for the economic regulation of Australia's water sector are carefully and succinctly explained in a submission from the National Water Commission to the Productivity Commission (DR130). This is available at the following link <http://www.pc.gov.au/projects/inquiry/urban-water/submissions>

⁶ The draft inquiry report can be found at <http://pc.gov.au/projects/inquiry/airports-regulation/draft>

related markets. Thirdly, distributional effects are of concern to the community and consumers, especially as they may ultimately pay for any monopoly rents.

Under the current regime, the ACCC monitors the major airports. Airport monitoring reports in recent years have identified trends that indicate the exercise of market power at some airports. Unfortunately, monitoring can identify areas of concern, but it doesn't do anything to actually constrain the use of market power.

The PC's draft report recommends continuing monitoring as a solution, plus the additional ability of the ACCC to propose price inquiries under Part VIIA. But it seems unlikely that yet more monitoring and inquiring will do much to constrain the use of market power.

A more effective solution is needed.

For this reason, the ACCC has proposed an approach to encourage true commercial negotiations between airports and their users, free of the use of market power. The ACCC's proposal includes providing arbitration as a fallback through the use of Part IIIA of the Competition and Consumer Act. The existence of a credible ability to call on arbitration restrains the ability to use market power. At the same time, practical experience – including in the aviation industry itself – is that it promotes negotiated commercial agreements, since the parties tend to prefer to negotiate an outcome.

Concluding comments

The Hilmer review provided some clear reasons for the establishment of the ACCC as an organisation that covered competition law, consumer protection and economic regulation. Resource constraints was one rationale; to devote resources to one organisation rather than many smaller bodies. The other major rationale was the philosophical position that the component parts are all part of a competition focus. The best way to help consumers is to promote competition. Where effective competition is not possible then regulation is needed.

Under my chairmanship, the competition focus will be maintained and I do see it as part of my brief to be a sometimes noisy advocate for competition.

In a speech eight years ago John Vickers, Chairman of the UK Office of Fair Trading, introduced a speech in the following way:

"In 1853 William Gladstone, then Chancellor of the Exchequer, introduced an important measure on competition policy. He initiated reform of civil services recruitment so that entry was open to competition on the merits of the candidates. Queen Victoria, unamused, asked: Where is the application of the principle of public competitions to stop?"

Let's hope there is no end to the role of competition in our economy.

Thank you for your time today.