Address to the Committee for the Economic Development of Australia

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Introduction

It is timely as we approach the start of another financial year, that I review major topics of interest to the Australian Competition and Consumer Commission, the consumers – including small business - it protects from any lawful anti-competitive or misleading behaviour and try to identify emerging challenges.

The Commission believes the time has come for serious consideration of criminal sanctions, including imprisonment, in relation to hard-core collusion.

Such penalties are the only realistic deterrent for hard-core cases of collusion. They would apply to the most serious and profitable acts of collusion such as price fixing, bid-rigging and market-sharing.

In the worst cases they are deliberate, secret acts of dishonesty, which indirectly impact on consumers and small business through over-charging. Price-gouging of this kind is a form of theft but it also seriously impairs the operation of free markets which are intended to operate in the interests of the public.

Such a move would bring Australia into line with a number of its major trading partners including the United States, Canada, Japan and South Korea that regularly impose criminal sanctions for collusion.

Let me make it clear that these stronger sanctions would not apply to small business or trade unions – they would be aimed at major business engaging in practices such as price-fixing or market sharing.

The relative leniency of Australia's penalty regime leaves us exposed to enormous risks in the global economy. Because Australian markets are comparatively small by international standards and tend to be characterised by high levels of concentration, they are particularly vulnerable to the detrimental effects of hard core cartels. It is crucial to the future integrity of Australian markets that these multinational firms, which operate in major foreign markets with much tougher penalties, do not come to see Australia as being soft on serious hard core collusion and anti-competitive conduct.

If the ACCC, as the competition law enforcer, is to effectively deter and properly punish this sort of behaviour in the future, it must follow the lead of several of our major trading partners and consider imprisonment as an additional sanction for

executives who engage in these highly profitable, hard core breaches of the restrictive trade practices part of the Act, specifically, conduct that is caught by sections 45A (contracts, arrangements or understandings in relation to prices) and probably 4D (exclusionary provisions).

The vast majority of Australian businesspeople have nothing to fear from a stronger law, as the vast majority is not engaged in anti-competitive behaviour. They, in fact, should welcome it. Moreover, it is not proposed that the criminal sanctions would apply across the board to all breaches of the Trade Practices Act but just to defined acts of collusion the burden of proof would be criminal ie. proof beyond reasonable doubt.

For the most part, the Trade Practices Act works well and it is not suggested that the present system be radically altered. It is just that it has a weakness for extreme collusive behaviour and the possibility of imprisonment would have a more powerful deterrent effect than fines as other countries have found.

There are troubling signs of an increase in hard core collusive activity internationally (and locally) which will not be deterred by anything other than true criminal sanctions, including imprisonment.

When one considers the large and quick potential gains to be made from cartels, the current maximum penalties are not sufficient to deter deliberate, determined hard-core collusive activity by large, profitable multi-national companies. Just look at the recent vitamins price-fixing cartel, which reaped multi-millions of dollars for its participants over many years.

With a rise in such international cartels, Australian executives of powerful multi-national corporations, should be given the clear message that their participation in hard-core collusive activity would see them facing the same serious criminal consequences as in the US, Japan, Canada or South Korea, that is, imprisonment. Also, the current maximum penalty of $A10 million could be reviewed with an alternative provision for a 10 per cent penalty on turnover, as is the case overseas.

Collusion is still occurring on a significant scale in Australia. For example, the Commission’s recent court action against the largest price-fixing cartel in Queensland resulted in penalties and costs exceeding $15 million. The case involved 38 individuals and more than 20 companies in the Queensland fire protection industry.

At industry meetings known as the “Coffee Club” decisions were made on pricing and who should submit the lowest bid for fire sprinkler installations projects as they came up for tender. The “lowest” tender was higher than it would have been if there had been no collusion.

There was obviously some merriment because the coffee club met at sports clubs, golf clubs and hotels, no doubt having a convivial ale before discussing how to conspire against the public and raise prices.

The representatives of companies penalised by the Federal Court last July for the price fixing of fittings and valves for DICL pipes actually met in a coffee shop in the Brisbane suburb of Hamilton. It is alleged that one general manager declared that “if we all maintain our market shares and lift prices, everyone should be happy”. The term “everyone” is rather sweeping, the company’s clients would not have been happy at discovering they were victims of a conspiracy.

The Trade Practices Act specifies that the Commission’s role is to “enhance the welfare of Australians through the promotion of competition and fair trading and the provision of consumer protection”. The coffee shop conspirators rarely have consumers, domestic or business, in the forefront of their minds. Their thoughts are on market domination that can mean charging higher prices to consumers and paying less to suppliers.

The cost to consumers can be enormous either directly in what they pay to the offending companies for goods and services or indirectly in the higher prices charged for the products of third companies who deal with the conspirators.

The Federal Court of Australia earlier this year, fined three multinational suppliers of animal vitamins a record $26 million for a price fixing conspiracy that had continued world wide for over a decade. The Court banned company representatives from meeting to discuss market pricing for four years while customers will proceed with a $100 million class action. The business customers were mainly farmers and, in many cases, their higher costs would have been passed on to those buying their produce at supermarkets.

We must also continue to review and revise civil penalties to ensure they remain a relevant and effective deterrent in the global economy.

We must also look again at the application of civil penalties to Part V [consumer protection]. The consumer protection part of the Act has curiously almost the reverse position and problems of the competition part of the Act. Breaches of consumer protection provisions do not attract the kinds of civil penalties that currently apply in the restrictive trade practices part. It is possible to get criminal penalties in the form of fines (but not jail sentences) for Part V offences. However, the arguments that justified the application of civil penalties to Part IV [restrictive trade practices] are equally compelling in relation to Part V. The Commission sees case after case where companies have breached Part V through a failure of compliance that is so serious and widespread that it cries out for a pecuniary penalty, but still does not amount to the type of conduct that would justify criminal action. As with Part IV, civil penalties for contraventions of Part V will ensure that would-be offenders are deterred, victims are compensated and justice is done promptly, effectively and at the lowest possible cost to the taxpayer.

The Australian Chamber of Commerce and Industry

The Australian Chamber of Commerce and Industry has today seemingly rejected Commission's calls for jail sentences on the ground that the case has not been proven. However they have quickly gone on to discuss an unrelated issue, possibly confusing people in doing so. There is an inquiry being held by the Productivity Commission concerning Prices Surveillance.

The ACCI has criticised the role of the Commission in relation to GST pricing, claiming that the Commission may have been responsible for some of the slow down in the Australian economy. The Commission makes no apologies for the role it played in relation to GST pricing and believes that there is strong community support for its actions. However we do not agree with the suggestion that we were in any way linked with the slow down of the economy. Our role was to prevent over-recovery of the taxes. We do not believe that we were a contributor to any under-recovery of tax changes. Any under-recovery was due to other factors including market forces. Indeed one school of thought says that the Commission's publicity made many businesses more aware of the impact of tax changes on them, and quicker to feed in the effects of tax changes than otherwise. An important positive contribution which the Commission made was to maintain consumer and community confidence in the fact that there would not be pricing abuse as a result of the major tax changes. We

believe that this enhanced confidence, made a positive, not a negative contribution to the state of the Australian economy. Before the introduction of the GST, surveys showed that most consumers thought that all prices would rise by 10% and were highly concerned. The Commission's very extensive education activities, which included a mail-out of price forecasts to all Australian households deflated those expectations and gave them more confidence about the likely reasonable behaviour of pricing and encourage them to purchase goods and services rather than to engage in a massive consumer strike.

As to the macro economic causes of the slow down, these are many and they include the full range of monetary, fiscal exchange rate and other policies, the state of the world economy and so on. It is impossible to claim that this slow down is in some way related to the activities of the Commission.

Regarding ACCI's comments on The Prices Surveillance Act and the review by the Productivity Commission, the ACCI has not accurately represented the position of the Commission which has been trying to lead sensible debate on the topic. Our view is that the Prices Surveillance Act needs modernisation, not general strengthening.

First, the Commission has played a very active role indeed in cutting back prices surveillance. In the 1990s the Commission and its predecessors, the Prices Surveillance Authority and the Trade Practices Commission played a very active role in cutting back the scope of prices surveillance in the 1990's. At the beginning of the 1990's, as a result of the Wage Price Accord between the Labor Government and the trade unions, over 75 firms were required to pre-notify price changes under the Prices Surveillance Act, covering a wide range of retail products and also some basic products such as concrete, cement, steel etc. Thanks to reports mainly by The Prices Surveillance Authority and then the ACCC, this activity has been reduced to virtually nil so we have been a leader in cutting back on price regulation.

Our contribution to the debate about the future role of the Prices Surveillance Act has been to point out that the role of prices policy in Australia needs to change. We have said from the start that we do not look in future to a continuation of the kinds of prices policies that applied during the 1970's, the 1980's and some of the 1990's private sector oligopoly areas. As I have said, we have already heavily cut back there and we see no need for a resumption of activity there in general although there will

occasionally be times when governments want to refer matters to us for special monitoring and/or investigation, eg this week the Government has asked us to look into the causes of recent rises in insurance premiums to be satisfied that they are legitimate.

Our view is, however, that there is a legitimate role prices surveillance and prices regulation in pure monopoly areas and that the Act needs modernisation on this account. This covers areas such as telecommunications, post, energy, water, airports rail and so on, which were actually left out of prices surveillance in the 1980's (largely because of public ownership). In all these areas there has been privatisation or if not corporatisation where major utilities with market power over essential goods and services no longer have their prices set by Ministers and where some form of independent price regulation is needed. We do believe there is a role for having a generic price regulatory law rather than a series of ad hoc measures that differ from one sector to another.

As to the puzzling comment by the ACCI that the Commission is recommending cost plus approaches, this is simply not the case. The Commission has been a fairly keen advocate in the right circumstances of incentive based pricing mechanisms. For example, mechanisms under which firms are told what their prices will be for the next few years (in terms of the Consumer Price Index minus X factor). That approach gives them every incentive to then cut costs and to become more efficient because if they do so they will make major gains over and above those implied in the CPI-X forecast.

In short the Commission does not seek additional powers. What it wants is a restructuring of prices surveillance to cut back on the areas that were regulated in the 1980's and early 1990's but to focus on areas of pure monopoly power where there is a legitimate case for price regulation.

Moreover the Commission regards the question of whether there should be any regulation at all as one for Governments, not for itself. So the focus of the Commission's recommendations is not so much on whether particular prices should or should not be regulated (we recognise this as the role of government) but on ensuring that there is satisfactory machinery and laws for those purposes and in particular that there is adequate flexibility.

Competition & Regulation

CEDA members will be well aware that there are substantial benefits to be derived through the extension of competition principles to the electricity and gas industries. Cheaper power greatly assists economic development throughout the nation.

Under reforms outlined in the 1993 Hilmer report and later adopted by the Council of Australian Governments (COAG) it was proposed to open up public monopolies and certain other facilities to competition. Where competition was not possible services were to be regulated to ensure that service providers did not hinder competition in related industries by extracting monopoly rents.

The regulator at the national level is the Commission, working under the guiding principle that access to certain facilities with natural monopoly characteristics, such as electricity grids and gas pipelines, is needed to encourage competition in markets such as electricity generation and gas production. Problems can arise when the owners of such facilities are in a position to inhibit or distort competition in upstream or downstream markets.

The business community has a major interest in seeing the effects of these reforms.

Public authorities have been restructured, re-branded and in some cases, privatised. Commercialised generators, retailers and traders conduct business in spot and contract markets and promote their services online. New investors are entering the market from overseas as well as other Australian industries. Monopoly networks are regulated and separated from the competitive businesses to provide non-discriminatory access for third parties.

The key development has been the creation of the National Electricity Market (NEM) which joined for the first time the separate electricity markets in Queensland, NSW, ACT, Victoria and South Australia.

This market has introduced new ways of trading wholesale and retail electricity. At the same time, customers have progressively earned the right to choose suppliers and services with the idea they could negotiate new deals based on prices and conditions driven by competition.

Such reforms are not unique to Australia: industry restructuring and competitive electricity markets are increasingly a global trend, with the aim of delivering power

more efficiently through competition. The result is intended to be an industry where commercial incentives drive management decisions and new investment, an industry that contributes more effectively to our economic growth and improves the well being of consumers.

Have these reforms delivered on their promises? Indications are that industrial and commercial customers benefited in the initial years from lower prices, especially in NSW and Victoria where electricity constantly traded close to the generators' marginal fuel cost. As a result, these customers experienced reductions of 20 to 30 per cent in charges. There were winners and losers too amongst the generators and retailers, with some well-publicised court disputes over contracts and prices.

So the larger customers gained from the early rounds of deregulation. Will similar benefits be available to smaller businesses and households when they enter the competitive market? Or will the market be less competitive, more concentrated and over-protected by governments?

A major concern I have is whether or not governments have the will to carry reforms through so that all customers (including small businesses and households) can share in the rewards.

Development of a unified, rationalised market is also at stake. Ten years ago Australian governments recognised some states had surplus capacity and slowing demand, whereas others had growing demand and supply shortages. The reforms intended that these excess resources would be shared, and not wastefully duplicated. There is to my mind some danger that this goal will not be achieved or, if achieved, will accomplish too little, too late.

Will consumers see lower prices?

Lower prices and customer choice were observable benefits of the new market, but these happened more in some states than in others. Also, these price falls resulted from introducing reform in an industry in NSW and Victoria with excess generating capacity. Individual generators faced the risk of their output not being dispatched, whilst as retailers were keen to increase market share. This combination of incentives yielded unexpectedly low prices and slim retail margins. While the newly contestable customers reaped the rewards, this was at the expense of the industry's profitability.

However, as demand has increased, the gap between supply and demand has contracted and prices have risen. Already, in states such as South Australia, high prices have been the order of the day. Queensland prices have fallen, but only after a volatile, peaky start to their market, which was symptomatic of system constraints.

I fear that a narrowing gap between supply and demand means that some of the early, easily won benefits will evaporate. For reform to deliver sustainable long-term benefits, the market must stay competitive. Higher prices should be revealing opportunities for new investment in generation and interconnection. After all, this was one of the fundamental aims of reform. Interconnection and generation projects in Queensland – which is likely to shift from supply shortages to excess capacity over the coming years – suggest these signals are working.

But this will take time. The NEM will not instantaneously erase the history and past practices in what was a centrally planned industry in each state. For instance, South Australia still relies on a base-load interconnect in a region with chronic peak load problems. Hopefully, new investments such as Pelican Point, Ladbroke Grove and the Port Pirie magnesium smelter will support new gas supplies and consequently new entry in electricity generation. That still doesn't explain why major investment in interconnection did not occur earlier, as with the proposed South Australian / New South Wales Interconnector (SANI project) some years ago.

A danger I foresee is that industry owners will lose patience with reform. Proposals to re-amalgamate generators, arrangements to boost sale prices on privatisation and anti-competitive pricing practices may well solve the industry's short-term profitability problems. They will not encourage a competitive industry and they will not deliver long term benefits to electricity consumers.

Further disaggregation, new entry and new investment in generation should be occurring in an environment where there is viable competition between fuel types (coal, gas, hydro, renewable) and technologies. The market and the networks should provide clear signals as to the best place and best time to invest. Ideally, alternative projects (new and refurbished generation, interconnection, co-generation or demand side projects) should compete for network access on an equal basis that reflects an appropriate sharing of costs and benefits.

As California has proven, stop-gap and compromise measures that take no account of market incentives will be ineffective and can be disastrous. Further disaggregation and more competition must be a high priority. Without this structural reform, any review and rewriting of the electricity market rules will be inadequate and, ultimately, meaningless.

Static reform = Too much interference

So why are these concerns still with us, six years after reform commenced? I believe that continuing intervention by governments – who still own most of the assets - overshadows the continued delivery of reform benefits to all customers. Governments become very sensitive about the sale (or revenue) value of these assets and about the impact of regulatory decisions affecting them. It is no surprise that governments (as owners and shareholders) take issue more often with regulators, than the electricity businesses or customers themselves. Government treasuries and energy departments often filter the views of these businesses before they are publicly known.

State treasuries still rely on the energy sector for a large slice of their revenues and budget outlays. Governments also have reasons for retaining control over how prices are set for different customer groups or different regions. Sometimes these cross-subsidies yield public benefits. In other cases this is not so clear cut, and often the arrangements are not transparent.

Until governments adopt a more hands-off approach to the outcomes of reform, there will be this ongoing conflict between their roles as asset owners, as tax collectors, as managers of an economy which needs to operated competitively and efficiently and as the elected representatives of voters and customers.

Telecommunications

The Commission welcomes recent initiatives by the Minister for Communications, Information Technology and the Arts to explore ways of improving the speed and certainty of telecommunications arbitrations. Senator Alston has proposed a number of amendments to the current arrangements. Several of these pick up recommendations made by the Commission itself in submissions to the current Productivity Commission review of the telecommunications competition regulation.

The Commission particularly welcomes the Minister's recognition that the legislative amendments will be an important component of any reforms. The problems are not

simply procedural ones. I note that many industry participants have already expressed strong support for the proposals.

Delays and uncertainty in resolving telecommunications access disputes risk damage to individuals and businesses well beyond the immediate parties to the dispute. The merits review provisions are a particular problem. Final price determinations for a number of critical services are currently subject to merits review and may be held up for the best part of two years while the Australian Competition Tribunal conducts its review. Indeed, it is beginning to seem that the provision is a real brake on the development of new services and that the only way to ensure that broadband services quickly become a reality in many areas is to abolish it – or to cut it back to major points of law or principle rather than to conduct a rehearing of every detail.

Mergers & the Commission

As the only national agency dealing with generally with competition matters and responsible for enforcing the competition provisions of the Trade Practices Act, the Commission is, at times, in the firing line.

The BCA tells every journalist within earshot that the Commission's merger policy is harming the Australian economy, driving company headquarters offshore and preventing the development of large companies that can perform effectively in domestic and international markets. The Commission is not anti-merger and, in fact, examines only a small percentage and opposes only the very few that could lead to a substantial lessening of competition.

Australia is not alone in taking an interest in mergers and governments worldwide have created strong laws to prevent the creation of cosy cartels. If the Business Council were serious about promoting the development of large competitive Australian companies it would acknowledge the benefits of competition between its own members as wells as between suppliers to them. Firms represented by the Council are major winners from more competitive markets. They would be less competitive if they had to obtain supplies of raw materials from a monopoly or export through a monopoly transport company or raise finance from a monopoly bank. Strong domestic competition has lowered their costs.

When it comes to international competitiveness, size is not the sole criterion. More important is domestic rivalry that encourages rivals to improve and, at times, export

so they can grow. Export growth is not the prerogative of large companies. Many small companies are achieving excellent export growth rates.

In these cases where a merger is anti-competitive, band the Commission does not find that many - they can be authorised if there is a sufficient public benefit.

In deciding whether to authorise a merger the Commission considers all the potential public benefits such as the real value of exports and import substitution and if there is an adverse impact on the ability of smaller companies to expand or develop export markets. A merger can be authorised even if it means a lessening of competition if there is compensating public benefits such as export generation, import replacement or a contribution to international competitiveness. In any case, where local companies have faced significant import competition the Commission has not opposed mergers under section 50 of the Act and authorisation has not even had to be sought.

It is inevitable that more companies will move offshore but not because of merger policy. A move can result from a variety of reasons such as taxation policy, getting closer to customers and easier market entry.

Some BCA members support a softer merger law or even no law even if this means an economy featuring a bunch of monopolies that cannot compete internationally.

The BCA and other critics can also challenge the Commission's decisions in Court but we tend to win most cases.

The Qantas-Impulse Merger

A recent and extremely difficult merger. The Commission concluded in the first instance, that the merger would be likely to lessen competition in the airline industry.

However, it became apparent to the Commission that a likely outcome, should the proposal be rejected out of hand, would see Impulse going into receivership. Given the structure of the industry and its regulatory framework, particularly the slot allocation mechanism, it was highly likely this would have lead to a more anti-competitive outcome ie the slots would have gone to Ansett or Qantas.

Our concerns were lessened in light of the court enforceable undertakings by Qantas to overcome anti-competitive elements of the deal. Qantas guaranteed slots to new and emerging airlines, helping to overcome a major barriers to entry and growth.

Guarantees were also given in regard to services and restrictions on fare increases for routes where both airlines were the only ones that competed.

The Franklins Undertaking

This was also a difficult matter given Franklins decision to exit the market due to unsustainable losses. The Commission has obtained the best outcome possible under the circumstances, boosting the market share of independent grocery retailers, while also facilitating the entry of two new competitive players in the eastern Australian supermarket industry.

As you know, Woolworths will acquire far fewer stores than they originally sought with independents offered two-thirds of the total sales value of Franklin stores. Foodland and Pick'N'pay are getting a significant number.

The Commission was concerned that Franklins was close to an uncontrolled collapse that would have seen more stores go to the major chains leaving fewer for independents. I believe the outcome is good for the industry and consumers. We have announced the detailed outcome today.

Woolworths can only use the "No Frills" brand name and Franklins trade names for a transitional period and must divest a number of its own stores to address local concerns about competition.

ACCC Resources

It should be noted that in recognition of the Commission's continuing and expanding role the Federal Government had significantly increased the resources available to the Commission.

In the recent Federal Budget the Commission received a 27% increase in funding to a total of $73.4 million in 2001-2002. Additionally, the Federal Government has created a litigation reserve fund of initially $10 million building to around $20 million over time, to assist the Commission in meeting the costs of large cases and court activity. This will strengthen our capacity to deal with major litigation.

The increase in funding follows a rigorous funding review of the Commission by the Department of Finance and Administration which verified that the Commission has been under-funded for a number of years.

The funding granted by the Government enables the Commission to maintain its high standard of service delivery and to meet emerging priorities such as e-commerce and rural and regional issues. The additional resources will also allow the Commission to effectively meet the increasing international challenges including:

- the impact of globalisation;
- the increased complexity of markets and technological change, and;
- major regulatory activity.

The funding will also allow the Commission the flexibility to reallocate resources with changes in its operating environment.

Our consumer role will be enhanced by this additional funding.

Can I remind you that the Trade Practices Act specifies that it is our role to "enhance the welfare of Australians through the promotion of competition and fair trading and the provision of consumer protection". The Commission's relationship with big business is at times tense because it is there for the benefit of consumers. However, the business community stands to lose from an uncompetitive economy.

The anti-competitive conduct provisions of the Trade Practices Act, including the merger provisions, are an attempt to enact economics as law. For this reason, interpretation of the Act is always going to be somewhat controversial and the Commission's decisions on some mergers will attract criticism and debate.

What should be remembered is that the Commission is the administrator and enforcer of an Act of Parliament introduced to protect the public against anti-competitive forces. The Courts are the final arbiters on whether breaches of the Act have occurred. Further, the Commission's authorisation decisions can be appealed to the Australian Corporation Tribunal.

There are ample safeguards for businesses that disagree with the Commission. They can appeal to the courts and the Australian Competition Tribunal. In court, the onus is on the Commission to prove its case if a business wishes to proceed with a merger considered anti-competitive by the Commission.