Australian Competition and Consumer Commission

Promoting Competition and Fair Trading

2004 Sir Wallace Kyle Oration

Competition and the Australian Way of Life

Graeme Samuel, Chairman

It is a great honour to be invited to follow in the footsteps of people like Edmund Hillary, Weary Dunlop and Gus Nossal – to name just a few – in delivering the Sir Wallace Kyle Oration.

Wallace Kyle was a truly great Australian – a boy from the Kalgoorlie goldfields who became Air Chief Marshall of the RAF, before finishing a lifetime of service back home in Western Australia as Governor.

He was one of that extraordinary generation of Australians called upon to serve his country in its greatest crisis – the second world war – and who were not found wanting.

His is a life that in all senses lives up to the Rotary motto of "service above self".

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In his superb "History of Britain", historian Simon Schama recounts how James the First opened up trade between his newly united kingdoms of Scotland and England.

> *"Once a ferocious border policing commission was in place and had started to catch, convict and hang the gangs of rustlers and brigands who had made the Borders their choice territory, cross-frontier trade took off. Fishermen, cattle-drivers and linen-maker all did well. Duty-free English beer became so popular in Scotland that the council in Edinburgh had to lower the price of the home product to make it competitive."*

Now a day, when we catch and convict those who seek to restrict competition and erect unfair trade barriers we prefer to penalise and shame them through the media rather than hang them. However, the benefits that come from removing barriers to trade and competition are just as apparent in Australia today, as they were to Scottish beer drinkers in the early 1600s.

For more than a decade now Australia has experienced consistent strong rates of economic growth.

When compared to other OECD countries, Australia has done very well. For example, during the past seven years Australia's annual rate of growth, at constant prices, averaged 3.8 per cent. This compares to 3.2 per cent in the United States, 1.4 per cent in Germany, and 2.3 per cent in France.

Unemployment is at a 20 year-low, interest rates remain close to the lowest levels in over 30 years, and we have seen the unprecedented development of:

- High value, sophisticated professional services in the areas of health, education and the law, including the export of those services;
- A dynamic tourism industry;
- The production of high quality food and drink, such as high quality wine (rather than more of the same, old, tired thing);
- The provision of consumer choice: of goods and services that consumers actually want – at a time they want it, and;
- The supply of innovative personal services, which improves the quality of life of consumers.

This has not come about by chance.

It is the results of over two decades of work to make the Australian economy more flexible, more productive, and more resilient.

Spurred by innovations in communications, financial services and information-based technologies, Australian firms now compete against the rest of the world. Our markets are no longer sheltered by barriers of information and distance; with the integration of markets, world's best practice is the new benchmark for efficient supply.

Some have argued that this strong performance was largely the result of a long-time American expansion and technological change. Basically, this pursues a self-deprecating view that, whilst our economic vices are all our own, our virtues emanate from elsewhere.

The factors that usually explain high rates of growth – market opportunities and stability in the economies of trading partners, capital investment and technological change – do not explain why Australia has done so well. We know that, amongst our trading partners, there have been recent periods of economic dislocation and disruption. Moreover, we know the United States economy has been prone on its haunches for a while, and that Australia enjoys no monopoly on capital equipment or technology.

We can conclude, therefore, that Australia itself must have been doing something right.

Sharper competition, a greater openness to trade, investment and technology, and increased business flexibility have boosted Australian productivity.

Unlike the 1960s and 1970s, our productivity performance during the 1990s was not part of a world-wide productivity boom. Australia was one of only three countries to experience a strong acceleration during the 1990s. We made productivity gains of three per cent per annum.

In fact, improvements in productivity during the 1990s have raised annual household incomes, on average, by about $7,000.

This is nation building stuff.

The removal of impediments to growth and competition allowed Australia to reap the benefits of global change. I think most people now agree that Australia's remarkable resilience during the Asian economic crisis of the late 1990s had much to do with the leaner, more flexible economy that had developed as a result of wide-ranging micro economic reform.

So we can safely conclude that the Australian experience makes clear that the nations that prosper will be those that adapt quickly to changing demand and supply conditions.

But as impressive as these results are, economists and policy makers acknowledge that there is still a way to go. We know that economic reform has generated clear public benefit. Our challenge is to ensure it continues so that we can maintain high levels of economic growth and create more and better jobs.

Although policy inertia might temporarily delay economic pain and uncertainty, the clear evidence is that economies that fail to adapt, and adapt again, and then readapt are punished, most profoundly, by their own deadweight.

So there can be no turning back the clock.

The reimposition of trade barriers would require the taxing of the inputs to our own industries, and the removal of the disciplines of competition. This would insulate us from the very impetus needed to sustain growth and employment in the years ahead. The isolationist approach is the road to becoming an economic backwater. History has shown that the costs fall heavily on those least able to shoulder the burden. Few countries would now even contemplate the idea.

In any case, even if we wanted to isolate ourselves again, Australia's interest rates and exchange rate – major influences on the well-being of all Australians - are now shaped by global capital markets and international perceptions of our responsiveness to the challenges of global change.

Now the task of quantifying the exact benefits and costs of economic reform is notoriously tricky.

But in general, the evidence I have already quoted allows us to confidently assert that opening up Australian business to market forces and the disciplines of a competitive market place has delivered real benefits. And as such, it has contributed in a substantial way to the stability and security of the nation.

So I believe the question now is not whether or not we should resist further change, but how we can best manage the forces of change to achieve the best possible outcomes for society. In short, given that we are surrounded by swirling and monumental change, the sensible course of action is to take control of our affairs.

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Now, I do not claim here that every proposal for reform that improves business competitiveness is desirable, or that every suggestion by an economist should be given credence.

It is true that competition will generally improve economic efficiency and community welfare. But this does not mean that considerations of equity, which sometimes are to be addressed at the cost of efficiency, should be ignored.

Nor does it mean that the benefits of reform will never be outweighed by associated costs, or that market failure does not exist or that it never warrants regulation by governments.

Certainly the role of the Australian Competition and Consumer Commission would be far simpler if this were the case.

So an important task for governments is to determine whether or not economic reform brings a net community benefit, and is not just reform for the sake of reform.

In doing this, governments must consider an array of community interest matters, including the environment, employment, social welfare, regional development and consumer interests as well as business competitiveness and economic efficiency.

The challenge for governments is to focus on outcomes that benefit the *community as a whole*, rather than providing special treatment for certain groups at the expense of consumers generally. At the same time, the impacts of reform on the individuals, regions and industries directly exposed to reform must be taken into account. It is also important that any trade-offs between the interests of different groups are made explicit so that governments can objectively consider the case for adjustment assistance to those who bear the costs of reform.

Of course many reforms that proceed on the basis of net community benefit will nonetheless impose costs. The same can be said for the process of change more generally. Global change, in combination with economic reform, is contributing to an expanding – and more robust – economic cake, but the shape and flavour of the cake is undergoing continuous change. In the process, cake ingredients are being substituted and rearranged, and some are losing their relevance in the mix.

In the short-run, the benefits of change and reform are reaped by those able to capture them through skill, initiative, resources and adaptability. In the long run, the benefits accrue more widely through economic and employment growth, in turn generating resources needed to fund welfare, education, health and other social priorities. But amidst this, economic change is also downgrading the relative values of some skills and eroding job opportunities in some of the industries directly exposed to change.

In socio-economic terms this means that, amidst aggregate production, income and employment growth, particular segments of the community will inevitably bear an excessive burden.

The old world of protected markets engendered feelings of comfort and certainty. Now, instead, many people feel a loss of power over their lives, not knowing whether they will still have the same job, or whether their small business or farm will be viable in the future. The global market can deal harshly with those that do not make the cut. Some industries and geographical regions may lose their economic viability.

The needs of communities to adjust to changes have often created significant challenges for those who have been instrumental in bringing about the changes – in particular, governments and business.

While policy reforms have aggravated hardship in certain industries or communities, the underlying issues are much broader. For example, the viability of some rural communities has been threatened due to a combination of a long-term decline in commodity prices, changing preferences among people to live near the coast, and advancements in farm technology. As agricultural markets become more integrated, producers with an eye for innovation, niche markets and cost-effective technology will do well; but the challenges for producers will certainly increase.

Whether adjustment costs flow from government policies or the wider process of change, a society split between haves and have-nots is simply not acceptable, no matter how much benefit is accruing in aggregate. Managing these changes must therefore go beyond the facilitation of change and must now work as an intrinsic process to see an equitable sharing of the economic rewards of the global market place.

The alternative – to accept the global market as both the engine of wealth and the ultimate arbiter of distribution may not be a sustainable proposition in the long run.

The biggest losers from change – people who have lost their traditional livelihood – can suffer swiftly and severely, and are often able to mobilise opposition to further change.

Against this, the beneficiaries of change and reform are millions of consumers who gain access to lower prices and better services. The beneficiaries also include producers whose input costs are lowered through reform, and people who find employment in the industries that grow off the back of these changes.

Given that the benefits to each individual may be relatively small, may flow through in the longer run rather than immediately, or may be too remote from the original cause for a link to be obvious, it's not surprising that we don't see street rallies demanding change and reform.

But the silence of the majority can give opponents of change considerable leverage in mobilising public and political opinion against change. This only adds to misinformation and confusion in the community that globalisation is a new and corrosive phenomenon – rather than a new stage in a process that has been evolving for centuries. And factors like immigration, international trade and policies of economic reform become scapegoats for the fallout from change, when in fact they are helping Australia capture the benefits of global change.

What this means is that a society that relies purely on market forces to distribute the benefits of change will inevitably sow the seeds for polarisation and resentment. Ultimately, this feeds into social dislocation and political instability.

However, developments in the global economy mean that Australia cannot afford to turn its back on a robust programme of economic reform. We need to make ongoing efforts to maintain our competitiveness in what is an increasingly cut-throat global marketplace.

So, on the one hand we are presented with a community need and desire for increased fairness. But on the other the imperatives to maintain or improve our economic performance remain.

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These developments all have implications for those of us concerned to see governments continue to pursue a robust and comprehensive programme of reform. It has implications in determining what reforms we undertake and how we manage their implementation.

The need to foster fairness does not mean that we should divert from a commitment to sound economic reform. After all, as I have indicated earlier, most reforms that improve our economic prosperity will also improve fairness. And there are often smarter ways of achieving fairness than cutting back on economic reforms that have some adverse side-effects for fairness. We need soft hearts, certainly, but we also need hard heads.

And so we really need to think smarter about what range of policies will give us the most prosperity with the most fairness and, where they are at odds, the policies that will strike the best balance.

Helping people adjust to change must become an integral part of reform. It is imperative not just on moral and equity grounds, but to help communities feel more optimistic about their ability to adapt in a world where ongoing change is a part of life. Perhaps, most important of all, sensible change management ensures that people don't feel that they have been forgotten or discarded by the rest of the community.

As Nobel Laureate Amartya Sen points out, global change can generate the resources needed to alleviate poverty and marginalisation, but it takes commitment and vision to achieve this end result.

Critically, governments must not undermine the incentives to create and innovate, for these are the very generators of wealth. The best safety net of all is a strong economy able to provide jobs. And while traditional safety nets such as social security, public health and education are important, what is also needed, in the face of rapid change, are opportunities for people to adapt so that they can play an active role in the dynamics of change.

Managing change involves advice and assistance (personal, business, financial and even psychological), retraining, re-skilling, and access to services. It may mean things like access to venture capital for entrepreneurs keen to invest in a depressed region. It may mean replacement of lost services with alternatives such as enhanced communications infrastructure.

Technological progress and engagement in world markets offer very substantial benefits to Australians. Indeed, more than enough benefits to be shared by everyone. Well implemented, economic reform that has as its foundation a public interest objective, provides the means to deliver improved living standards for the whole community. But governments must go beyond facilitating and implementing reform to also ensure that the benefits are shared equitably.

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In all of this, what then is the role of business?

Increasingly over recent years, our political and community leaders have been exhorting Australian businesses to assume a greater level of corporate social responsibility. For reasons I want to outline in a moment, I think the expression corporate social *sensibility* is a better one.

Now many in business take the position that business responsibility should remain focused exclusively on returns to shareholders. In this they are inspired by Milton Friedman, who wrote more than thirty years ago that "… the social responsibility of business is to increase its profits."

According to a view popularised by Richard Lambert, Editor of "The Financial Times", Friedman held that the social responsibility of directors and executives was discharged if they contributed towards the operation of a vibrant business sector. Now, this interpretation is not entirely correct – in a sense, Friedman has been verballed by Lambert - but it does accord with opinion widely held in the business community. The corollary of such an opinion is that governments alone should look to concerns of justice and "social legislation".

Now there is a good argument that, if shareholders wish to direct some of their returns to philanthropy, or in fulfilling a social responsibility, that is their right - that it is not the place of company directors to make those decisions on their behalf.

However, taken to extremes, such positions are surely myopic, ignore the lessons of history and, perhaps more starkly, fail to read the clear messages that have surfaced over recent years in the Australian social and political scene.

Lambert describes three main reasons for companies to adopt a level of corporate social responsibility:

- Reputation – a company's reputation can enhance or destroy the value of its brands, especially in the area of consumer products,
- Internal morale – providing assistance in recruiting, training and retaining the best employees, and
- Improving the competitive context and thus improving the long-term business prospects of a corporation

By enhancing reputation, morale and the long-term business prospects of a corporation, a company serves the objective of increasing shareholder wealth.

While I think that each of the above can provide justification or comfort to company directors in pursuing a socially sensitive and sensible policy in conducting their business affairs, it seems to me that each of these support rather than debunk Milton Friedman's views. For they are all focusing on an ultimate objective of increasing shareholder wealth through improved corporate business performance and competitiveness.

But business does not operate in glorious commercial isolation. The ethics of profit maximization do not replace the ethics of honesty and competence, of compliance with the law. Business, whether it realises it or not - whether it wants it or not - exists as a full participant in the Australian community and has a responsibility to develop a social sensibility.

Interestingly, Michael Porter and Mark Kramer have argued in 'The Harvard Business Review' that in a world of open, knowledge-based competition, "… companies do not function in isolation from the society around them."

And it is this theme that, I suggest, should be pursued more vigorously in the increasing debate concerning corporate social responsibility or sensibility.

For if we continue to focus our discussion in relation to this issue on the ultimate business or wealth accretion benefits to a corporation and ultimately its shareholders, we will inevitably lead to a very narrow view of corporate social sensibility that is singularly focused on the ulterior objective of wealth accretion. For business, as a full participant in the Australian community, has a social responsibility – or rather a responsibility for social sensibility.

What does this mean in practice?

In the first instance, I think it demands of business a sensibility and responsiveness for those actions that have pervasive impacts on the community.

I am wary about describing this as a corporate social responsibility. The very use of the expression "responsibility" raises an inherent conflict with the legal responsibilities of directors to act in the interests of shareholders. We therefore end with a legal debate that tends to divert attention away from the fundamental message

– that there is a community expectation that business will act with a sensibility and responsiveness for its actions that impact on the community.

Corporate social sensibility is a business imperative as well as an altruistic nicety. It is not so much about cheques as it is about attitudes, social involvement, and sensible, socially responsive business management.

For business, as a full participant in the Australian community, has its role and responsibilities defined by more than public relations jargon.

We need to recall that the corporation was primarily designed to enable a group of investors to join together and make a common business pursuit by way of a legal entity. This entity, the corporation, provided the benefits of limited liability, continuity of existence and simplicity in contractual dealings.

Investors collectively appoint their agents, the board of directors, to manage their common business pursuit. But we should not forget that the interposition of the corporate being and its board of directors, is a legal convenience, indeed a fiction, which does not negate the reality that this is ultimately a collection of individuals in our society, albeit with a common business pursuit.

No-one would deny that individuals in our society, both separately and collectively, have social obligations. A functional and coherent community requires more of its citizens than mere adherence to the rules and an ethos that individuals can do whatever they can get away with. A sound community relies on the acceptance of the social and economic objectives behind the rules.

These principles apply to all individuals, whether acting separately or collectively, in joint venture, partnership, or through a corporate form.

The second point is practical in nature, and reflects the way society and governments operate. Just as a lack of community support for reform can stop or impede reform itself, so can a community, through its government, load business with a heavy regulatory burden. A business community that abjures social sensibility runs the risk that governments will intervene to address the community's needs through regulatory requirements. This is the nature of the government beast, and is not without significant cost.

My late father in law, a property investor, used to say in relation to his tenants, that if you squeezed the orange too hard you would get the pip.

It's an analogy that I believe applies to all areas of life, and in particular, business and the way it conducts its relations with its suppliers, its competitors and its customers.

Primarily of course business is obliged to act at all times in the interest of its shareholders. Some have interpreted this as maximising shareholder wealth.

But business needs to be aware of community expectations, for it is those expectations that, if they are not met, can cause governments to introduce new laws which may hamper the capacity of business to act in the best interest of its shareholders.

To paraphrase my father-in-law, if you squeeze the shareholder wealth orange too much to get every last ounce of juice out of it, then there's a risk that all they will end up with is the pip of a community backlash.

Let me emphasise at the outset this is not a discussion about corporate social responsibility. Rather it is inviting business to consider the real politic of the political environment in which business operates.

One has only to look at the increasing level of regulation relating to the environment, occupational health and safety, and recent demands for regulatory requirements covering executive salaries and other issues of corporate governance. In each case, governments are being asked to respond to a perceived default by business in addressing social needs or community concerns and expectations, or assisting the community to adapt to decisions made by business in response to inevitable economic technological and social change.

I do not say here that business decisions should be guided entirely, or even significantly, by social considerations. Indeed, the capacity of business to generate national wealth derives significantly from its ability to respond quickly to market conditions. I am therefore very cautious about embracing notions of triple bottom line reporting or ethical investment guidelines. It seems to me that these notions run the risk of providing simplistic legal challenges for corporate boards and management that inevitably will lead to a diversion from fundamental principles of good business management and to a box-ticking mentality. This would contradict the attitudinal and behavioural mindset that is appropriate to the values that I have described earlier.

It is easy to take a narrow view – to focus exclusively on returns to shareholders.

But it is just as easy to get excited by rhetoric, to demand the kind of corporate behaviour and social responsibility that may backfire on businesses' ability to survive and thrive.

I acknowledge a very real tension – one that is difficult to resolve.

But it's better to concede that tension, and to acknowledge that reconciling the legal obligations that companies have with their sensibility for evolving social and community values, is not a task that can be avoided.

Ultimately the business leaders who best respond to this challenge will find that their business success significantly reflects the sensibility and responsiveness of their relationship with the broader community.

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Three key themes emerge when dealing with the question of how best to implement and manage economic reform.

The first is that we cannot avoid change. The world will no longer allow us to sit on our hands while the dollars grow on our sheep's backs, for instance. Change is hard for all of us, but it is inescapable.

There is a need to recognise the nature of our economic situation as a small trading nation in a changing world, dependent on trade to maintain our living standards. It is simply unrealistic to cut ourselves adrift from the rest of the world. In our circumstances, change *is* a reality, not an option. We can tackle it or let it tackle us. We therefore need to ease and facilitate change, and address real and tangible social costs.

It would both unfair and ultimately self-defeating to seek to halt the process of reform indefinitely: because sheltering one area of life from the realities of change simply shifts the costs to other people and ultimately makes us all poorer. We would avoid change only at a greater cost to our own future.

On this, we would do well to recall the message attributed, I believe, to St. Francis of Assisi:

> "Grant me serenity to accept the things I cannot change, courage to change the things I can, and wisdom to know the difference."

We need the wisdom to know that we cannot stop the world changing, and the courage to act to make the most of our changing circumstances and opportunities.

The second point is that there are few straightforward answers. When it comes to change, there will always be differences of opinion on what is the best way to deal with it - what is the best course of action to take.

This implies that before we endeavour to implement change, we must recognise that other sections of the community may not share our views. Indeed, in many instances they may not have considered the issues from our perspective or, indeed, from any other, and need first to be informed and ultimately convinced as to the need for change. These views need to be discussed in the community, to develop an understanding that there is a problem that requires to be fixed before an attempt is made to promote the merits of a solution.

The approach to any problem must recognise and reflect the interests of all elements of the community, individually and collectively, rather than the narrow interests of a reform proponent. Why should anyone support, or even acquiesce in, a reform measure that involves no apparent benefits and perhaps a few risks? Ideally everyone is a winner. Or, more realistically, there are substantially more winners than losers. And even the losers can be shown to have been treated fairly and equitably.

And this leads to the third and final point - the importance of addressing fairness, as well as economic prosperity, when considering government policy. As I have said, this does not mean that we should abandon economic reform. Nor does it imply a descent from robust wide-ranging reform into populist policy palliatives. But it does mean that we need to recognise and address the trade-offs that will sometimes emerge between fairness and prosperity objectives, and ensure that we choose the right policy mechanisms to pursue these community goals. And this applies in all areas of reform, whether it be tax, competition, labour market policies, the bush, or social areas.

Australia must continue to make progress in established reform areas and ensure the right processes are in place for identifying, assessing and managing any future reform processes. First, reforms need to be identified in a transparent way. Governments must also commit to implementing any new reforms with full and explicit consultation. And last but not least, mechanisms have to be in place that maintain the momentum of reform and manage the effects of change. This approach values the fiscal/human nexus by placing the focus of economic reform where it should be – on human beings.

Evolution in modern times is a quiet beast - especially economic. We learn where we are going as we go. We can't predict the future because the world is changing too fast.

Past changes become so integrated into the fabric of our social structure that we can't recall a time we were without them. They create benefits and can, as a result, also reveal or highlight problem areas of which we were not aware. In other words, we cannot know what will emerge from that which is not yet built.

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I began this speech by declaring my belief that competition and the opening up of the Australian economy had been unambiguously good for this nation and its people.

Now, some might suggest this is not an entirely unexpected thing for the head of Australia's competition regulator to say.

But the truth is, I don't support competition for competition's sake, or even because the law requires me to promote competition – but rather because I fervently believe that competition is crucial to the economic well-being of this nation, and the quality of life for all Australians.

I fervently believe that the opening up of our economy has likewise delivered genuine and ongoing benefits to this nation, and that not only would turning back the clock be disastrous, but that if we wish to maintain those benefits, we must continue to reform.

I fully recognise that every reform has to be judged on its merits and on its benefits to the whole community – the public. And that many reforms that proceed on the basis of net community benefit will impose costs on some members of the community.

Those harmed by economic reform, or at least, perceive themselves to be harmed by it, are always going to be louder than the beneficiaries.

There will never be demonstrations outside supermarkets or at IMF conferences by supporters of economic reform demanding greater deregulation and faster free trade agreements!

It is therefore incumbent on those who are the beneficiaries of reform to ensure that the benefits are, as far as possible, spread around the community.

As I said at the outset, this is not just philanthropy, or social responsibility, but good business sense.

Only by ensuring that the benefits that flow from a more open and competitive economy are spread to all will reform fatigue be avoided, and community support continue for the changes that are needed for our economy to continue provide the profits, jobs and continuing improvements in living standards.

Business does not operate in isolation and whether it wants it or not - exists as a full participant in the Australian community.

So I say to business – the choice is yours. Continue the relentless pursuit of profits and shareholder wealth without regard to community concerns and expectations and you will be left with the pip – government regulation.

Or, listen to the community, become a full player in Australian society and take control of your own destiny.