CHAPTER 1: OVERVIEW

Competition and consumer welfare

The provisions of Part IV of the Act prohibit various trade practices that tend to prevent or lessen competition in an Australian market for goods and services. These provisions are at the heart of the Act. Since 1974, they have been instrumental in shaping the Australian economy. They lay down rules which, as interpreted by the courts from time to time, restrain anti-competitive behaviour and promote competition in the market place.

Section 2 states that the object of the Act is to:

> '… enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.'

Although the Act provides no further guide to the welfare of Australians, it is apparent that the Act is concerned primarily with economic welfare. This may be shown in a variety of ways. In economic terms, welfare will be enhanced by rising living standards in the form of higher incomes in real terms and an increase in consumer choice, by sustainable high economic growth, and by a lower unemployment rate. These benefits flow when human and other resources are used more efficiently to increase productivity and to maximise returns on investment. Competitive markets are the key to economic efficiency.

In a relatively small economy like Australia, the misuse of market power can be particularly detrimental to competition. The competition rules in Part IV of the Act seek to restrain conduct that tends to lessen competition. Thus, anti-competitive agreements or arrangements amongst competitors are proscribed, as are mergers between competitors that would have the effect of substantially lessening competition in a market. Where a corporation has acquired market power, the Act protects consumers and other businesses from its misuse.

Both anti-competitive and pro-competitive conduct may result in changes in the structure of markets, notably by the exit of individual businesses. Part IV seeks to prevent conduct that may lessen competition, not to protect less competitive businesses. The distinction is an important one. However, some of the submissions made to the Committee in support of changes to Part IV appear to conflate these two objectives.

Competition is an important mechanism for achieving the advances in efficiency and productivity that are essential to enhance welfare. Competition creates an environment that provides incentives and disciplines for continuing improvement. In a competitive market, each participant seeks to constrain costs to maintain its position in the market and achieve some advantage over its competitors. Business decisions made in response to competitively determined prices direct resources within the economy to where the best opportunities lie. Ultimately, consumers benefit as increases in productivity are reflected in lower prices in the short term or through greater choice in the longer term. Their welfare is enhanced.

Greater competition in Australian markets and higher productivity have been an essential part of strong growth in the economy over the past decade. In the second half of the 1990s, productivity increased at an annual rate which was substantially higher than the average annual rate recorded since the 1960s. During the past decade economic growth has averaged around four per cent per annum and has been reflected in higher living standards, which are to be seen, in part, in falling unemployment rates and real wage growth of three and a half per cent per annum.

The increase in the rate of growth in productivity is attributable to significant structural reform of the economy over the past two decades.[1] This reform has resulted in more competitive markets. By providing a more competitive business environment, structural reform has helped to restrain inflation and has made the Australian economy more flexible, enabling it to adjust more readily to adverse developments overseas and changing export opportunities.[2]

Structural reform allowed Australia to adjust well to changes in international economic conditions during the 1990s, including the 1997 Asian financial crisis.[3] It has become clear that developing and maintaining a competitive environment is necessary if Australian businesses are to compete in markets for goods and services which increasingly cannot be distinguished as domestic or international.

Structural reform has brought greater competition to the markets for products, services and labour. This has benefited consumers through lower prices,

1 Parham, D. 2002, *Microeconomic Reforms and the revival in Australia's growth in productivity and living standards.* Productivity Commission 1999, *Microeconomic Reforms and Australian Productivity: Exploring the Links*

2 *Statement 3: Economic Policy Reform and Australia's Recent Economic Performance,* 1999-2000 Budget Paper No. 1.

3 OECD 2001, *OECD Economic Surveys Australia.*

improved quality and a wider range of choice amongst goods and services. For example:

- Competition in product markets was increased by significant reductions in barriers to international trade, including reductions in import tariffs to five per cent or less on most goods. Tariffs on passenger motor vehicles were reduced from just under 58 per cent in 1988 to 15 per cent. The Productivity Commission has found that over the last decade, the price of imported cars has fallen by an average of 10 per cent. There has been a stronger focus on customers in the car industry which is reflected in significant improvements in the quality of locally produced cars.[4]

- In the financial sector, the removal of banking regulations has allowed access to finance and the value of the currency to be determined by competitive forces. Barriers to competition between different kinds of financial service providers have been reduced. The availability of different types of financial service has increased considerably. The major banks' interest rate spread (the difference between interest rate received and interest rate paid) has narrowed, notwithstanding changes in the structure of bank fees.

- Greater competition in the Australian telecommunications market has benefited consumers, including businesses, by allowing them to choose the services best suited to their individual needs. There have been significant real price reductions — a representative 15 minute call in peak time between Melbourne and Brisbane fell from $7.25 in 1997 to $3.28 in 2002 and a 30 minute call to the United States fell from $31.73 in 1997 to $6.85 in 2002.[5]

Experience has shown how competition in one market drives improvements in a related market. For example, the need for Australia to compete internationally has required the cost of producing exports to be minimised. The competitive pressures thereby induced flow through to related markets, such as transport, communications and financial services. The need to maintain international competitiveness has been significant in driving major changes in government policy in relation to taxation and the labour market. There has also been significant reform in the regulation of the labour market

4 Productivity Commission 2002, *Review of Automotive Assistance: Position Paper.*

5 Based on data supplied by the Department of Communications, Information Technology and the Arts.

aimed at increasing its responsiveness, reducing impediments to job creation and improving productivity.

The implementation of the National Competition Policy from 1995 has involved the progressive reform, or removal, of regulations that unnecessarily restricted competition. It also saw the introduction of competition in the provision of services traditionally provided through public monopolies. The Act was amended to provide for access to essential infrastructure with a view to facilitating competition in related upstream and downstream markets.

Competitive markets and efficiency

Although the competition provisions in Part IV of the Act focus on the promotion of competition in markets, Part VII provides for the authorisation of conduct when that conduct is justified in the public interest, notwithstanding a lessening of competition. This reflects the fact that, whilst competition is an important means whereby an economy can achieve economic efficiency, competition is not an end in itself. The achievement of economic efficiency is the ultimate goal, because it results in high productivity, which in turn sustains economic welfare. Maximising competition is the means to that end.

Economic efficiency may take a number of forms. Productive efficiency is achieved when goods and services are produced at minimum cost, that is, when optimum output is achieved through the best combination of labour, capital and technology. Corporations seek economic efficiency because it means increased profitability and the scope to gain a competitive advantage in the market through lower prices. Allocative efficiency is achieved when market processes allocate society's scarce resources in accordance with their most valuable use. For example, a vertical merger between two firms may result in lower prices for the same product with the removal of one mark-up, thus allowing consumers to purchase more of another product. Dynamic efficiency is evident where the market is supplied with better quality goods and enhanced services due to technological innovation.

In most circumstances maximising competition will maximise economic efficiency. Thus a test designed to prevent the substantial lessening of competition will generally be a good test for economic efficiency. However, there may be circumstances in which, for example, a merger will offer gains in efficiency which also result in a substantial lessening of competition. This may occur when there are economies of scale, benefits or costs that are external to the market price or when transaction costs are significant.

Box 1.1: Competition versus efficiency

Competition may not be consistent with the most efficient outcome in the following examples:

- Economies of scale or scope may result in continual declines in unit costs as production expands. The most efficient outcome may be achieved when there is only a single producer in the market.

- It may not always be possible for property rights to be clearly assigned with the result that a corporation is unable to capture the full benefit of its invention in the price it charges for a product. Competitors may benefit from the invention because they can exploit it in their own products without being required to pay a fee for the property right. An efficient outcome which allows this 'externality' to be captured by the inventor may not be consistent with the same level of competition.

- Alternatively, it may not be possible for all the costs of the production of goods to be attributed to the corporation involved. In this case, the price charged in a competitive market will not reflect the real social cost of the product. For example, the price charged for goods may not reflect a negative environmental cost that has been incurred in its production. A competitive market outcome would reflect this negative 'externality' and allow excessive consumption of the product because it is essentially under-priced.

- A competitive market may not deliver the most efficient outcome when transaction costs are significant. For example, a manufacturer of a specialised product may find that consumers are unable to appreciate the full benefits of their product, resulting in less sales. The manufacturer may acquire retail outlets to maximise sales since this may be necessary to ensure consumers are well informed about the product. However, the acquisition of retail outlets may reduce competition in the market.

International context

In the course of its review, the Committee has had regard, where relevant, to the laws of other countries. International comparisons can be valuable because of the perspective they provide in assessing the utility of existing laws and

proposals for change in Australia. There may, however, be differences in context, both of an historical and legal nature, which make it inappropriate simply to translate a law from one jurisdiction to another. It is desirable, nevertheless, to be alert to developments, particularly in policy, in other countries, in the light of the growing internationalisation of trade and commerce and the increasing links between the various national regulators, including the ACCC, which have the responsibility of enforcing competition laws.

The Committee considers that, whilst there are some differences between Australia and other jurisdictions with substantially larger domestic markets, the competition provisions in Part IV have served Australia well. Subject to the changes that are proposed in this report, they should govern the regulation of market conduct in a satisfactory manner. In particular, the Committee regards the power given to the ACCC and the Tribunal to authorise, in the public interest, conduct which would otherwise be in breach of Part IV, as providing flexibility in the administration of the Act and a valuable means of ensuring that ultimately the economic welfare of consumers is enhanced.

A Memorandum of Understanding has been concluded between the Governments of New Zealand and Australia, which recognises that the harmonisation of business laws, including competition laws, can be of mutual benefit. This Memorandum of Understanding encourages consultation between the countries but does not oblige them to have identical competition laws. The Committee has drawn on the New Zealand experience in considering, in particular, the proposals concerning the prohibition per se of certain conduct and the treatment of joint ventures (see Chapters 8 and 9 respectively).

The general application of the competition provisions

Originally, the scope of the Act was limited by the extent of the Commonwealth's constitutional power. The Act relied primarily on the trade and commerce power and the corporations power and thus could not be applied generally across the country. It did not cover the activities of State or Territory governments or of their instrumentalities. Nor did it apply to the activities of unincorporated entities operating within a state. This meant that individuals, such as those in the professions, were not subject to the competition provisions unless they were within the Australian Capital Territory.

These limitations were examined by the Hilmer Committee which recommended that the competition provisions should apply uniformly to all business activity in Australia, including that undertaken by government enterprises, in order to realise fully the gains offered by a more competitive economy. These recommendations were adopted and implemented by a set of intergovernmental agreements concluded by the Commonwealth, State and Territory Governments in 1995. In particular, the Competition Principles Agreement and the Conduct Code Agreement sought to ensure that all jurisdictions achieved and maintained consistent and complementary competition laws and policies for all businesses in Australia, regardless of ownership.

To extend the coverage of Part IV and overcome the constitutional limitations, the Commonwealth amended the Act to insert Part XIA (the Competition Code). This facilitated the application of the Competition Code by the States and Territories. Part XIA introduced a Schedule version of Part IV into the Act, which is identical to the ordinary version of that Part, except that it refers to 'persons' rather than 'corporations'.

Each State and Territory enacted a Competition Policy Reform Act (CPRA), which came into force between 9 June 1995 (New South Wales) and 21 July 1996 (Western Australia). These Acts applied the Competition Code as a law of that State or Territory (section 5), which ensured that the Competition Code was administered as if it constituted a single law of the Commonwealth. Section 19 of each CPRA specifically confers on the authorities and officers of the Commonwealth, including the ACCC, the functions and powers set out in the relevant Competition Code.

To ensure that government enterprises are not immune from the competition laws, the Commonwealth amended section 2 of the Act. Sections 2A and 2B now provide that Part IV binds the Crown in right of the Commonwealth, the States and the Territories in so far as they carry on a business, either directly or through a government authority.

However, the universal coverage of Part IV is not complete. Section 51 of the Act provides for exemptions. It allows conduct, otherwise in contravention of Part IV, which is specified in, and specifically authorised by, Commonwealth, State or Territory law.

The Committee received submissions that either seek additional regulation to meet the needs of particular sectors of the economy or raise the possibility of exempting some sectors from the competition provisions. The Committee considers it important to avoid resorting to special provisions, especially

exemptions, to meet particular problems that may arise. It also notes that the benefits to be derived from competition are derived whether or not the businesses involved are publicly or privately owned.

The competition provisions should apply generally and consistently to business conduct without regard to the nature of the industry in which the conduct occurs. Efficiency, and consequently welfare, may suffer if the regulation of competition is not uniform. Differing regulatory treatment of different sectors of the economy will provide differing incentives for investment and effort by discouraging participation in particular sectors and will detract from the ability of markets to allocate resources in an efficient manner. Productivity, growth and welfare may then all suffer.

As Australian markets have become much more competitive in recent years, both domestically and by the introduction of international competition, the scope for anti-competitive conduct has been reduced. This would suggest that the need for government intervention has also been reduced. However, the Committee has noted pressure for additional regulation in some sectors, particularly those where structural change has resulted in a high degree of concentration in the relevant markets. The airline industry is one example and the grocery industry is another. Proposals to modify the regulatory framework for these sectors include the introduction of stronger general rules, including an effects test to establish the misuse of market power, or the introduction of regulation which is specific to the particular industry.

The Committee does not favour the introduction of competition measures specifically directed to particular industries to respond to perceived shortcomings in the relevant markets. Often the complaint when analysed is not about reduced competition but about the structure of the market which competition has produced. Concentrated markets can be highly competitive. It may be possible to object to the structure of such markets for reasons of policy (the disappearance of the corner store, for example), but not on the grounds of lack of competitiveness. Of course, concentrated markets should attract scrutiny to ensure that competition is maintained, but the purpose of the competition provisions of the Act is to promote and protect the competitive process rather than to protect individual competitors. The competition provisions should not be seen as a device to achieve social outcomes unrelated to the encouragement of competition. As a matter of policy those outcomes may be regarded as desirable, but the policy will not be competition policy. Nor should the competition provisions seek the preservation of particular businesses or of a particular class of business that is unable to withstand competitive forces or may fail for other reasons. Those are matters which may

legitimately be the subject of an industry policy, but that is not a policy which is to be found in the competition provisions in Part IV of the Act.

If there is to be regulation which is specific to a particular sector of the economy, especially if it is directed to competition, it should have regard to the potential for further structural change in the sector in the longer term. In particular, regard should be had to the scope for entry to the market by new suppliers and the possibility that their presence will affect the market share of incumbent suppliers. An approach that distorts prices and returns necessary to induce the entry of new suppliers to the sector should be avoided. The market should be given time to work and provide the signals necessary to induce new entrants. In the shorter term, the competition provisions, together with Parts IVA and V of the Act, should equip the ACCC with the necessary capacity to protect the interests of consumers. It is also open for the ACCC to draw issues affecting particular sectors to the attention of the Government. Where it considers that such issues should be reviewed, the Government may issue terms of reference for an inquiry or research study by a body such as the Productivity Commission.

Part VII of the Act provides a mechanism for responding to some pressures through the authorisation process. It offers exemption on a case-by-case basis from most of the competition provisions for conduct which may be anti-competitive according to the tests laid down by Part IV, but which offers public benefits sufficient to outweigh the anti-competitive detriment.

Whilst authorisation is widely available, the process should not also be seen as a means of implementing an industry policy with goals that extend beyond competition concerns. Authorisation does, however, provide a means of resolving issues that arise when the application of the competition provisions may not promote economic efficiency. Whilst competition will generally result in greater efficiency and higher productivity, as noted earlier this will not always be the case.

Fostering compliance with the Act

The role of the ACCC includes fostering compliance with the Act. This can be achieved by various means ranging from the function of detecting and taking action against those who contravene the Act to the education of business and the public about the requirements of the Act.

Submissions made to the Committee indicated that many corporations have initiated voluntary compliance programs that provide their staff with training

intended to make them aware of trade practices issues. It was also apparent to the Committee that training programs concerning trade practice matters are available on a commercial basis. The Committee understands that compliance programs are particularly effective in achieving compliance with the Act.

To a large degree, an awareness of the requirements of the Act is the result of efforts on the part of the ACCC to publicise trade practice issues. The ACCC also contributes to compliance education. For example, the ACCC has developed a basic compliance manual, *Best and Fairest*, for use by business. This manual addresses restrictive trade practices, unconscionable conduct and consumer protection and can be developed by businesses to suit their particular needs.

The major responsibility for compliance with Part IV, and with other parts of the Act, rests with corporations. It is clearly preferable that compliance be achieved through making corporations and their employees aware of the Act's requirements. The alternative is for the ACCC to take costly action to enforce the Act. The Committee considers that voluntary compliance programs should be encouraged so that they become more widespread. The ACCC might consider providing greater assistance in this regard. It would be appropriate for the ACCC's role in this regard to be discussed with interested parties, using the consultative committee which this Committee recommends.

Conclusions

- Competitive markets increase efficiency and productivity in the economy, thereby enhancing the welfare of Australians. This has been evident in the contribution that more competitive markets have made to the strong performance of the Australian economy over the past decade.

- Whilst differences in circumstances may prevent the simple translation of regulatory approaches from other jurisdictions, it is desirable that changes to Australia's regulatory framework have regard to international developments in policy.

- Governments should continue to ensure that the competition provisions of the Act are applied as broadly as possible across the economy and include the commercial activities of governments themselves.

- The competition provisions should be universally applied to avoid distortion of economic activity to the detriment of consumer welfare.

- Whilst from time to time there is pressure for additional regulation in particular sectors, measures using the Act to promote competition which are specific to a particular industry should be avoided. Competition provisions should protect the competitive process rather than particular competitors. They should not be seen as a means of achieving other social or organisational objectives, including the preservation of particular corporations that are not able to withstand competitive forces. The regulation of competition should be distinguished from industry policy.

- The authorisation by the ACCC of conduct that offers public benefits sufficient to outweigh any detriment to competition is a significant feature of the Australian system of competition regulation. Importantly, it offers a means of dealing with situations in which the application of the competition provisions may not facilitate the most economically efficient outcome.

- The regulatory framework established by the competition provisions generally remains appropriate to Australia's circumstances.

- It is preferable to secure compliance with the Act through ensuring that corporations and their employees are aware of the competition provisions.

Recommendations

1.1 The consideration of possible changes to Australia's regulatory framework should continue to have regard to international developments in the area of competition.

1.2 Australian Governments should ensure that the competition provisions of the Act are applied as broadly as possible across the economy and extend to the commercial activities of governments themselves.

1.3 Competition provisions should be uniformly applied and measures which are specific to a particular industry should be avoided.

1.4 The competition provisions should not be regarded as a means of implementing an industry policy or the preservation of particular corporations that are not able to withstand competitive forces.

1.5 Businesses should seek to ensure that voluntary compliance programs are provided for their staff and the ACCC should review the assistance it is able to provide to businesses in this regard in consultation with interested parties through the reconstituted consultative committee recommended by the Committee.