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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON THE PRICES SURVEILLANCE ACT

DR N. BYRON, Presiding Commissioner
MR J. MacLEOD, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON FRIDAY, 8 JUNE 2001, AT 9.30 AM

DR BYRON: Good morning, ladies and gentlemen. Welcome to the public hearings for the Productivity Commission review of the Prices Surveillance Act which follows the release of our draft report in March this year. My name is Neil Byron. I'm the presiding commissioner for this inquiry and my fellow commissioner is John MacLeod. The purpose of this round of hearings is to facilitate public scrutiny of the commission's work and to get comment and feedback on the draft report. Following this hearing we'll complete a final report to government in August, having considered all the evidence presented at the hearings, submissions as well as other informal discussions. The participants in this inquiry will automatically receive a copy of the final report once it's released by the government which may be or should be up to 25 parliamentary sitting days after we transmit it to the treasurer.

We do like to conduct all hearings in a reasonably informal manner and we are taking a full transcript for the record and so comments from the floor and interjections are not helpful but at the end of the day's proceedings I will provide an opportunity for anybody in the audience wishing to do so to make a brief presentation and although participants are not required to take an oath under the PC Act, they should be truthful in their remarks and of course participants are free and encouraged to comment on issues raised in other submissions. The transcript will be available to participants and will be available from the commission's Web site as soon as possible after these hearings and the submissions are also available on the Web site.

I would now like to welcome our first participant for this morning, Dr Warren Mundy, from Australia Pacific Airports Corporation. Warren, if you would just introduce yourself for the purposes of the transcript and then proceed to your opening remarks. I would like to record that we have appreciated your submission, the first one we received for this inquiry, and your draft submission, and I have also seen your submission to the Part IIIA access regime inquiry and read the transcript of your evidence to those hearings. So you can sort of take a bit as read.

DR MUNDY: I'm no stranger to this court. Thanks, Neil.

DR BYRON: Thank you very much.

DR MUNDY: Dr Warren Mundy, manager strategy Australia Pacific Airports Corporation. I'll be brief. We generally support both the findings and the proposals in the draft report. I think we've indicated in relation to this inquiry and the national access regime inquiry and in the airports prices surveillance inquiry that we think the Prices Surveillance Act is a poor device from another time for another purpose and that it in no sense in its form represents regulatory good practice and in fact, a device even of its type is not an appropriate way to regulate infrastructure.

Having said that, and having had the opportunity to briefly review the response of the Australian Competition and Consumer Commission to the draft report, it seems in that submission that the commission has received that another purpose is

also in mind for the ACCC and that is not one of regulating infrastructure industries but rather something more akin to the original purpose of the PS Act and that is for government to have in its policy toolbag - and whether it's in the control of the government or the ACCC from their draft response is not entirely clear to me but to be able to intervene in what you might call outrageous price increases or to look at industries which may not have elements of natural monopoly characteristics to them like infrastructure but rather to look at issues like petrol pricing, insurance, milk or whatever.

I'm not going to make any comments in particular on those issues because they're really issues in which we have no particular expertise or interest but we just make the passing comment that they may be issues which are different and separate. Just moving on, we support the commission's proposition that a price monitoring arrangement should be moved within the general rubric of the national access regime. We've made representations and comments to the commission elsewhere that at the moment the fact that there is a prices surveillance device being used to regulate airports, a set of access arrangements in section 192 of the Airports Act 1996 and the more general propositions under Part IIIA of the Trade Practices Act seems to create a situation of regulatory triple jeopardy although having said that it's hard to see why you would ever bother using Part IIIA of the Trade Practices Act against an airport, given you've got much weaker tests in the Airports Act.

So we would hope that in that process of integration of price monitoring, if that's appropriate, into the Part IIIA, that problem of if you like regulatory double jeopardy or double-dipping by the part of access seekers which is something we're now experiencing in relation to an access to our domestic express terminal, would be eliminated. Beyond that, looking more generally at the monitoring and what you might call - rather than the price control function, a surveillance reporting sort of function, we have raised the question in our response to the draft report, whether in fact that needs to be done under legislation as proposed or whether it can be constructed for example in relation to our industry under Parts 7 and 8 of the Airports Act where extensive financial and quality of service information is required to be produced and provided anyway.

We note that if you like productivity information in relation to stevedoring has been collected and published now by the Bureau of Transport Economics with its various names for an extensive period of time and that that work that's in the quarterly Waterline reports published by the BTE now seems to perform a function not particularly dissimilar to that information that you may want to look at in relation to other industries. It covers both price information and quality information. It's not clear to us in fact indeed whether the ACCC need be the body that collects this information or whether that information couldn't be collected by another Commonwealth agency such as the BTE. Reflecting on our industry, if what you're doing is wanting to look at this for sort of sound public policy reasons and you think that the information gathering function is to inform policy makers rather than to enable the regulator to undertake pricing interventions it may be some sense that the

body that collects information on passenger numbers and all those sorts of things for the aviation industry may also sensibly collect that information on airports and it wouldn't be particularly difficult. We don't see that there's a problem with the ACCC doing it but we don't see they have any peculiar expertise in that regard.

Just moving on, we find in particular the notification arrangements to be exceptionally intrusive as currently administered by the commission and really the proposition that every time a firm seeks to make a marginal change in price it has to run off to the regulator is really a bit of overkill. I think in our first submission to this inquiry we made the passing comment that virtually every price application that has been made to the ACCC in relation to regulation of airports under the PS Act probably with the exception of the recent Sydney decision and the Adelaide MUET decision, have involved price increases no smaller than the weekly fluctuation in metropolitan petrol prices. We're talking about price increases of 2 and 3 per cent. We're not talking about what you may consider to be gratuitous exercises of market power. These are minor, relatively small price increases which would seem in a more sensibly constructed regulatory system would just flow through and there would be some monitoring of prices rolling through.

I guess just in relation - I guess a couple of questions and I'll just finish on this point. There were a couple of questions that weren't clear to us. There was a mention at the start of the report about how monitoring may be used for the implementation of CPI minus X style regimes. It wasn't quite clear to us how that would work. As I mentioned earlier, we would like to think that a firm subject to monitoring could have some - and I think it sort of comes out from having now read the national access regime inquiry that the monitoring arrangement would be some lighter form of regulatory structure than declaration and arbitration so presumably therefore a firm that was - whoever the relevant regulator was, be it the NCC presumably - not overwhelmed by the argument for declaration but would like to see some monitoring in place. Presumably that would stand in the place of declaration. So again that solves this problem of double jeopardy that I spoke of before.

We would also suggest to the commission that particularly for regulated industries if that's where this monitoring device goes that market power abuse - I mean the literature on this is pretty clear; market power abuse need not only manifest itself in terms of pricing activity. It can manifest itself in reductions in quality and things like that so we would suggest that this monitoring tool should have a slightly broader remit if you like than simply the collection of information on prices, costs and profits. Indeed, I think it's generally accepted that one of the good things about the airport regulatory regime that actually arises out of Part 8 of the Airports Act is the quality of monitoring material. So we would urge the commission to think about the scope of the material that would be subject to monitoring because that information is in many senses as important as the pricing information. I think I would leave it there now.

DR BYRON: Thank you very much, Dr Mundy. There are a number of interesting

points that you raise in your submission that we need to follow up. Most of our questions I think would probably deal with the monitoring - why don't we go straight to that first. I think it might be useful if we attempt to unpack this word "monitoring" because it seems to me that it's used in a number of different senses. There's the reporting that's done under Part 7 and 8 of the Airports Act. There's monitoring as done under the Prices Surveillance Act by the ACCC and then there's other monitoring of fuel prices done by the ACCC but not under the Prices Surveillance Act. Monitoring can be seen as like the weakest form of regulation control in a whole suite of instruments there but I think in our draft report we're probably using it more in the sense that you said of information provision to policy makers in the public about deregulated firms. So rather than being a form of regulation it's about monitoring the behaviour of deregulated firms although recognising there may be some element of conditioning of firms' behaviour in that.

In your evidence to the access regime I think you said something like even though this sort of monitoring and statutory reporting under the Airports Act is not cheap - I think you mentioned $500,000 - you also said that a lot of the information in this was useful for internal management purposes anyway and your firm could live with monitoring. Now, does that mean monitoring in the sense of annual disclosure of certain prespecified variables in a standard format, as you say, whether it's to the ACCC or to the BTE or the ABS or whoever or monitoring in the sense that the ACCC can ask for further details on this and additional information on something else and could decide that they also need information on some other supplementary area as well.

DR MUNDY: I guess it's more the prior than the latter. I mean, the difficulty that - just in sort of an operational sense if you know you've got to produce information every year in a certain way in compliance with certain predetermined formats or form or whatever, then you can systematically deal with that. We've found I guess in relation to the ACCC's consideration of notices under section 22 that the information that they sometimes require is information which either is not readily available - we don't quite understand the purpose for which it is being sought and indeed sometimes it's simply not available and it's not meaningful.

We see this monitoring process very much as a reporting device in the same way that I think the commission sees it. It's for a firm that is deregulated where there are some residual concerns about potential abuses of market power. So effectively what policy-makers are saying is, "We're happy for those people over there to get on with their business with their customers, but we would like to keep an eye on what they're up to. We would like to see reporting from them," and the Commonwealth has an interest in this as well as the freehold lessor of the airport in our industry anyway, so, it's more in that circumstance than - we don't see price monitoring as price control; we don't see the monitoring function as a control function, we see it as a reporting information function. It's in a very real sense additional segment data which you are required to produce in your statutory accounts anyway.

MR MacLEOD: Can I just ask you to follow up that.

In what we suggested in the draft report, we thought any such monitoring would be very limited, that there weren't literally hundreds of thousands of examples out there. That they're very few indeed and it's a last resort. What you just responded is raising a question of whether deregulated industries, or privatised industries, or whatever, are different from all the rest or you might think monitoring was useful in some circumstances. Do you think there's anything in that argument that there is a phase, I mean, you do say several times - and I presume you'll take this up later - that there have been some problems in the airport moving to a commercial basis after years of government monopoly? Do you really think there is a special case for these industries that we could say, "Here's an example of where you could use this monitoring if you wanted to, having gone through all the previous processes."

DR MUNDY: Look, I guess there's an extent to which we're conditioned to it anyway because the Airports Act requires it of us by statute in Parts 7 and 8. We've got to do a huge chunk of it anyway, in respect of the PIA. Now you may well say we should repeal Parts 7 and 8 of the Airports Act as well. That's a different debate I guess.

MR MacLEOD: This raises the real question of is it better to put it in the Airports Act, this requirement.

DR MUNDY: It may well be that you have a view that for the major airports in Australia - I mean, the airports inquiry is looking at one of the questions we've been asked which is should we have to regulate all the airports that are currently subject to regulation and I think the answer to that one will ultimately be no. I know that the ACCC is now even conceding some of those points. I think there is a case where - and perhaps only as a transitional measure as people get more confidence. We have very strong statements on the public record from the chairman of the ACCC about the market monopoly - market power - of airports and these things raise concerns in the minds of both policy makers and the general public. So we see this certainly as a transitional arrangement, not a difficulty at all. Whether there would be other industries you'd wish to require to make disclosure, it's hard to say. You could easily, as you say, I mean the Airports Act - if there's a concern about airports, do it in the Airports Act. If a state government is concerned about issues in relation to provision of information about electricity distribution companies, well, make the provision of that information a condition of their licence. There are other ways of doing it.

So I guess the question then is could you conceive of situations, for example, where you may wish to acquire this information from petroleum companies, insurance companies, banks, whatever. If you thought there is an issue with an industry you could probably almost find for the vast majority of them a legislative vehicle in which you could construct essentially an industry specific regime which

you could then move on with. I mean it's a generic problem. I guess it's something that when we bought our businesses we were fully aware of and freely entered into as consenting adults, so it's something we're pretty relaxed about.

MR MacLEOD: That was, in fact, part of your tender to buy - recognition of that.

DR MUNDY: We saw the Airports Act; we knew about Parts 7 and 8 when we bought the airports.

DR BYRON: But that raises the question that the types of information that your organisation is required to supply and to whom and the issue that you raise in your submission about the overlap between the different types of information. So, presumably, like every other company, you provide information to the ABS; Department of Transport has their AVSTAT system; you've got statutory reporting under Parts 7 and 8 of the Airports Act. We've got the notification and the monitoring under the Prices Surveillance Act - I assume that there are probably some other - - -

DR MUNDY: I'm not certain, I'm sure we have to make certain statutory returns to CASA as well, for safety purposes, I imagine there are all sorts of things we have - - -

DR BYRON: So how much overlap is there between these things and is it simply a case that the information that you are required to give the ACCC for monitoring under the Prices Surveillance Act is the same information that you've already given them under Parts 7 and 8, or is it - - -

DR MUNDY: No, it's different information, but it's information which if the regulations under 7 and 8 were slightly amended could easily be collected. The information that's provided under 7 and 8 are essentially accounts, and quality service information, although 7 and 8 - our view is that the regulations under - Parts 7 and 8 create a broad regulation making power for the minister and then the minister makes regulations. The regulations under 7, which are the financial reporting regulations, could - I guess the two bits of information that aren't collected are information about prices of aeronautical services and then certain cost information relating to the aeronautical related monitored services. That reg could easily be redrafted so that all the information collected under the Prices Surveillance Act - under the monitoring arrangements - could be collected there without any doubt. Now, the information that the commission collects in relation to the notification procedures is very different, because that then goes into really information which looks very much like your traditional rate case, you know, capital expenditure; expenditure on project; rate of return; operating costs, all that sort of information. We don't particularly favour that as an ongoing device.

DR BYRON: I was going to ask how much more expensive - what's the difference in cost of compliance between the monitoring and the statutory reporting as opposed

to the compliance cost for the notification?

DR MUNDY: To be honest, it depends on the nature of the notice. They're very different things, I guess, what we're doing essentially each time we issue a notice under the PS Act is running a rate case for an incremental increase in price and the building blocks approach applies. We issue the notice, we consult with our customers, which is fine - we don't see that as an issue. We then issue a draft notice to the commission; they then come back and that process typically takes about three months. The documents that we produce often run to dozens of pages which then have fairly detailed costing information in them. The commission's draft reports often run to 30 or 40 pages and then the final report is a similar length. The costs incurred in that process are not only costs to ourselves, but costs to the commission, to the ACCC and costs to the airlines.

MR MacLEOD: Can I ask you then - you've referred to some kind of overload in terms of data provided - do you have any idea at all about what use that's put to? Do you have any clue that the public is better informed and better able to query your operations or - - -

DR MUNDY: Well, one would have hoped that this information was sufficiently valuable that would have lead to its - the information that's published by the ACCC annually would have been of sufficient import to have lead to its publication prior to your commission's consideration of the airports pricing inquiry. We've questioned - we're happy - we don't have a big problem in doing this - we'd like to think it was put to good purpose though and when we are required by statute to provide this information by the end of September for the preceding June engine financial year and we see the ACCC doesn't publish it until the following May, when the inquiry for which its primary purpose was already under way, we're worried; we're not happy about that quite frankly, we've been unhappy about that timing. It's important information for everyone who wants to participate in these public policy debates and for it to take so long to be released, it does question the purpose to which it's put.

It's rarely used in relation - I mean, it seems to play no significant role in relation to the ACCC's consideration of notices under section 22, so we - I guess the thing is that it may well be that it plays no role until such time as it turns up something that is of concern, I mean, that may also be the argument, so you know, it's a disclosure device. You'd probably best ask the ACCC what they do with it, or the Department of Transport what they do with it.

MR MacLEOD: Sure, but I mean in terms of your participation and the public debate, if this information was in fact terribly useful, and people were lying in wait for it to be released, then you would have seen some feedback of that kind. You do refer somewhere in your evidence or submissions to the problems with commercial in confidence here, I mean, I presume that the airlines would be interested in this data although whether they know it already I don't know. I'm really asking you have you seen any evidence that legislators or other people in the debate about airports are

better informed because of this and better able to conduct a debate.

DR MUNDY: Look, I think in a sense it's important for us - there is this view that airports are out there earning monster profits, ra-ra-ra. These documents published by the ACCC are audited and so on - are useful to us in the extent that they show what the true nature of the financial position of our regulated business is, and that is fairly poor. Now, we bought the airports on the cash flows and we knew all about that, but it's important for us in making debates about the future structure of airport regulation to be able to - - -

MR MacLEOD: In your filings of balance sheet and profit and loss statements and so on which are public documents would - the public's got access to that.

DR MUNDY: The segment data is not available. The break up between the regulated and non-regulated parts of the business are not available. It's important for us, for example, to be able to demonstrate I think to - on the issue of quality and the quality of services - monitoring stuff - but we could do that and publish it ourselves in our own annual report anyway and if we didn't, we probably would. Our quality of service monitoring arrangements are not particularly different to those of BAA, who is one of our shareholders where we source a lot of this intellectual property from. They have no obligation to publish and they do. We probably - as I said in the submission - there's a lot of this data which we would probably publish ourselves anyway. So it may well be the case that an airport such as ourselves would publish it anyway. That's not to say that all would, and I guess the question for policy makers would have to be would they be comfortable with that situation and that's, I guess, the question it probably best need to ask them rather than us.

There seem to be, as a participant some time ago in the debate about the passage of the Airports Act, this was seen by bidders, by airlines and by the Commonwealth and the parliamentarians to be a fairly reasonable set of arrangements to go forward with to provide some public information for assets which will ultimately revert again to the Commonwealth, albeit in a long timeframe. So if the question is - is there a sense in which people really use this stuff? We use it a bit. I'm not sure the extent to which the ACCC relies upon it heavily. I frankly don't have any sense of what, for example, the Federal Department of Transport do with it. They may do something with it, they may not, I simply don't know. It's a question to best address to them.

MR MacLEOD: We don't see in the public debate people quoting this back at you and saying this is the basis of our claims.

DR MUNDY: No, there's nothing in it, John, about taxi fares, so I don't hear much in public debate. I guess the question is we haven't had a public debate yet, I mean, it's a very closed - most of the discussions about these issues are commercial discussions between us and our customers and around the notification procedures and the price increases which is the focus of attention.

DR BYRON: One of the questions when you raised the commercial negotiations - the intent at the time of the sale of the leases was that there'd by normal, arms-length commercial negotiations between the airports and the airlines after this transition period. Is there any sense in which the type of information or the detail of the information that you're required to disclose alters those commercial negotiations in that the people on the other side of the table are not required to disclose to you as much information as you are compelled to disclose to them?

DR MUNDY: We have had a policy of disclosing all information that is relevant to a pricing discussion to the other parties to that pricing discussion and to the commission and making that public in our submissions, except to the extent that it may impact on us negotiating a contract of supply, for example, for a service provider; or where the public release of that information would provide information about one of our customers to their competitors, who are also our customers. So, the case in point being the domestic express terminal, if we've got two users of that facility - or we used to have two users of that facility - we would not disclose the gross passenger volume, because if you disclose the gross, the other guy can work out what the other guy is doing. That's the only circumstance in which we've not provided information publicly, and we provide that to the commission on a commercial-in-confidence basis. To be fair to them, they've always respected that.

What our concern has been is that in relation to, for example, a number of pricing - and this an experience of other airports - that in making a response to a draft decision or a draft notice to the commission, some users have made their entire submission on a commercial-in-confidence basis and the ACCC has just accepted that. I guess the most dramatic case in point of this was when the ACCC was considering a notice under section 22 in relation to the domestic express terminal where we were not privy to the passenger volumes that Virgin had told the commission. We're still not privy to those numbers even today.

That raises a whole pile of issues about transparency in due process and all that. It raises a fundamentally also more important issue from our point of view: how the hell do we know we're building the right thing if they won't tell us what their passenger numbers are? So that was part of the difficulty. Now, we were able to back-engineer the numbers, but we would have thought that information which we would ultimately know, because we can get down there and count them, should have been provided to us. Granted, it shouldn't have been made publicly available, but for the ACCC to be sitting and making a decision on the basis to a key variable to our business which we had no knowledge of struck us as extraordinary.

DR BYRON: We've also said in the draft report that with the provision of information to a central repository, which could be the ACCC or could be the Bureau of Transport Economics or the ABS or who knows - we've suggested that that information once reported would be published without comment. This regulatory report seems to have relatively little commentary in it. Do you have any reaction to

that or do you have any objection to the idea that the ACCC or the Bureau of Transport Economics would not only receive and collate these figures under the reporting type of system but would also be able or encouraged to do their analysis and make comments and recommendations?

DR MUNDY: I guess it's a question of what's the nature of the comment. Is it simply factual statement of an analytical nature, or does it go beyond that to be comments about conduct and so forth? The ACCC conducts a survey of airlines, and those survey sizes are relatively small because by their very nature they have to be. The ACCC then publishes that commentary. We don't see the survey, we conduct it; it's conducted confidentially by them.

To be fair to the ACCC, after they've conducted this survey they provide us with a draft, which we can then respond to. They are pretty good on removing factual errors and so forth. In a survey of that nature there's an airline manager who fills it out on a given day and, if you've had a run-in with them on that day, that's probably going to be reflected. There are some periodic pieces of nonsense in these comments. I think the best one most recently - and I think it's actually in the most recent report - was a complaint by an airline that one of our runways wasn't long enough, even though we haven't nicked out in the last 18 months and lopped a couple of metres of tar off the end of it. We've never had a problem with runway length before, never had a complaint about runway length, but apparently there's a problem with runway length. So I think there's a test of reasonableness. But this is a problem of small sample opinion based surveys.

The ACCC makes virtually no comment on the balance sheet information and so on. They make a comment about whether the cap has been complied with or not. That's a statement of fact. I guess the more contentious issues over the period of time have been the issues about treatment of taxi charges in Brisbane, Perth and Canberra, but that's in a sense the ACCC discharging that sort of function. They've got a view. The other airports in question and indeed ourselves have a different view. Gyles J's decision in the Federal Court - he's got a view too. So that's sort of where the matter rests. I wouldn't want to see a situation where when these things were reported, the comments were, "This happened and therefore this is evidence of abuse of market power," but commentary of the nature that we're sort of getting now doesn't seem to me to be unreasonable - general proposition.

MR MacLEOD: Can I go back to the question of the generic regulator against an industry-specific. That ACCC in their letter of submission to us have stressed the benefits of the generic approach, which largely seemed to be that they've got expertise in pricing matters and that that's something we shouldn't lightly give up. You said a minute ago I think that you were sort of agnostic about whether the BTE would be better than the ACCC or whatever. What I'm asking about is, we're trying to get to a light-handed approach and away from something that was focusing on price regulation. Now, price regulation in the inquiry phase of our proposal might be something that comes up, but in terms of just monitoring that wasn't the intention.

The whole idea of light-handed I want to come back to in a minute if I can, but just on this particular issue of who should be the monitor, do you have any worries about regulatory capture or whatever?

DR MUNDY: I've got some interesting theory on regulatory capture, but I think we made the comment in one of our submissions that it doesn't appear to us necessarily that the function of collecting information, putting it together in a useable form, a simile, and publishing it is something that's necessarily the sole preserve of the ACCC. Indeed, we don't necessarily see that that function, which is essentially what you'd assume to be some sort of statistical function, is necessarily the sort of skill that arises from people who are conducting pricing inquiries. I mean, the ACCC says they have a lot of expertise in this matter. I think you could say they've got a lot of experience in it. I think there would be people who would argue they have no expertise in it at all, but they probably would say that.

I think if your purpose for this is a general public policy purpose and you're trying to understand and provide information about how an industry works, then that's more the province of statisticians and economists than it is of regulators. That's just my general view, the same as we make the observation that we're not quite sure whether the conduct of inquiries is necessarily as sort of proposed in the draft - whether the sort of inquiry process is something that a competition regulator is necessarily expert in, and whether that's not necessarily the expertise of another body. I guess it's fair to say that that was one of the arguments which we were quite keen to advance when we made representations to the government about who should conduct the review of prices surveillance of airport services is that wider issues are - the regulators are quasi-judicial bodies. They think about precedents, they're concerned about enforceability, they're worried about the administration of the law. That's what they do, and when they're invited in to undertake other functions they bring, naturally, those prejudices and issues to them. If they're performing a regulatory function they are part of the process, and perhaps the reporting, monitoring, whatever process should be observed from the outside rather than from the inside looking out.

DR BYRON: So I take it then that you support the suggestion in our draft report about the separation between the policy and the implementation process.

DR MUNDY: Absolutely, without any doubt.

MR MacLEOD: Can I follow up then with the comment you made in the Part IIIA evidence, where you used the term "no teeth" in our proposal. Our proposal deliberately had no teeth in it, because this was the approach that we were thinking of - a very rare number of circumstances, uncertainty about whether it should be declared or not and therefore let's keep an eye on it for a period. The ACCC of course have questioned that, and there are two aspects I'd like to ask you. First of all, when you raised the question of no teeth, what was lying behind your thinking? Secondly, one suggestion that the ACCC have put to us is at least they should have

power to compel participants to provide information. You did somewhere mention about having a cup of coffee and wondering what your reaction ought to be at the first stage. What do you think about this idea about giving power to compel the information be provided?

DR MUNDY: When I was reading the draft report, this was an issue that crossed my mind. I guess the question is, if that's a situation where the people collecting the information can go and make requests for any information they like, they can be outrageously onerous on what they want and so on, I'd have a problem with that. If the situation is there is a monitoring regime put in place, the form of what's required is known, the information to be provided, presumably on a periodic basis, is well-specified and the power to compel is simply, " You will provide that information as required," then I have a different view. Again, it's very much like the situation in 7 and 8 of the Airports Act. We are required by law to provide that information, and we do. We don't have a problem with that. If it was a case that the ACCC or whoever the regulator is could hop on the phone and ring up and say, "Look, we've just been having a bit of a think about this. We'd like you to give us this, this and this in 30 days and if not we're going to compel you to give it to us," then we'd have a problem.

So it's a question of, if you're subject to a monitoring regime and you know the information you've got to provide is known and you provide it on a known periodic basis then I wouldn't necessarily see a huge problem with that. If you don't provide it, remembering that perhaps the monitoring situation from the point of view of the regulated business is an infinitely preferable option to what it might have been, then I reckon you've got a pretty fair chance of compliance. So I think that's a situation that I'm comfortable with monitoring arrangements and compulsion. On the question of no teeth, you've got me at a bit of a disadvantage because I can't actually remember precisely the context in which I said "no teeth".

MR MacLEOD: Do you have the transcript there?

DR MUNDY: Not of the IIIA inquiry, no.

MR MacLEOD: It's page 7 of that anyway. Would you like to refer to any of that? It's just to refresh your memory but - - -

DR MUNDY: It's three hearings ago now. Okay, this is on the lack of enforceability of the PS. The way section 22 works is you put your notice in, you get a view back from the ACCC and if you don't like it you can effectively tell them what to do with it and say, "We're not interested in that. We've heard what you said. We know the emperor's got no clothes. It's not enforceable." I think the ACCC notes that that's a problem as well, principally because it's regulation by shaming and that's what section 22 was always about. We think that if you're going to have a regulatory system it must in some sense be enforceable. Now, it's either enforceable in the way that a determination under Part IIIA is enforceable, it's enforceable in

on the appropriate course of action. We think this is really an important part of the process. The government is in at two stages here. Firstly, they are initiating the action, they are then receiving the recommendations. It becomes part of the political process. It's very important that we're going to have something as sensitive as price regulation in this country then it should be embedded in the political process. If the government then decides that, yes, there was a recommendation that some kind of regulation is necessary and that there is a need for some kind of surveillance then this would be undertaken by an independent regulator. The government, as we see it, would have set down the objectives that were to be achieved and these objectives would be turned into a code of practice of some kind by the regulator. But again it's a government that's actually providing the momentum to the regulator and it is a government decision.

Then finally as number 8, there would be a requirement for a periodic reassessment of the need for a prices oversight. I think that's really crucial to the whole process that individual regulators at individual instances - and there will be the ongoing in-built review process that's part of the original terms of reference, that even if it's agreed to set up a regulatory agency the final stage is still after three or five years to have a second look and go through the whole thing again and make sure it's not doing damage and that whatever originally was thought to be a problem is still a problem. We certainly think an approach such as that would be far more appropriate than the current circumstances.

There are then proposals for further consideration. We certainly endorse these as a sensible and appropriate way to achieve outcomes. But then as we say on page 7, this is certainly - if done in that way - a light-handed approach and it would limit the damage to the economy from overly-zealous price regulation. We would end up with price monitoring but no price controls that would seriously impede the economy. If this process were restricted to those industries in which outlays were relatively large and there were no alternative sellers, it would be relatively simple to endorse this procedure. But what we are worried about is that if you only put this approach into practice in a partial sense, rather than fully, then we are opening up the process to far more regulation and what we are concerned particularly here is that the thin edge of the wedge for the ACCC to take an even larger hand in dealing with prices regulation and given the manner in which the ACCC interpreted its mandate during the introduction of GST, this would be an outcome that would be genuinely disturbing to business. We also note that from the Productivity Commission's draft report where it noted:

> The ACCC considers that it required to adopt a cost base approach to assessing prices.

I think this is only one example of quite a few that where the ACCC's ability to deal with sensitive economic issues is shown not to be appropriate, that it is an agency that is not thinking in terms of what makes the Australian economy more efficient, it seems to be an agency that thinks more in terms of what it can do to keep prices

down as if that's itself some kind of legitimate outcome in an economy where prices provide the signals to the market, that it thinks almost individually, not as a price level but as an individual firm. I'll come back to that.

In our own view, this foot in the door by the ACCC will lead to a more inefficient industry structure and a more inefficient economy overall and to actually worse outcomes for the community, lower real incomes, lower growth. We just simply don't believe that the ACCC will be able to widen it's methodological scope to deal with the genuinely problematic issues involved. Therefore, as our conclusions, we think there should be no single agency monitoring prices, that the notion of a generic regulator of prices is simply something we are completely against. To the extent that we have seen it in action it has not - it has been a failure.

Secondly, we think, given that there's no generic regulator, the role should be conducted by specialist agencies with deep knowledge of the industries, so that we say that we agree with the recommendations of the report and with the desire to limit the role and scope of price surveillance. We also believe that the ACCC should not become the single regulator. We think there are few instances where this approach will be needed of any kind of price regulatory system at all. We think that it is too important an issue to hand the responsibility to an agency which has insufficient expertise to monitor the pricing process. Finally, we say that the additional cost of a small secretariat which would monitor prices will be more than repaid in the greater understanding that agency will have of the issues and problems that the regulated industries will face.

If I could just briefly turn to the ACCC's own submission dated February 2001, so this is following the interim report and draft report. The impression one has in reading the ACCC's submission is that it seeks more than just the thin edge of the wedge and the foot in the door, it seems to seek the whole box and dice and they see itself as conducting and taking on a major role in price regulation, as that form of roving bureaucracy that we are seriously concerned about. Under the heading of relationship between a reformed public Prices Surveillance Act and Part IIIA on access, I think you get some kind of the sense of where the ACCC is coming from, so they say, "Well, I'll give you a few examples," and they say, for example, that there are essential or bottleneck facilities that are involved.

In this particular instance we agree that there is a role for a regulator, not just for prices but to look at the whole of the industry and see things and prices in context. But, given the other issues they raised where they talk about network externalities where there's economies of scale and scope where they actually worry about the fact that the increased efficiencies of large industries, the lumpy and sunk investments that they seem to have, I think, an imperfect grasp of how economies actually work and how the continuous jostle between firms trying to provide the consumer's needs and to do it, and to replace each other, how that actually works in practice and I think that just reading that the view we have is that there's much greater danger from regulatory inefficiencies than there are from the inefficiencies that might exist in the

market. The actual concerns we have are that the ACCC taking an aggressive approach to its mandate would cause far more damage than any remote possibility of good that they might achieve.

I'll just come to the end here, but I think that - go back to the problems that would come from this kind of approach is that you would find, as with the GST introduction that they can say, "Well, there was no problem." Where the problem lay in the end was that the concern that businesses would have that the spotlight would be turned on them, so that the concern ultimately was a fear that the ACCC would single them out and the way they did with Video Ezy as the firm that was somehow exploiting prices and therefore damage their name in public. The fact that the ACCC has now dropped the case is no surprise to us because there was very little reason to think there was any issue there other than the fact that the ACCC was going to fine someone; that they were going to hold up as an example to the others. The effect, ultimately, was that we had the introduction of the GST where there was a surprise amongst many about how slow prices rose, and yet I wouldn't separate that slowness of the pricing to the fact that the economy did much worse in the post-GST period. I think that part of the problem was that businesses were afraid to raise their prices even though there were sound commercial reasons that prices needed to go up, that there was this concern.

I would then take this further that if investors become aware that Australia is a country in which there is this kind of aggressive attempts to monitor and control and regulate and oversight and whatever price regulators do, that we will become a much less appreciated destination for international capital. That there are reasons to be concerned that others will view us less favourably if we go down this tram line of using a much more aggressive approach to prices regulation. The approach, therefore, in conclusion, that the Productivity Commission draft report has outlined we would endorse, but we would also note our caveats that there are dangers to the economy if it is not put together as a single package but is in fact only some of it gets put in and some of it, particularly the bits where it's light-handed and rare, if those parts are taken out of the final process. Thank you.

DR BYRON: Thank you very much, Dr Kates, for those observations and comments. You've raised a number of very interesting and important issues. The first one I would like to take up which was in your submission and also referred to in your comments this morning about setting up criteria for industries or firms to be subject to some form of oversight surveillance or monitoring. As your submission rightly notices, in our draft report we haven't taken the approach of specifying a set of criteria, as, for example, the industry commission did in 94. They said if market share is greater than this, number of firms is less than that, and so on and so on. We've proposed instead a sort of investigative diagnostic inquiry process and one of the reasons for that is because of concerns about whether the criteria could be specified in such a way that it would always distinguish between cases where some intervention is necessary and cases where intervention is unnecessary and unhelpful.

One of the criteria that you have listed there is that the proportion of income spent on the product or service is large. Could you elaborate a little further on your rationale for including that one because it seems to me to imply that oversights concerned with distributional effects, or the impacts on inflation rather than efficiency consequences.

DR KATES: Thank you. Well, it was neither efficiency nor inflation that were the issues there, but what we're trying to do is make it limited and limited in the sense that - - -

DR BYRON: That's the substantiality test.

DR KATES: That's right, we're trying to ensure that whatever becomes the criteria for deciding that the process should begin, you should at least recognise that if you're dealing with a milk bar or - I shouldn't even say something as trivial as that, that there are almost no instances that I can conceive of in which we are dealing with a problem where it is only a tiny or smallish part of a consumer's income. I mean, where the problems have arisen are in things like petrol pricing, where people feel that they're big, you know, they really notice it - the price of petrol's gone up and it's 65 cents a month ago and now it's 95 cents - that is the kind of issue that comes to the attention of governments and regulators, so I think that in those circumstances that there is a case.

But if we're talking - just the example of Video Ezy and the video rental market - I could almost not think whatever else might be the case with whether, especially in such a ridiculously competitive market, where the idea somebody exploiting prices ought to have already been ruled out just from the start, but even if you thought there might be something there, that I think the substantiality test would fail right there. You'd say, expenditure on videos is so minor that whatever else is going on I don't think it's worth our while to interfere with the market because we think we can protect consumers by keeping the price of videos from rising as rapidly as it otherwise might have. I think that you really should build into the criteria that you choose something that says that the market has got to be allowed to unfold as it will and that the consumers are not protected if you are going to be worrying about small bits and pieces here in the economy, but what in fact will happen is that you'll have a far less efficient economy because price setters will worry about this organisation standing over their shoulder and they will worry about the enormous complexity of dealing with such a regulator if, for some reason, they happen to be the one that is fixed on by the regulator.

MR MacLEOD: Can I take you back to this question of generic versus specific regulator. You've come out fairly clearly on favouring the industry specific area, but there are two aspects of it that I would just like to follow up. One is since you are now a denizen of Canberra, the question of regulatory capture arises when you immediately talk about an industry specific party - point 1. Point 2, in what you've just said - I'm not sure whether I understood it correctly, but if I might be a little more direct, in which I think you might have said - are you implying that business

views anything that the ACCC does as different to what the BTE or ABARE or someone else might do? What's behind what you're saying?

DR KATES: The issue of regulatory capture - if the process is done appropriately - I mean, capture takes time. One assumes that - whatever regulatory body you might set up, it doesn't happen instantly. The process, since it's under review all the time, is one that if you start it, it is being reviewed anyway, so one of the issues that you might easily want to build into the review process is whether there is a regulatory capture in that sense. But also, I think, that behind the notion of regulatory capture is the idea that somehow those who are doing the regulating have some kind of sympathy for the industry itself and therefore when industry says, "Look, you know, we have a cost of capital is this; and depreciation rates are that," and whatever is relevant to them will reach a sympathetic ear, that they will actually understand that there are certain issues involved in trying to manage and run a business. So that the great danger you have is in a situation where those who are doing the regulation do not understand what those who are being regulated are trying to tell them. I think that slips into the second kind of issue, the second issue you raised, which is the - - -

MR MacLEOD: Just before you go on, can I stop you. The ACCC in their submissions to us are saying they are the body that's got most experience in questions of prices. Is it not better to keep that specialist knowledge together whereas say an industry-specific body might not have detailed knowledge of this?

DR KATES: You see, it's precisely the point that the specialist knowledge should not be in price determination. I mean, price determination is something that - we draw supply and demands curves as economists, but one thing you know is that prices are determined by such a hazy process within a firm that do you actually say to somebody, "How did you reach that price?" It's not as if you're dealing with a price. You're dealing in many firms with thousands of products, you're dealing with whole notions of how you want to market, where you want to market, to whom you want to market, the kind of sector of the market you're trying to reach. You have so many complexities going on just on the demand side, where you're trying to sell into. There are cost considerations. There's a long and medium to a short run. There are so many considerations that go into the process that there is no I think expertise that's available to anyone other than to know about the individual industry and what its own objectives are.

So to say that you have expertise in monitoring prices or in looking things over as a pricing organisation I think is just kidding yourself. They don't have that expertise. The very fact, as you noted in your report, that they mention the cost price as their approach to pricing almost itself says that they really don't understand how businesses set prices. The one certainty when you go through the literature on price setting in firms is that cost-plus pricing is not how firms do it. They may tell you they do it, they may even sometimes think they're doing it that way, but the reality is that no-one can ever demonstrate for any serious length of time that there is a cost-plus price approach being used, and in fact that's not how it happens. It's much

more subtle, a process much more subtle.

If I could, I'll go on to the second point, about the ACCC. While we were in this GST phase, trying to go through the process of how prices were being set and what kinds of problems were being caused by the ACCC's own approach to the pricing process was long and arduous. It was a long, arduous procession of meeting after meeting after meeting on something that was extraordinarily important to the economy - to make sure we got that right. I don't think in the end we did get it right, but we got it righter. But the problem here was that you say the expertise in price setting is only the expertise in price setting in a particular market context. It is a knowledge of the market and of the industry and of the firm within the industry which is the relevant knowledge, not in some senses the pricing process but the actual economic process in general, that is important. I don't think from our own experience with the ACCC during the GST or for other areas where we've seen the ACCC looking into the pricing process that they really do have that kind of sense of what the issues really are.

MR MacLEOD: If I can follow that up on the same line, the ACCC when they looked at our model of very light-handed monitoring - and I use the word "monitoring" deliberately, and notice they haven't mentioned prices anywhere - did suggest that there may be ways of improving our model. Two things in particular they mentioned were the ability of whichever party it is doing the monitoring to comment on the monitored data and, secondly, the power to enforce companies to provide the data that was to be monitored. Do you have any comments on those two points?

DR KATES: I think if I understood your draft submission properly - and I hope I have on here - one of the things that we agreed with very strongly was that this process should be one that's done quietly. It's not one that's done by regulation through press release. The process during the GST is I think really one graphic example of the problem here, where the ACCC would decide there was a problem and then the whole country would know it. Whatever else the process should be, that should be one of the things that is pulled out. The process is one in which everything is done quietly.

Once you get into the pressure by press release and, "We have named such and such a company as potentially in breach and we're now going to go and investigate. We're going to throw the full force of law," you are blackening a company's name, causing it serious commercial problems, before there is any evidence whatsoever on the record that there is a problem. It is simply the belief of the ACCC that there might be a problem. What you end up with is an outcome in which firms are terrorised into price setting that is actually harmful to the economy overall because they are concerned that the ACCC will take the approach it does.

So one of the important parts of the whole monitoring process should be that those that do the monitoring say nothing. It should not be their role to take on and to

publicly chastise businesses, which are just simply trying to set prices in a very difficult market situation. Now, what was the second - the power to expose the process - - -

MR MacLEOD: The second question is the power to enforce companies to provide monitored information. Would you have problems if that was included?

DR KATES: Yes, this is again one of those really crucial issues. The kind of diversion that takes place in a company when the ACCC rolls in has been quite extraordinary. The problems for, just to take Video Ezy, was not just that its name was commercially harmed, but also the fact that it then took a tremendous amount of resources inside the business itself to turn around and deal with the issues that were raised. So what you really do not want - this is again this roving bureaucracy issue - you do not want a situation to develop in which the ACCC or whoever this regulator is has the power to command anything it wants whenever it wants and to insist upon pricing behaviour going back years, cost behaviour, whatever. You really do want to have a process in which there is some understanding of how much difficulty and the kinds of problems that are created for a business in trying to comply with regulatory demands.

MR MacLEOD: That was my next question. It follows on. The ACCC have been politely critical of us in their latter submission in that we rely heavily on theoretical evidence rather than practical evidence for some of our discussion about the pros and cons of regulating prices. A problem here has been that the ACCC is repository of a lot of this information that would be useful and business, of course, has got the information as well. Neither party has been willing to divulge a lot of it to us. Can you explain to us why business is so reluctant to give us that sort of evidence? I'm talking about things that are in a sort of cost-benefit analysis of the whole operation?

DR KATES: I would first say that anybody who thinks that they have an empirical approach without a theory sitting there is again just kidding itself. There is no such thing as facts without theoretical organisation, and there's no doubt that the ACCC has a theoretical framework in which it puts its data together. In fact, as I said earlier, one of the problems with this is that the ACCC puts its data together in a theoretical way that does not actually address the subtleties of what's going on in the market.

As to why firms don't want to provide sensitive commercial data and put it on the public record, I'm not particularly surprised that they're reluctant to do that. It is one of the facts of life that such data has a tendency to be misinterpreted by those who have a desire to be mischievous with the data, and also the commercial-in-confidence genuinely is a problem. I actually don't see the problem for you in that you don't have actual data. I think much more sensible in fact is the fact that you do it on a theoretical basis. It's difficult to see what data you could find out that would change how you think about the way - that the best way to approach is to have light-handed dealings with the price-monitoring process. It's the

understanding of how markets work which is what is so crucial, and what is so admirable about the report is that it recognises the limitations to an empirical data-driven approach to deciding what the right price is.

There is no external body capable of telling a firm what the right price is. Even firms are never dead sure what the right price is, but is their capital and stake and it is proper for firms to make these decisions, except in the example of the access regime in bottleneck. I think for virtually all other instances the market will be the proper determinant, and if the ACCC finds that approach too theoretical, then this is part of the problem with the ACCC taking on this role as a regulator.

MR MacLEOD: Can I change the subject a little to monitoring itself. We have had experience in Australia of monitoring for some time. We've got sort of recently milk, petroleum, airports as examples of data that's been put into the public arena under the monitoring process. Can I ask you to comment on how useful you think that's been. Does your organisation avidly read these documents and use them in their advocacy? Do your members lie awake at night waiting for them to come out and find them useful? I'm asking about the process itself rather than any individual case.

DR KATES: It's clear that there's very little interest in these reports generally and certainly business in general does not worry over what the milk report might have been. They don't worry about the airports decisions and these are I think inevitably politically driven rather than commercially driven. Where these have shown up have been in situations where there is a concern that is expressed through the community or to governments about what has been taking place, for example with petroleum pricing or with I guess milk during the transition period but - - -

DR BYRON: I was just going to say I think it might be useful if we explore that there are different types of activity under this heading of monitoring that I think we should put on the record, that the monitoring of prices and the implementation of the GST was not done under the Prices Surveillance Act. We have the monitoring that is done under the Prices Surveillance Act. There's also monitoring of fuel prices which we'll be talking about shortly which I believe is not under the Prices Surveillance Act. Earlier this morning we were talking about the monitoring of airports charges which is done under Part 7 and 8 of the Airports Act. So there's four different processes, if you like, and we're calling them all monitoring and yet the way it is done, the degree of intrusion, the costs if anything that it imposes on business, the beneficial effects, may well be different for each of those different sorts of monitoring and I was just wondering if in answering John's question it might be helpful if we recognise that there's all sorts of different animals and we're calling them all monitoring at the moment.

DR KATES: There are different animals and that's exactly - I think each of those arrived at the monitoring stage because of the political process which is in fact how you envisage the process yourself, that government sees an issue that it wants

investigated if for no other reason than just to satisfy itself that there's no problem or to satisfy the community that there's no problem. So it sets the process going so that whether it's milk or airports or fuel prices, the underlying issue is to demonstrate that there is no problem or if there is a problem, to investigate it and to work out a potential solution to a problem if it exists. I think the fact that it's done in this way more or less reinforces what you were saying in your draft report, this is how it's going to be; this is how it should be. No generic regulator where there is a recognition of the commercial realities that lie behind. All of these within someone who has as its fundamental aim the insurance firstly that the industry is responding to market forces and secondly that the consumers are not being excessively charged because of the nature of the industry. I mean, this is what the process is for, to satisfy itself that everything is going appropriately.

MR MacLEOD: But it brings me back to the question of do you have any evidence of the usage of this data? I mean, you are in the business of public advocacy in your organisation and I presume in that process you're always looking for data and so on. Are these sort of monitoring reports, no matter where they emanate from, are they of prime value to you?

DR KATES: No, I've never used them.

MR MacLEOD: Do you know of anybody who does in the business world, any of your members who have said to you, "This is great stuff?"

DR KATES: No, I would say that there would be virtually no use made of them outside the regulatory bodies themselves.

MR MacLEOD: I mean, we shouldn't rule out the possibility that on its own is worthwhile. We're not doing that. Just because say business doesn't take them up and use them doesn't mean to say there's no value in it if the whole purpose of the monitoring is simply to put the information into the public arena and if anybody wants it it's there, they can go and get it, that's fine. I don't object to that.

DR BYRON: Or confirmation that there is in fact no problem.

MR MacLEOD: Yes.

DR KATES: Yes. I mean, the data is part of the political process of demonstrating one way or the other whether there is a pricing problem and whether the community is being charged excessively so that outside that kind of narrow usage there's not much use made of it. Within business, the assumption I think made pretty well across the board is that the market will take care of itself except in those situations such as the bottlenecks that are mentioned there so that powerlines may well be a genuine problem that those who own the powerlines can charge what they like. But aside from those very, very rare instances more or less I think business is quite relaxed about the fact that the market really does work and that since most of the

prices charged within the economy are actually prices charged from one business to another. There is very little concern, I would say, within business, that the market is doing anything other than what it ought to do and that is restraining prices.

DR BYRON: I think that leads into a question that I wanted to ask next where the ACCC has referred to the need to having prices oversight occasionally for what they call natural oligopolies and we will be talking further with the ACCC about this but how widespread do you think - maybe you first have to define what you understand by the term natural oligopoly but how familiar are you with this context in the context of regulation or is it a concept that is widespread in other countries perhaps?

DR KATES: It's a phrase I have not heard before but I sort of take it it means the two airline policy type of thing so - - -

DR BYRON: Four banks.

DR KATES: Yes. There are laws against collusion so that if you thought that they were setting prices together then there are laws that will stop that from happening and will prosecute those companies that do it. Other than that, it takes a second firm in an industry to make it a genuinely competitive environment. It almost only requires the potential for a second firm in the industry to make it a genuinely competitive environment. The educational aspect of what the Productivity Commission report should stress is that in situations like that there is no need for community concern; that there are the processes of the market that will ensure that no-one can long keep a price above the market. I mean, if nothing else was tested by the advent of Impulse, it was that trying to charge the prices that they did was too low. It didn't work. In good times and bad, if you're going to keep your firm afloat, you're going to have to find the pricing structure that works and they did not.

I think that the idea that there is a natural oligopoly that needs someone to keep an eye on it is fundamentally wrong; that in only those situations where there is a natural monopoly would you even begin to say, "Look, there is a call here potentially for someone to maybe keep an eye on prices," but once you're talking about industries which are competitive and in which there is more than one firm, I think that need just simply evaporates.

DR BYRON: So I take it you wouldn't agree with the ACCC's submission where they argue that a generic price regulation function can act as an incentive for self-regulation in industries by providing a clear alternative if their own pricing is excessive. In other words, the mere existence of the generic prices surveillance mechanism has a disciplining or conditioning effect on market behaviour, keeps them honest?

DR KATES: I go back to the GST story, that it didn't keep businesses honest. What it did was it kept businesses from doing what they ought to do in the market and that rather than allowing the market to unfold as it should they actually, in as it

sees it, keeping businesses honest, led to being partially responsible for the liquidity problems that businesses have had in the last nine months. So that rather than being able to earn the incomes that they otherwise would have had their pricing behaviour been as it normally would have been, instead businesses were constrained from behaving appropriately and putting prices up based on whatever it is, on the market conditions they faced, instead we ended up with firms less well off than they should have been and we ended up with I think a slower economy than we otherwise would have. I by no means say that was anything like the major part of the story but it was an important part of the story.

The idea that there is a need for a generic regulator, what we call is a roving bureaucracy to keep an eye on business where there is competition is just simply flawed. It is wrong. It sends all the wrong messages to business and it sends all the wrong messages to international investors. We just simply should not do that. We should limit as much as we can where you would like to have monitoring or regulations or surveillance. You should limit it to the fullest extent you can, say, "Here and here only," and everywhere else there should be the acceptance that the market will be the determinant of prices.

DR BYRON: I think that's probably a good point to finish on so thank you very much for your evidence, Dr Kates, and thank you for coming.

DR KATES: And thank the committee for giving us opportunity.

DR BYRON: The next participant will be from Shell Australia, Mr Harris and Mr McKenzie, if they're ready. So if you gentlemen would like to just take a seat and then introduce yourselves for the benefit of the transcript and the transcribers so they can recognise your voices later.

MR McKENZIE: Thank you. I'm Ian McKenzie and I'm retail strategy and development manager for Shell.

MR HARRIS: Peter Harris, senior economist for Shell Australia.

DR BYRON: Thank you both for coming. We don't actually have a formal submission from you yet but I assume - - -

MR HARRIS: It's coming.

DR BYRON: If you would like to take 10 or 15 minutes or whatever you want to make opening remarks or comments and then we can exchange dialogue later.

MR HARRIS: Hopefully you've received a draft submission, however?

DR BYRON: We have, yes.

MR HARRIS: Okay. We won't go on for that long. You've seen basically our main points in the submission. First off, thanks for providing this opportunity to comment on the report. We just began by quickly highlighting some of the things we might like to discuss today. Shell certainly agrees with the general principles outlined in the report that price controls should be a remedy of last resort and we apologise for focusing on a very, very narrow part of the report on price monitoring of the petroleum industry. Given the fact that actually a lot of the price monitoring activities are now becoming more ad hoc and called on by the government it in fact doesn't sit exactly with the terms of reference of the report.

But we certainly agree with the commission that price monitoring should only apply where there's evidence of monopolistic pricing and given we think our industry is ultra competitive in all segments of the market - we've got the lowest pre-tax petrol prices in the world and all that sort of thing - in an ideal world we shouldn't be subject to price monitoring but given the issue of petrol prices - it has become a real political football - there is perhaps still a role there for prices monitoring to overcome some of the information asymetries that continue to dog the industry. We certainly still think there's a role for the ACCC to play in doing this but perhaps the role needs to be more focused and objective.

We think perhaps some of the recent comments and actions by the commission haven't been objective, haven't perhaps been timely, and I think as with all government intervention you really need to assess the costs and benefits of such intervention. If I could highlight - and we can go into more detail if you would like

us to discuss it later - some of the ACCC investigations into post-GST petrol prices and also the fuel sale grant scheme, also comments on price rises on Anzac Day and Easter Thursday, we don't think were particularly helpful to the industry which in many instances is struggling to survive. If the criteria for prices monitoring is to improve economic efficiency, a clarification of the role of the ACCC could help improve some of the state by state outcomes, such as South Australia and Western Australia where we're seeing restrictions on competition and poorer outcomes for consumers.

As we highlighted in our draft submission which we've now formalised, Shell believes that this is best done by the interim step of requiring the ACCC to report annually on its monitoring activities clearly stating the objectives and making a rigorous assessment of the benefits and costs. Perhaps we can spend some time today discussing what those objectives might be. We also suggested the Productivity Commission might like to conduct a periodical review of the effectiveness of the ACCC's monitoring activities. Obviously that depends on what might happen down the track and whether they continue to monitor prices. We certainly don't profess to have all the answers but we'd be happy to discuss these issues today, in particular the commission's views about the appropriateness of ACCC commenting on prices. If the ACCC was stopped from actually commenting on prices this might go a long way to depoliticising the issue but if the objectives of price monitoring were actually clearer, the more comment the better perhaps. It depends on what the role of price monitoring is and what the objectives are. I'll stop there and be happy to field any questions you might have unless, Ian, you've got anything you'd like to add.

MR McKENZIE: No, that's all right.

DR BYRON: Thank you. I think much of what we need to explore and clarify in moving from the draft report to the final report does relate to this issue of monitoring. I don't know if you were in the room a few minutes ago when I said we seem to have four different procedures that are all called monitoring. There was the implementation of the GST that was not done under the Prices Surveillance Act; the monitoring of petrol prices which affects you now is not done under the Prices Surveillance Act. But there's also, in the case of airports, in the Airports Act there's a stipulation that each airport is required to report annually on data X, Y and Z to a central repository which happens to be the ACCC who will then publish that information and so on, with or without comment; and then there's monitoring under the Prices Surveillance Act where the ACCC, if you like, has much more discretion and flexibility. It can ask for additional data; it can ask for more detail on this; it can come back to you and say, "What about somewhere else."

We're really trying to sort out what sort of monitoring under what conditions and then perhaps the question of who receives this information is important and what they do with it and how often and so on, and whether the fact that a monitoring system is in place would in some way vaccinate the company against other claims, provide some sort of protection on it and so on. The question, I guess, is the

informal monitoring of the retail petroleum industry at the moment by the ACCC. Your submission basically says that you don't feel that's too intrusive and if credible authoritative monitoring by the ACCC prevents something worse from happening, that's okay. I mean, you're quite happy to live with that sort of monitoring.

MR McKENZIE: I think it really comes down to the clarity of the objectives, what the monitoring is designed to do, and the quality of that monitoring and how objective it is. Clearly, the petroleum industry has a huge problem with public perceptions, although as Peter said, we've got the cheapest pre-tax prices in the OECD. We've got a long history of low profitability, yet the public perception is an industry that's anti-competitive in delivering bad outcomes for consumers but on a hard objective analysis of the facts, it doesn't support that proposition. Hence we have a public perception problem. That turns into a political problem and then ironically in terms of consumers that can work against their interests because the political pressure leads state governments to intervene and in our view it's detrimental to both the interests of industry participants and consumers.

So from our perspective, trying to get a better understanding in the general community and in the political community of the reality of the industry, as opposed to the perception, is very important. I think the industry itself bears the lion's share in doing that and educating our customers and external stake-holders about what the facts are. The sort of things that Shell has been doing in that area is to put a lot of information in the public domain via the Web site - - -

DR BYRON: We looked at the Web site.

MR McKENZIE: - - - giving a breakdown of petrol prices, historical trends in petrol prices, also getting together with organisations, such as the RACV, to publish in their forums a breakdown of petrol prices so people can see exactly who gets what. So although I'd say the industry has the prime responsibility, if we've got a perception problem it's up to us to address it. An independent body, whether it's the Productivity Commission or the ACCC, can certainly help doing that if it's done in a robust, timely and accurate fashion. Our main concern is where that activity isn't done in an objective fashion and it has political overtones, then it does more harm than good which promotes the likelihood of further public anxiety which leads to political anxiety which often leads to political intervention.

MR MacLEOD:

ripping them off.

MR MacLEOD: But what you're doing is destroying any idea of self-regulation in your industry and saying, "That's not on, it has to be a public body." The ACCC are saying something slightly different to us: that is, they have built up expertise in pricing matters and across a wide range of industries and that if that is what you're primarily focusing on then the case for the generic regulator - namely ACCC - is stronger.

I presume also - I'm not sure - but I presume the question of regulatory capture comes along and it's a bit harder to capture them than it is ABARE or someone else - I don't know who. Do you have any views about that expertise that they have built up and whether it is in fact the right place to do this monitoring?

MR McKENZIE: Perhaps if I go back to the first point, where we're saying we're sort of giving up and taking the second best option. Even though first principles suggest there's no need for monitoring, we've got a perception problem that we need to deal with. We have been trying for a number of years to deal with that ourselves but somewhat unsuccessfully. So independent third parties I think can send a powerful message.

Hopefully you don't have to do that forever and you really only need to do it for as long as the gap between perception and reality is so large that it's causing problems, and by "causing problems" what I mean is creating the environment where other regulatory intervention which is detrimental to the interests of the industry and consumers is being actively considered. So the ACCC I suppose, by the nature of its history and involvement in the petroleum industry, starts with a good background and a high public profile in this area. So I think organisationally it is well placed to try and address this information asymmetry. But I don't think that's how it sees its role. It's pursuing a different role, which is more about a legal compliance role than an information asymmetry role.

DR BYRON: We talked about the enormous number of inquiries over the years into the petroleum industry in Australia. Do you know if any of them concluded that the petroleum industry was uncompetitive or anticompetitive or - - -

MR McKENZIE: Lots of them have, yes. There's a lot of diversity in the style and quality of the reports. I would say examples of robust reports where the inquiry has been detailed and has gone beyond the assertion to try and establish the facts would have been the 94 Industry Commission Report and the 1995 New South Wales Price Commissioner's Report, but they're also examples of reports which reach entirely the opposite conclusion. An example of the most recent one would be the Western Australian parliamentary report which we actively participated in, submitted a lot of data, generally put the view that if you - many people say the industry's not competitive, but you need to go beyond the assertion and look for the evidence. The way these reports are generally written, when they conclude that the industry is

uncompetitive, is lots of sentences that say the committee was told XYZ. They report those uncritically and in our view have recommendations that are based largely on anecdotal assertion, rather than a rigorous analysis of the facts.

MR MacLEOD: But those people have concluded that - the basis of that likely to be covered by some other section of the Trade Practices Act?

MR McKENZIE: Sorry, I don't understand the question.

MR MacLEOD: Well, just for example, I don't know whether any of them actually thought you colluded, for example, between the majors, well, then that is an offence under the act.

MR McKENZIE: Yes.

MR MacLEOD: So, what we're addressing is not relevant to that, to those sorts of behaviours. Everybody agrees there are strong measures in the act and they ought to be used. But that's not the circumstance we're talking about, and I just wonder about this. I also wonder about your suggestion, which is the first time I've seen it so positively, except in my old days of bank nationalisation, that the industry itself has got a responsibility to educate people. If that was a common view, then monitoring would be somewhat redundant.

MR McKENZIE: I think where we're at at the moment is somewhat in the middle and is the least desirable outcome. The body that does most of the monitoring in this area is the ACCC and I'd say their performance in this area is somewhat mixed. In our view that activity needs to be done in a more robust, accountable and objective fashion, or not done at all. Where we're at, at the moment, is the least desirable place to be.

MR MacLEOD: Can we just come back to the word accountable in a minute.

MR HARRIS: Could I back track from, say, Western Australia; the Select Committee Report that Ian described - it described the complete lack of transparency in prices in the industry then threw out the whole report - quoted prices from Shell. There was just no substance to the report. We're now in a situation where they've completely re-regulated the industry; set maximum wholesale prices; capped prices; talking about setting retail prices. So if you think that is a bad outcome for consumers, if you actually believe the industry is very competitive, I would have thought - one reason why the government would want to be involved is to stop that from happening. If you believe the industry is uncompetitive, well, the state governments are doing the right thing. I think that's where we're coming from. That's the role for monitoring and if there is a role for an independent government authority, whoever that be, actually stopping uncompetitive outcomes from happening, that's a good thing. If we could do that by ourselves that would be great, but as we say, our public perception, which is nothing new, is pretty bad and people

despite how many facts we put in front of them don't believe us.

MR MacLEOD: Stop for a minute. One of the things we are saying is that if it's clearly a competitive industry, then our report doesn't apply, and you are saying in your submission that if any industry is competitive, this one is. So that's a slightly different argument to some theoretical monopolist who is ripping off - perceives to be ripping off - - -

MR HARRIS: I'd say there's different sorts of market failure and I suppose the market failure focused on in your draft report is about where markets aren't delivering competitive outcomes. I suppose the market where there's, in our view, clearly a role for intervention. Our view is that that sort of market failure is not apparent in the petroleum industry and we think the facts support that, but there is a market failure in terms of an information asymmetry in that the public perceptions of the industry are far removed from reality. That information asymmetry and market failure is, in our view, the thing that leads to a whole lot of these public inquiries; leads to these reports and leads to government intervention and they're detrimental to the industry interest and the consumer interest.

So it's the information asymmetry market failure. It's the one which we have been trying to address through a whole range of mechanisms - have not been fully effective in addressing that mechanism. We think that the way that the ad hoc monitoring has been carried out has probably increased that information asymmetry rather than decreased it, but if that role was carried out in a more robust manner, we can see scope for it to reduce the information asymmetry.

DR BYRON: I think most of the debate about prices surveillance and monitoring, particularly monitoring as about getting evidence, to prove that something untoward is going on, and what you're asking for is to have monitoring imposed to get evidence to prove that nothing is going on.

MR HARRIS: Correct.

DR BYRON: Whereas the ACCC might be looking for evidence of guilt, you're asking for monitoring to prove evidence of non-guilt.

MR MacLEOD: Is there something behind your idea of accountability? This is the first time it's been raised with us - accountability - was this lying behind, I mean, what you're saying to us all along is that if the analysis was objective; if the data collection was objective, you would have no objection to it. Is there some hint in this that it's not?

MR McKENZIE: In your draft report, in appendix B, you had suggested principles of best practice regulation which we agree with entirely and number 8 of those was accountability, so the person doing the monitoring has to be accountable for the accuracy, quality, timeliness of - - -

MR MacLEOD: Can you give us an example in the petroleum industry of how that might work.

MR McKENZIE: Well, the suggestion that we've made is that the ACCC was continuing to undertake this ad hoc monitoring, that in their annual report they summarised their activities outlining the cost and benefits of that monitoring and that periodically a third party, perhaps the productivity commission, assesses the effectiveness of the monitoring activity.

DR BYRON: So you'd like to see the ACCC get a front page headline on the Sydney Morning Herald that says "Petrol companies NOT ripping off 500 million."

MR McKENZIE: That would be helpful, yes.

DR BYRON: That's something of a similar prominence to the sort of accusations that get thrown up occasionally.

MR McKENZIE: Yes.

DR BYRON: Rather than a one inch retraction on page 42.

MR McKENZIE: Correct. I mean that issue, in our view, could have been dealt with within a week and the political heat could have gone out of that quickly, rather than 11 months after the event.

MR MacLEOD: So what does the accountability phase do to that, I mean, would the accountability be - did they deal with this promptly, within a week as you're saying. Would that be one of the things you are accountable for?

MR MacLEOD: I'd say, well, you would set up your principles - the ones that you have here I think are a fairly good set of principles, but essentially what we would argue is that the activity needs to be timely, fundamentally it needs to be accurate and it needs to be objective. Now, if I was to say another example where we believe those criteria haven't been met would have been on the lead up - the period just after Anzac Day, where the oil companies were criticised by the ACCC in the Sydney and Brisbane markets for increasing prices on or prior to Anzac Day and the statement was made this is cynical, opportunistic and un-Australian behaviour and the grounds for making that statement were that prices never go up at the start of the week, whereas a factual analysis of the market shows that unlike the Melbourne and Perth markets, the Sydney and Brisbane markets routinely tend to be higher at the start of the week than the end of the week, so there was an example where the factual analysis was simply incorrect. Therefore, the conclusions drawn from that analysis were incorrect, but the industry was, through this ad hoc monitoring, held up to ridicule.

MR McKENZIE: What you are really saying to us is that monitoring has got a lot of dangers.

MR MacLEOD: Correct. Exactly right. In our view the only way it can have a positive role in an industry such as ours is if it's done in a manner which meets the best practice principles that you've outlined. If it doesn't meet those principles, you're better off doing nothing.

DR BYRON: Do you have any suggestions with regard to that page in front of you, ways that we might improve that proposal or suggestions of what would - anything you'd do differently or add to it or suggestions for implementation of that sort of monitoring regime?

MR McKENZIE: In terms of these principles - no, we think they're excellent.

DR BYRON: I guess a lot of the concerns that you are expressing come down to the manner of implementation of the monitoring or even the wording of the press release. You can either say, "This party has been found to be completely innocent of the claims," or you can say, "We haven't yet found enough proof to prove that this party is guilty." Now, I don't know that legislation can handle that and I don't know that you can say changing from this agency to that agency or from a - I don't know how you prescribe to prevent the wording of the press release being one spin rather than the other spin.

MR HARRIS: Well, that's what I sort of mentioned in the opening statement. We don't know what the objectives would be to try and achieve those sort of outcomes and as John's alluding to, maybe you're better off with no regulation at all - or no monitoring at all, if you can't achieve that, but it would be quite difficult without the ACCC becoming just an all-industry advocate. What they could become is perhaps more of an advocate for competition and stressing that it does exist; it is there and consumers will get a reasonably good deal and explaining why change occurs. But, again, it's very difficult to put that into legislation or objectives.

MR MacLEOD: The risk here is that once you set it up there is a preservation interest of the party concerned to make certain that it continues, therefore, you're never definitive, you never say this is a useless exercise, we're not achieving anything. You always say, "Well, maybe nothing's happened so far, but who knows what's going to happen next week." That's why we, when our proposal were - trying to contain a power given to somebody that started off by wanting to monitor unleaded petrol and turned out to be monitoring service stations selling ice-cream of, whatever - other things that were peripheral to it. We were trying to find a way of containing it, realising that that's probably wishful thinking, but - - -

MR McKENZIE: We share your concerns and recognise the risks inherent in going down active monitoring of an industry which is obviously competitive. I suppose our submission is somewhat borne out of desperation in that we've tried

everything we can think of over a number of years and have had little impact.

MR MacLEOD: I suppose the idea that we put forward that any such monitoring might be subject to review in three years, you wouldn't be enthusiastic about that other than that history shows you that nothing has changed.

MR McKENZIE: No, I think review of the monitoring in terms of both its impact on the market and to come back to the accountability point of view, a review of how effective that monitoring was done would be very useful and without that sort of review mechanism and without that sort of accountability, we think that's critical if you're going to go down this path. You asked the question how do you ascertain the degree of objectivity or fairness of the monitoring. That's always going to be a somewhat subjective judgment. That was the thinking behind our suggestion that you get a third party to review the activity of the party doing the monitoring, in that way to try and have a greater degree of transparency and accountability about the monitoring process.

MR HARRIS: And again, very difficult to assess the effectiveness. What do you say, "Australia has still got the cheapest petrol in the world. Maybe the ACCC has been doing a very good job in helping achieve that," or do you have to look at examples where intervention is occurring like Western Australia where prices are going up? It's very difficult, I think to - that's where we're very broad, I think, in our submission, because as I said, we don't know the answers and it's very difficult to sort of come up with a precise definition of what we're trying to ask for.

DR BYRON: Can I change the subject slightly. In the submission you note that retail margins in Australia are low and that in the year 2000 Shell's petrol retailing business actually lost money.

MR HARRIS: The oil price.

DR BYRON: The oil price, okay. Going back to John's point about history, what was the situation like when petrol prices were actually being regulated in the past? Was Shell a more profitable company then when it was less competitive?

MR HARRIS: I can actually show you a chart here of historical profitability which is - - -

MR MacLEOD: Is this including or excluding the production of oil and gas?

MR HARRIS: This is just on the downstream - - -

MR MacLEOD: So it's refining and marketing.

DR BYRON: I was wondering before when we were talking about public perceptions of the industry, you may be suffering from the fact of being vertically

integrated and people think that because of your exploration and your drilling extraction activities they just sort of think of Shell as one huge monolithic organisation and therefore you've obviously got far too much money et cetera whereas if you were the XYZ Petroleum Co and you were buying, you know, at arm's length from a producer and refining it and retailing it yourself or buying it from a refiner and just retailing, then you wouldn't have all that baggage in the terms of public perceptions that you're making money out of the OPEC oil price.

MR McKENZIE: Yes, I think that certainly contributes but it's not an explanation of where we find ourselves and why do I say that? For example, Caltex only has downstream activities in Australia, it doesn't have upstream activities, but they could find themselves under a similar level of attack.

MR MacLEOD: Do you think the Australian public distinguish between Caltex Australia and Caltex worldwide?

MR McKENZIE: Probably not.

MR MacLEOD: But did Shell - they would look at it worldwide.

MR McKENZIE: No, but perhaps the more persuasive argument is undoubtedly it contributes when Shell announces a record profit this year of $1.3 billion yet the refining and marketing activities lost $63 million the focus is inevitably on the $1.3 billion which is largely generated out of sales of LNG into Asia. So there's a good story to be told there about record export earnings for Australia but you're quite right that the connection is between record profits and high petrol prices. But you don't have to go back only a few years ago when oil was $12 a barrel not $30 a barrel and the upstream part of the business was losing money. We still had these perception problems about petrol so I think it's a contributing factor but doesn't explain - it's not a total explanation.

MR HARRIS: Even if we called ourselves, you know, United Aussie Independents, we would still have perception problems. For example, the 24-hour rule in WA, the people that are hurting most from that rule are the independents so a rule that's brought in to perhaps protect their interests has actually been most detrimental to the smaller operators that have been really hurt with lower margins.

DR BYRON: If rules were brought in by a state government that in effect eroded your margins completely or set retail prices higher than what you can buy the stuff for, is there a serious possibility that some petroleum refiners in Australia would just say, "We can't operate in the country under those conditions"?

MR McKENZIE: That's a real possibility. The Western Australian regulations at the moment - the maximum wholesale price is set below our cost of supply. The way the regulations are written, we remain entitled to continue to supply our existing contracted customers at the contracted price. If those regulations were changed such

that all customers had to have access to the maximum wholesale price as it's currently set then we would be placed in a position where we're required to sell at a cost that's lower than our cost of supply. So I suppose this would not be a new argument to the commission but the consequences for bad regulation to have serious impacts are quite high.

MR MacLEOD: Can I just follow that point up because the ACCC have been a little critical of us in a polite way that we're relying on theoretical arguments against price regulations of any kind and we've had problems in getting industry data that was adequate for us. We've got bits and pieces but nothing there. Here is an industry, the petroleum industry, that if anything ought to be able to show us the cost benefit to the Australian community, economy, whatever. I mean, if you were a PhD student and you just had to do this thing it would sound a very attractive proposition that you ought to be able to say some effect on investment and employment and all those sorts of things. Is it as clear-cut as that or is it more difficult?

MR HARRIS: To try and assess - - -

MR MacLEOD: To get that information that supports the case that you can intervene in prices without harming the national interest? Your predecessor is sitting there. I'm not quite clear about that. It's based on theory, what he's saying.

MR McKENZIE: I'm not sure I understand the question.

MR MacLEOD: What I'm saying is to say that intervention in prices by government authorities is not good for an economy and therefore ought to be severely lifted. You have to have some evidence of cost benefit. You can't just make the assertion. You can if you just want to believe in theory and say, "Look at the rest of the world and look at all the textbooks that have been written and I'll show you that," but wouldn't it better if you had some practical examples.

MR McKENZIE: Okay.

MR MacLEOD: In this industry above all others surely those examples ought to be there. It has got every sort of possibility of government intervention including wanting a refinery in their own backyard, those sorts of things, which were nonsense from years ago, but are there. It has probably got examples of over-investment in terms of service stations and so on - those sorts of issues about where's the public benefit.

MR McKENZIE: I could think of a couple of examples spring to mind where government intervention has been clearly detrimental to the public benefit. In South Australia at the moment the South Australian government has built a new fuel quality standard which is tailor-made for the local refinery. In our view it's not about producing good environmental outcomes, it's about creating a situation where effectively it becomes very difficult to supply fuel into that market except from the

one local refinery so it's protectionist policy, not environmental policy. The effect of that has been to increase the market price to South Australian consumers. So in some ways that's worse than general say tariff type protectionist policy because at least that is transparent and you can have a clear judgment about whether that's appropriate. Here you have a piece of protectionist policy which unambiguously has increased the price paid by consumers but it's cloaked in these environmental objectives so it's not even clear that it is protectionist policy to the casual observer.

MR MacLEOD: Do you think if I was a PhD student I could make a case for the industry despite all this having over-invested?

MR McKENZIE: If you looked at some of the profitability of the industry and it has been poor, by no means do you attribute that blame to government regulation. I think there's many examples where Shell and other companies have made investment decisions with the benefit of hindsight we wouldn't have taken, be that spending too much money on building a service station or be that spending too much money on upgrading a refinery.

DR BYRON: I guess what John is getting at is that we've found some evidence of what the costs are of these price interventions in the economy but it's very hard to get anybody to tell us what they think the benefits have been and I would have thought that the ACCC was very well placed to make that claim of what benefits price intervention have produced but basically we are having to rely on first principles, given that nobody has sort of come forward with claimed achievements of what have been the beneficial outcomes of this.

MR HARRIS: Somewhat perversely in our industry it's the competitive nature of the market that means we're not actually making any money. If there was more regulation perhaps we would make better returns but at the same time, as say for example what is happening in Western Australia, you would think fundamentally that that regulation would allow us to make more money but if price controls are set and they're set too low it just puts you out of business straightaway. So the sovereign risk that imposes on Shell is greater than the potential to make more money under re-regulation so that's our major concern. So again, it's very hard to assess the benefits of avoiding price regulation if prices are already low.

MR MacLEOD: Can we go back to that period in Australia when a government regulatory body was in fact setting daily prices and say what happened then.

MR McKENZIE: You only have to go back a few years to when the ACCC was setting a maximum wholesale price. My view is what impact did that have on market prices? I would say it had a minimal impact. The way that the maximum wholesale price was effectively landed - an import parity, derived price, landed price from Singapore plus 7.1 cents. Why it didn't have much impact on market outcomes is because the competitive nature of the market meant in the vast majority of cases you weren't able to achieve 7.1 cents in the market. So I suppose here's a case of

intervention - if maximum prices are set, it's one of the difficulties I guess if you set the price too high it has no effect; if you set the price too low it has a disastrous effect on the sustainability of the industry and the ability of someone to set the price just right is very difficult.

DR BYRON: The previous witness made that point very strongly too. Just to come back to the question about the monitoring process, the proposal we've described in our draft report is we have an inquiry and if the inquiry is convinced that there is a problem they may propose a period of monitoring, after which there would be some other evaluation, that the monitoring wouldn't just continue to be a sunset. If, for whatever reasons, it was still on the agenda as a major political issue, after say the three years of monitoring, what we're proposing is that there would be another sort of - it would start at step 1 again with the inquiry. What we had in mind was that that would say, "Is there a problem? Is it pricing? Are there structural reasons or pro-competitive reforms that you want or is monitoring or some sort of price surveillance required or something?"

But we're seeing that as a re-evaluation of the whole issue rather than just say, "Well, how good has the ACCC's performance been for the last three years." Is there a difference between what we're proposing and what you're proposing?

MR McKENZIE: I think we were just proposing an additional step. I think your proposal is about looking at the industry and making an assessment about whether monitoring is required. We were taking it really from quite a narrow perspective saying that the only reason for doing monitoring in this industry was to try and address a public perception.

DR BYRON: It's the information provision.

MR McKENZIE: It's politically driven rather that economically.

MR HARRIS: If perceptions haven't changed, maybe that's the criteria. After three years say, "It hasn't worked. Scrap it."

MR McKENZIE: But the problem - and this not going to be terribly helpful to you, but the problem with a review is that it all comes back to the quality of that review. Another example would be the recent Senate inquiry which was another inquiry that we made that submission to it. That had representation from the government, the opposition and the Democrats. The report that came down - there were three different reports with three different conclusions. So the difficulty is when you go through that review process is in theory it sounds fine but at the end of the day it all comes down to the quality of that piece of work.

DR BYRON: Also that point can be made, I guess, about all the inquiries that not all inquiries are equal. All oils ain't oils and so on.

MR McKENZIE: Correct.

DR BYRON: I'm a bit conscious of the time and I realise that you gentlemen have other commitments. Is there anything else that you would like to say in conclusion or to summarise?

MR McKENZIE: I suppose if we were to wrap up the discussion, we certainly recognise the concerns you express about monitoring activity in industries where there's demonstrable competition and we've put forward a suggestion that there is a role for monitoring in an industry such as ours and you might make an argument that it might be appropriate in banking or insurance or other industries where there is a similar perception problem. But if we're to go down that route it's only in our view going to be a beneficial thing to do if the quality of that monitoring is of a high standard, it's objective, and the body doing the monitoring is accountable for the quality of their work.

DR BYRON: That's a very good point. Thank you very much.

MR McKENZIE: Thank you.

DR BYRON: I said at the opening this morning that if there was anybody else at the end of the proceedings - that completes the agenda. Is there anybody in the audience who would like to come forward and make a contribution on the record for the transcript? I'll give you all a moment to think about that but if not then I would like to thank all the participants this morning, particularly Mr Harris and Mr McKenzie here, and declare the hearing closed and we move on to deliberations and preparation of the final report. Thank you very much for your participation.

AT 1.06 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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