Pro-competitive regulation is currently being reviewed in Australia. A number of parliamentary inquiries have dealt with the role and specific provisions of restrictive trade practices legislation, and the scope of the Trade Practices Act is to be considered by an independent review of a national competition policy. The Industry Commission has also encountered a number of these issues in its public inquiries.

In this paper, the Commission examines how pro-competitive regulation, and particularly restrictive trade practices legislation, can best be used to improve market outcomes. It integrates the research and findings of recent Commission inquiries which have dealt with these issues.
1 INTRODUCTION

`Competition policy' broadly aims to enhance community welfare by either removing, or reducing the undesirable features of, impediments to competition. Impediments to competition can result from existing government intervention in markets, the characteristics of the markets themselves, or the behaviour of firms within those markets. As competition for resources and markets is the driving force of an efficient economy, competition policy underpins a country's economic performance.

Competition policy is an amalgam of regulatory and deregulatory measures. The regulatory measures include prices surveillance and the prohibition of certain restrictive trade practices, and are called `pro-competitive regulation'. The deregulatory measures involve the progressive removal of `anti-competitive regulation', and include the phased reduction of tariff protection and the removal of regulations which restrict entry into markets by new firms.

The Commission has encountered both the regulatory and deregulatory aspects of competition policy as part of its inquiry program. Reflecting the nature of the references sent to it, the Commission has traditionally focussed on deregulatory means of promoting competition. Increasingly, though, the Commission's inquiries have required it to analyse the operation of the regulatory aspects of competition policy, particularly legislation governing restrictive trade practices. Recent examples include the Commission's inquiries into government (non-tax) charges; statutory marketing arrangements for rural produce; rail services; energy; and water resources and water waste disposal. These issues will also be addressed by current

1 'Restrictive trade practices' is the common term applied in Australia to conduct subject to the anti-trust provisions contained in Part IV of the Trade Practices Act.
inquiries into post, mail and courier services; ports; and horticulture.

Even with progress in the deregulation of many parts of the economy, individual markets can fail to engender competition, for two main reasons:

- first, monopolistic supply is entrenched in some markets, either because goods or services can most cheaply be supplied by one producer (that is, there is a natural monopoly) and/or because government mandates supply by a single producer; and

- second, some markets exhibit certain characteristics which may allow some participants to acquire and exploit a high level of influence over prices, output or sales in the market; and thereby profit at the expense of others.

In either case, pro-competitive regulation may be warranted. For markets of the first type, restrictive trade practices regulation and some form of control or monitoring of prices may be needed to restrict abuse of monopoly power. For markets of the second type, restrictive trade practices regulation may be needed to prevent anti-competitive market practices arising from concentration of market power.

Part IV of the Trade Practices Act provides the restrictive trade practices component of pro-competitive regulation in Australian legislation. The practices prohibited include:

- arrangements between competitors which lessen competition including price agreements and exclusionary provisions such as boycotts;

- use of market power to damage or threaten existing or potential competitors;

- exclusive dealing — that is, imposing conditions which impede the ability of buyers or suppliers to deal with third parties;

- resale price maintenance — that is, imposing a minimum price for the resale of a product;
1 / INTRODUCTION

- price discrimination between purchasers of like products on like terms; and
- mergers that would place the acquiring corporation in a position to dominate a market or strengthen its power to dominate.\(^2\)

The grounds for prohibition vary from practice to practice. Some are prohibited only if they result in a substantial lessening of competition. Others, such as resale price maintenance, are prohibited outright, regardless of their actual impact on competition.

In addition, the Trade Practices Commission (TPC) can authorise firms to engage in some practices that would otherwise breach the Act, provided the organisation can show that such behaviour is likely to confer a net public benefit.

The prices surveillance side of pro-competitive regulation is currently the responsibility of the Prices Surveillance Authority (PSA). The PSA was established in early 1984 as part of the Government’s Prices and Incomes Accord. Under the Prices Surveillance Act, the PSA has broad powers to investigate and control prices for the supply of goods and services by a range of corporations (other than state government organisations) in any market in Australia, upon the request or approval of the Treasurer. The PSA has two broad functions:

- to hold inquiries into prices in nominated markets; and
- to approve specific price rises or the supply of products at specified prices by organisations who have been ‘declared’ as subject to the Prices Surveillance Act.

Progress in the deregulation of many markets during the 1980s now requires a shift in the focus of pro-competitive regulation. In markets where tariff reductions have

\(^2\) In June this year, Cabinet authorised a change in this provision which is discussed later in this paper.
increased competition from imports, pro-competitive regulation is now less important. On the other hand, the removal or downgrading of specific regulatory regimes, such as in banking and domestic air travel, has increased its relative importance. Meanwhile, the corporatisation and privatisation of some government enterprises has necessitated the review of current exemptions from pro-competitive regulation.

Further, during the last two decades, some fundamental rethinking has occurred in other OECD countries about the role of pro-competitive regulation. There has been a shift of concern away from industry structure and towards market behaviour. Additionally, some business practices, such as various arrangements between suppliers and retailers, which were once thought to be unambiguously anti-competitive and detrimental to community welfare, are now acknowledged to reduce costs and to improve community welfare in certain circumstances.

It is therefore timely to assess the operation of pro-competitive regulation in Australia, and the Prime Minister has announced an independent inquiry into this area of the law.\(^3\)

In this paper, the Commission draws together and extends its analysis of the pro-competitive components of competition policy. It concentrates on the role of restrictive trade practices regulation rather than prices surveillance. Discussion of the direct regulation of prices is restricted to the analysis of measures designed to regulate markets where there are natural or mandated monopolies.

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2 THE ROLE OF RESTRICTIVE TRADE PRACTICES REGULATION

Discussion about restrictive trade practices regulation often assumes, either explicitly or implicitly, that competition, consumer interests, and community welfare are synonymous.\(^1\) Thus, each is regularly used as the goal of restrictive trade practices regulation on the assumption that what is good for one is good for all three.

But while these goals are closely inter-related and policy measures designed to further one will often achieve all three, this is not always the case.

In this chapter, the Commission discusses the inter-relationships between competition, consumer interests and community welfare, and considers which of these should be the goal of competition policy in general, and restrictive trade practices regulation in particular.

2.1 Efficiency and competition

According to Johns, the fundamental objective of restrictive trade practices regulation is to `foster and preserve competition where this is likely to contribute to greater economic efficiency'.\(^2\)

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\(^1\) Consumer interests in this sense means the direct interests of consumers as a specific sub-set of society, and as opposed to the direct interests of taxpayers, shareholders, employees etc.

Economic efficiency has three components: first, the efficient organisation of production and distribution within firms — productive or technical efficiency; second, the efficient allocation of resources across industries — allocative efficiency; and third, the innovativeness of firms and their responsiveness to change — dynamic efficiency. Maximum productive efficiency requires that goods and services be produced at the lowest
possible cost. Maximum allocative efficiency requires the production of the goods and services that consumers value most from a given set of resources. Greater dynamic efficiency means that consumers are offered, over time, new and better products and existing products at lower cost.

Competition is important to each. A lack of competition can lead to productive inefficiency through, for example, poor management performance, inefficient work practices, and unnecessary waste of material inputs. Competition fosters allocative efficiency by ensuring that firms bid resources away from less productive to more productive uses. And competition provides a strong incentive for firms to embark on measures that determine dynamic efficiency, such as undertaking research into new product design and production processes, reforming management roles and strategies, seeking new means of identifying consumer needs, and ensuring that products are efficiently distributed.

However, in some instances, measures that promote competition can detract from efficiency. For example, requiring firms to provide other firms access to their intermediate products at a `reasonable' price may undermine the role higher prices can play in rewarding innovation and/or signalling the desirability of entry of new firms to a market. Similarly, forcing a firm to share the benefits of an innovative (but unpatentable) production process may result in an undesirably low level of innovation. And intellectual property law, which imposes restrictions on access to technology, reflects a recognition that the interests of competition and efficiency can conflict. By ensuring that innovators are able to capture most of the benefits of their efforts, intellectual property law helps promote an efficient level of innovation.

Further, the gains in productive efficiency from higher concentration of production in an industry may far outweigh the immediate costs to consumers resulting from reduced competition. Markets with natural monopoly characteristics are an extreme example of this. In some other markets, the
gains in productive efficiency from a merger may not be shared immediately or directly with consumers, but may feed into the economy in the form of higher dividends to shareholders, higher tax receipts to government and the release of productive resources from the merged firm for use in other industries.

Overall, the Commission considers that, in formulating trade practices legislation and competition policy generally, the three aspects of economic efficiency need to be recognised as do the ways in which competition can enhance or, in some instances, detract from them. That is, the goal of trade practices legislation should not be to maximise competition *per se*. Rather, it should be to use competition to maximise economic efficiency.

### 2.2 Efficiency and consumer interests

In Australia, the regulation of restrictive trade practices has aimed to achieve both economic efficiency and equity goals. Economic efficiency can be broadly equated to the welfare of the community as a whole, whereas equity is concerned with how it is distributed among society’s members.

While not stated explicitly in the legislation or elsewhere, the equity role of both the restrictive trade practices part of the Act and the TPC can be represented as an aim to enhance the bargaining position of consumers relative to producers, often by making maximum competition in markets the prime goal of restrictive trade practices regulation. This is reinforced by the fact that other parts of

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3 Strictly speaking, measures to lower prices will not necessarily improve equity, because off-setting economic adjustments to, for example, firm profitability, investment, interest rates, wages and employment levels may nullify any initial beneficial impacts on consumers. Further, general measures to lower prices confer benefits on high-income consumers as well as low-income consumers.
the Act, also administered by the TPC, are concerned directly with consumer protection.

Most other OECD countries have adopted similarly multi-faceted approaches. Economic efficiency is a consistent goal, but the equity goals and public interest goals vary. Nearly all jurisdictions share the objective of maintaining and encouraging competition in order to promote the efficient use of resources. To this are added several other economic, social and political objectives of competition policy. These vary but include pluralism, decentralisation of economic decision-making, preventing abuses of economic power, promoting small business, fairness and equity. 'Freedom of economic action' is another commonly cited objective. Germany accords it equal status with efficiency, Portugal refers to the aim of freely organised supply and demand and the need for balanced relations among economic agents, while Switzerland also ranks it as an important goal.

But many OECD countries, such as Sweden, Norway, and Canada, are increasing the emphasis on the economic efficiency objective of competition policy. In addition, in the United States where anti-trust regulation has been used for a variety of purposes in the past, the clear view is emerging the prime role for anti-trust regulation is to promote efficiency by maintaining the competitive process:

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5 Swedish Competition Commission, Sweden's Comments on the Objectives of Competition Policy, Note by the Delegation of Sweden to the OECD Committee on Competition Law and Policy, May 1992; Delegation of Norway to the OECD Committee on Competition Law and Policy, Objectives of Competition Policy, May 1992; Canadian Bureau of Competition, Objectives of Competition Policy, Note to the OECD Committee on Competition Law and Policy, May 1992.
For many years, the premise that antitrust protects the process of competition, but not competitors, coexisted uncomfortably alongside a significant tendency toward using the antitrust laws to protect small businesses, regardless of the consequences for the efficient functioning of competitive markets...

Over time, however, the practical conflicts generated between pursuit of the economic efficiency goal for antitrust, and pursuit of those other vague and varied goals, gave rise to the modern consensus...that economic efficiency is in fact the appropriate basis for U.S. antitrust policy.

Nonetheless, few countries have abandoned the strong influence of `public interest' issues on competition policy. Governments see their role as furthering the broad public interest which includes not only economic goals (narrowly defined) but also social and political goals. Economic policy is seen as an instrument of public policy rather than an independent policy field, while much is made of the lack of unanimity amongst economists on the appropriate policy mix to maximise economic efficiency and distribute the gains amongst the community. In view of these complexities, it is often easier to seek to maximise consumers interests rather than total economic welfare.

But such an approach raises the obvious question: what is in `the public interest' if it constitutes something more than the overall welfare of the community?

This issue is complicated by the fact that specific public interest measures can often be pro-efficiency. This will be the case where such measures are designed to deal with some aspect of a market that fails to work properly, such as where consumers have inadequate information to make rational choices. In fact, it is possible to interpret most `public interest' goals in terms of allocative and/or dynamic efficiency. Sweden's proposed new Competition Act is a good

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example. Its objective is `to create and maintain efficient competition' that:

1. promotes rational production and sound resource allocation (the efficiency goal);
2. helps to open up markets and promote entry of new companies and development of new products (the growth goal);
3. results in low prices and charges (the income distribution goal); and
4. gives consumers and other purchasers freedom of choice and scope for influencing the supply of goods and services (the consumer goal).’

One interpretation of these goals is that the explicit efficiency goal refers to static (technical and allocative) efficiency only, while the second goal seeks to maximise dynamic efficiency. It could also be said that the best way to achieve the third and fourth goals in the long term is to maximise allocative and dynamic efficiency.

However, a more likely interpretation is that trade-offs should be made between the efficiency and other goals, so that, for example, efficiency may be sacrificed to further particular consumer interests.

But if maximising consumer interests is given status as a general goal of competition policy in addition to that of maximising overall community welfare, then a confusion, or an inappropriate trade-off, between equity and efficiency goals may occur. The Treasury has stated:

Governments have means of promoting fairness of income distribution including the transfer payments and taxation systems and via programs to provide subsidised goods and services. Competition policy, on the other hand, is a very blunt instrument for achieving fairness of outcomes; if equity considerations were allowed to override...efficiency goals...competition policy could make the

\[\text{7 Swedish Competition Commission, op. cit.}\]
community poorer in an aggregate sense. This would act to reduce the level of income available to redress income redistribution via transfer payments and the taxation system.

Making overall community welfare the goal does not mean that consumers should not be considered the main beneficiaries for restrictive trade practices legislation, because consumers are the largest part of the community and action to promote the goal of economic efficiency will generally involve benefits being passed on to consumers. Rather, it simply says that measures designed only to increase the bargaining power of consumers, or to pursue any other goal, may set up a conflict between means and ends that is counter-productive.

Overall, the Commission considers that economic efficiency alone should be the goal of restrictive trade practices regulation and competition policy. Maximising economic efficiency will maximise the welfare of the community as a whole. Measures which enhance the bargaining power of consumers are, in most cases, stepping stones to this fundamental objective.

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8 Department of the Treasury, Submission to the Senate Standing Committee on Legal and Constitutional Affairs — Cooney Committee inquiry into mergers, monopolies, and acquisitions, October 1991, p. 6.
3 REGULATION OF COMPETITIVE MARKETS

As noted in Chapter 1, pro-competitive regulation may be required to prevent firms from engaging in anti-competitive practices in particular markets which may allow some participants to acquire and exploit a high level of influence over prices, output or sales. In Australia, this regulation is provided by the restrictive trade practices part (Part IV) of the Trade Practices Act 1974.

Identifying markets which are essentially competitive but which may nonetheless be prone to anti-competitive practices involves two fundamental processes: defining the relevant market and assessing the level of actual and potential competition.

In this chapter, the Commission discusses whether, in current practice, these processes are resolved in ways that accurately reflect the ability of individual corporations, or groups of corporations, to influence markets; and in accordance the economic principles which are regularly espoused by the TPC, the Trade Practices Tribunal (TPT) and the courts.

In light of this discussion, the Commission then examines the current provisions of Part IV of the Act.

3.1 Defining the market

Currently, most restrictive trade practices are only prohibited if they fail one of two competition tests and are thus deemed likely to substantially constrain competition. These tests are expressed in terms of either a substantial lessening of competition (as in sections 45, 47, 49 and,
shortly, 50\(^1\)), or an abuse of market power designed to damage a competitor or competition (as in section 46). These tests exist because, in the absence of an ability to substantially influence a market, anti-competitive practices have little effect.

The likelihood of a particular practice by an individual firm or group of firms causing a significant constraint on competition depends on the definition of the market affected.

`Delimiting' the relevant market involves identifying four components:

- the relevant temporal dimension;
- the relevant functional market;
- the relevant product market; and
- the relevant geographic market.

The Act provides a definition of a market in section 4E. Of note is the reference to `market in Australia' which prevents geographic markets being defined in broader terms:

For the purposes of this Act, `market' means a market in Australia and, when used in relation to any goods or services, includes a market for those goods and services and other goods and services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.

\(^1\) The mergers test (section 50) is to be amended to bring it into line with other provisions. Currently, a merger is prohibited only if it is likely to create or enhance a position of dominance in a market.

\(^2\) Some provisions of the Act do not include a threshold competition test because the practices they govern are considered so obviously damaging as to not require the step of establishing a threshold impact on competition. Such practices are prohibited outright.

\(^3\) The temporal dimension refers to the time period under consideration: that is, when the anti-competitive activity is claimed to have been conducted.

\(^4\) The functional market refers to the type of market under consideration, for example, whether it is a retail or a wholesale market.
This quite legalistic but rather basic definition of a market is complemented by subsection 46(3), which refers to potential competitors as well as existing competitors in outlining the factors to be considered by a court in determining a firm's market power. The reference to potential competitors is an implicit direction to the court to take into account `barriers to entry' in delimiting a market. While none of the remaining provisions of Part IV of the Act include an equivalent subsection, the courts have usually explicitly included potential competitors in considering the threshold competition test, so subsection 46(3) may be superfluous.

Over the years, both the TPC, the TPT, and the courts have taken an increasingly sophisticated view of market definition. Product substitution on both the demand-side and the supply-side, import competition, and the estimation and use of cross-elasticities of demand are all accepted delimiting factors of a market. For example, in the Queensland Co-Operative Milling case, the TPT drew a broad picture of a market which has been cited with approval in many subsequent court and TPC decisions.

We take the concept of a market to be basically a very simple idea. A market is the area of close competition between firms, or putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.

Nonetheless, the process of defining relevant markets is prone to practical problems which somewhat limit its usefulness.

The recent High Court decision in the Queensland Wire case helps to demonstrate these points. The court decided that

5 (1976)1 ATPR 40-012.
BHP had abused its market power contrary to the Act by refusing to supply `Y-bar' to Queensland Wire Industries, thus denying the latter the opportunity to compete with BHP's subsidiary in the farm fencing market. The court recognised the importance of both demand-side and supply-side substitution, the concept of contestable markets (ie how amenable a market is to competition from newcomers), and the role of import competition. But on the evidence put before it, the court concluded that BHP enjoyed a protected position in the market because of high start-up costs, a lack of import penetration, and BHP's belief that it may benefit by withholding supply considerations which largely reflect a static view of the operation of markets. Queensland Wire won the case, but then decided to import Y-bar from a South Korean producer.

Similar complications arose in the Australian Meat Holdings (AMH) decision. In that case, the Federal Court found that a proposed acquisition of Borthwicks by AMH would result in demand-side dominance of the market for fat cattle in north Queensland, despite considerable evidence of actual and potential trade beyond both the geographic and product markets as defined. There was already significant supply-side and demand-side substitution between fat cattle, feed lot (grain-fed) cattle, and store (unfattened) cattle; as well as significant levels of existing inter-regional trade in cattle, with most producers closely monitoring prices in other regions. Further, the cost penalty of transporting cattle to southern Queensland was often less than 5 per cent of cattle value. Nonetheless, because the market was defined so narrowly, the competitive discipline placed on north Queensland abattoirs by those further south was effectively excluded from consideration. This conclusion was based on an essentially static view of the operation of markets. Factors taken into account included producer loyalty to local

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7 'Y-bar' is the matrice input to the production of fence posting most commonly used in rural applications.

8 AMH Pty Ltd V. TPC, (1989) ATPR 40-932.
abattoirs, and that most of the cattle shipped south were first sold within north Queensland. AMH's argument that, given a sufficient `economically feasible' price incentive, north Queensland cattle producers would sell to south Queensland abattoirs (and, in fact, already did to an extent) was rejected.

The TPT has proved more adept than the courts on the issue of market definition. It has suggested that markets should be defined so as to identify `...the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive'.

Even so, the TPT has tended to define markets narrowly in the past. In Re Tooth & Co for example, it defined the relevant market as bulk and packaged beer in an area slightly smaller than the whole of NSW despite the fact that packaged beer is traded internationally.

Williams has suggested that anti-trust law often puts too much emphasis on the issue of defining the relevant market. His criticism appears to be directed at the lawyers' preoccupation with this issue and their desire to determine every conceivable detail:

Economists define a market only as a tool of analysis. In considering issues of public policy, their eye is trained to the goal of economic efficiency. If defining of a market in identifying a monopoly is used as a standard of evaluation then the goal of an economic allocation of resources has departed from vision.

Williams therefore endorses the view from Queensland Wire that the process of defining a market should be `object

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From an economic viewpoint, Williams is suggesting that looking at a firm's own price elasticity of demand better indicates its market power than identifying its competitors and calculating cross-price elasticities.\textsuperscript{13} The simple solution (in theory) to the issue of a firm's market power is to plot the demand curve for its product.

However, the simple theoretical answer is not usually feasible, since substantial empirical analysis is required. The issue of market power therefore has to be addressed using applied theory and available data. Considering existing competitors is the first step in this examination. As Pengilley suggests, lawyers use market definition as an essential stepping stone in the determination of an anti-trust issue:

One cannot object to an obsession with market definition in the terms of the criticisms levelled in Phillip Williams' paper. One can object if lawyers get it wrong - but this is another question.

A strict market definition approach has some advantages. It is simple, certain, and many flawed anti-trust charges can be dealt and dispensed with at this stage. The approach readily reveals many of the limits on the individual firm's market power \_ if the target corporation can show that it is subject to competitive pressure from other existing producers and so enjoys little market power, the case can be dismissed. Thus, market definition is the first and probably most critical hurdle for the anti-trust case.

\textsuperscript{12} Ibid.

\textsuperscript{13} Own price elasticities are a measure of the change in the level of demand for a product in response to a change in its price. Cross price elasticities are a measure of the change in the level of demand for one product in response to a change in the price of other (for example, substitute) products.

\textsuperscript{14} Centre for Independent Studies, op. cit., p. 40.
But as the cases cited above illustrate, while the market definition approach is an important analytical process which facilitates the transfer of economic concepts into law, if applied too rigidly it can cause problems. Substitution between products and regions usually varies by degrees rather than absolutes. By drawing absolute boundaries, the courts have at times effectively excluded for consideration some existing competitive discipline. So in difficult cases, the simple market definition approach is too narrow.

The solution may lie in the use of a strict market definition approach as an initial hurdle; but a flexible approach once this hurdle is jumped, with a more fluid relationship between market definition and assessing competition within markets. A more flexible approach may result in a less certain determination of the market: for example, all existing competitors able to readily shift production from one good to another may be difficult to identify. But it will mean that the market definition and assessment of competition processes more closely approximate the Williams' ideal.

3.2 Assessing competition

In discussing how the level of competition should be assessed, Stigler states:

It is not enough to prove that a given industry is not competitive. The crucial question is: how far do conditions in the industry depart from competition. In many and perhaps most cases the answer is the departures are not large.

Given this and the difficulties of delimiting markets discussed above, the level of competition in a market should be considered in conjunction with the determination of market limits, rather than as a distinct process.

In making this assessment, the issue to determine is whether any particular firm, or a number of firms in

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Collusion, could wield sufficient power in the market to cause such a reduction in competition that society as a whole would become less well off than would otherwise be the case. (The reduction in competition would need to be significant enough to ensure that government intervention – which itself is not costless – would lead to a net improvement in community welfare).

This approach neatly by-passes the difficult question of 'what amounts to a substantial lessening of competition or a substantial degree of market power?', by providing the circumstances in which a practice or merger would not satisfy the relevant competition test, and thus would not reduce economic efficiency.

Various indicators are used to determine the level of competition in a market, including:

- industry concentration;
- firm profitability;
- barriers to entry;
- barriers to imports;
- quasi-substitutes; and
- countervailing market power.

The current approach to assessing and interpreting these indicators is based around an essentially static view of competition, despite acceptance of advanced theoretical thinking by the courts. A static model of perfect competition assumes many buyers and sellers acting independently. The observation that any one firm cannot exercise market power in such circumstances has led to a focus in competition policy on activities which either reduce the number of firms or link firms contractually in ways which may reduce their independence.

However, over-reliance on the simple 'many players' model of perfect competition has caused advocates of intrusive competition policy to believe that an overly high proportion
of industries deserve attention. The simple model ignores the dynamic characteristics of competition. As the Treasury has pointed out:

Clearly, the simple model [of perfect competition] omits important features of markets. Differentiated products and brand loyalties are the norm, not the exception. Economies from larger production units or from carrying on a range of activities in one business (economies of scale and scope) are common. Problems arise from the separation of ownership and control. Crucially, the operations and relations within the firm determine the features of its product. Accordingly, in many instances, industry structure resembling perfect competition cannot, in the real world, be engineered by governments without great cost.

Competition is multi-dimensional in that all the features of goods and services — not just price, but quality, means of delivery and other aspects — impact on the value consumers place on the package offered to them. Competition is dynamic in that it is necessary to be continually changing in order to provide better offers to consumers than rivals are offering. It is necessary to move forward or be overtaken.

The relevance of the indicators set out above, and the way they are interpreted, therefore needs to be reviewed so that they better reflect the dynamics of competition.

This is particularly important given the substantial progress in the deregulation of several key markets, and the consequent changing role of pro-competitive regulation. In markets where domestic firms formerly enjoyed significant protection and assistance, pro-competitive regulation was often used to limit the abuse of such privileged positions. As already noted, these markets are subject to increased competition from imports, and restrictive trade practices regulation is less important. In other markets, the removal or downgrading of specific regulatory regimes, such as in banking and domestic air travel, has increased the relative importance of pro-competitive regulation. Meanwhile, the corporatisation of some government enterprises has

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16 Treasury, op. cit., p. 8.
necessitated the review of current exemptions from prices surveillance and restrictive trade practices regulation.

Pro-competitive regulation should be applied in ways that facilitate pressures for structural change resulting from lower levels of anti-competitive regulation, and enhance community welfare over time.

In the following sections, the Commission discusses the extent to which various indicators are relevant in determining the competitiveness of markets.

Industry concentration

While the number of domestic firms in an industry can clearly influence the intensity of competition, it is rarely a good indicator in itself. It takes no account of international competition, substitution into other products, or the potential for entry of new firms. Furthermore, competition itself may reduce the number of firms as those with better management or superior technology displace others; or it may increase the number of firms as new, innovative firms establish themselves in an industry. As the Treasury has observed:

It is the rule rather than the exception that firms have some discretion over prices they charge. This is because goods are usually not perfect substitutes and competition arises from the availability of a range of more or less close substitutes. In this environment, marketing executives search for niches of consumer demand which are not filled or imperfectly met. Competition at this extensive margin is strong and dynamic, even though firms will often lack competitors in the static sense of producers of exactly the same product.

Thus the presence of some control by a firm over price setting and the absence of many producers of the same product may be consequences of the healthy process of competition, rather than indications of its absence.

These views appear to run counter to often cited extracts from Michael Porter's recently published study of the relative strengths of the sources of economic performance, the *Competitive Advantage of Nations*. Porter concluded that strong anti-trust law, at least in terms of horizontal arrangements, was vital to ensure domestic rivalry, and therefore international competitiveness. (Porter's more liberal views on vertical arrangements are discussed below.) In studies of knowledge and skill intensive industries in developed countries, Porter found that strong domestic rivalry (ie competitive pressure from domestic firms) was a crucial ingredient of success, and that individual firm size was a less significant component. From these observations, Porter inferred that there was little justification for the emphasis on industry rationalisation and efficient scale of operations that has prevailed over more interventionist anti-trust law in Australia and other OECD countries in recent times. In fact, he suggested that such policies actually undermined competitiveness by creating 'champion' national firms which were not subject to sufficient domestic competitive discipline. Economies of scale, he suggested, are best achieved by exporting; not by dominating a domestic market.

Porter's findings need to be interpreted with care. His strong advocacy of anti-trust law is carefully qualified by the need to avoid underpinning or protecting inefficient industries, and he provides little guidance on the fundamental problem of discriminating between regulation which enhances economic efficiency and that which undermines it. Further, Porter claims that his propositions apply equally to large economies and small, but none of his studies involved countries that shared Australia's size, isolation or resource endowments. Porter's focus on export oriented manufacturing and service industries can be contrasted with Australia's resource-based exports and substantial non-

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traded and import-competing sectors. And some `success stories' are not explained by this thesis – Sweden, for example, has only one significant company in many international industries. Finally, Porter does not suggest that import competition and contestability provide little or no competitive discipline; simply that they are less important than domestic rivalry. Indeed, his studies observed vigorous competition between as few as two domestic firms.

The application of this approach to New Zealand by Crocombe, Enright and Porter\textsuperscript{20} appears to have shed little additional light on the policy implications. A review of the work by Scobie suggested:

\begin{quote}
A strange ambivalence pervades the book. On the one hand, the Porterian framework requires that we should move away from the export of `structurally unattractive' commodities. On the other hand, the arguments have had to be modified in the light of reality; natural-resource based industries are important to New Zealand and will remain so. What is more, they have diversified and now involve a bewildering array of products in hundreds of markets. It is simply not true that New Zealand's competitive advantage in export industries is based on `natural factor advantages'. Investment and rapid productivity growth have been the hallmarks of primary industries in New Zealand.

If we slavishly follow the Porter prescription and set as our goals increased non-traditional exports, the creation of domestic value added, or the growth of offshore investment, then we risk implementing policies that usurp the decision-making responsibilities of the firm; it is up to managements to make such decisions and reap or bear the consequences. New Zealand has surely learnt that relying on the state to pick winners is hardly a prescription for sustained growth.
\end{quote}

Overall, the Commission considers that it is difficult to draw conclusive new lessons from Porter's work. On one hand, it


\textsuperscript{21} Scobie, G., `Competitive Advantage: Porter's Path to Prosperity', in Centre for Independent Studies' \textit{Policy} Summer 1991, p. 45.
agrees that domestic rivalry is an important source of competitive discipline — often more effective than import competition or contestability. It also agrees that anti-trust law is an essential means of ensuring effective competition from any of these sources, and perhaps more importantly from existing domestic rivals. On the other hand, an excessively intrusive anti-trust regime can undermine rather than enhance economic efficiency if it protects inefficient incumbents (by, for example, impeding mergers) in a market. Further, domestic rivalry is far from the only source of effective competitive discipline, and often economic efficiency will demand industry rationalisation and the realisation of scale economies.

While the lessons for Australia from Porter's work are unclear, other authorities support taking a dynamic approach to competition policy issues.

In the Queensland Wire case for instance, the High Court recognised that competition can be a dynamic process rather than a static concept. By determining that a market can exist even though there is no trade in it at a particular moment — Y-bar was an intermediate good wholly within internal BHP production processes when this action was brought — the court implicitly acknowledged the role of contestability as a source of competitive pressure. According to the reasoning, competition policy must recognise the potential for a new firm to emerge and take that potential into account.

Further, in its report into Food Processing and Beverages, the Industries Assistance Commission (IAC) found that, despite extensive corporate takeover and merger activity since the early 1970s that led to much higher levels of concentration, there had been no reduction in competition in this industry. Increased concentration resulted from the rationalisation of firms supplying mainly small regional or

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State markets into larger firms involved in production, marketing and distribution at the national level, and the dominance by relatively few enterprises in most sectors. Single processors held greater than 50 per cent market share in 13 of the 30 product categories studied. This was common in most developed countries, indicating that some relatively uniform forces such as the influence of underlying technologies, size economies and product differentiation were responsible for high concentration in such industries.

While concentration may lead to the exercise of market power, high concentration may mean anything from fierce competition, as in the Australian beer industry, to collusion.

Market forces tend to concentrate industries where efficiency calls for greater concentration and deconcentrate where efficiency calls for less concentration. Increased concentration may indicate nothing more than that the more efficient firms are becoming larger and more profitable. For example, there are divergent trends in concentration in the US consumer and producer goods industries. Consumer

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23 ACIL Australia Pty Ltd, commenting on competition in beer said that: "...takeovers in the Australian brewing industry [have] led to the domination of brewing by two companies. They compete vigorously for market share but have also created an environment where new entrants have seen commercial opportunities to give consumers more choice. Over recent years a number of new, initially small, brewers have emerged. In Queensland, one claims to have quickly captured twenty per cent of the market. 'The emergence of two dominant brewers has had another, perhaps more important, effect. Two national companies replacing a number of state-based firms has resulted in a more integrated national market. Aggressive marketing and the development of new products has meant that these two firms compete more vigorously than did the state-based firms. The demise of numerous regional firms has resulted in more vigorous competition nation-wide. ACIL Australia Pty Ltd, A Discussion Paper prepared for the Primary and Allied Industries Council, International Agribusiness trends and their Implications for Australia, Department of Primary Industries and Energy, April 1989."
goods industries are increasing in concentration because of the costs savings associated with mass marketing and chain stores. Producer goods industries are decreasing in concentration because new scale economies are not keeping up with growth in demand; and smaller suppliers have grown more rapidly than larger firms who had already achieved optimal size.

In any case, concentration ratios based on manufacturing statistics may give a distorted picture of the number of participants in a market. For instance, they should take account of supplies from overseas and group products which are substitutes to correspond to the concept of a `market'. Thus, the number of domestic firms in an industry is not necessarily a reliable indicator of the extent of market competition.

Firm profitability

While the presence of a high level of profitability by a firm or number of firms within an industry may sometimes result from an undesirable lack of competition, it may also reflect other factors. As the Treasury has noted:

In order to compensate for operation in relatively risky industries, for chancing innovation and for risking the introduction of new products, it is necessary for rewards to be commensurably great...To maintain a business, the production costs of the failures and the `overheads' of the firm must be covered by `excess profits' on the successes.

Recognising that business decisions made now relate to the uncertain world of the future, it may be necessary to take actions which, at least in the short term, constrain competition as more traditionally defined in order to foster a more dynamic kind of competition. For example, it may be desirable to provide a system of property rights for successful inventions, research and mining rights to successful mineral exploration if future research and exploration are to be encouraged. Similarly, it may be desirable that a firm making a large and risky investment in plant and
equipment be sure that it will not face legally enforced requests to provide semi-finished goods to competitors.

Indeed, `excess profits' provide an important signal to other firms either to emulate the success of the profitable firm or to attack its markets. Both these actions are pro competition.

Similarly, `locational rents' ___ the extra profit available to a firm as a result of its choice of location ___ often represent a reward for successful judgment and risk-taking. Locational rents are particularly important to assessing the competitiveness of a market in the restrictive trade practices context because of the significance accorded to defining the relevant geographic market. Locational rents give firms an incentive to set up earlier than they otherwise would at particular sites, and ensure that land in Australia is allocated to its highest value. Using pro-competitive regulation to deny locational rents would mean that land would be used less efficiently and any price saving would be dissipated in, for example, transporting raw materials from poorly located sites.

While the existence of locational rents may mean restricted output and higher prices, the alternative might be no output at all from that region. Where locational rents accrue, successfully preventing mergers often results in the ultimate failure of the target facility; with the actual result being a loss of capacity and higher prices to users and consumers.

These points suggest to the Commission that firm profitability in the short to medium term is generally a poor indicator of whether there is sufficient competition in a particular market.

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24 Treasury, op. cit., p. 11.

25 See, for example, the results of successful anti-mergers activity in AMH Pty Ltd V. TPC, and the West Australian Newspapers authorisation application. In both cases, the target firm ceased trading shortly after the decision to impede the merger, resulting in a loss of production capacity and output in the market under consideration.
On the other hand, a firm which sustained high profits over a long period of time on all its activities is likely to be enjoying a high degree of market power that is not easily challenged. There is likely to be a lack of competitive discipline in such a market.

Barriers to entry

Barriers to the entry of new firms into a market can clearly reduce its competitiveness, unless that market is already highly competitive.

Common definitions of barriers to entry are quite broad. Bain, for example, defines a barrier to entry as anything that allows incumbent firms to earn supernormal profits. Scale economies, product differentiation, capital requirements, and absolute cost advantages of established firms have traditionally been listed as key barriers to entry. More recently, advertising and promotion costs have been added to this list.

While low level barriers to entry can always be identified, the important question from a competition policy perspective is whether the obstacles to new entry are such that, over the medium to long term, they allow incumbents to extract significant monopoly profits with no offsetting gain in economic efficiency. Defining relevant barriers to entry thus involves identifying factors that give incumbent firms an advantage over new or potential competitors which prevent market forces from eroding rents over the medium to long term.

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In this context, the following definition of an entry barrier by Baumol, Panzer, and Willig is relevant:

...anything that requires an expenditure by a new entrant into an industry, but imposes no equivalent cost on an incumbent.

In the following discussion, the Commission examines the extent to which the traditional barriers to entry fulfil this criterion.

Product differentiation

Product differentiation can allow producers to increase their profitability. Indeed, Bain concluded that it was the single most important determinant of the ability of firms to earn above-normal profits.

Firms try to differentiate their products to create their own market niche, which other firms would find difficult to enter. Product differentiation precludes perfect imitation and is thus sometimes said to impede entry.

However, product differentiation need not imply barriers to entry. While the rents from product differentiation might not be fully contestable, new firms can always compete for other niches in the overall market. And differentiation impedes entry only to the extent that consumers prefer the established version of the product.

28 Baumol, W., Panzer, J., and Willig, R., *Contestable Markets and the Theory of Industrial Organisation*, Harcourt Brace Javanovich, New York, 1982, p. 282. Similarly, Stigler defines a barrier to entry as a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry. Stigler, op. cit., p. 67


Advertising and promotion

Advertising is sometimes said to bar the door to new firms, either by establishing brand loyalty or as a form of predatory conduct.

In fact, advertising generally reflects new entry and vigorous competition. Advertising allows new firms to announce their presence and solicit sales. New products are advertised more heavily than mature ones, there is less customer loyalty in markets which have advertising, and smaller firms advertise relatively more heavily than the larger ones. The provision of new information tends to break down established market shares.\(^{31}\) Heavily advertised brands are often associated with unstable brand preferences. Massive advertising induces consumers to switch back and forth between brands, not the customer loyalty posited by those who argue that advertising creates a barrier to entry.

A number of studies have shown that prices are significantly higher in markets where advertising is prohibited by law. For example, the average prices of eyeglasses and prescription drugs were significantly higher in states in the USA which prohibited advertising. The efforts of the professions to restrict advertising also suggests that advertising is pro-competitive.\(^{32}\) In fact, it is restrictions on advertising that may constitute a barrier to entry.

A market with heavy advertising may be costly to enter, but new entrants always have the option of advertising less and underpricing the existing firms.\(^{34}\) They can rely, for example, on assistance from large retail chains to publicise the


availability of a new low-priced substitute. Retailers often offer low advertised and cheaper house brands.

Capital requirements

High capital requirements are sometimes seen as an entry barrier. One reason is that established firms in high capital industries have much lower costs because their original investments have been written-off or were bought long ago when costs and interest rates were lower. Bain identifies large capital requirements as a barrier to entry.

However, excluding the extent to which there are imperfections in the capital market, the problems that affect new firms also apply to established ones when they seek finance, both now and in the early days of their growth. Regarding the writing down of large capital investments by established firms, book values are not relevant to determining the existence of entry barriers. Current replacement and opportunity costs at the margin are what matter in decision making. Incumbents and aspiring entrants bear the same present opportunity cost. Likewise, although established firms can raise capital through their retained earnings, this is not a free good. Retained earnings have an opportunity cost: the return they could have obtained in the external capital market.

Hence, large capital requirements do not necessarily constitute a barrier to entry.

Scale economies

Economies of scale refer to the reduction in the average unit cost of producing goods that firms can achieve by expanding their output (up to some level). For example, the average cost

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36 Bain, J., op. cit.
37 Gilbert, op. cit. pp. 493-5.
of producing 80,000 cars in a factory is generally less than the average cost of producing just 10,000 cars, because the fixed capital costs of the factory are spread over more vehicles.

But entrants still have access to the same cost function as the established firms. When investing in plant, new firms are not required to bear a cost that has not also been borne by the incumbent firms. And once an entrant has invested in an efficient plant and organisation, there are no cost differences between the new and the established firms.

Thus, economies of scale `per se' simply dictate the level of output the new firm must achieve to minimise costs.

However, as discussed below, scale economies can exacerbate sunk and/or exit costs to constitute significant barriers to entry.

**Absolute cost advantages**

If a potential entrant has a cost disadvantage with respect to an established firm, the established firm may be able to price above cost.

Determining what qualifies as an absolute cost advantage, and whether it constitutes a barrier to entry, is not easy.

An extremely efficient production technique may confer a cost advantage to its possessor in the short term, but it need not be a relevant barrier to entry. This is because the profits from firm-specific factors reflect earlier efforts of that firm. As such, new entrants can obtain the same cost advantages over time if they make investments in similar assets that are specific to the firm. The rents that go with these firm-

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specific factors are often the reward for their creation and for the risk of making irreversible investments in reputation, in quality, in learning, or in networks.

At a minimum, there must be some factor of production that is in some way denied to the entrant and prevents it from being as efficient as the established firm for absolute cost advantages alone to constitute a barrier to entry.\textsuperscript{41} One example discussed in the Commission's report on Water Resources and Waste Water Disposal is in water harvesting. For a particular region, the first source harvested is likely to enjoy significant cost advantages over subsequent sources. The advantage held by the first dam is, therefore, not contestable.\textsuperscript{42}

Relevant barriers to entry

Generally, barriers to new entrants to a market are surmountable, and competition between existing participants and/or threatened by potential participants ensures that the operation of the market provides the best outcome for the community. Thus, relatively few factors satisfy the Baumol, Panzer, and Willig criterion.

Nonetheless, the Commission considers that there are important entry barriers that are relevant from a competition policy perspective. These include

\begin{itemize}
  \item unavoidable sunk costs — committed capital that cannot be withdrawn without significant loss, including exit costs,
  \item privileged access to information or technologies, such as patents, and
  \item regulatory barriers to entry or exit.
\end{itemize}


\textsuperscript{41} Gilbert, op. cit., p. 493.

Further, some of the factors discussed above which do not constitute barriers to entry per se may nonetheless be relevant to the consideration of whether there are sunk costs. According to the Canadian Bureau of Competition:

In addition to the various start-up sunk costs that new entrants are often required to incur, such as acquiring market information, making the entry decision, developing and testing product designs, installing equipment, engaging new personnel and setting up distribution systems, potential entrants may face significant sunk costs as a result of a need to:

(i) make investments in market specific assets and in learning how to optimize the use of these assets;
(ii) overcome product differentiation-related advantages enjoyed by incumbent firms; and/or
(iii) overcome disadvantages presented by the strategic behaviour of incumbent firms.

Each of these potential sources of sunk costs can create significant impediments to entry by presenting potential entrants with a situation where they must factor greater costs into their decision making than incumbent firms that have already made their sunk cost commitment, and can, therefore, ignore such costs in their pricing decisions. This asymmetry typically presents potential entrants with a recognition that they face greater risks and a lower expected return than what is faced by incumbent firms. In general, risk and uncertainty increase, and the likelihood of significant entry decreases, as the proportion of total entry costs accounted for by sunk costs increase.$^43$

Thus, while high start-up costs, product differentiation, and strategic behaviour may not constitute barriers to entry of their own accord, they may nonetheless contribute to sunk costs to the extent that an incumbent will have a significant cost advantage over a potential entrant. Several of these factors, which alone may not constitute a significant barrier, may do so when combined.

$^43$ Canadian Bureau of Competition, Round Table Discussion on Barriers to Entry, Submission to the OECD Committee on Competition Law, 7 November 1991.
Regulatory impediments do not need to be prohibitive to constitute significant barriers to entry. For example, high capital, economies of scale and promotion costs are sometimes cited as significant barriers to entry in domestic aviation in Australia, but any impediment probably lies in the statutory constraints on participation, particularly by foreign international carriers. As a result, the economic size of an airline is large relative to the total size of the domestic market, and contesting the two incumbents is difficult. The Compass experience supports this: entry using leased aircraft was relatively easy and the investment in promotion could be traded for value. The Bureau of Transport and Communications Economics considered that barriers to entry in the industry following partial deregulation are relatively low. In considering the level of competition in the industry, it said:

...a critical structural feature of a market is the height of industry and operational barriers, which determine whether existing and potential new entrants can survive and thrive... Barriers to entry can be classified into three broad categories: natural (or economic) barriers; firm-created barriers; and government created barriers.

Natural barriers to entry are not significant:
...there do not appear to be serious natural entry barriers into the Australian domestic airline industry.

Firm-created barriers are also minor:
...firm-created barriers to entry generally do not appear to be insurmountable impediments to new entrants in Australia, with ownership of travel agencies perhaps the most serious problem for existing new entrants, although the initial capacity constraints imposed by the terminal leases could inhibit further expansion of domestic aviation by new carriers.

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46 Ibid., p. 29.
But new entry would be easier and the viability of new entrants would be enhanced if the regulatory impediments to participation by international
carriers were removed:

This important entry restriction could be relaxed if conditions warranted, and provides a further mechanism to increase the level of competition should the market evolve in a way that competition proves inadequate.

It is always possible to identify some level of entry barrier to a market, especially some level of sunk costs. What is important is the height of any barriers to entry, and whether they are such that entry on a significant scale is unlikely.

Barriers to imports

Similar arguments apply to considering the competitive discipline provided by imports. Significant actual import penetration in particular markets is widely recognised as an important competitive discipline in both theory and practice. But a principle generally accepted in theory, yet seldom in practice, is that a low level of actual imports in a market does not mean that potential imports do not provide significant competitive discipline in that market.

The important consideration is whether there are significant barriers to imports in the relevant market.

Important barriers to imports include government restrictions (for example: tariffs, quotas, quarantine restrictions) and natural protection. Natural protection exists where transport costs are high relative to production costs, or possibly where there is a lack of information about import opportunities.

Often these natural cost relativities will impose a significant cost on trade, but not constitute an absolute barrier. In these cases, imports will still provide some competitive discipline, although not as much as otherwise.

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47 Ibid., p. 29.
Alternatively, a potential importer may face entry or exit costs akin to the barriers to the entry to domestic competitors discussed above.

But just as in that case, it is important to distinguish genuine barriers from the often illusory hurdles, such as scale economies, product differentiation, absolute cost advantages, and marketing costs. For example, one popular and often-cited barrier to imports is the cost of establishing retail outlets, but only a small minority of products require dedicated retail outlets — why are importers of tinned fruit, for example, in any different position to local suppliers? And even then, importers face the same cost as domestic manufacturers in setting up dedicated retail outlets.

The Commission considers that many so-called barriers to imports are not relevant, or their impact is overstated, from a competition policy perspective. Imports can be a significant source of competitive pressure even without high levels of existing import penetration.

One qualification to this is, however, that the anti-dumping regime is not used to replace protection for domestic producers being phased out by progressive reductions in tariffs.

Quasi-substitutes

Producers of products that would not be included as participants in the relevant market under the traditional approach of the courts may nonetheless exert competitive discipline on the target firm, because some consumers will `make-do' with those products even though they may not be ideal substitutes. Examples of this marginal competition include the substitution of car or bus travel for air travel, and of rented videos for theatre tickets.

The influence of quasi-substitutes may significantly reduce the market power a firm appears to have from consideration of the relevant product market alone.
Research has revealed quasi-substitutes with high cross price elasticities of demand. A study of domestic power consumption revealed a cross price elasticity of demand between gas and electricity in excess of 30 per cent. This means that a 5 per cent increase in the price of domestic gas supplies would have resulted in a 1.5 per cent increase in domestic electricity consumption, despite the short-run barriers to this substitution caused by capital costs of switching from gas to electricity.

In a submission to the Commission’s current Mail, Courier, and Parcel Services inquiry the Australian Postal Corporation suggested that in the market for the delivery of letters, it faced considerable competitive discipline from courier, telephone, facsimile, telex, telegram, and direct delivery services, and even from firms using in-house staff. Australia Post estimated that its share of this extended market had declined from 50 per cent in 1960 to 20 per cent in 1990. As a result, the market power conferred on it by a statutory monopoly over the delivery of letters has been considerably reduced.

However, the way that the TPC, the TPT, and the courts currently confine discussion of competition to the product and geographic markets as defined ignores the influence of marginal competition and quasi-substitutes on the level of market power of a firm. For example, in the Australian Meat Holdings case where the product market was narrowly defined as the market for fat cattle, in the final determination of the issue of market dominance, no account was taken of the competition provided by other types of

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48 Department of Resources and Energy, Forecasts of energy demand and supply, Australia, for 1984-85 to 93-94, Canberra, AGPS, 1985. The same study revealed a cross price elasticity between electricity and gas in the residential sector of only 0.11, suggesting that existing gas consumers are more price sensitive than existing electricity only consumers.
cattle. These would certainly provide some level of substitution, at least in the longer run.

Countervailing market power

It is sometimes argued that a supplier in a market who, according to the traditional legal approach, enjoys a high degree of market power would be incapable of substantially lessening competition if its customers enjoyed an equivalent level of market power. A monopolist, for example, could gain little if any benefit from its status if it had only one customer.

The Commission encountered this argument in its inquiry into statutory marketing arrangements. A popular justification for these arrangements was that, in their absence, a large number of rural producers would be exploited by a small number of processing firms.

While the Commission found no general lack of competition to justify the creation of statutory producer monopolies, it accepted that both sides of markets should be considered. Indeed, in suggesting that authorisation of voluntary recommended price agreements between fewer than 50 rural producers should be available, the Commission accepted that conferring some level of countervailing power on producers by allowing what would otherwise constitute an anti-competitive practice may actually constitute a pro-competitive balancing of market power. However, care would need to be exercised to ensure that such a price agreement actually enhanced community welfare — it may simply allow producers to extract or share in excessive profits.

3.3 Regulating market practices

In those markets where competition is inhibited, a range of anti-competitive practices have been observed. Each

requires specific counter-measures tailored to the circumstances. In the light of the discussion above, this section discusses the anti-trust provisions of the Trade Practices Act, whether each is appropriate, and how each should be applied.

Anti-competitive agreements

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

Section 45 aims to deter anti-competitive collusive behaviour. It prohibits arrangements between competitors which either contain an exclusionary provision or have the purpose or effect of substantially lessening competition. Exclusionary provisions are collective refusals to deal with another party or arrangements to deal with another party on certain terms only (see section 4D). Section 45A effectively prohibits price agreements outright by deeming price-fixing to cause a substantial lessening of competition.

But collusion can be difficult to arrange and enforce while, on other occasions, it may be achieved tacitly and thus be difficult to prosecute.

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51 Restrictive trade practices are prohibited per se under the TPA when there is no requirement to satisfy the relevant competition test.
Pre-conditions for collusion

Firms are only likely to collude in certain market environments. Brozen and Posner suggest the following conditions favour explicit collusion:

- market concentration on the supply side;
- no fringe of small sellers;
- high transport costs;
- small variations in production costs between firms;
- readily available information on prices;
- inelastic demand at the competitive price;
- low pre-collusion industry profits;
- entry delays;
- many buyers (otherwise selective discounting to big buyers will be too tempting while monitoring adherence to the agreement will be difficult);
- no significant product differentiation;
- large suppliers selling at the same level in the distribution chain;
- a simple price, credit and distribution structure;
- price competition is more important than other forms of competition;
- demand static or declining over time; and
- stagnant technological innovation and product redesign

Stable collusive arrangements are thus likely to be rare; the absence of any of the conditions will tend to undermine the potential for successful collusion.

The above indicators suggested to Brozen and Posner that evidence of collusion would include: fixed relative market

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shares; regional price variations; large output and capacity changes with the birth of the cartel; the sudden appearance of excess capacity; a declining market share among the leading firms; and less frequent but larger price changes.

Effects of collusive arrangements on economic efficiency

Collusion between competitors on the price or quality of a product can result in excessive profits for the participants and a reduction in efficiency.

However, some collusive arrangements can also increase the participating firms' efficiency by, for example, reducing their transactions costs.\textsuperscript{54} Indeed, competition itself encourages firms to seek out ways to reduce transaction costs through non-standard contractual arrangements (that is, trade between buyers and sellers not conducted at arms length). Such efficiencies arise when firms can reduce their costs by acting in concert, without merging. Indeed, the ability for such arrangements to survive in the long term may depend on the existence of such efficiencies, especially where industry concentration is low. The wide-spread adoption of joint ventures in large projects is evidence of the benefits of some forms of collusive behaviour.

Consequently, some collusive arrangements can promote overall economic efficiency, even if the firms involved also gain through anti-competitive aspects of their behaviour. Many such arrangements would be found to breach section 45 of the TPA and, on current interpretations, would be unlikely to be authorised.

\textsuperscript{53} Posner, R., ibid., pp. 62-8.

\textsuperscript{54} Transaction costs are the costs of exchange, in addition to the price. For example, the cost of telephone calls to arrange the purchase, transport costs, time and effort can all be considered transaction costs.
Misuse of market power

Merchants are occupied solely with crushing each other: such is the effect of free competition.

Section 46 of the TPA prevents a corporation with a substantial degree of market power, either as a supplier or consumer of a product, from using this power to threaten or damage existing or potential competitors in any market. In order to prove a breach of this section, it is necessary to establish that:

- a firm has a substantial degree of power in a market; and
- the firm took advantage of that power for a proscribed purpose.

The proscribed purposes are specified in section 46 and cover conduct designed to:

- eliminate or substantially damage a competitor in that or another market;
- prevent the entry of a person into that or another market; or
- deter or prevent competitive behaviour in that or another market.

The proscribed purposes

The three proscribed purposes of section 46 have been the source of disagreement and confusion. Arguably, all firms seek to damage their competitors simply by engaging in competition. It seems incongruous to punish a firm simply because it succeeds in this endeavour. Similarly, an efficient and competitive firm may deter entry by another firm simply because the latter may not be able to compete with the incumbent.

In a submission to the Cooney inquiry, Professor Baxt referred to the `as yet unresolved problem of whether the section is...aimed at ensuring that competition and the

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competitive process is at the heart of the protection provided for by the legislation, or whether...individual competitors might also be the beneficiaries of...the law'.

Judicial interpretations, and particularly the Queensland Wire decision, appear to have favoured protecting competition and the competitive process:

...the object of Section 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to ‘injure’ each other in this way. This competition has never been a tort ... and these injuries are an inevitable consequence of the competition section 46 was designed to foster.57

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56 Baxt, R., Submission to the Senate Standing Committee on Legal and Constitutional Affairs, Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Control, Sept 1991.

This apparent endorsement of section 46 as a means to protect competition, rather than competitors, undermines the case for amendment. There appears, therefore, no reason to amend section 46 so long as competition and the competitive process, rather than individual competitors, remain the focus of the protection afforded by the provision. Otherwise, some form of statutory guidance may be required.

**The purpose test**

The effectiveness of section 46 has been questioned because of the onerous requirement to establish that the defendant intended to damage an actual or potential competitor, or deter competitive conduct.

In the USA where the emphasis of anti-trust is on outcomes rather than intent, considerable litigation has revolved around allegations of `predatory' behaviour (that is, behaviour aimed at developing or maintaining market power by using aggressive marketing, for example, to eliminate competitors). The result of the concentration on outcomes rather than intent has often been perverse, with firms obstructed or deterred from engaging in genuinely competitive behaviour.

In Australia, the courts and the TPC have always found it hard to discriminate between genuinely competitive behaviour, whether predatory or not, and an unlawful exploitation of market power.

Nonetheless, because the effects of these actions are ambiguous as to whether they promote or undermine economic efficiency, it is the purpose or intent behind the actions which confers the offensive element of any alleged misuse of market power. While the proscribed purpose may be difficult to establish, it appears to be the best means to distinguish pro-competitive from anti-competitive activities.

The *Swanson Committee (1976)* argued that it should be purpose and not effect that is culpable. It considered that an effects test would mean that breaches were actionable only
after the damage was done. It also noted that the courts had interpreted the section to cover most conduct that was not merely protecting legitimate trade and business interests. The courts have tended to draw an inference of improper purpose if, for example, there was no other feasible commercial explanation for the actions.

In addition, in a submission to the recent Cooney Committee inquiry, the Attorney-General's Department suggested that, to the extent that remaining difficulties might be identified with the need to prove purpose, these may be alleviated by a rebuttable presumption of intent — that is, placing the onus on the firm to show that the relevant activity was undertaken for some legitimate purpose in defined circumstances.

Administrative problems

The TPC exercises considerable discretion in administering section 46 of the Act.

In some cases, it or the courts will be placed in the position of, de facto, having to determine prices administratively; such as in the case of firms with market power quoting prices which were very low (to drive competitors out of the market) or very high (constituting, in effect, a refusal to supply). Avoiding repeated prosecutions would require either the firm and the TPC agreeing on an `acceptable' price, or

58 See Queensland Wire Industries Pty Ltd V Broken Hill Pty Co Ltd, op. cit.. Section 46(7): `a corporation may be taken to have taken advantage of its power for a [proscribed] purpose...notwithstanding that, after all the evidence has been considered, the existence of that purpose is ascertainable only by inference from the conduct of the corporation or of any other person or from other relevant circumstances.'

some indication from the bench of what would constitute a lawful price structure.

The *Queensland Wire* case is an example of where such a negotiation may have been necessary, although the parties settled on a price without further judicial or TPC involvement.

The difficulties which might arise therefore remain untested, and are probably more amenable to solution from a policy perspective rather than relying on the courts to develop a doctrine.

**Anti-competitive exclusive dealing**

Section 47 prohibits a supplier or buyer from attempting to interfere with the freedom of its respective buyers or suppliers to deal with whom they choose. Generally, exclusive dealing is only prohibited where such conduct has the purpose or effect of substantially lessening competition; except for third-line forcing which is prohibited outright. Third-line forcing is supplying goods or services on condition that the purchaser will acquire other goods or services from another supplier, even a related company.

Exclusive dealing can be one way of exploiting market power. When exercised by a supplier, it reduces competition with other products in resale markets, increasing sales. Part of the benefits of that increase will be shared with the purchasing firm in the form of lower prices, as compensation for the restriction imposed. When exercised by a buyer, exclusive dealing reduces competition from other outlets, either by limiting the range of products available to them or by forcing them to use a less preferred source, thereby raising their costs. Some of the benefits of that exclusive dealing will be shared with the supplier in the form of higher prices, as compensation for the restriction imposed.

Exclusive dealing can also be used to generate market power. For example, by deciding to stock only one supplier's
product, a retailer creates a valuable right which can be `sold' to that supplier, the `price' being a mixture of freedom from competition from other outlets or a lower price from the supplier. Similarly, by deciding to supply only one outlet, a supplier creates a monopoly right for the retailer who purchases it, either by agreeing to stock only that supplier's products or by paying a lower price for the products.

Whilst exclusive dealing might be viewed as simply a restrictive practice, the outcome differs little from vertical integration. Products transferred between stages within a firm are often not sold to outside firms.\textsuperscript{60} By offering an alternative to dealing solely within the firm, exclusive dealing can reduce costs. Firms will choose whichever arrangement is most efficient.

Consequently, exclusive dealing need not be viewed as an imposition by one party on another, but rather as a part of the price of a contract. For example, retailers balance the inducement offered by the supplier (for example, lower prices) against the disadvantage of handling only their product range. If they find the balance to be in their favour, they will become parties to the agreement.

There are also savings in transactions costs in exclusive dealing. The retailer, by only dealing with one supplier, avoids the need to search the entire range of products and suppliers. Further, where such arrangements ensure supply for a contractual period, re-ordering will be simpler.

The IAC's Food Processing and Beverages report suggested that firms often seek to make contractual arrangements with their suppliers/purchasers to minimise the cost of purchasing or controlling resources. Vertical arrangements may reduce competition, but they can also improve

\textsuperscript{60} Although the freedom for consortiums to deal in this way has limitations - see Queensland Wire op. cit.

\textsuperscript{61} Bork raises the possibility that part of the advantage to the retailer may be passed on to consumers. Bork, R. 1978, ibid. p. 301.
economic efficiency by reducing uncertainty where the supply of essential inputs is uncertain and by reducing the costs of transacting with suppliers/purchasers.

With specific regard to food processing, (these arrangements) can also reduce the costs of discovering and altering the quality of agricultural inputs. For example, a food processing firm may require its agricultural inputs to be free of artificial fertilisers.

Aside from vertical integration, some form of exclusive dealing arrangement may be the only way of ensuring this requirement is met.

Porter suggests that pro-competitive regulation should be applied carefully to exclusive dealing arrangements, taking all the costs and benefits into account:

Antitrust laws must also not be a barrier to vertical collaboration between suppliers and buyers that is so integral to the innovation process. Vertical activities should not be generally impeded unless they unduly exclude other competitors from access to customers. (Emphasis added)

The TPC has recognised that exclusive dealing arrangements can confer net benefits on the community. This year, it authorised an exclusive dealing arrangement between BHP Petroleum and Australia's two largest consumers of methanol to ensure the viability of a pilot methanol plant. The agreements commit ICI and Borden to purchasing all their methanol requirements from BHPP for the next ten years.

The TPC accepts that the plant is likely to bring substantial public benefits. It also accepts BHPP's contention that it needed the security of revenue supply that the exclusive dealing arrangements would provide before investing in the pilot project.

While the benefits of agreements such as these are always more transparent when greenfields investment or the

63 Porter, p. 663-4.
possible failure of a firm are involved, the benefits may be just as high in other circumstances and they should all be taken into account in authorisation applications.

The strong evidence that vertical arrangements often enhance economic efficiency suggests to the Commission that exclusive dealing should be subject to the substantial lessening of competition test: thus, the outright prohibition of third line forcing should be reviewed.

Resale price maintenance

Section 48 deals with anti-competitive pricing agreements. It prohibits vertical supply arrangements designed to underpin price levels, except in the case of genuine recommended retail prices or loss-leader selling. A supplier cannot in any way fix a price below which a reseller may not sell or advertise such products; for example, by threatening or actually suspending supplies. The section prohibits resale price maintenance per se; that is, without any requirement to show that there has been a resultant substantial lessening of competition.

But there are some cases in which resale price maintenance may be justified. One is where resale price maintenance is used to alter the nature of competition, rather than to reduce it. Generally, the bundling of different products together, such as in third-line forcing discussed above, is anti-competitive and efficiency demands that each product be priced and available individually. On occasions, however, a market in an associated product, such as providing pre-sales advice, may be impossible or impractical, and the most effective way of ensuring that such a product is not undersupplied (due to, for example, free-riding) is to bundle the advice and the primary product together. In such circumstances, resale price maintenance can be used to induce the right level of service, raising the value of the product to the consumer. Consequently, resale price
maintenance is not so unambiguously efficiency reducing as to justify an outright prohibition.

Subjecting resale price maintenance to a competition test may negate the need for separate prohibition of this practice. Resale price maintenance, to the extent that it causes a substantial lessening of competition that reduces economic efficiency, would constitute a breach of section 46(1c) in that it would deter or prevent competitive behaviour.

However, this would also add the requirement to establish a proscribed purpose in relation to these actions.

Consequently, the Commission considers that the current absolute ban should be reviewed. Consideration should be given to subjecting the prohibition of resale price maintenance to the competition test and introducing authorisation for such practices. Whether a separate prohibition of resale price maintenance is justified is an open question.

Anti-competitive price discrimination

According to section 49 of the TPA, a supplier must not price discriminate (for example, by differential price discounting) between purchasers of products of like grade or quality if it results in a substantial lessening of competition, from either the magnitude or repetition of price discrimination. This provision, however, recognises some valid reasons for price discrimination, such as discounting for large volumes.

The Commission argued in its Raw Materials Pricing report that, because of the potential of section 49 to impede efficient pricing practices, the Government should consider repealing it:

...efficient pricing in raw materials markets demands that a seller be able to discriminate between different buyers. Section 49 may inhibit raw materials suppliers from adopting such an approach for fear of contravening the Act. The Trade Practices Commission has
advised that section 49 has been little used in the past and that, in any case, price discrimination could if necessary be dealt with under section 46 of the Act.

Any firm with a substantial degree of market power would contravene section 46 if it used that power either:
- as a seller to charge different prices to different buyers;
- or
- as a buyer to extract concessions from a seller;

in order to achieve any one of the three proscribed purposes.

In comparison with section 49, the application of section 46 to price discrimination is broader in some ways and narrower in others. Whereas section 49 applies only to the activities of sellers, section 46 applies to the activities of both buyers and sellers. However, unlike section 49, it is not enough in section 46 to establish price discrimination and a resultant substantial lessening of competition — the intent to achieve one of the proscribed purposes also must be proved.

Although the proscribed purpose may be difficult to establish (see discussion of section 46), it appears to be the best way of distinguishing pro-competitive from anti-competitive activities. If necessary, price discrimination could be included as one of the defined circumstances that triggers the rebuttable presumption of intent also discussed above.

The Raw Materials Pricing report concluded:

In view of the inhibiting potential of section 49 to efficient pricing, and the scope for section 46 to deal with discriminatory pricing to the extent that it may be a problem from an economic efficiency point of view, the Industry Commission concludes that consideration should be given to the repeal of section 49.

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66 Ibid., p. 25.
Hay and Morris conducted empirical analysis of three different types of price discrimination and concluded:

These examples illustrate what appears to be a useful conclusion about price discrimination. Given that the pre-conditions for practicing price discrimination are met, and that nothing can be done by the competition authorities about the existence of monopoly, then price discrimination in final consumer markets will probably increase aggregate social welfare, but at the expense of equity. The gain in social welfare arises in each case because output is higher than it would be if a
uniform price were set. There are, of course, a huge range of such practices in addition to the ones we have analysed... But in so far as each of them involves an increase in the quantity sold, compared with uniform pricing, it is probable that a welfare gain is present, even though the equity implications are less attractive. More complex considerations enter where the goods are intermediate rather than sold to final demand. However it is worth noting, on the basis of the previous welfare analysis of vertical relationships between firms, that any discriminating practice that has the effect at the margin that the good is supplied at a price nearer to marginal cost than would otherwise be the case is probably welfare enhancing.

Thus, price discrimination usually enhances efficiency because it tends to mitigate, rather than exacerbate, efficiency losses associated with market power. As long as price discrimination increases sales, as it usually does, society moves closer to competitive output levels, and efficiency losses associated with market power are reduced. Prima facie, the welfare effects are ambiguous as some consumers are paying more and some are paying less. But as a rule of thumb, welfare in aggregate is improved when total sales increase.

3.4 Regulating market structure

In Australia, trade practices law has largely concentrated on market practices. The first five of the six provisions of Part IV of the Act deal with practices, and these have dominated both private and TPC initiated actions. In addition,

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67 Hay, D.A. and Morris, D.J., *Industrial Economics and Organisation: Theory and Evidence*, Oxford University Press, 1991, p. 604. The types of price discrimination considered were: First degree price discrimination which occurs where the monopolist firm is able to charge a separate price for each unit sold. Second degree price discrimination is where the firm sells different blocks of output along the same demand curve at different prices. Third degree price discrimination requires the firm to identify market segments with different demand curves and charge higher prices where demand is less elastic.

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administrative activities by the TPC have concentrated on provisions of the Act dealing with market practices.

...the Act is mainly aimed at anti-competitive conduct. By and large it accepts established industry structures, and there is little if any power to break up established enterprises by the process of divestiture (which means splitting up an enterprise into smaller units), whether horizontal (ie breaking up an enterprise into competing units) or vertical (ie separating different functional levels of vertically integrated organisations, (e.g. oil exploration, production, refining, wholesaling, retailing)).

Further, the rationale for the anti-mergers provision in the Act has often been represented as surrogate regulation of market practices; that is, as a `second best' means of preventing market practices that are difficult to prevent in highly concentrated industries. For example, without some regulation of mergers, prohibitions of price fixing could be avoided by merger of the participating firms. In addition, regulating mergers may reduce the problems of detecting and proving collusive arrangements between a small number of participants in a market.

As discussed, much of the recent debate on the reform of restrictive trade practices law has concerned proposals to increase the emphasis on regulating market structure and, in particular, strengthening the application of section 50. This culminated in the decision in June to modify the competition test in section 50 to prohibit mergers likely to cause a substantial lessening of competition, rather than where a merger would create or enhance dominance of a market by the acquiring corporation.

While there may be differences in theory between the dominance test and substantial lessening of competition test, cases on the two seem to suggest that there may not be a substantial difference in practice.

This is shown by the way in which the courts go about determining whether the thresholds have been breached. In the oft-quoted case of Queensland Co-Operative Milling Association (QCMA)\textsuperscript{69}, which was decided under a substantial lessening of competition test, the TPT offered a list of indicators which could be used to determine market structure (since "whether firms compete is very much a matter of the structure of the markets in which they operate").\textsuperscript{70} This list was cited in the Ansett Transport Industries (Operations) case, in which Northrop J. offered his own list of indicators to assess market dominance.

The two lists show remarkable similarities. Both lists mention market concentration, barriers to entry, the extent to which products in the industry are characterised by extreme product differentiation and sales promotion, and the character of corporate relationships and the extent of corporate integration. The only distinguishing mark of the dominance test included in the lists is the ability of the firm `...to determine prices for its services without being consistently inhibited in its determination by other firms'.\textsuperscript{72} However, in QCMA, this notion may have been incorporated in the view of what was rivalrous behaviour: the TPT said, `In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.' (Emphasis added.)

The recent cases of Arnotts and Australian Meat Holdings cite both of these cases. In the light of these precedents, it would seem that there may not be great differences between how the different tests are applied in practice.

\textsuperscript{69} (1976)8 ALR 481
\textsuperscript{70} ibid., p. 516.
\textsuperscript{71} [1978] ATPR 40-071
\textsuperscript{72} ibid.
\textsuperscript{73} ibid, p. 516.
However, it may be that the same indicators could be applied to `dominance' and `substantial lessening of competition' to arrive at substantially different outcomes.

In accordance with the recommendations of the Cooney Committee inquiry, the decision to strengthen the threshold competition test for mergers was also accompanied by statutory factors of what amounts to a `substantial lessening of competition'. These factors will provide a legislative basis for the future assessment of the effects of mergers on competition, and therefore tend to render precedent on both `dominance' and `substantial lessening of competition' redundant.

The statutory factors to be taken into account in determining if a merger has the effect of substantially lessening competition in a substantial market for goods or services in Australia, a State or Territory will be:

(a) the actual and potential level of import competition in the relevant market;

(b) the height of barriers to entry, that is the ease with which new participants may enter and exit the market, now or in the future;

(c) the level of concentration in the relevant market;
(d) the degree of countervailing power;
(e) the ability of the merged firm to increase prices or profit margins significantly and sustainably without being inhibited by other market participants;
(f) the extent to which acceptable substitutes for the products of the merged firm are available or likely to be available;
(g) the likelihood the merger would result in the removal of a vigorous and effective competitor;
(h) the nature and extent of vertical integration; and
(i) any other relevant factor.

While many of these factors reflect the discussion on assessing competition above, that discussion also indicates that some of the factors should be approached carefully. Concentration ratios and short-run profit levels, for example, can provide ambiguous signals on the level of competition in a market.

At present, these factors will apply to the mergers provision only. They will not apply to interpretations of `substantial lessening of competition' in relation to other provisions of the Act, and to the similar threshold competition test in section 46. The fact that one of the justifications for the change in the mergers test was to make the provision more consistent with other provisions of the Act, and that applying the factors to section 50 and not to others will undermine this goal, suggests that the factors should be applied to all provisions of Part IV. Further, the factors will be just as useful to help ensure consistent approaches to competition issues for other provisions of the Act as they will be for the mergers provision. Some modification of the factors may, however, be required. For example, factor (g) would require amendment.

Effects of mergers on economic efficiency

Mergers can have both benefits and costs. The benefits derive mainly from the potential for merged firms to
improve their productive efficiency. Costs can arise if the merged firm is able to exploit market power.

Whether any particular merger will enhance or detract from economic efficiency will depend on the size of the benefits compared to the size of the costs.

Empirical evidence on the relative magnitude of these factors is ambiguous. The New Zealand Economic Development Commission has stated that there is evidence showing that, on average, mergers do not result in firms engaging in monopolistic behaviour. This implies that increases in the profitability of merged firms generally reflects improvements in productive efficiency. However, after examining a number of USA studies on horizontal mergers, Waterson concluded:

...the increased profitability often associated with successful horizontal mergers will sometimes be a result of increased efficiency. At other times, it will be due merely to exercise of the increased market power which is available. Quite commonly, it will be a mixture of these factors.

Similarly, after examining the advantages and disadvantages associated with mergers and takeovers, the House of Representatives Standing Committee on Legal and Constitutional Affairs (The Griffiths Report) concluded that the outcome of any individual case would depend on the circumstances.

Empirical analysis of the overall economic efficiency benefits of mergers falls into two categories of methodology:

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74 A review of reviews and studies may be found in EPAC 1989.


76 EPAC 1989, op. cit., p.60.

77 House of Representative Standing Committee on Legal and Constitutional Affairs, Mergers, Takeovers and Monopolies: Profiting from Competition, May 1989, AGPS, Canberra.
• `event' studies, which infer the profitability of mergers from changes in stock market values at the time when transactions are announced; and
• `accounting' studies, which assess the productivity of mergers by using accounting data on the post merger performance of acquiring firms.

Generally, event studies have shown that mergers confer significant net benefits while accounting studies have not. On this point, the Treasury has stated:

There has not been a satisfactory resolution of the fact that the event studies...have shown clear direct benefits, while the studies using accounting data have demonstrated mixed results. Some of the net gain to shareholders identified in the share market event studies no doubt results from an expected redistribution of wealth away from other parties (labour, bondholders, consumers) rather than reflecting wealth creation. However, in general the magnitude of the gains do not appear to be satisfactorily explained from this source.\(^78\)

The Cooney Committee report also addressed recent empirical analysis of the efficiency benefits of mergers. It found that:

…the empirical evidence on the effects of mergers is conflicting and not conclusive. The economic evidence that mergers actually result in productive efficiencies remains equivocal. Nor is it clear that efficiencies, where they have occurred, have improved the international competitiveness of Australian firms, or resulted in demonstrable benefits to consumers.

However, the Treasury has also argued that:

…even if mergers on average fail to deliver expected productivity gains, a substantial number succeed in doing so. Caves puts the number at 40 per cent on the basis of his review of the US post-merger studies.\(^79\) If these productivity gains then enhanced the competitiveness of the whole market in a dynamic sense, the gains

\(^78\) Treasury, op. cit., p. 19.

would be reflected throughout the market in terms of improved overall efficiency gains and not necessarily reflected in increased profit indicators of merged enterprises in any on-going manner.

Overall, the evidence implies that, for most mergers, it is not possible to determine conclusively afterwards, let alone beforehand, whether any particular proposed merger is of net benefit to the community.

However, this evidence is based on studies of mergers which have proceeded under the relevant mergers regulation. There are likely to be some mergers, which would not have been considered by these studies, that would clearly reduce welfare.

Applying the mergers test

While the foregoing evidence may rule out the wholesale prohibition of mergers, it also clearly indicates that preventing at least some mergers may be beneficial. As EPAC concluded in its study:

All that can be said is that the evidence is strong enough to reject a prohibitive approach to mergers, but is subject to sufficient empirical and theoretical caveats to reject calls for a passive acceptance of all horizontal mergers.

Views differ on what level of intervention against mergers is necessary. An ideal administrative arrangement would cost-effectively identify undesirable mergers, but not obstruct beneficial mergers.

There is considerable logical merit in amending section 50 of the Act to prohibit mergers that would likely result in a substantial lessening of competition in a market. To start with, it would increase consistency in the application of Part IV of the Act — the competition tests in other sections are expressed in similar terms. Further, since the maintenance of competition in markets is the focus of Part IV of the Act, it makes sense that competition in a relevant market should

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Treasury, op. cit., p. 20.
be the focus of Section 50, rather than the question of whether a firm does or is likely to dominate that market. Finally, the amendment of Section 50 would bring more mergers under TPC examination, at least partially satisfying the policy need to regulate market concentration more closely.

However, because it is difficult, if not impossible, to judge the likely impact on competition in the relevant market prior to a merger, the substantial lessening of competition test should be applied to mergers regulation with care to avoid substantial costs.

Since the mergers most likely to reduce overall economic efficiency will be those where the impact on competition is greatest, it seems sensible to act against only those mergers that clearly threaten competition. By taking into account the discussion of assessing competition above in the application of the statutory factors to the new mergers competition test, section 50 is more likely to work in this way. Authorisation would continue to be available to those mergers which, although likely to result in a substantial lessening of competition, would nonetheless result in a net public benefit!

Divestiture powers

Section 81 of the Act currently enables the Court to order divestiture only where a merger or acquisition has been undertaken in breach of section 50.

The Griffiths Committee considered and rejected a proposal to permit the TPC to seek, and the court to order, divestiture of the assets of a firm guilty of `intractable and continuous breach of section 46' — the misuse of market

81 However, the authorisation process may be of little assistance here because of the effective presumption against the merger going ahead and the public interest, rather than economic efficiency, criteria applied (see discussion in Section 6.1).
power provision.\textsuperscript{82} The Cooney Committee report concurred with this recommendation.

The Attorney-General's Department considers that there is no compelling case for the inclusion of divestiture as a remedy for misuse of market power, and that intractable breaches of this section should be addressed by increases in monetary penalties: divestiture is a `very blunt and infrequently effective remedy'.

Further, divestiture orders raise difficult practical problems:

For breaches of section 46 not related to access to facilities, for example predatory pricing, divestiture would be difficult to apply, as there is no acquisition of separable plant to order divestiture of. Difficulties would arise in identifying which part of a business should be divested. In this case divestiture is likely to involve an arbitrary decision about which part of the corporation is to be divested and may involve divestiture of part of the business which had little to do with the actual breach of the Act.

The TPC tends to support this view, but nonetheless considers that there may be a role for a divestiture power to structurally separate state GBEs:

I have never been a great supporter of having a divestiture power in the Trade Practices Act to apply to established Australian businesses in the private sector.

However, I believe there is soon likely to be a debate about whether some kind of divestiture power is likely to be needed in the deregulating areas of the economy.

\textsuperscript{82} House of Representatives Standing Committee on Legal and Constitutional Affairs, \textit{Mergers, Takeovers and Monopolies: Profiting from Competition?}, AGPS, Canberra Mat 1989, p. 102.

\textsuperscript{83} House of Representative Standing Committee on Legal and Constitutional Affairs, op. cit., p. 99.

\textsuperscript{84} Attorney-General's Department, Submission to the Senate Standing Committee on Legal and Constitutional Affairs, \textit{Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls}, August 1991, p. 29.

\textsuperscript{85} Treasury, op. cit. pp. 61-62.
The Industry Commission reports on gas, electricity and rail all point to the apparent need for extensive divestiture in those sectors. Although these are basically matters which are in the hands of State Governments, I think it's worth pointing out that the Industry Commission's prescription could be implemented if the Trade Practices Act included divestiture powers.

While a specific divestiture power may provide a means to enforce divestiture of state GBEs, other approaches to such reforms, involving the consideration of competition policy amongst other policy considerations, are preferable, and probably more likely to be achievable.

3.5 Summing up

The foregoing analysis suggests that current restrictive trade practices legislation, and current approaches to the application and enforcement of these laws, should be modified. At present, restrictive trade practices regulation, based largely on a static model of competition, ignores many of the dynamic sources of competition and the potential gains in economic efficiency attainable from practices which have traditionally been deemed anti-competitive.

The Commission alluded to the need for the development of a more dynamic approach to restrictive trade practices legislation, and competition policy generally, in its Food Processing and Beverages report:

Market structures and contracting practices that potentially permit the exercise of market power do not necessarily mean that community welfare would be improved by intervention. Differences in cost structure, entrepreneurial ability, or the costs of determining consumers' wants, create the possibility of a wide range of industry structures and the need for contracting to retain command over resources. The level of competition prevailing and the need to economise on transactions costs may be fully consistent with the maximising of community welfare. The

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economic cost of allowing greater concentration to develop or potentially restrictive practices to operate in the food industries may be less than the costs to society of their regulation, particularly where markets are contestable and free of government intervention.

Over recent years the TPC, in respect of its competition regulations, has been operating under a specific government policy directive aimed at increasing the international competitiveness of Australian industry, including that of the food processing and beverages industries. In the light of the foregoing analysis of competition in the food processing and beverages industries, the Commission believes that the TPC's continued pursuit of this efficiency-based objective would be in the best interests not only of consumers but also of the community in general.

\[87\text{ Op. cit., p. 74-5.}\]
Government legislates against competition for various reasons.

Commonly in the post-war period, governments in Australia have exclusively supplied markets considered, at least in part, to exhibit natural monopoly characteristics — that is, where the characteristics of the industry mean that these markets can only be provided efficiently by one producer. Examples include electricity generation, transmission and supply; telecommunications; water; and transport infrastructure. In other OECD countries, governments have facilitated private provision of such natural monopoly services, usually by legislating for exclusive supply by a nominated firm.

Australian governments have also undertaken exclusive supply of some products primarily to further social goals, such as providing certain postal services, urban bus services and rail services, at prices below cost. The Commission considers that the direct provision of subsidised services to particular parts of the community, or the cross-subsidisation of the provision of services between parts of the community, is generally not the most efficient way to meet social policy objectives. Nonetheless, to the extent that this practice continues, pro-competitive regulation should take it into account.

Often, supply is mandated to government for both economic efficiency and social policy reasons.

In this chapter, the Commission discusses the role of pro-competitive regulation in the provision of goods and services which have natural monopoly characteristics, and/or where government has legislated against competition.
4.1 Natural monopolies

According to Freidman:

There is unfortunately no good solution for technical monopoly. There is only a choice among three evils: private unregulated monopoly, private monopoly.
Several Industry Commission (and formerly IAC) inquiries have explored the issue of effective regulation of the provision of services where there are natural monopoly characteristics.

General approaches

In the *Government (Non-tax) Charges* report, the Commission addressed the general issue of identifying natural monopolies and devising the most efficient ways of dealing with them. It sought an approach to the regulation of natural monopolies that would achieve two sometimes conflicting objectives:

- ensuring production in natural monopoly markets is technically efficient; and
- ensuring that opportunities to abuse market power in these markets are minimised.

The Commission discussed some common misconceptions on natural monopoly markets, and criticised current approaches to regulation. It suggested that, while economies of scale, scope, and organisation are often characteristics of natural monopoly, testing for it is more complicated:

Whether an industry is a natural monopoly depends on conditions of supply (e.g. technology) as well as demand (e.g. the size of the market). Thus, least-cost supply may vary between single firm and multi-firm production over different output ranges, according to the level of demand. An industry that is a natural monopoly in Australia may not be one in the USA, where the size of the market may be sufficient to warrant more than one supplier. In addition, technological change will almost certainly alter the cost structure of an industry over time (e.g. by impacting on the degree of economies of scope or scale in the production process).

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Consequently, whether not an industry is a natural monopoly may change over time.

The Commission considered that regulation of natural monopolies in Australia has, to date, not taken these factors into account.

Partial consideration of these factors usually meant that the benefits available from legislating barriers to entry in natural monopolies were exaggerated, while the costs of such regulation were underestimated.

On the benefits of legislating barriers to entry, the Commission concluded:

Thus, consideration of the existence of sunk costs as well as the likely strategic behaviour of both existing and potential suppliers, suggest that a firm would only enter the industry if it possessed a medium to long term cost advantage relative to the incumbent (e.g. because it possessed a more efficient technology or because the incumbent was inefficient), rather than envisioning a 'hit and run' operation. If entry occurs because the newcomer is more efficient than the incumbent, this competition is desirable because of the resulting overall gains to the economy, rather than being wasteful or destructive. Taken together, these considerations suggest that, even when the cost conditions of a natural monopoly render it potentially unsustainable, in practice purely wasteful or destructive competition is unlikely to arise. When inefficient entry does occur, it is unlikely to result in a large loss to society, since it is unlikely to continue for long periods and is unlikely to involve significant sunk costs.

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3 Ibid., p. 85. 'Essentially, an unsustainable natural monopoly arises where it is impossible for the incumbent firm to charge prices which cover costs, without also providing an incentive for other firms to enter the industry.' Exposing unsustainable natural monopolies to competition may 'result in waste in the form of uneconomic duplication of infrastructure and the loss of economies of scale, organisation, thereby creating additional cost burdens on consumers.' pp. 83-84.
The costs of legislating barriers to entry in natural monopolies were usually underestimated, for two reasons. First, legislative barriers to entry often precluded any pressures for dynamic efficiency in the industry. Second, the regulation usually made no allowance for the introduction of new technologies. For example, recent technological developments in telecommunications (such as microwave links, cellular phones, and PABXs) appear to have substantially lessened the scope of natural monopoly in that industry.

The Commission suggested that both these factors highlight the need, in the presence of market restrictions, for the natural monopoly status of industries to be periodically reviewed in the light of changing technologies.

Further, the reach of legislated barriers to entry has usually extended well beyond the bounds of the area of natural monopoly. Indeed, it is only in the case of an `unsustainable' natural monopoly that any legislative barriers to entry should be considered; and then only if the benefits of the intervention are likely to exceed the costs.

Thus, the Commission concluded that legislative barriers to entry are rarely justified:

The principal conclusion from this discussion is that legislative barriers to entry are generally redundant (ie natural monopoly is generally sustainable without them). In the exceptional circumstances where it can be argued that a natural monopoly may not be sustainable in the face of competition, the potential waste due to inefficient entry needs to be balanced against the adverse effects on production efficiency of restricting competition. There is, therefore, a strong case for removing any legislative barriers to entry so that, regardless of whether the incumbent monopolist is public or private, it faces continuing external pressures to produce and price efficiently.

The Commission also found two constraining influences on the abuse of market power by firms considered to be natural

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\[4\] Ibid., p. 87.
monopolists: the existence of substitutes and the existence of actual or potential competitors in the supply of the good or service in question.

However, the Commission argued that such influences would not be sufficient to ensure economically efficient practices by firms in natural monopoly industries:

Under certain circumstances, however, removal of legislative barriers to entry will not be sufficient to ensure that a market is contestable. In particular, the existence of unavoidable sunk, as opposed to fixed, costs provides a natural monopolist with some leeway before departures from efficient pricing and production processes will attract rival firms into the industry.

The Commission therefore considered that government intervention may be justified to limit abuses of market power by natural monopolists.

The Commission considered three broad policy approaches to the problem of restricting abuses of monopoly power in natural monopolies while facilitating production efficiency:

- public ownership and operation;
- promoting competition; and
- regulated private supply.

Public ownership and operation

As already noted, Australian governments have traditionally sought to own and control firms in industries with natural monopoly characteristics.

The Commission considered that this is not generally the best way to deal with the problems posed by natural monopolies. It questioned the argument that because public enterprises theoretically act in the public interest and are more amenable to requests for information from regulators, it is easier to prevent abuse of monopoly power by a public enterprise than a private one. It further argued that:

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5 Ibid., p. 88.
Even if it is presumed that altruism and government demands for information do result in allocative gains through the avoidance of monopoly pricing, the case for public ownership depends on there being appropriate incentives for public enterprises to produce efficiently. Otherwise, any potential gains from regulating prices and/or returns may be dissipated in cost padding, over-manning etc...The very factor that diminishes the likelihood of public enterprises deliberately exploiting users by raising prices (ie the suspension of the profit motive).

The Commission canvassed the use of general pro-competitive measures such as existing trade practices law and the establishment of specialist agencies to oversee prices, as mechanisms for controlling abuses of natural monopoly power.

However, it considered that these would do nothing to alleviate the principal difficulty with the public ownership approach that it relied upon administratively based mechanisms as a substitute for market forces.

Promoting competition

This approach shifts the emphasis from administrative based incentives for efficient supply of goods and services to pro-competitive regulation for at least part of the industry. There are three ways this can be achieved.

Contracting out involves the use of public and/or private suppliers selected by a competitive bidding system, usually covering a specified period. Competition within a market is effectively replaced by competition for the right to service the market or a particular part of it. In principle, competitive bidding for contracts would ensure that opportunities for providing goods and services went to the most efficient operator and that operators were encouraged to maintain and improve their efficiency, or risk losing their contract. Problems with this approach include uncertainties

6 Ibid., p. 92.
associated with the requirements of the contract, and implications for long-term investment.

Common carrier provisions and joint ownership arrangements involve the sharing of infrastructure characterised by natural monopoly among independent firms or government agencies under appropriate access arrangements. Generally, common carrier provisions impose a legal obligation on the owner of the network to provide services to allcomers at a `reasonable' price. Where the natural monopoly arises due to technical factors rather than economies of organisation, joint or co-operative ownership may be warranted. Common carrier provisions and joint ownership arrangements require careful regulation of the monopoly power, in particular to prevent the monopoly owner from extending its advantage into competitive markets through the monopoly (exclusionary) pricing or denial of access:

One question that arises is whether regulation designed to ensure that all users have equal access to the basic infrastructure is best achieved by reliance on general pro-competitive measures (e.g. TPC or PSA oversight) or by specialist industry agencies such as AUSTEL. Where the technical characteristics of an industry are complex or the industry is seen as `strategically' important, there may be a case to use industry-specific regulatory bodies. However, in most cases it would seem appropriate to rely on more general measures, unless these subsequently prove to be inadequate. Regulatory bodies with economy-wide responsibilities have the advantage that they are less likely to be `captured' by the enterprises they regulate.

The Commission considered that the common carrier approach offered considerable scope for encouraging efficiency in industries which have some elements of natural monopoly by allowing competition in other areas.

Segmentation, or structural separation, is aimed at promoting competition in the industry as a whole, even where competition cannot be introduced into the segment

\footnote{Ibid., p. 95.}
seen as the natural monopoly core. It involves reducing or removing the opportunity for a natural monopolist to prevent or distort competition in related markets, by excluding it from operating in the potentially competitive segments of the industry. The benefits from eliminating the need to regulate the competitive segments must be balanced against the costs of preventing firms from operating in both competitive and natural monopoly segments. The need to regulate the behaviour of the monopolist in respect of the natural monopoly component of the industry would remain.

Regulated private supply

A private firm's ability to restrict output and increase profits in a natural monopoly could also be countered by general behaviour monitoring measures such as TPC or Prices Surveillance Authority (PSA) oversight, or industry-specific price or rate of return controls, aimed at ensuring that the benefits of single-firm supply are passed on to consumers.

However, the Commission noted:

Unfortunately, regulations aimed at controlling market power tend to have direct and indirect costs of their own, particularly where they are poorly conceived or implemented. Empirical evidence...suggests that such regulations seriously blunt the incentives for productive efficiency associated with private ownership. For example, where private firms are constrained to a maximum allowable rate of return on capital, decisions relating to the use of inputs are distorted, thus undermining productive efficiency.

The Commission considered that the benefits from the private supply approach will depend heavily on the ability to design regulations which are effective in controlling market power yet do not seriously impair sharemarket and capital market disciplines on private firms for productive efficiency.

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8 Ibid., p. 98. `Productive efficiency' here refers to a combination of technical and allocative efficiency as explained in Chapter 2.
Efficient regulation

Regardless of the specific arrangements chosen for the ownership and operation of firms supplying goods and services in industries with natural monopoly characteristics, the effective regulation of monopoly power is an essential ingredient to attaining technical, allocative, and dynamic efficiency. The Commission favoured economic regulation by economy-wide rules and organisations — such as the TPC and PSA — over industry-specific regulation, where the former is possible.
Specific applications

Other Commission inquiries have attempted to apply these lessons to specific industries.

In its report on *Energy Generation and Distribution*, the Commission suggested that the most effective approach to natural monopoly characteristics in the supply of electricity transmission was to structurally separate this sector, mandate supply to a separate utility, and require it to operate the grid on an open access basis:

Functions that would be undertaken ultimately by the transmission utility include the operation and maintenance of the grid, merit order dispatch, pricing of transmission services, planning of grid extensions, and coordination functions to maintain system integrity.

Following a transition period involving close monitoring of performance and behaviour by the TPC, transmission would be subject to general TPC and PSA supervision:

However, mainly because of natural monopoly characteristics of transmission and the implications of this for pricing, some difficulties may arise if both agencies are involved. Consequently, it would be appropriate to consider amendments to the Trade Practices Act to ensure that all network activities are covered and that efficient forms of pricing for a natural monopoly are not construed as discriminatory.

The latter point shows the importance of ensuring that the transmission authority should be able to set prices for services according to the customers willingness to pay, without obstruction from section 49 of the Act.

In its *Rail Transport* inquiry, the Commission addressed the issue of dealing with the natural monopoly in rail infrastructure:

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The Commission considers that some new arrangements are required in order to prevent abuses of monopoly power, especially in relation to freight rates, and to resolve conflicts between rail authorities and others concerning open access to rail tracks and the appropriate terms and conditions.

The Commission considered track access to be of particular concern because rail and infrastructure services (such as train control) could not be structurally separated, and the rail authority would be competing with other infrastructure users in the supply of rail services. The Commission also favoured general pro-competitive regulation by the TPC rather than a specific regulatory body, because of the additional costs of an extra authority and the dangers of regulatory capture. However, the inability of the Act and the TPC to deal with monopoly pricing would have to be addressed.

In other industries, however, the issues may not be so clear. In particular, when the natural monopolist is a government business enterprise (GBE), it is not always easy to delineate economic regulation designed to limit abuses of market power with measures designed to monitor the performance of the enterprise. Performance monitoring of GBEs is designed to protect tax-payer investments and help ensure productive efficiency. Thus, in theory, performance monitoring provides incentives for maximising prices and returns to GBEs. But practical and political factors may dictate that, instead, the performance monitoring role is used to maximise community welfare — the same goal as pro-competitive regulation. Where this is the case, vesting responsibility for pro-competitive regulation in a separate body to that responsible for performance monitoring may lead to duplication of effort. For example, in its report on Water Resources and Water Waste Disposal the Commission suggests that special factors present in the range of natural monopolies in the supply of water mean that a range of

institutional structures could be appropriate for the industry. The Commission is currently considering similar issues in other areas, including postal services and ports.

Policy implications

Overall, these reports suggest that the preferred approach to the pro-competitive regulation of industries exhibiting natural monopoly characteristics is adoption of a general restrictive trade practices regime and the current investigation and enforcement role of the TPC, with possibly some assistance from the powers and functions of the PSA. This general regulatory regime should then be supplemented by industry-specific regulation to the extent considered necessary to deal with remaining problems. The level of this supplementary regulation will vary from industry to industry.

These matters are discussed further in section 4.3.

4.2 Mandated monopolies

As noted, past Australian governments have often undertaken exclusive supply in a particular industry to achieve some social policy goal. GBEs are often required to provide community service obligations (CSOs) — services which a firm would not supply on strictly commercial criteria. And statutory marketing arrangements (SMAs) are imposed by governments in otherwise competitive markets to achieve a range of economic and social goals.

\[12 \text{ Water Resources and Waste Water Disposal, op. cit., p. 116.} \]
Community service obligations

In its report on *Government (non-tax) Charges*, the Commission questioned obliging GBEs to provide CSOs:

Many of the CSOs of public enterprises have been in place for decades. Their rationale has not always been made clear; in general terms it seems to be based on a mixture of welfare, regional development, industry assistance and national unity objectives. The question arises as whether the original objectives remain legitimate today. It is also necessary to review the relative costs and benefits of CSOs to determine whether the associated costs imposed on public enterprises and the economy generally can be justified in today’s social and economic environment by the benefits derived from them.

Social policy goals — such as ensuring comprehensive services or concessional pricing to disadvantaged groups — can be achieved by more efficient ways than mandating exclusive supply to an organisation to enable it to cross-subsidise some consumers from higher prices charged to others:

The alternative mechanism most suggested for implementing CSOs is direct cash transfers to the targeted recipients. It has several advantages and the large part of government welfare programs are delivered in this way. However, there is a case for welfare packages to include some in-kind transfers, although the desirable extent of these may require case-by-case examination...

Several alternative mechanisms can be utilised to implement CSOs. They include voucher systems, direct funding and contracting out the services to be provided. None of these mechanisms provides a complete solution to the problems encountered with CSOs. They all involve trade-offs between efficiency and other objectives.

Nevertheless, all these mechanisms could be considered as potentially part of a complementary set of measures to implement government objectives more efficiently. Direct funding of CSOs provides an avenue for ensuring that the objectives of government policy are made more explicit and provide for public scrutiny of the costs incurred in implementing them. It is also a means of overcoming some of the more serious efficiency effects of cross-

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subsidies. Selected use of voucher systems and contracting out services to be provided to meet government objectives could be used to improve consumption choiée.

Nevertheless, some monopolies mandated for social policy reasons, or for a mixture of social and economic policy reasons, will no doubt continue to exist. Thus, competition policy has a role in ensuring that these monopolies cause a minimum of distortions and inefficiencies, and in particular that these distortions do not flow into more competitive markets.

In the past, mandated government supply of certain services has been provided, at least ostensibly, in the public interest. It has thus been assumed either that no contravention of competition policy principles was involved, or that there was a net benefit to the community as a result of the contravention. This has been one of the reasons that the instrumentalities providing these services have not been subject the Part IV of the Act.

But as part of the drive toward greater technical efficiency in the provision of services by government, GBEs are being encouraged to operate on commercial lines. Any distinction between the supply of services by the public and private sectors is disappearing. Indeed, provision of many services by the public sector no longer pays even lip service to altruism.

Consequently, the Commission considers that these organisations should be subjected to pro-competitive regulation.

Statutory marketing arrangements

In the Statutory Marketing Arrangements for Primary Products report, the Commission identified a wide range of

\[14\] Ibid., p. 67.
objectives for statutory marketing arrangements based on a multitude of rationales:

The stated objectives and rationales for statutory marketing arrangements vary between commodity groups, reflecting different market conditions (e.g. whether the good is domestically- or export-oriented) and the characteristics of the product (e.g. whether it is perishable or amenable to storage). A common thread to these arrangements is the recognition that producers, by virtue of their numbers, geographical diversity and irregular production patterns, may face difficulties in the absence of statutory backing.

Many of the rationales advanced for statutory marketing arrangements centre on a desire to correct perceived failures in market processes. Some, however, relate to social and/or assistance motivations.¹⁵

Like the provision of CSOs by GBEs, justifications for statutory marketing arrangements are usually questionable:

Because of the possible unsoundness of their objectives or the powers used to achieve them, many statutory marketing arrangements require specific examination. Even where an objective is sound, a statutory marketing arrangement may not be the most effective way of pursuing it.

The TPC Rural Guideline

In August 1989, the TPC published its Rural Guideline, which outlined how it thought the Act applied to primary produce marketing arrangements and, in particular, the circumstances that such arrangements could be authorised.

The Guideline sets out the considerations the TPC applies to authorisation applications. Some of these are more concerned with social welfare issues than efficiency. For example, the Guideline states that "employment creation or the maintenance of employment that benefits a particular region" has been used as an indicator of public benefit.¹⁷

¹⁵ SMAs, op. cit., p. 35.
¹⁶ Ibid., p. 6.
¹⁷ TPC Rural Guide-line, p. 5.
Regional employment might be a benefit for that region, but should not be mistaken for a public benefit if the costs to the rest of the community are higher.

4.3 The regulatory regime

How should existing pro-competitive regulation be adapted to the role of regulating natural and mandated monopolies?

From an economic efficiency perspective, there are two fundamental requirements:

- guaranteeing access to the regulated service; and
- ensuring an efficient level of pricing, and in particular preventing monopoly pricing, of the regulated service.

Guaranteeing access to services

There are two aspects to guaranteeing access to the service.

First, the owners of the natural monopoly must be prevented from using their market power to extract monopoly rents in competitive markets which depend on access to the natural monopoly service. This is particularly important where it is not possible or desirable to structurally separate the natural monopoly, such as in the rail example above. In that case, without some form of regulation, a firm that operated trains and owned the rail infrastructure could use its power in the latter market to attain an advantage over its competitors in the provision of rail services.

In the US and New Zealand, this practice is regulated by the general misuse of market power provision, and there appears no reason that section 46 of the Act could not be used in the same way without amendment. Section 46 prohibits a firm with a substantial degree of market power from deliberately using that market power to damage a competitor or competition in any market. Thus, in the rail example, the infrastructure owner would be prohibited from using its
control over the track and time-tabling to deliberately undermine the competitive position of another train operator.

The decision of the High Court in the *Queensland Wire* case provides a good example of how section 46 of the TPA can be used to enforce supply. As discussed above, in that case a successful private action was brought against BHP for its refusal to supply Queensland Wire with 'Y-bar', by showing that BHP wanted to restrict supplies to its subsidiary to retain dominance of the fence post market. Thus, the refusal to supply was held to be an attempt by BHP to undermine competition in the market for fence posts.

The second aspect is that the owner of the natural monopoly must be encouraged to supply an appropriate level of services; and in particular, be deterred from restricting supply in order to underpin profits or prices, or avoid new investments.

While it is theoretically possible that section 46 could be used to enforce supply in these cases too, there is a practical problem. It is easier to establish an intent to undermine competition contrary to section 46 where the supplier has a direct interest in the market being supplied. Thus, in the *Queensland Wire* case, BHP had a direct interest in its subsidiary. Where there is no such direct interest such as where a natural monopoly has been `structurally separated' from related competitive markets, it may not be possible to establish an intent to undermine competition in one of those related markets. The refusal to supply may merely reflect, or be excused as, a desire to maximise returns or minimise costs. In these circumstances, there would be no breach of section 46, but there would be an inefficient under-supply of the natural or mandated monopoly market.

New Zealand relies heavily on the general misuse of market power provision of the Commerce Act for the pro-competitive regulation of natural monopolies. This provision was copied from section 46 of the Australian Act. The
adoption of a specific essential facilities doctrine in New Zealand was considered but rejected in favour of a general obligation on natural monopolies to disclose their costs and pricing practices. This disclosure alleviates many of the difficulties of establishing one of the `proscribed purposes' under the Commerce Act.

But there are concerns at present over whether these measures are sufficient. The Commerce Commission of New Zealand has suggested that the Commerce Act's general misuse of power provision provides insufficient regulation of natural monopolies, even when complemented by the compulsory disclosure provisions. A case currently before the courts involving NZ Telecom and its `megaplan' arrangements is considered a crucial test. The Commerce Commission would regard failure in this action as a clear indication that further regulation of natural monopolies, such as an `essential facilities' provision, is necessary.

In the US, the courts have developed an `essential facilities' doctrine. This doctrine obliges the firm in control of an `essential facility' to provide access to that `facility' to anyone, including competitors, who requests it. Thus, the doctrine `constructs' an intent to undermine competition from the mere refusal to supply certain products. The problem, however, and the source of considerable controversy, is determining what is an essential facility:

...we have some difficulty, at least in cases where a monopoly of electric power, communications or some other `essential service' is not involved, in seeing the limits of the concept of `essential facility': in Fishman v. Wirtz [807 F.(2d) (1986)], it was a sports stadium in Chicago?

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In the US, the doctrine has been applied beyond natural monopoly markets, and in the *Queensland Wire* case, it was argued that it should apply to the supply of `Y-bar' by BHP.

But the Full Federal Court rejected application of the doctrine to Australian trade practices law. In particular, the court noted the difficulty of applying the doctrine where there is no ready mechanism available for determining the appropriate terms and conditions of supply; and the potential conflict between the doctrine and "another `doctrine', that of upholding conduct engaged in for a `legitimate business purpose"."

Despite the court's decision not to incorporate an essential facilities doctrine into Australian trade practices law, the Commission considers that there may be some scope for the application of the principle to the regulation of natural monopolies. The use of the doctrine in this area would resolve many of its controversial aspects: natural monopoly markets would be explicitly identified and, as discussed above, there is already a need to regulate the terms and conditions of supply in these markets. The identification of natural monopoly markets would have to be reviewed regularly, to ensure that the natural monopoly aspects have not been undermined by new technology.

**Preventing monopoly pricing — the role of the PSA**

As discussed above, a mechanism is needed to regulate the terms and conditions of supply (particularly prices) in natural monopoly markets.

Adapting the powers and functions of the Prices Surveillance Authority (PSA) to this role would be one way of meeting this requirement.

The PSA was formed in 1984 as part of the Government's Prices and Incomes Accord. Under the Prices Surveillance

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20 Ibid., p. 49077.
Act 1983, the PSA may monitor and examine prices for the supply of goods and services in Australia upon the request or approval of the Treasurer. According to the Act, the selection of goods and services subject to surveillance will focus on areas where effective competitive disciplines are not present and/or where price or wage decisions have pervasive effects throughout the economy.\textsuperscript{21} The PSA has two broad functions:

- to hold inquiries into prices in nominated markets; and
- to consider specific price rises or the supply of products at specified prices by organisations who have been `declared' as subject to the Prices Surveillance Act.

The Government has `declared' 28 products to date, involving 73 nominated firms, as subject to the provisions of the Act. Products subject to PSA surveillance include beer, coffee, tea, and toothpaste.

The Act directs the PSA to take into account three specific factors in performing its functions. These are the need to:

- maintain investment and employment, and the impact of profitability on these;
- discourage taking advantage of market power in price setting; and
- discourage wage/price flow-ons beyond the bounds of principles established by `relevant industrial tribunals'.

The PSA's approach to price surveillance has also been influenced by several ministerial directions given under the Act as to the Government's policy:

- of generally not supporting price increases in excess of movements in unit costs; and

\textsuperscript{21} The Act covers Commonwealth authorities and all corporate enterprises operating within Australia. The range of suppliers subject to the Act does not cover unincorporated enterprises (this is limited by Commonwealth Constitutional powers) or State authorities (which are specifically excluded from the Act).
that increases in executive remuneration in excess of those permitted under wage fixation principles and decisions announced by the relevant industrial tribunals should generally not be accepted as a basis for price increases.²²

The overall aim of the Prices Surveillance Act, and the functions of the PSA, is to constrain abuses of market power in price-setting by firms in both the public and private sectors. It therefore supplements Part IV of the Trade Practices Act which, as discussed above, has no general power over prices:

The existence of many product markets with oligopolistic structures, where there can be potential for market power to be exercised, creates the potential for high costs and high price-cost margins. While the Trade Practices Act 1974 prevents certain abuses of market power, its provisions do not necessarily apply to enterprises which use their market power to set prices higher than would be the case if the market was competitive. However, this behaviour may not be specifically covered by section 46 of the Trade Practices Act unless it is designed to eliminate competitors, prevent entry or prevent others from engaging in competition. Only the PSA has a statutory role to intervene in price determination in this circumstance. In acting directly to prevent firms charging excessive prices, the PSA's objective is to encourage price restraint consistent with competitive market outcomes, thereby promoting allocative and cost efficiency.

The only natural or mandated monopolies that have been subject to the PSA's scrutiny have been Australia Post, the Civil Aviation Authority, the Federal Airports Corporation, and, before the advent of AUSTEL, Telecom. The numerous state-owned GBEs have avoided attention because the Prices Surveillance Act specifically exempts these monopolies from its scope:

...there are major areas of consumer expenditure and important inputs to domestic production and export activities which lie outside the scope of current prices policy and may be cause for concern regarding their pricing practices. Of major importance are: State government public utility prices (electricity, gas, water and
In the absence of this specific exemption, there appears to be no barrier to applying the Prices Surveillance Act to state GBEs. While the Act specifically excludes application to state legislation, few if any GBEs would enjoy Crown immunity from prosecution. Further, unlike the Trade Practices Act, there is no general exemption in the Prices Surveillance Act for activities authorised by legislation. State GBEs would fall within the meaning of corporations in the Prices Surveillance Act, and thus would fall within its scope. The same would apply to most, if not all, statutory marketing authorities.

The exclusive jurisdiction of the PSA over prices *per se* and the fact that PSA and TPC functions already complement each other to a high degree makes the PSA an obvious candidate to undertake the pricing role in the regulation of natural monopolies. This could entail diversion of the PSA from operating in competitive markets. In order to ensure a co-ordinated approach to the regulation of natural and mandated monopolies, and to avoid the difficulties likely to arise by the involvement of two separate agencies in such regulation referred to by the Commission's *Energy* report, it could also involve the amalgamation of the TPC and the PSA.

24 Ibid., p. 31.

25 The discussion in Chapter 3 on the need, or lack thereof, for pro-competitive regulation in competitive markets applies with even greater force to the more intrusive direct regulation of prices than it does for the regulation of market practices or market structure. In particular, the chapter emphasised the role of prices in facilitating dynamic efficiency and providing rewards to innovation and successful risk-taking. Thus, the benefits of the regulation of prices are rarely likely to outweigh the costs in markets where there is no natural or statutory impediment to competition.
One problem that would have to be addressed, however, is the unit cost approach that is mandated by the PSA's charter. This would require amendment if more flexible, and generally more efficient, pricing approaches (such as CPI-X) are to be adopted.

The merger of the TPC and PSA was considered by the Cooney report. In its submission to the inquiry, the PSA suggested that if this merger were to proceed, its powers should be incorporated into a separate provision of the Act rather than include them in section 46. Alternatively, a substantially modified section 46 could be subject to the jurisdiction of an administrative tribunal such as the TPT (possibly joined with the existing PSA), rather than enforced by the courts who are not well equipped to determine prices.

An alternative to the use of PSA powers to provide the pricing role for natural monopolies may be to utilise state pricing authorities. NSW recently established the Government Pricing Tribunal to depoliticise and rationalise pricing, minimise abuses of monopoly power, and encourage price reform and efficiency gains by GBEs. The Tribunal's role is limited to prices in government commercial monopoly services. In contrast, Victoria's Prices Commissioner is granted powers under individual Act's over specific staple products, such as fuel and milk, or product groups, such as groceries.

Using state pricing authorities to regulate prices for state GBEs may be more attractive to the states.

There may be disadvantages, however, to using state pricing bodies in this way. First, it would be more difficult to coordinate pricing and other regulatory functions resulting in inconsistencies and regional treatment of emerging national markets. Second, state pricing bodies would have to be established in most states thus entailing duplication of effort.

Sweden has recently adopted a regime that relies on general competition law and limited pricing powers to regulate what
it sees as natural monopoly aspects of the provision of postal services. From the beginning of next year, Sweden Post will be permitted to set its own charges, subject to a price cap set using a fixed percentage of a weighted basket index. It is thus a form of CPI-X, with X fixed at 30 per cent of any change in the index. Anti-competitive activities by Sweden Post, such as predatory pricing, would be regulated through scrutiny by the Competition Commission and the new competition law legislation. Competition in the provision of postal services would be permitted and interconnect charges would be left to direct commercial negotiation, with oversight by the Competition Commission.

While the ability to regulate prices in natural monopoly markets is a necessary element of pro-competitive regulation, it is not necessary that this power be exercised regularly. New Zealand's Commerce Act provides for price control where there is a lack of competition in an industry; but in effect this power has only been used in relation to the supply of gas, and even here this control is about to be withdrawn. This is because the disclosure provisions discussed above also help alleviate the need for specific price regulation.

In the New Zealand view, this provides (when combined with the discipline provided by the risk of new price regulation) a regime that, while not perfect, performs at least as well as more intrusive regimes in the US and Britain. The New Zealand Treasury considers that more thinking needs to be done on the role of prices control, suggesting that the current approach may leave too much scope for monopoly pricing. But it is determined to avoid the distortionary impact of highly regulated price structures.

The New Zealand experience suggests that if the PSA's powers over prices were to be incorporated into the TPC, it could usher in a different approach to prices regulation in Australia. Not only would the existing PSA role in

competitive markets be much reduced, if not eliminated, as envisaged above, but the influence over prices in natural monopoly markets would be exercised generally as a threat rather than specific price setting. Specific price setting might only be employed in the face of clear monopoly pricing, or to resolve terms and conditions where a court has found a refusal to supply contrary to section 46.
Fifteen years ago the Swanson Committee expressed the view that the application of restrictive trade practices regulation should be as universal as possible:

We believe it to be extremely important that the Trade Practices Act should start from a position of universal application to all business activity, whether public sector or private sector, corporate or otherwise.

More recently there have been calls to support extending the range of individuals and organisations that are subject to restrictive trade practices regulation. Following an initiative by then Prime Minister Hawke in March 1991, the development of a national competition policy has been placed on the agenda for the Heads of Government.

There are four categories of limits on the universal application of the Trade Practices Act. These are:
- current exemptions applying to government agencies;
- government industry-specific interventions;
- current exemptions applying to the labour market; and
- the protections provided for intellectual property.

There are constitutional barriers to removing some of these exemptions which can only be overcome by parallel state legislation or, preferably, a referral of power to the Commonwealth. For others, the appropriate level of application of restrictive trade practices regulation is not clear.

Nonetheless, the universal application of the Act enjoys strong support from within the TPC:

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1 Report to the Minister for Business and Consumer Affairs, Trade Practices Act Review, August 1976, AGPS, Canberra, p. 84.
The Commission agrees and considers, in principle, that the Act should have universal reach. In recent years it has drawn attention to its limited coverage and the consequent adverse effects on the economy, as well as the associated inequities and anomalies. At present the Act, although the cornerstone of competition policy, does not apply to some of the most important areas of the economy—areas in which there is perhaps the greatest potential for large gains from the greater efficiency resulting from competition.

In this chapter, the Commission discusses the extent and means by which the Act might be extended to the areas listed above.

5.1 Exemptions to government agencies

Government agencies enjoy some protection from the provisions of the Act, for two main reasons.

Firstly, the Crown is presumed not to be bound by legislation unless Parliament indicates that it is. This immunity is often referred to as the `shield of the Crown'. The Crown for these purposes includes the Crown in the right of a State or the Commonwealth, ministers of State, government departments in the performance of their public functions and some statutory authorities.

Secondly, under section 51(1) of the Act, activities specifically authorised by Commonwealth, State or Territory legislation are automatically exempt from the restrictive trade practices provisions of Part IV. For example, if a statutory marketing organisation is created with specific licensing powers, these licensing activities are exempt from the Act.


3 Australia consists of seven sovereign entities, each of which enjoys `Crown' status. The expression `Crown in right of a State or the Commonwealth simply denotes the exercise of Crown privilege by one of those seven entities.
The exemption of government agencies under the Act warrants review. This is particularly so because many government businesses have been or are being corporatised and many government utilities are being split up as part of moves to structurally separate the natural monopoly elements of markets from those amenable to competition. Consequently, the government organisations involved should be made subject to some form of trade practices regulation.

More generally there is the issue of whether public enterprises should enjoy immunity from economic regulation applying to their private sector competitors, customers, and suppliers. Private sector corporations that have been forced to become more efficient and competitive by microeconomic reforms are understandably irked by continued protection of the public sector from pro-competitive regulation.

Government business enterprises

The immunity enjoyed by some Commonwealth and State GBE's are among the prime areas targeted by the National Competition Policy Review. The Review has been specifically requested to consider:

...the best structure for regulation including price regulation, in support of procompetitive conduct by government business and trading enterprises and in areas currently outside the scope of the Trade Practices Act 1974.

The Business Council of Australia also regards the removal of the section 51 exemption for government enterprises an essential plank of structural reform. In its submission to the Cooney Committee inquiry, it said:

The Business Council supports the extension of the provisions of the Trade Practices Act to the public sector...The Council considers that the extension of the competition provisions of the [Act] to

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4 The Prime Minister, the Hon P. J. Keating, ibid.
Government enterprises can provide greater competition advantages than all the matters before this inquiry.

Subject to specific exemptions contained in particular Acts, removal of the section 51 exemption would end any preference for Commonwealth bodies in trade practices regulation. The `shield of the Crown' protection afforded to Commonwealth government enterprises has been removed by section 2A inserted in accordance with a recommendation of the Swanson Committee which subjects the Commonwealth and its agencies to the operation of the Act but retains the Commonwealth protection from prosecution under the Act. Since breaches of Part IV of the Act cannot be the subject of criminal proceedings actions by the TPC are civil proceedings for pecuniary penalties and other remedies the `shield of the Crown' protection now confers no special privileges on Commonwealth-owned business enterprises compared to private corporations in relation to restrictive trade practices provisions.

The position of state enterprises is more difficult. Some `shield of the Crown' issues may remain. The Swanson Committee assumed that the Commonwealth could not bind a State, although this assumption is open to question. Further, few state enterprises would enjoy `shield of the Crown' protection in relation to commercial activities, reflecting a trend toward more restrictive interpretations of the application of this protection as government activities have become increasingly commercial.

6 Victoria v. The Commonwealth (Pay-roll Tax Case), (1969-70) 122 CLR 353; in Bradken Consolidated Ltd. V. Broken Hill Pty. Ltd., 1979 ATPR 40-106, the High Court decided that the Trade Practices Act was not intended to bind the Crown in right of a State.
Nonetheless, there would be benefits from removing any uncertainty on this issue by specifically removing any remaining "shield of the Crown' protection for State GBEs, preferably by a referral of power to the Commonwealth, or application of the Act through parallel State legislation.

Statutory marketing arrangements

The exemptions applicable to GBEs also generally apply to statutory marketing authorities. In addition, the Trade Practices (Primary Products Exemptions) Regulations have been created under section 172 of the Act to exempt certain activities of organisations or bodies which perform functions in relation to the marketing of primary products.

Primary Products Exemptions Regulations

These regulations are available to exempt agreements of non-statutory bodies. They also exempt the restrictive activities of some statutory bodies where their enabling legislation does not specifically endorse those activities.

As a matter of policy, exemptions have been limited to anti-competitive agreements (sections 45 and 45B) and some exclusive dealing arrangements (section 47). Section 172 regulations have a life of up to five years, but can be renewed.

In the past, such exemptions had been applied as a matter of discretion by the Commonwealth Government, usually where the activities significantly contribute to the marketing of primary products. An organisation or body would specifically request an exemption through the political process.

However, a change to the procedures and guide-lines for handling section 172 exemptions was made in 1981. This change occurred as a result of the report prepared by the
Trade Practices Consultative Committee (TPCC) in 1979, and now requires that applicants apply to the Attorney-General for such exemptions. The Attorney-General's Department and the Department of Primary Industry and Energy then consider the application and prepare a joint report.

For an exemption to be approved under the current guidelines, the activity must either promote stability in the production or marketing of primary products or enhance export marketing. The anti-competitive nature of the activity is also taken into account so that income stability or export advantages are achieved with the least possible reduction in competition. After considering the views of any interested parties and further examining the applicant, the joint report is then considered by the Attorney-General. Consumer interests are taken into account only indirectly through this procedure, unlike exemptions by authorisation or notification, where a public benefit test is applied.

The exemption by regulation procedure has not been used extensively. Only twelve such arrangements have been put in place since implementation of the Act, of which three remain but are due to expire this year.

Removing SMA exemptions

The Commission discussed the impact of removing all exemptions for statutory marketing arrangements in its Statutory Marketing Arrangements for Primary Products report. It considered that a range of current SMA practices would contravene the Act, including the use of vesting and acquisition powers to coerce individual producers to behave in a specified way, collusive conduct between producers to

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influence prices, some exclusive dealing arrangements, and the use of licensing, permits and quotas to control the availability of some primary products.

Statutory marketing arrangements are often justified as an essential means of counteracting deficiencies in the markets for primary products. The SMA report addressed two aspects of the way restrictive trade practices regulation is, or might be, applied to the rural sector:

First, on the assumption that the general statutory exemptions of statutory marketing arrangement activities under section 51 of the Act would no longer apply, is the issue of whether the remaining means of exempting the practices of rural producers and their organisations are sufficient to overcome any peculiar disadvantages in the market-place. If not, are effective amendments available to solve the problems?

Second is the issue of whether the Act, either in its present or in amended form, can be an effective means of regulating one of the commonly alleged market deficiencies: abuses of market power by buyers of rural produce.

Overall, the Commission found few reasons to justify existing protections to statutory marketing agencies and questioned the usual justifications for their existence, but it did not make a conclusive recommendation in this area:

In each case, judgment needs to be made about whether separate provisions are required, or whether general trade practices arrangements are appropriate and sufficient. For example, a State Government could, if it wished, opt to leave the question of marketing of a rural product to the trade practices regime. Judgments about statutory marketing also need to take account of the Commission's conclusions...about the soundness of objectives of statutory marketing arrangements.

The Commission did, however, identify one area where the Trade Practices Act should be amended in relation to its treatment of statutory marketing arrangements. The reasoning is applicable to the general operation of the Act:

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9 Ibid., p. 164.
10 Ibid., p. 107.
The Commission sees no justification for the blanket prohibition on authorising voluntary recommended price agreements between fewer than 50 parties. Whether such an agreement is in the public benefit or not does not depend solely on the number of parties to the agreement. Rather, it should be assessed on a case-by-case basis as it depends on the particular circumstances of the commodity in question, its markets, and the degree to which such an agreement would reduce competition.

5.2 Industry-specific regulation

There is currently considerable overlap between the economic regulation provided by the TPC and the Act, and that provided by industry-specific regulation. This will increase as government enterprises are increasingly made subject to the general provisions of the Act.

Some of this overlap is broad in nature. Industry-specific regulatory bodies determine the level of competition in an industry, and the terms and conditions of contracts with customers and suppliers.

Elsewhere, the overlap is very specific. Mergers between financial institutions and between media organisations, for example, are subject to industry-specific rules which differ in content and application from section 50 of the Act.

The debate before the Senate Standing Committee on Finance and Public Administration on the Insurance Laws Amendment Bill 1991 provided a good example of the problems raised by this overlap. A provision of that Bill was aimed at preventing 'undue concentration of economic power' in the general and life insurance industries. The Insurance Council of Australia (ICA) expressed concern that this provision's competition test 'probably cast a much wider net than that found in the Trade Practices Act'.

11 Ibid.

12 Senate Hansard, Standing Committee on Finance and Public Administration - Friday, 13 September 1991, p. 28.
Further, some finance sector mergers may have to satisfy three regulatory regimes. For example, the competition policy aspects of a bank acquiring a life office, such as in the case of the proposed ANZ-National Mutual merger, would be reviewable under banking regulation, insurance regulation, and the Act. Each would apply a different competition test. Both the ICA and the AMP Society suggested that any regulation of market power in the insurance industry be left to the Trade Practices Act.

Similar arguments might be made in regard to the regulation of other industries which are currently subjected to separate economic regulation.

Given the extent of overlap between industry-specific regulation and the Act, the Commission considers that there may be some scope for the Act to supplant industry-specific regulation, particularly in the light of proposed or realised deregulatory reforms in some industries.

Of course, much industry-specific regulation is intended to achieve social policy goals which are beyond the scope of this paper. Nonetheless, as in the case of CSOs, these policy goals should be transparent and amenable to objective, critical review.

However, the detailed regulation of markets by governments ostensibly for social policy reasons often has the effect of conferring preference on incumbent firms, and therefore has competition policy implications. Comprehensive treatment of these implications would require a full examination of social regulation, aimed to reveal the level of intervention necessary to attain the identified social goals and minimise the level of spillover into competition policy.

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13 Ibid., p. 37.
5.3 Labour market exemptions

The Act generally only regulates the activities of corporations, due to the constitutional limitations on Commonwealth legislation. While the consumer protection provisions of the Act are loosely duplicated in state legislation to overcome this gap, there is no state restrictive trade practices legislation. As a result, Part IV of the Act generally does not apply to unincorporated associations and individuals.

The professions

From a competition policy perspective, this deficiency has a significant impact in the area of trade practices conducted by the professions, particularly large professional partnerships. Few professional firms are incorporated.

Common practices within the professions that would otherwise be contrary to the Act include various forms of collusive dealing, especially price-fixing agreements, exclusive dealing arrangements, and anti-competitive restrictions on entry and conduct.

The TPC is conducting a series of studies on the professions to assess whether existing regulations are in the public interest, and to identify whether there are gains from reducing or improving such regulations. It also seeks to identify areas in which the scope of the Trade Practices Act may be extended to cover anti-competitive practices in the professions.

The TPC proposes that, where professional conduct appears to be against the public interest, it will seek to:

- ensure the conduct is modified to comply with the Trade Practices Act, where the conduct is not specifically authorised by State or Territory legislation; and
persuade relevant governments to amend legislation, where the conduct is specifically authorised by that legislation.4

The protections currently enjoyed by the professions from the application of the Act will be one of the key issues for the national competition policy review.

Unions

Most union practices enjoy exemptions from the provisions of Part IV of the Act, even when the union is incorporated.

Section 51(2) exempts the operation of the Act in relation to employment contracts, or action taken in relation to employment terms and conditions, other than the following provisions:

- section 45D which prohibits secondary boycotts;
- section 45E which prohibits primary boycotts;
- section 48 which prohibits resale price maintenance.

The application of prohibitions of primary and secondary boycotts to union actions related to employment terms and conditions has been controversial. There have been suggestions that the regulation of unions should be left to specific industrial relations law, rather than anti-trust law.

But others consider the Act's current protections for unions are a significant impediment to competition and efficiency.

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15 Secondary boycotts are where supplies to or from a third party are purposely hindered in order to lessen competition or damage a business.
16 Primary boycotts are collective refusals to deal with another party.
17 The inclusion of resale price maintenance is a hangover from the period when the union movement was involved in retailing enterprises. It is of little effect now.
In providing examples of government imposed protections as the main source of barriers to competition, Swan discussed TPC attempts to prevent collusion between the Transport Workers Union and the oil companies in trying to exclude independent wholesalers.

...the real issue here is the monopoly power of the TWU, which, however, lies outside the powers of the TPC. Only if a secondary boycott were involved could the TPC step in. The point is not so much the fact of a horizontal agreement (which I would oppose) but that, in the absence of the monopoly power of the TWU, the agreement would be unenforceable. The Trade Practices Commission can do very little to attack the root cause of the problem...Unless the Trade Practices Commission is given the power to override all government and politically inspired monopolies, consumers are going to need all the help they can get from `potential' competition and contestable markets.

Similarly, Logan, Milne, and Officer consider that the anti-competitive actions of unions stem primarily from government imposed barriers to entry in labour markets, rather than specific exemptions from the operation of the Act. The statutory barriers to entry, and `legality' of certain activities such as strikes, provide unions the means to abuse market power. Exemptions within the Act exacerbate the problem by failing to provide a check on union activities. Thus, in labour markets, the government institutionalises behaviour and structure that Part IV of the Trade Practices is designed to prevent: collusion, monopolisation, and exclusive dealing.

Thus, as in the case of professions regulation, many of the current problems with union activities stem from existing anti-competitive regulation rather in labour markets rather than exemptions from pro-competitive regulation. Ideally, the anti-competitive regulation should be reviewed before pro-competitive regulation is applied.

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18 Centre for Independent Studies, op. cit., p. 43.
19 Ibid., pp. 133-135.
5.4 Intellectual property exemptions

Behaviour designed to protect intellectual property rights is generally not subject to the restrictions imposed by Part IV of the Act. This exemption is contained in section 51(3). However, neither the misuse of market power conferred by intellectual property (contra section 46) nor resale price maintenance in relation to intellectual property (contra section 48) are covered by the exemption, and are thus still unlawful.

Intellectual property rights are merely a subset of property rights and, as such, form one of the cornerstones of a market economy. As with physical property, the owner should be able to have some sort of security attached to an invention, and be able to reap profits associated with owning something that other people value.

The OECD describes intellectual property rights thus:

Intellectual property rights are designed to promote the creation of innovations and thus to promote economic advance and consumer welfare. This occurs by giving the innovator an exclusive legal right to the economic exploitation of his innovation for a period of time; the reaping of profits serves both to reward the innovator for his investment and to induce others to strive to innovate in the future. If innovators were not granted property rights in their work, widespread copying could be expected to occur, diminishing the returns to the innovator and the incentive to innovate. Thus, the ability to exclude imitation is the most important aspect of the property rights granted to the innovator. Intellectual property rights also include the right to license others to exploit the innovation. Licensing is an important additional source of income to the innovator, and can be the only source when the holder of the property right is not well situated to engage in large scale commercial exploitation.

In many respects, the aims of intellectual property rights regimes and competition policy coincide. As Patrick Fair points out, intellectual property rights make it possible for...

markets in ideas to exist.\textsuperscript{21} Intellectual property rights create the things to be traded in a market; competition policy ensures the correct functioning of that market.

One of the basic aims of competition policy is allocative efficiency. An apparent conflict arises because the marginal cost of a piece of intellectual property — the additional cost of another person using an idea — is close to zero. However, if owners of intellectual property were forced to charge nothing for their ideas, there would be no incentive to innovate. So, in the interests of dynamic efficiency, that is, allowing the economy to change and grow to increase welfare, some short-term allocative efficiency must be sacrificed.

Intellectual property rights are seldom so important as to grant the owner monopoly power in a market:

In relation to patents and designs, it is the specific invention or visual appearance of the product in respect of which exclusive rights are granted; for copyright, it is merely the form of expression of a work which is protected; for a trade mark only the brand name product ‘get-up’ is protected; and know-how is only protected in circumstances involving a contractual or equitable obligation of secrecy. Where the market is competitive, all firms have an opportunity to innovate.

Even if some monopoly power were to be conferred, the welfare implications are still unclear. Through licence terms, the monopolist may be able to engage in price discrimination. For example, different prices could be charged according to field of use, or geographic area. It could be that more people could afford to use the idea than if a single price were charged.


Licence terms may also be pro-efficiency through:

- helping to manage risk and lower the transaction costs associated with deciding how the idea is to be used;
- giving the licensee an assurance that no other competitors in that field has access to the idea, which gives that firm the incentive to innovate further on the idea without fear of "free-riders" in the form of other licensees; and
- maintaining the quality of output, for example through conditions on inputs.

Fair points out that to work properly, markets need information. For instance, competitors need information about productive processes to compete in a market for a final product. If there were no legal ownership of rights assigned to knowing how something is produced, there would be no incentive for the possessor of that knowledge to tell other people. However, if the innovator is assigned a property right, he can sell that information. The result is that more people have the information on how to produce the final good than before, and there may be more firms competing in the market for the final product.

A related point is that enabling people to sell information means that firms may enter markets with otherwise high barriers to entry. For example, the incumbent firm in a market may operate equipment which is impossible and/or wasteful to duplicate. Intellectual property rights create the incentive for someone to invent a new way of producing the same good and then sell that information to a potential competitor of the incumbent firm. Again, the result is that more firms may be in a position to compete in the market for a final product.

Implications of the exemption

Nonetheless, intellectual property rights may present some serious antitrust problems.
According to the OECD, the single greatest concern is cartelisation. This can be achieved though licence terms affecting prices, geographic area, customers, uses, or output.

Cartelisation could occur in a number of ways. An example is patent-pooling, where a group of competitors gain control of all of the patents associated with producing a certain good. There may be reduced competition in the market for that technology, as well as in the market for the final good produced.

Another concern is when firms try to use exclusionary terms in licences which force them into using a third good, thereby ensuring the buyer's entry into two markets at once. (How successful the licensor could be in this endeavour would be dependent upon the nature of both markets — it would be impossible to charge more for the package than what a substitute combination costs.)

Other possible anti-competitive uses of intellectual property rights include acquiring exclusive rights in competing technologies to deny access to the market, and using the threat of legal action (over alleged intellectual property right infringements) to deter other firms from entering a market.

The scope of the exemption has competitive implications.

Although generally exempted from intellectual property, section 50 (mergers) will have some application. Only the conditions or terms of the contract of assignment of intellectual property rights are exempted by section 51(3), not the assignment itself. Thus, if the actual assignment of the asset (the rights) leads to a substantial lessening of competition in a substantial market, there will be a breach section 50.

A refusal to sell or assign intellectual property may be contrary to section 46 (misuse of market power), since this provision is not included in the exemption. If the firm has a substantial degree of market power, a refusal to sell may be construed as a misuse of market power, if done for the
purpose of undermining competition in a market. This is akin to the refusal to supply intermediate goods in *Queensland Wire*.

Finally, resale price maintenance (section 48) is still prohibited, not being exempted by section 51(3). Thus, the owner of intellectual property cannot seek to set a minimum retail price as a condition of sale to retailers.
6 Administration Versus Judicial Enforcement

The TPC is not a regulatory body in the conventional sense:

...the Trade Practices Commission is not a body which could be called regulatory in character in the same way as a prices body or AUSTEL might be. The Commission seeks to promote competition. It does not seek to regulate, in detail, price levels, quality and the provision of service and other such matters dealt with typically by public utility regulatory bodies. With its present structure and organisation, the Commission would not, and arguably should not, do the kind of work that AUSTEL does.

Nonetheless, the TPC uses a mixture of judicial and administrative measures to enforce the restrictive trade practices provisions of the Act. On the judicial side, it investigates and prosecutes possible breaches of the Act and conducts civil actions on behalf of `deserving' litigants. On the administrative side, it encourages sector-by-sector compliance with the spirit of the Act by, for example, negotiating `industry codes of practice' with industry. It also encourages firms, particularly those contemplating mergers, to consult with it at an early stage. And it uses the threat of action against corporations who decline to comply with administrative matters.

The administrative approach appears to provide greater benefits than the more judicial path in terms of the guidance and advice it provides to market participants, the timeliness of responses, flexibility and relatively low direct costs. It is also more amenable to economic analysis.

But the administrative approach has costs. These may result from its case-by-case approach, lack of transparency in decision-making, divergence of views between the TPC and the courts because of the reduced role of litigation in the

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1 Fels, op. cit., p. 3.
judicial interpretations of provisions, or uncertainty resulting from the judicial power to overturn any administrative decision. Further, an emphasis on preventing practices that are assumed to be uncompetitive prohibits the emergence of actual market behaviour and its consequences. This reduction in market experience can be considered a further cost.

In recent times, the TPC has adopted a more `pro-active' approach, giving preference to encouraging firms to comply with the Act before they contravene it rather than enforcing the provisions afterwards. To this end, the TPC has published guidelines for industry explaining what it sees as acceptable commercial conduct under the different provisions of the Act. It has also negotiated voluntary codes of conduct with industry associations, and is conducting a wider range of economic and research work on competition and micro-reform issues. It now makes more selective use of litigation, for example, where there are important precedents or widespread issues involved.

The TPC believes that its pro-active approach is more cost-effective than a traditional judicial approach to enforcing the Act. The pro-active approach reduces the number of court proceedings and thereby the cost to tax-payers and businesses — running a restrictive trade practices court case is unduly costly and time consuming, not least because of restrictive rules on the admissibility of evidence.\(^2\) The TPC's pro-active approach also allows it to make most use of its limited resources.

In this chapter, the Commission discusses the arguments for and against the more `pro-active' administrative approach to trade practices regulation currently preferred by the TPC.

\(^2\) Other reasons for the excessive costs of judicial enforcement include a lack of competition in the provision of legal services.
6.1 Judicial enforcement

Prosecutions, civil actions and remedies

All actions under Part IV of the Act are civil proceedings requiring proof on a `balance of probabilities' rather than the criminal law requirement of `proof beyond reasonable doubt'.

Part VI of the Act contains the sanctions and remedies for a contravention of any of the restrictive trade practices provisions of Part IV.

The TPC can seek, through the Federal Court, to have fines imposed for breaches of Part IV of the Act. Before the June government response to the Cooney Committee inquiry, the maximum penalty was $50 000 for individuals, and $250 000 in the case of a body corporate. However, breaches of Part IV, except sections 45D and 45E, will soon be subject to new maximum penalties of $500 000 for individuals and $10 million for a body corporate.

Alternatively, the TPC can seek other remedies such as injunctions or ancillary orders where the affected party suffers loss or damage. Ancillary orders may include: the return of property or money, specific performance, rescission or variation of contracts, and provision of repairs or spare parts and divestiture orders.

Individuals and corporations, through private action, can also seek a remedy from the Federal Court for a breach of one of Part IV's restrictive trade practices provisions. Remedies include damages, injunctive relief, ancillary orders and divestiture orders. However, private injunctive relief against an alleged breach of the mergers provision is not available because of the risk that such actions would be used purely as a means to prevent contested take-overs.

\[\text{3} \text{ The remedy of specific performance of a contract is a court order requiring a party in default to complete its part of the bargain.}\]

\[\text{4} \text{ Divestiture of shares in relation to an unlawful merger.}\]
The TPC will also seek leave to intervene in proceedings brought under the Act by private parties in some circumstances. This is likely to occur in a case where the TPC feels an important legal issue is to be raised and/or the plaintiff has limited resources with which to continue proceedings.

Statutory guidance for judicial interpretation

In recommending that section 50 be amended to reduce the threshold competition test, the Cooney Committee also proposed that the Act include factors for courts to follow when considering a merger's likely impact on competition in a market. The factors were suggested partly in response to the Treasury's argument that the courts should take a broader view of the competition process, particularly if the competition test for mergers regulation were lowered. The factors suggested by the Cooney Committee and the government's recent decision to adopt them are discussed in Chapter 3.

The proposed factors are likely to improve the courts' assessments of economic issues such as market definition and judging the level of competition in a market.

As discussed earlier, since these issues are equally important in cases involving provisions of Part IV of the Act other than section 50, the Commission considers that attaching general guidance on the nature of competition to the restrictive trade practices part of the Act may be warranted.

Authorisation

Some practices which would otherwise contravene Part IV of the Act can be authorised by the TPC under sections 88 to 91. Authorisation can be granted in the case of: anti-competitive agreements (section 45); anti-competitive

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5 Ibid., p. 39.
exclusive dealing arrangements (section 47, including third line forcing); and mergers resulting in market dominance (sections 50 and 50A). Authorisation is not granted for misuse of market power (section 46); resale price maintenance (section 48); price discrimination (section 49); or price agreements (section 45A, except for genuine recommended price agreements involving no less than 50 parties).

The authorisation process has a number of steps. The applicant must first make a submission to the TPC listing the likely public benefits of new marketing arrangements and any anti-competitive effects. The TPC then invites any interested party to submit information on the matter. At the completion of this process, it issues a draft determination. If anyone objects to the draft decision, they can request that a conference be held to allow further discussion of the issues before the TPC makes its final determination. The final determination is reviewable, on appeal, by the TPT and, ultimately, the courts. Authorisations have no time limit.

To succeed, an authorisation application must satisfy a net public benefit test. Hence, the authorisation procedure provides a substitute for an 'efficiency defence' — that is, a general defence to a restrictive trade practices action on the grounds that the activity promotes efficiency — which operates in some countries, including Canada.

As discussed in Chapter 2, the Commission favours an efficiency approach to the broader public interest approach. The authorisation process does not always permit activities that confer a net benefit on the community. Authorisation has been available when economies of scale have led to a cost-saving benefit or where the need for long-term contracts has been used to justify exclusive dealing arrangements. But authorisation is not granted to some other practices, such as resale price maintenance and price discrimination, which also have the potential to provide efficiency gains sufficient to offset potential anti-competitive effects. It is possible for such practices to
enhance efficiency, even though the firms providing those goods and services are exercising some degree of market power (see section 3.3). According to Williams:

It is clear that, despite the arguments of economists (see Hanks & Williams, 1987; Officer, 1987), the Australian TPC and the New Zealand Commerce Commission do not always adopt the standard of economic efficiency in their evaluation of public benefit. In particular, they frequently depart from Hume’s law that a dollar is a dollar. Because they value benefits to consumers above benefits to, say, shareholders, both bodies have hesitated to classify cost reduction from restructuring as a public benefit unless competition in product markets compels the restructured firm to pass on these benefits to producers in the form of lower prices.

From the point of view of transactions costs, authorisation requires greater involvement and more discretion on the part of the TPC, with savings in legal costs per proceeding. An efficiency defence would probably mean fewer cases being considered, but with a higher cost per dispute. Further, authorisations must be reviewed periodically so as to take changing circumstances into account; the TPC is undertaking a comprehensive review at the moment.

Market definition and the competitiveness of the market are also important issues in examining the likely costs and benefits of a restrictive trade practice. The impact of any restrictive trade practice will depend critically on the influence of that practice within the relevant market. The larger the market and the wider the sources of competitive discipline, then the smaller the negative influence of the practice on competition and the greater the likelihood that it will confer a net benefit on the community.

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6 Centre for Independent Studies, op. cit., p. 25.
Jurisdiction and rules of evidence

Jurisdiction of the TPT

Pengilley considers that the jurisdiction vested in both the TPT and the Federal Court on competition policy issues causes conflict:

Both the Federal Court and the Trade Practices Tribunal determine issues related to competition. However, one adjudicative body has a judge as the sole arbitrator. This judge is untrained in economics or business and has to work under highly constricting laws of evidence. The Trade Practices Tribunal, deciding essentially the same issues in a public benefit context, has expert economic and business expertise available to its decision makers and is not constrained by the rules of evidence. The position is even more peculiar when the Federal Court regularly cites the holdings of the Tribunal in the Tribunal's reasoned competition analysis.

Pengilley suggests that only one body should exercise jurisdiction and appears to favour the responsibility going to the TPT. Alternatively, a separate division of the Federal Court could be created with members appropriately trained in economics or competition law.

Pengilley doubts that anyone from the 'traditional seed bed' of the judiciary, no matter how learned, could deal thoroughly with the economic issues raised in restrictive trade practices cases. He suggests the constitutional problems of appointing non-lawyers to the judiciary could be resolved and points out that such an approach would parallel those in other countries, such as the US and New Zealand.

Rules of evidence

Two rules of evidence in proceedings under Part IV of the Act which complicate the resolution of disputes are that:

- the views of economists are sometimes not admissible as expert evidence; and

7 Ibid., p. 35.
market survey results are not admissible as evidence.

Pengilley suggests that:

It is clear that the rules of evidence are one of the main bugbears of trade practices laws. The rules of evidence are made for murder trials, and in this regard I support them fully. However, they are not appropriate for assessing questions of opinion rather than questions of fact. It seems to me absurd that an economist cannot give an expert opinion (at least this seems to be the present state of Australian law) whereas a medical practitioner or an engineer can do so. It is likewise absurd (at least this seems to be the present state of Australian law) that properly conducted survey evidence is inadmissible as hearsay whereas it is probably the best manner of determining issues.

Evidence from expert economists. Courts usually have to address issues from applied principles, but economists are not permitted to express views in court that go beyond explanations of the available empirical evidence. As mentioned in chapter 3, reliable empirical evidence based on actual market data is often not available. As a result, the sometimes complex application of the principles discussed in this paper may have to be carried out without the assistance of the views of expert economists on issues for decision before the court.

Market survey results. As also mentioned in chapter 3, the lack of reliable empirical evidence based on actual market data usually means that obtaining the most effective proof of a firm's market power, an accurate estimation of own price elasticity of demand, is not possible. A good surrogate for this calculation can, however, be achieved with the use of well compiled, objective market surveys of producer and consumer responses to nominated changes, such as an increase in the price of a product. While this evidence should not be relied upon in isolation, it may provide a useful complement to the application of economic principles. In its absence, parties are forced to rely on what actual empirical

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8 Ibid., p. 36.
9 See, for example Australian Meat Holdings loc. cit.
evidence can be collected, substantially increasing the length and cost of restrictive trade practices actions.

6.2 Administrative measures

TPC guidelines

Section 28(1a) of the Act requires the TPC to provide guidance to the business community on the powers and functions of the Commission. The TPC discharges this duty primarily through the issue of `Guidelines' for the operation of some provisions, in the light of judicial interpretation, and through the regular reporting of TPC and TPT involvement in restrictive trade practices regulation. Guidelines have also been issued for the operation of sections 46 and 50.

While such Guidelines are an invaluable source of information for business on restrictive trade practices judgments and TPC interpretations, they do not constitute legal authority. To be effective, they require regular decisions by the courts to ensure that TPC and judicial views do not diverge. They also need to be regularly updated.

Industry codes of practice

The TPC is often involved — usually at the behest of government — in the determination of codes of conduct for industry self-regulation. TPC involvement is designed to ensure that such codes comply with both the restrictive trade practices and consumer protection provisions of the Act (Parts IV and V).

The TPC sees advantages in self-regulation in terms of costs, speed and the capacity for reflecting marketplace values, but also acknowledges the need to specify desirable outcomes when testing for beneficial self-regulation. Such as approach excludes codes which are fundamentally anti-competitive or
anti-consumer in intent and operation — typically those presented as ‘orderly marketing’ arrangements which restrict price competition or entry into markets.

In recent times, the TPC has devoted significant resources to help develop self-regulatory or co-regulatory codes of practice in various industries, such as the petroleum industry. There is often a fine line between desirable self-regulation and undesirable anti-competitive collusion. Self-regulatory codes are an efficient way of regulating practices in some markets, and TPC involvement facilitates their development and helps ensure there are no anti-competitive elements built into the codes. However, there is also the risk that close TPC involvement in code development may compromise future TPC action if the codes do not achieve the outcomes expected.

Administrative settlements

Recently, the TPC has introduced the use of administrative settlements to avoid the need to go to court on some matters.\(^\text{10}\)

On the one hand, administrative settlements could be seen as simply a mechanism to ensure the enforceability of settlements out of court — they invariably involve an undertaking not to offend in the future.

On the other hand, their widespread use could represent a shift towards more administrative regulation. The TPC has, however, indicated that there would not be a substantial increase in actions under Part IV of the Act as a result of the availability of administrative settlements.

\(^\text{10}\) An administrative settlement involves an agreement (called a compliance deed) between the TPC and a suspected offending party in which the TPC agrees not to proceed with its action if the other party agrees to take certain remedial measures and modify its behaviour in the future.
The Cooney Committee inquiry recommended that undertakings made to the TPC by parties under investigation should be legally enforceable. Such a change would render the use of compliance deeds unnecessary in most cases. The government has recently announced that this recommendation would be adopted.

Pre-merger notification

The Act has never required a merging or acquiring firm to provide advance notice to the TPC, although the parties may attain authorisation of the arrangements under section 88(9) by showing a net public benefit. The TPC currently operates an informal, voluntary clearance procedure, but claims that this system rarely provides it with sufficient opportunity to properly investigate proposed mergers.

The TPC proposes an additional scheme to apply only to:

- horizontal mergers where both parties to the mergers operate in the same market; and
- mergers involving combined assets in excess of $150 million or a transaction value exceeding $25 million.

Mergers having a negligible impact on competition, such as corporate reconstructions, real estate acquisitions, and sales by mortgagees in possession, would be specifically exempted from the new procedures.

The Cooney Committee report accepted that the TPC receives insufficient notice of impending mergers and sometimes has difficulty affording each full consideration. It therefore recommended that parties involved in a substantial merger or acquisition should be obliged to notify the TPC, but in a way that avoids imposing an undue burden.

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on them, or involves information requirements that are too wide, vague, onerous, or vexatious.

Many submissions to the Cooney Committee inquiry suggested that the case for a compulsory scheme had not been fully made. Further, in January 1991, New Zealand moved from a compulsory to a voluntary scheme, because the higher workload associated with the former made full investigation of all proposals difficult.

Merging or acquiring firms could be expected to minimise the risks associated with their proposals by taking advantage of a voluntary notification scheme if they were concerned that they might breach the Act. They would do so if the likely costs of ignoring the risk of prosecution outweighed the likely benefits. The former is a positive influence, minimising the efforts of all parties devoted to clearly innocuous transactions. The latter would be a problem if, as has been the case, the penalties associated with breaches of the Act were set too low. Fixing this problem should mean that a voluntary scheme works efficiently.

Nonetheless, the government has adopted the Cooney Committee recommendation and will introduce a `simple form of compulsory pre-merger notification.' The details of this scheme have yet to be announced.

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12 See submissions by McComas, Pengilley, the Law Council of Australia, the Victorian Employers' Chamber of Commerce and Industry, the Confederation of Australian Industry, CRA, and the Business Council of Australia. Most suggest that regardless of the arrangements adopted, the costs associated with a compulsory scheme would be considerable.
Effective competition policy means pursuing a range of deregulatory and pro-competitive measures across all markets so that the community's resources are put to their best use. Australia has already introduced many deregulatory measures, and it is timely to now review pro-competitive regulation.

7.1 Focussing regulatory effort

A review needs to distinguish three types of markets:

- markets that sustain a sufficient level of competition without regulation;
- markets where certain characteristics allow some participants to profit at the expense of others by either influencing prices, output or sales; and
- markets where monopolist supply is entrenched, either because goods or services can only be supplied efficiently by one producer and/or because government mandates monopolist supply.

Deciding into which group a particular market falls is not simple. For example, while it may appear that a market is not competitive, if new competitors can rapidly establish themselves, then there will be sufficient competition. In order to adequately identify markets, all the elements of the competitive process should be taken into account.

Pro-competitive regulation of markets of the first type is not warranted.

For markets of the second type, regulation may be needed to prevent anti-competitive market practices by firms or cartels with a substantial degree of market power. Such regulation should be constrained to those practices which
impose costs on the community that outweigh any benefits. At present, prices surveillance and restrictive trade practices regulation of such markets does not appear to take full account of all the sources of competition, and may therefore tend to underestimate the benefits, and overestimate the costs, of some restrictive trade practices.

Restrictive trade practices regulation of these markets in Australia has concentrated on the prohibition of market practices rather than the regulation of market structure. Only the mergers provision of the Act deals with market structure. In fact, the rationale for the anti-mergers provision has often been represented as surrogate regulation of market practices; that is, as a `second best' means of preventing market practices that are difficult to prevent in highly concentrated industries.

Given the uncertainty associated with judging the likely impact of a merger, and since the mergers most likely to reduce overall efficiency will be those where the impact on competition is greatest, prohibiting only those mergers that most threaten competition seems warranted.

For markets of the third type, regulation may be needed to restrict the ability of producers to limit supply, reduce quality, and/or increase prices. Such regulation should be the minimum necessary to achieve these ends, provide an apprised uniform economy-wide approach, avoid `capture' by market participants, and limit intrusion on other commercial decisions. At present, regulation of these markets lacks a rational foundation, generally performs poorly, and is ill-equipped to deal with likely changes over the next decade.

7.2 Expanding the scope of the Act

Extending the range of individuals and organisations that are subject to restrictive trade practices regulation has been mooted recently.
At present, application of the Act is not comprehensive because of

- current exemptions applying to government agencies,
- government industry-specific interventions,
- current exemptions applying to the labour market, and
- protections provided for intellectual property.

Moves toward corporatisation, privatisation, and/or structural separation of existing government activities, particularly in public utilities, justifies the application of both pro-competitive and industry-specific regulation in these markets. It is also timely to consider the overlap and inconsistencies between these forms of regulation. There are solid arguments in favour of an increased role for broad pro-competitive regulation at the expense of industry-specific approaches.

Similar arguments apply to current exemptions accorded to the professions. Competitive discipline is no less important in these markets, and there is no economic justification for a blanket exemption from the operation of pro-competitive regulation.

The application of pro-competitive regulation to intellectual property and the unions involve more difficult issues. In both cases, however, a review is warranted to assess if the balance of regulation is appropriate.

7.3 Targeting administration and enforcement

The TPC uses a diverse range of mechanisms to promote the aims of the restrictive trade practices provisions of the Act. These include the investigation of possible breaches and prosecution, conducting civil actions on behalf of `deserving' litigants, the administration of sector-by-sector compliance with the spirit of the Act through the release of guidelines, and the negotiation of industry codes of practice.
The administrative approach to restrictive trade practices regulation favoured by the TPC provides benefits, compared with a more judicial path, in terms of the guidance and advice it provides to market participants, the timeliness of responses, flexibility, and relatively low direct costs.

But the administrative approach also imposes significant costs. Costs may result from the ad hoc nature of TPC activities, the possible divergence of views between the TPC and the judiciary because of the limited role of litigation in the interpretation of important provisions, and uncertainty resulting from the judicial power to overturn any administrative decision.

Further, the costs of judicial enforcement may be higher than necessary for a range of reasons. For example, evidence on market power must be compiled in a more protracted and expensive way because of the rules on the admissibility of evidence in restrictive trade practices cases. Other reasons for the excessive costs of judicial enforcement include a lack of competition in the provision of legal services.

7.4 Conclusion

The Commission has attempted to canvas the range of issues associated with pro-competitive regulation in the context of competition policy. Pro-competitive regulation in Australia appears to play too large a role in some markets, mainly due to misconceptions of the nature of those markets, while its application to many other markets is too limited, mainly because important market participants enjoy statutory exemptions. There may also be scope for expanding the coverage of the Act, and for improving the administration and enforcement of pro-competitive regulation.

The forthcoming review of a national competition policy will provide an opportunity to consider all these issues in the one forum, and determine the best means to achieve
consistent application of pro-competitive regulation to all markets.