

The Policy Pitch – Competition in the Australian economy: too little of a good thing?

Melbourne 3 October 2017

Around the world, concerns are rising about market power. In Australia, sectors like supermarkets, banking, and telecommunications are mostly served by a handful of large firms. Some argue that the power of large firms in Australia has grown, hurting consumers and other firms or even pushing down wages. Others are concerned that while online platforms disrupt incumbents, they also exercise market power in their own right.

At the same time, the government is progressively implementing recommendations of the 2015 Harper Competition Review, including more recourse for small business, and pushing for more competition in human services like health and public housing. It has relaxed restrictions on cross-ownership in the media, on the basis that changing technology has intensified competition. And it has ordered an inquiry into competition in financial services. But some argue there's still much work to be done, including addressing sectors where competition is not working for many consumers, getting enforcement right, and refining the rules for new digital platforms and data.

In this Policy Pitch event, an expert panel discussed the role of competition and competition policy in the Australian economy:

- How valid are concerns about competition and market power in Australia?
- Where is competition working less well than it could, and what are its limits as a policy tool?
- What else should policymakers do to ensure competition benefits the community?

Moderator: Dr Jim Minifie, Grattan Institute

Speakers: Professor Caron Beaton-Wells, University of Melbourne Law School
Dr Stephen King, Commissioner, Productivity Commission

ANNA BURKEY: Good evening everyone, it's lovely to see you here at State Library, Victoria. My name is Anna Burkey and I am heading up StartSpace for the Library, which is our new centre for innovation and entrepreneurship, a new business centre that will open in 2019. It is a great pleasure for me to be here for *The Policy Pitch* with tonight's topic being about competition in the Australian economy. Before we begin, I do want to make a point of noting that we are meeting on the traditional lands of the Kulin nation and pay my respects to any elders past and present and those who may be here with us this evening. I'd also like to give a warm welcome to tonight's speakers, Caron Beaton-Wells, Dr Stephen King and Dr Jim Minifie. We also have Grattan Institute members and staff and, of course, Friends of the Library here with us this evening. *The Policy Pitch* is a joint initiative between the Library and the Grattan Institute and the partnership contributes to a really important aim of the Library to be a catalyst for ideas, discussion and debate, and, as we go into our very exciting Vision 2020 redevelopment over the next few years, the space and time that we make available for those ideas and debates will only increase. It's an important space for discussion and reflection on policy issues.

StartSpace, which we will be developing, will be a really wonderful and important way for us to be able to bring together entrepreneurs, individuals who may never have thought of starting up a business together with experts, and that's something that will be growing over the next few years. But tonight I'm particularly looking forward to hearing from our leading experts in economics and competition law. Our moderator will be Dr Jim Minifie, who will lead the discussion on the role of competition policy in the Australian economy. Jim is the Director of the Productivity Growth Program at the Grattan Institute and I'd like to welcome him to the stage to introduce our speakers for tonight. Please welcome Jim, Caron and Stephen.

JIM MINIFIE: Thank you Anna and thanks everybody for joining us, I'm really excited about the topic tonight. It's a topic which is really at the heart of how we run our economy. It's part of our ideology that competition is supposed to be a good thing and increasingly in recent years there's been a lot of concern, particularly emanating out of the US, that competition is not working in the way that we would like it to. What I want to do before I introduce our two speakers is to run you through a series of slides that I've created with my co-authors, Lucy Percival and Cameron Chisholm, who are here tonight, which tries to put forward some facts about how Australia's non-traded economy fits in the global picture of increasing market concentration and make some observations about how returns, the profits, if you like, relate to aspects of market barriers to entry across the economy. So bear with me, I'm trying out these preliminary slides, which could change before our final publication, which will give you a bit of a fact base about our non-traded economy.

So what we chart on this first slide, on the vertical axis is the market share of the biggest four firms and on the horizontal axis is the output share of individual sectors across all of our non-traded economy. The big takeaway that I think you can see is that there's about a third of output - excluding the traded part of the economy which, of course, is subject to competition from overseas - that is either medium, high or very high on this measure of market concentration. Those sorts of facts have been a source of concern for some commentators on the basis that they could be associated with market power that firms might be exercising, whether to restrict output and get high prices and high profits or possibly to soften the incentives to innovate and so forth. But I think it's important to recognise that when you zoom out and look at Australia in the global context, many, many economies have a number of sectors where a small number of firms have significant market share. So to the extent that we've got a problem with market power, it's something that is not unique to us. This is a chart about the banking sectors of a range of economies and on the vertical axis is the three firm market share, the biggest three firms, and, again, you've got population on the right axis and you can see that Australia is in the pack on at least this measure of concentration in that very major sector. Another example, supermarkets, you've got very large economies at the top, like the US, Germany, the UK, and down the bottom you've got much smaller economies, Ireland, Portugal, Belgium and so forth, and you can see that many of those economies have got high concentration, but we are unusually high on that measure in that sector. So the story differs a bit across sectors, but it is certainly not the case that we are unique in having some sectors with very high market shares.

I've now got a couple of slides about time trends. What this chart shows is the revenue of the biggest 50 firms in the economy going all the way back to 1992 as a share of GDP and you can see that there really hasn't been much of a trend. Something of an uptick, particularly during the resources boom if you include mining and metals firms, which of course are tradeable producers, but otherwise it doesn't seem like there's much to see when it comes to a putative increase in the market share of the largest firms in the economy, and there are other measures that give you a similar picture. The story, of course,

becomes much more pressing and interesting once you drill down to particular sectors. What we've got here is time trends for the largest three firms in mobile telecommunications, you've got supermarkets in the middle with the market share of two large supermarkets, and then you've got banking over time on the right here with the four largest banks. You can see that on the left two columns there's a tendency for some decline in the market share of those large firms and an opposite trend in banking. There are facts about mergers post the global financial crisis (GFC) that seems to have driven up the market share of the large banks, whereas in supermarkets you've had the entry of firms like Aldi and Costco and so forth tending to progressively erode, at least to some extent, the market share of the large supermarkets.

Now, I want to turn to our best effort at Grattan to produce an imitation Jackson Pollock slide. What we've charted here is the four firm market share, on the horizontal axis, of every non-traded sector that we had enough data to characterise, and on the vertical axis we've got the average profitability of firms working on those sectors. You can see that there's a huge spread of profitability across the economy and maybe a slight tendency for the most concentrated sectors to be more profitable, but also the spread at that end of the chart is extremely large, reflecting, among other things, the fact that just a few firms are material to each of those sectors, by definition they've got a very high market share and firms differ greatly, whereas at the far left of the chart, where no firm has got much market share, you can see that sectors tend to cluster much more around what you would think of as a competitive return on equity. Having noted all of that spread, nevertheless, it is quite notable that some of what you might think of as the usual suspects - the supermarkets, wired telcos, wireless telcos - are earning very, very high return on equity, and we've adjusted this in various ways that I can go into. The banks do pretty well, but they're also very, very large. The bubble sizes here are the equity, the shareholder equity or a measure of that in the economy. But it's clear that concentration per se is not the story and I don't think any competition economist would tell you that that's the story.

Let me just wrap up with three slides that cut into this data. Firstly, by looking at what we assert are natural monopoly-type sectors, sectors where you'd only really expect to have one player at least for a local market, so things like electricity transmission, you're not going to have multiple competitors in a given market, airports have got quite a significant natural monopoly characteristics, ports, water transport terminals, electricity distribution, wired telco. You can see there's a subset of those markets where firms are earning very, very high returns but, nevertheless, their total excess profit arguably is not huge compared to the amount of capital that's allocated, so there might be \$3 or \$4 billion of excess profit by our measure across those sectors. Similar sort of number across what we think of as highly regulated sectors, so health insurance, banks, and then a lot of gambling firms seem to earn super-normal returns but there are some that are earning sub-normal returns as well in this sector. Again, the sheer size of the banks really stands out there. The final group of sectors are sectors that have got economies of scale which might be a network effect, like in supermarkets where your distribution and logistics system gives you a strong cost advantage over firms that aren't as large or don't have as dense a network of stores. You can see quite strikingly high returns in liquor and other food retailing, in wireless telco, credit cards, the Australian stock exchange itself does very well, supermarkets, internet service provision, and then the last column on the right are some of those platform firms, like Seek or realestate.com.au, internet publishing firms. Before we get into the discussion, let me just note that the fact that a sector is earning high returns could be due to market power, but it might also be due to economies of scale. It might be that if you break up these large, powerful firms you could increase the cost base in the industry. Nevertheless, these groupings do map into how competition regulators, at least to some extent, think about how competition operates and what to do about it.

So without further ado, having done that whistle-stop introduction through some of the fact base, let me introduce our two speakers for the evening. Professor Caron Beaton-Wells is at the University of Melbourne's Law School. She runs the Competition Law & Economics Network, she's published very widely on a number of aspects of competition law, including in particular recently around cartels, which are a critical part of how concentrated sectors can go wrong from the consumers' standpoint, and we'll talk more about those things. She is widely sought as an expert in competition law, so Caron, thank you so much for joining us tonight. Our second speaker is Dr Stephen King who joined the Productivity Commission this year. He's had a number of interesting roles over time including as a Commissioner at the ACCC and also in a previous life as a Professor of Economics, both at Monash and Melbourne University, with a long-standing interest in competition and industry economics. I can't think of two more appropriate and well-matched people to have a discussion with about competition in the economy, so if I could invite you to come up and join me and we can start the discussion.

To kick off I think it's appropriate to start with the once in a generation review of competition policy, law and institutions that Ian Harper led in 2014 and 2015. As I alluded, from time to time governments will commission such an exercise. They don't pay off the year they're done, they tend to set an agenda for a significant period of time, and they're difficult to digest in the first instance. There's a lot of content in these occasional reviews. So if I can start with a low ball question, a really easy question for both of you and perhaps, Caron, if you want to kick off. What is the policy agenda for competition and was there anything missing in the Harper Review?

CARON BEATON-WELLS: Thanks Jim and thanks very much to you and the Grattan Institute for the invitation to participate this evening. The Harper Review was really styled as Hilmer Mark II, and that's a reference to the wide-ranging review on competition in the economy Chaired by Professor Fred Hilmer in the mid-1990s that led to the introduction of national competition policy, which has been credited, including by the Productivity Commission, with jump-starting economy growth in our economy, lifting living standards, and contributing substantially to household income. So why did we need a Mark II, given all of the great work that was done and was seen to be successful in so many ways? Well, there were concerns about productivity starting to stall in the Australian economy and both sides of politics have been equal supporters of competition policy and associated microeconomic reform, so there was strong support for taking a fresh look to see what had been left behind by the Hilmer Committee's work and its implementation. But the Harper Review was styled as actually something even more far-ranging than what was done by Hilmer and that was to look not just at competition policy, but to look at our competitions laws and our competition institutions. The Harper Review process was an extensive one with wide-ranging consultation, issue papers, draft papers and a final report, much of the recommendations of which were accepted and some of which were highly controversial, and now we are down to the hard work of implementation.

We can get into some of the specifics, but competition policy remains very much on the agenda with bipartisan political support as a very important lever in our suite of microeconomic policies in Australia consistent with the approach around the world.

JIM MINIFIE: We were talking before we came in about the notorious Section 46 which got quite a lot of attention, that's a section of the Competition Consumer Act which Harper proposed be changed in a way that will make it easier for prosecutions to be undertaken around the misuse of market power. There was quite a lot of contention about that. Do you think that got an appropriate amount of attention,

Stephen, or in the bigger picture would you say there was a lot else in the report perhaps of equal or greater import for competition?

STEPHEN KING: The Section 46 changes got a lot of publicity and they became obviously very political in Australia. I personally think that the changes of removing of take advantage, which is part of the change to that particular bit of law, is a bad idea, but we can debate that back and forth and it has been debated back and forth. It did tend to overshadow some other changes that were probably more important and just to pick on one. Harper recommended, and it's going through parliament now, the introduction of essentially a facilitating practices rule or issue with our competition law. So to give an overseas example of where this has been used, one famous case from the US, a large company advertises in advance that it's going to put up its prices in a couple of months, so it's just telling its consumers. Then if its rivals don't also happen to advertise within a couple of days that they're doing the same thing, well guess what? That company readvertises and says, "We've changed our mind, we're actually going to reduce prices and you guys are going to learn better in the future" the "you guys" being the competitors, so these ideas that you can create institutions or norms in a marketplace by which firms can collude without them sitting in a smoke-filled room.

That's a huge change to our law. I don't think anyone completely knows what that's going to do to business practice in Australia. We're not going to know until some cases get before the courts. An excellent first case would've been the informed sources case, one that the ACCC settled probably about 12 months ago now, where the petrol retailers all used a third party to exchange price information. That would've been a great one to test under this new bit of law. Unfortunately, it won't be, but that's the sort of thing that I think should've got more publicity and certainly needs more and better understanding by the business community. It will make big changes, but has gone under the radar.

JIM MINIFIE: Caron, are there any missed opportunities in Harper?

CARON BEATON-WELLS: Before I answer that, I can't resist the opportunity to respond to some of Stephen's comments. I don't think the Section 46 changes were blown in terms of the level of debate they attracted because, just to tie in with the comments you made at the start, our law and our policy has never been to penalise the possession of market power per se, because market power, as you pointed out, could be attained through exceptional performance, through meeting and anticipating consumer needs, through driving down the cost of production, through innovating. But our law does rightly try to capture, deter and ultimately, if necessary, penalise misuse - we sometimes refer to it as abuse of market power - because that does have very serious adverse effects on competition and the competitor process. So getting that prohibition right both as to the economic analysis that should be reflected in the law and as to the workability of its enforcement is extremely important to the cogency and effectiveness of our competition laws. Stephen is right, however, on flagging the importance of the other prohibition that was recommended and will be introduced into our law, and that's the prohibition on concerted, sometimes called facilitating, practices, in particular where that relates to information sharing, sometimes referred to as tacit collusion, amongst businesses where business people don't have to meet in a room or talk in code on prepaid mobile phones, but are able to signal to each other through their conduct in the marketplace as to how they intend to set prices or set output levels, and that leads to a degree of co-ordination and removes the uncertainty for competition. So it is a very important amendment and yes, as you say, we'll have to watch with interest as to how it's going to be implemented.

In terms of one other gap, to come back to the initial question that I think was left by the Harper Review, the one I would single out is private actions. Because we very much rely for enforcement in our competition laws on the ACCC, on public enforcement, but the ACCC only has so many resources and a limited enforcement budget and just simply cannot be expected to detect or, where it does detect, take action in the case of every instance of serious anti-competitive conduct. In other jurisdictions, particularly the US, 90% of enforcement is undertaken by private claimants who have very strong incentives, particularly in the form of treble damages, to take that action and that complements and boosts the public resources and activities of the government agencies. Harper really gave that short shift. There were a few recommendations around lifting hurdles for private claimants, but they were at the margins and some very significant obstacles still remain.

JIM MINIFIE: While we were talking before you would've perhaps added to that list the use of data in the competition context as well as being something that needs more attention?

CARON BEATON-WELLS: Yes, I would definitely add that. That's not necessarily as a criticism of Harper, because really governments and competition agencies around the world have been slow to come to grips with and are still very much trying to navigate the challenges posed by data-driven sectors and large companies. So while Harper did certainly, in setting the context for the review, point to the rapidity of technological change as something that was going to have to be taken into account in the context of competition policy and law, unfortunately there wasn't much further analysis on just what does it mean for our economy that now across the world the five most powerful companies are data-driven companies. Of course, I'm referring to Apple, Facebook, Google, Microsoft and Amazon. Their power lies in the collection and their use of data and that has enormous implications not only for competition, but for privacy, cybersecurity, and a range of other public policy areas.

JIM MINIFIE: I hope we can come back to that in the course of the discussion. Stephen, there was a long list of what you might think of as the usual suspects of potentially, in some cases, relatively minor reforms that Harper noted have been left undone since the early 1990s, whether it's retail trading hours, pharmacy locations and ownership restrictions, or shipping and so forth. Now, not all of these in the government's response were "agreed to". I think the technical term is they were "noted" on the way through, which I think I read you said might've been the government prudently choosing its battles. Do you think they ought to pick up some of these battles or have they decided how much they ought to bite off in this area and focused on a more positive agenda?

STEPHEN KING: It's horses for courses. It depends. Let's give a couple of simple examples. The Potato Marketing Board has finally gone from Western Australia. I expect to hear a cheer for things like that! In Western Australia, I was a regulator over there for six years, you couldn't import evil east coast potatoes because you have no idea what a potato grown out near Port Fairy could do to the sensitive digestive systems of a west coaster. It finally got removed only because one farmer got put into jail. The same way, by the way, that our retail trading hours restrictions got removed in Victoria going back to the Kennett years. The government has to pick its battles. In some cases the fights aren't worth it and technology and change will eventually make the restrictions redundant. We've seen that already, with Uber and taxis being the most obvious. In some cases the restrictions cause real pain and suffering. A simple example and something that hasn't been really picked up very well by the press over here and one of the main reasons for the slow response in getting relief supplies to Puerto Rico post the hurricane over there is a thing called the Jones Act. It's their version of cabotage: you can only ship materials between two US ports, which includes Puerto Rico, on ships that are made and manned in the US. So

you can drive around in a BMW truck or a Mercedes truck and take the stuff to the port, but when it gets to the port you've got to put it on a US-made ship. The US doesn't make any relevant ships anymore. They've finally, a couple of days ago, got around to suspending the Jones Act so they can get relief supplies in. It's simply madness. We have cabotage in Australia and you've got to really question those are laws that are redundant. They may have been brought in for a good reason - the Jones Act was due to World War I excessive shipping supplies. We're in a different century now, it's 100 years later; maybe it's time to revisit some of these things, not just in Australia but elsewhere.

The final thing I want to mention is you've got to be very careful when looking at the data. I've just finished the review of pharmacy remuneration and regulation. The final report hasn't yet been released by the government so I can't talk about what's in it, but you would've noted when Jim put up the rate of return on equity slide in some industries that some regulated industries don't seem to be making a high return on equity. A-ha, therefore the restriction doesn't matter. Wrong. In the case of pharmacy, it's built into the price of pharmacies. When you sell a pharmacy all the monopoly rents get built into the price. Go out and try and buy a pharmacy - if you're a pharmacist, by the way; you can't buy one otherwise. But if you're a pharmacist, go out and try and buy a pharmacy, you'll find out how much it costs because it's got all of those rents built in because of the restrictions. So you've got to be very careful when looking at the data when you say, "Oh, they're not making excessive returns". Of course they're not now. It's the taxi licence problem: you're paying \$500,000 for a taxi licence because it's got all the rents built in.

JIM MINIFIE: It's actually a puzzle to me why pharmacies are so low because we did make that correction on every sector that we could, so we'll need to look into that further. For example, you see Coles earning a relatively low return on equity on its Wesfarmers business, but the underlying business unit continues to earn, we estimate, about as much as Woolworths does, which is well over 20%. If we just zoom back then, so Harper set this very broad agenda. We haven't spoken much and maybe we don't have time now to touch on some of the institutional reforms in terms of who should play what role and so forth, which is a big issue if you're a practitioner in this field but potentially, from a policy perspective, looks somewhat arcane. One of the issues that I think really does get to the heart of how competition functions is around cartels. We touched on the concerted practice issue but, Caron, in correspondence prior to this event you noted that cartels are often thought of as the supreme evil, the most egregious part of anti-competitive conduct because it's a situation where two entities who we think of as competitors actually work in concert. Do you think we've got the rules, the penalties and the whistle-blower protection about right in that field or are we still far from what we need to control cartels in this country?

CARON BEATON-WELLS: Well, just to link back to your opening, Jim, and the reason why we should talk about cartels when we talk about market power and concentration all in the same breath is because, of course, when we talk about cartelisation or collusion between businesses we're talking about instances where firms are able to gain and exercise power jointly that they would not otherwise be able to exercise independently, so it's another route to market power where it cannot be gained and exercised unilaterally. So yes, it is the supreme evil because we are talking about instances here where the harm to the competitive process can be egregious. In cases where firms, for example, allocate customers or geographical territories between them there's a complete elimination of competition, not just competition on price but competition on quality, competition on range, competition on convenience and other non-price factors. So there is an international consensus that you need stringent laws with strict liability, that is liability that will attach without the requirement to prove an effect on competition, because that can be presumed when you're talking about price fixing or market allocation and you need

sanctions of the toughest, scariest type, which generally means jail terms for white collar people in the C suites. It'll only be through those mechanisms that you will adequately detect, deter and ultimately, if you need to, punish collusion.

Have we got the rules right? Well, I think we are about to fill a gap in the rulebook with the introduction of a prohibition on concerted practices because business people now, particularly in big businesses, know this conduct is illegal. Even if they don't know what the text is on the statute, they just have an intrinsic sense that there's something wrong about talking to your competitor about your future prices and increasingly they know the dire sanctions or the significant threat of scary sanctions if they breach these laws. So there is that understanding and it means that cartels have gone underground and business people have become more creative, more sophisticated in the way in which they achieve the same effects of co-ordination with the same adverse implications for consumers than if they were to explicitly collude. So I think we're getting the rules right and I think we've got the right sanctions on the books. Since 2009 we've had criminal sanctions for serious cartel conduct which includes a maximum jail term of ten years, which rates cartels as highly as many other felonies, including white collar crimes, but we are only just starting what is a marathon in building the capacity to effectively use those criminal sanctions.

JIM MINIFIE: We should come back to some of the data-related or online-related challenges to traditional detection and enforcement of cartel behaviour before this discussion is out. If I can just move on to a totally different dimension of the competition law which is around, I guess, economists spend most of their time, for good or evil, thinking about efficiency, but there's this strand in competition law around fairness and unconscionability, and those are bases for actions that have been used, for example, with respect to supermarkets' treatment of their suppliers. Caron, is this an arena of competition law that's functioning effectively and that can play an appropriate role alongside the more, if you like, efficiency-focused aspects of the law? Or is it somehow a hangover from the courts of equity back in the 1600s and an area that's not really adding value?

CARON BEATON-WELLS: It's a good question and many might react to the idea that "competition" and "unfairness" shouldn't appear in the same sentence. Certainly you commonly get that reaction from economists because competition, by its nature, might well be unfair. If competition is really working it can be brutal; there will be casualties, there will be blood on the floor. Those who are inefficient and can't compete effectively will be seriously injured, if not eliminated. So competition, fair, do the two go together? Interestingly, the research we've done around supermarkets suggests that there is interdependency, a connectedness between competition and fairness. That's perhaps the reason why in our Competition Act we have provisions not just relating to competition and consumer protection, which are also synergistic and connect, but laws also relating to fair trading. Fair trading is not a competition issue as such, not facially. It's about responding to asymmetry in bargaining power, which is quite common in our economy, particularly given the concentrated nature of many of our sectors where you have a small number of big firms and then you have a fringe of smaller firms either as suppliers or customers trying to negotiate with those big players, so a real imbalance in bargaining power which can generate problems of fairness.

Why do we worry about that if our primary objective is competition? Well, we worry about it because over the long run if those smaller suppliers or customers can't get transparency in their dealings with the bigger players and can't get certainty over the long run in their contractual arrangements they're either going to consolidate, so we'll see even further concentration in different levels of the market, or

they are not going to have any incentives to invest, innovate and give us the diversity we want as consumers. Because we don't just want low prices, we want choice and for choice you need diversity, which means you need big and you need a healthy range of small as well. So, bargaining power and the linked issue of fairness is, in fact, very important to competition, as well as important just socially, I think.

JIM MINIFIE: Stephen?

STEPHEN KING: I think there are good and bad reasons to pursue fairness. Let's think of a good reason first. When you're talking about some small businesses, they are no more sophisticated than consumers. They're often consumers in most of their life and then they're running a small business on the side. When I was at the ACCC there were plenty of cases, often involving franchises, where we'd just sit there and shake our heads and say, "Why did you sign that contract?" "Oh well, it seemed like a great opportunity at the time." "Did you read it?" "No." "Did you get legal advice?" "No." So in some ways there is a group of small businesses out there who, probably a bit like consumers, need to be covered by those laws that add the extra protection. We don't think they're sophisticated all-seeing, all-knowing business people who are looking for the best way to get the next buck. That's on the good side of fairness. The other part on the good side is, as Caron said, when there are big differences in bargaining power and there are economic consequences of that. So if you've got the big supermarkets slugging it out and both having an incentive to be opportunistic with regards to certain suppliers, well those suppliers will eventually leave the market and the two supermarkets will have to ask where will the new suppliers come from? Now, they may then invest back and may vertically integrate, but that creates other barriers to entry if someone else, like Aldi or IGA, for instance, wants to access those supply chains.

So there are economic reasons behind fairness but, and this is a big but, fairness is often used as an excuse to say let's not have competition. Because yes, competition can be pretty ruthless and when I'm competing with Caron, you know, that may just not be fair because Caron's a lot better than I am at this particular industry, it's just not fair. So we've got to be very, very careful when fairness is just used as an excuse to get the government to come along and say, "Well look, we can't have too much competition here". The guys who are losing the competition war because consumers didn't like their product will go, "Thank God for that, now I'm protected". So we've really got to be very careful with that word "fairness".

CARON BEATON-WELLS: I can't resist responding to Stephen, and for some of the audience this might get a bit fluffy. I think fairness is a very subjective concept. Everyone's going to have a very different idea of what's fair or unfair, but I don't think we should underestimate the importance in Australian society and our attachment to what you might call egalitarianism or you might know better as "the fair go". I actually think that is quite important to our social order and to our identity as Australians. Often when people say in the context of supermarkets "that's just not fair" they're expressing a social reaction about a value that we have in Australian society and not necessarily just an economic consequence, and I think politicians are responsive to that.

JIM MINIFIE: In that context, the Harper recommendations which were accepted by government to permit small firms to collectively bargain is relative as well. It's quite striking that collective bargaining is not a form of competition. I mean, you've got an acceptance inside that competition framework of a totally different mode of coming to a deal, which to my mind is quite striking. But the other aspect that I

wanted to discuss is around you picked up that people possibly haven't read all of the fine print and, more generally, when you look at consumer behaviour what we see is that sometimes the outcomes of competition have not been what economists suggested. There are people in this room who I know have written on this topic to note that when consumers are averse to assessing options which they might find complex they're putting them off, or even once they've figured out that they're on a bad deal they seem to be very resistant to actually making the switch. You do have to ask yourself, if you like, a utilitarian question which is are we in favour of competition just purely on the basis that it almost ideologically is something that we think ought to be the principle on which society runs, or are we actually making a case for consumer welfare?

So you go to retail power, for example, and you can do the same thing in superannuation where there are many consumers who are clearly on dominated products year after year and then there's a subset of people who are assiduous enough to navigate their way through the complexity and find themselves a good deal. So that calls into question the arenas in which you say it's caveat emptor, buyer beware, go for your life competitors and if the consumers are asleep or don't care enough or they've got other concerns or the product's too complex, it's not our problem. To my mind, that is an area where I think the role of competition in our society needs to be investigated and potentially improved. Do you see that opportunity, Stephen?

STEPHEN KING: You've just made a justification for competition and consumer laws. That's why we have these laws. Competition works really well a lot of the time, but there are some sectors where we know it won't work. There are some sectors where we've tried to shoehorn competition in and it's not clear that that competition has worked. I noted one of the high return on equity industries that you had up there was electricity distribution. Surprise, surprise, we have a competitive electricity distribution sector, except it ends up being massively highly regulated and the benchmarking that was meant to be done under the original reforms when they broke up the State Electricity Commission here in Victoria was never done, so the proxies for competition were never done. So there's no magic bullet. People who come out and say economics says we always prefer competition to the alternative, well, I'm not sure what economics they read because that's not in any economics I know. But people who say competition is a bad thing, we should get rid of it and have something else, fine, but show me the something else. Because nobody has come up with it so far and where we get rid of competition and where we try and replace that with some sort of regulation you actually end up with something that looks pretty bad from the perspective of a consumer and the perspective of Australia.

JIM MINIFIE: I'm aware of time. Can we shift now to a couple of sector-specific issues and then I'm sure there'll be people who've got perspectives and questions that we should get to. Caron, you've done a lot of work on supermarkets over time. Supermarkets are a huge part of our retail experience; they generate directly in their own value-add about 1% of GDP and employ almost a quarter of a million people. As I noted earlier, it's a sector that at least in recent years, potentially to a lesser extent these days, has been dominated by the two major players. Have we got the rules about right for that major sector?

CARON BEATON-WELLS: Jim, I don't think there should be rules that are specific to the supermarket sector. I think we have sufficient policies and rules relating to competition economy-wide that, if applied correctly in the context of groceries, would be as effective as if applied to any other sector. But there has been a spate of public inquiries and investigations into the level of concentration in grocery and the conduct of Coles and Woolworths over the last ten years which must raise some questions. What is the

problem and, if there is one, what should be the appropriate response to it? Is it a competition problem and, if so, what's causing it, or is it some other problem? We've had a good look at this and we've now had consensus amongst policymakers and enforcers that, despite what some people think of as a Colesworth duopoly, an anticompetitive structure in the sector, competition is actually working for consumers. Consumers are voting with their feet in their patronising of the supermarket chains because of the prices on offer, but also because of the convenience of one-stop shopping and because of perceptions of range and quality.

So competition seems to be workable, if that means anything to anyone, but what we've noticed is that over the last ten years in fact competition has been intensifying. The major factor in that of course has been Aldi, the German discounting chain, which the data tells us drives down prices 2% or 3% when you are looking at a micromarket of, say, a shopping area of 3km to 5km where consumers might switch between major supermarkets - you will see the average price of a grocery basket 2% to 3% lower where there is an Aldi in that market as compared to somewhere else. We know competition is only going to intensify further because we know Amazon Fresh is here, or at least they have a warehousing site, and there isn't a corporate board in Australia that hasn't had a few management papers written about Amazon and what it will mean to them, and that will include our supermarkets. There is at least another discounting chain on the horizon, David Jones is looking at going high end and, more to the point, there is an increasing emergence of smaller niche online providers and food delivery services that consumers, with the benefit of technology, are taking up. So competition might be working too slowly for some, but it is working at the retail level.

The concerns are really about what's happening at the level of suppliers, our manufacturers and, even further upstream, our primary producers and whether the buying power of Coles and Woolworths is going to be hurting dynamic efficiency, that is incentives to invest and innovate in our supplier base. Those are, I think, legitimate concerns and the government is onto them. It has taken several steps, including introducing a statutory code that is intended to regulate supplier/retailer dealings in that sector. So that's certainly on the government's radar and, I have to say, ultimately it's competition that is driving those retailers to rethink their approach to suppliers anyway and to become smarter in partnering with and treating suppliers well, because without suppliers they're not going to be able to complete.

JIM MINIFIE: So what's striking is, nevertheless, these processes do operate on an almost decade by decade timescale, so Woolworths and Coles still continue to earn very attractive returns, their market shares decline but ever so marginally. It feels to me like this is a discussion that we could well be having in another decade and you look to seeing, hopefully over time, the government can find opportunities to ensure that the market power of those major players is not being used to cement their position.

CARON BEATON-WELLS: Yes, well I would put down the level of political attention and public angst about our supermarkets to two things. One that's driven the debate in the last five years has been concern about farmers and primary producers and the search for a cause for the plight of our rural sector and the communities they support and serve. But if you ask the Farming Federations and those who are steeped in agricultural and rural policy they will say that the list of policy challenges facing primary production in Australia is long and the buying power of Coles and Woolworths is one of those challenges, but it's almost at the bottom of the list. First you've got to talk about international commodity prices, you've got to talk about underinvestment in infrastructure, and you've got to talk about seasonal fluctuations and climate change. There's a whole raft of other issues, but unfortunately Coles and Woolworths are readily characterised as the villains because they're obvious and easy to target and the

public sympathises. We are attached to our farmers, this is a country that's grown up on the sheep's back, so we're sympathetic but it doesn't translate into our behaviour. When supermarkets say, "Okay, you don't all want to buy own brand milk at a dollar a litre, we'll put on the shelves a choice for you so you can directly support your farmers at a higher price point" it doesn't move. So consumers are fickle and that's problematic for policymakers and politicians.

JIM MINIFIE: Let me do one final gear shift before we open to questions. In some respects, the most controversial part of the Harper recommendations was about the expansion of competition into human services. What Harper noted was that there are still wide swathes of really critical human services - and let me give you the list that was put forward by Harper: social housing, public hospitals, end-of-life care services, public dental services, services in remote Indigenous communities, family and community services - in which choice and competition do not play a significant role today. Now, these are all services that are intensely important to the community and there's been a great deal of community scepticism and - let me put it in a slightly pejorative way - the ideology of competition in those realms will lead to for-profit extraction of value from sectors that really matter to the community. Stephen, among other things in your time at the Productivity Commission and, indeed, before, you worked extensively on these opportunities, assessing them, evaluating them. Can you share something of your view about is this an appropriate or inappropriate realm to apply the principles of consumer choice and competition?

STEPHEN KING: The starting point is to separate out those two elements, one is choice and one is competition. Competition is a tool to an end, so competition is not an end in itself. The key feature coming out of the Harper Review is the benefits to individuals when they have choice. So they may still be receiving government-funded services, but they have a choice that they can make over the types of services that they receive. That's got two huge benefits for individuals. One is, if you like, the hard economic one that you can choose services that better meet what you prefer, what you think best meets your needs. Now, there are a lot of people in the human services area who say, "Sorry, I know what you need best". I'm not sure many of the recipients of human services have that view and if you look at the National Disability Insurance Scheme (NDIS) the positive feedback there is from members of the disabled community who've said, "Thank you for this scheme, it is enabling us to have choice".

The second thing that it does is it empowers the user. Imagine how un-empowered you are, for example, as a recipient of disability services if you're simply told you will receive these services from that person over there and if those services don't meet your needs best and if that person isn't the best supplier for you, well sorry, someone else has made that decision. That's what disabled Australians faced for a long time in this country and the effect of the NDIS has been to empower them. We often take that empowerment for granted. If you don't believe it, let's take a simple human service most of us access which is a GP. I doubt anyone in this room would be in favour of a situation where some government bureaucrat says, "Sorry, we will determine the GP that you're able to see. You don't get a choice of doctor. We will tell you which GP. We will tell you exactly which services you can get from that GP and when you can visit them. That's the way the choice will be determined". So the key part of reform in human services is not competition; it's user choice. Now, to make user choice reasonable, to have choice you must have alternatives and often that will mean that having competitive alternatives will be reasonable. It's what we have when we go to GPs and when people say, "Oh, well human services shouldn't be for-profits, they shouldn't have competition", sorry, your GP doesn't see you on the basis of, "Hey, we're a not-for-profit and we're just going to see you" or they're a government employee. We don't have the British National Health Service here. They are small for-profit businesses and you choose

your GP on the basis of your experience with them, their reputation, how well you get on with them, the service they provide and numerous other features. You wouldn't want that taken away.

Now, human services cover a huge range of areas. You mentioned remote Indigenous communities. You're not going to get competition in remote Indigenous communities. It's hard enough to find any individual service providers that are able and capable of providing in these communities, so the idea that you're going to have competition is just fanciful. That doesn't mean we should ignore user choice, however. In a remote Indigenous community it may be a community voice that we're interested in, it may be an empowered community to try and have community choice and community input into the services they provide. So it is very much horses for courses. So yes, I think it was the biggest bit of Harper. We have seen some of the benefits of that through the NDIS. We're going to see a lot more benefits in this in the future as long as governments are willing to put the extra resources - and this stuff isn't free, human services is all about spending other people's money and if you don't believe that just think about next time that you want to get that rebate through Medicare, say, "No, I'm not taking that". You are spending other people's money every time you go to the GP. You may be paying a top-up, but you're not paying the whole fee. It's all about spending other people's money and we have to be really, really careful and governments need to be really, really careful when spending other people's money. But we want choice and sometimes competition can be desirable and there are huge gains to be made there.

JIM MINIFIE: Thank you Stephen and Caron. Let me now open it up for questions.

AUDIENCE: You were talking before about human services. What about the scope for competition for the market? So although you might not get multiple suppliers to an Indigenous community, the government or someone else on their behalf could effectively create a competition for that market and contract with someone. Also, going back to the point that Jim raised about to what extent do we rely on competition in areas where consumers are perhaps a bit inert, like, say, electricity retailing or superannuation. I know that Grattan has done a lot of work looking at the scope for introducing competition for those markets, so for default electricity consumers who don't really shop around and in superannuation. Obviously, we would like to rely on competitive markets as the institution to allocate these resources, but given that inertia amongst consumers what do you both think about the role for, in a sense, a level of government paternalism to implement that competition for those markets?

AUDIENCE: Jim, I think you started off with the slides where there's concentration in certain sectors and a lot of it's to do with barriers to entry and level of investment required. The advancements in technology have also created the opportunity for niche markets to be serviced by some of these new providers, but what we tend to see happen is that the major players buy up any new emerging technologies and it sort of perpetuates the problem. So just a response to that market behaviour please?

JIM MINIFIE: Great. Why don't we take those two? So the first part of the first question was around competition for the market and the second part was around default government paternalism to try to improve defaults.

STEPHEN KING: Also, just very briefly on your one, competition for the market? Yes. So let's take the remote Indigenous communities. The obvious way to get service provision there is to have tendering for service provision. What does the government do wrong there? Governments sometimes can be very, very naïve or myopic, whatever word you want to use, in their tendering processes. So, for

example, and this has been on 4Corners and in the media, the contract for all the maintenance of houses in Indigenous communities in the Northern Territory is run either out of Darwin or Brisbane, it's run an awful long way from those communities. When a tap washer goes so you've got a leaking tap or a toilet is overflowing, they have to fly somebody into the community. That's a very expensive way to do it and if you're the service provider you don't want to just be flying someone in for one toilet, so you'll let these jobs bank up before you bother sending somebody in. We were out there talking to one of these communities and some of the elders said, "Under the old contract, we - as in the Indigenous people - were actually provided with some of the equipment and were able to do things like fix tap washers and just do simple maintenance. We're not allowed to anymore". We're sitting there saying what madness is this that you've said you have people who can fix this, you've got the skills, but we're going to make sure that you haven't got the equipment and we're not going to allow you to do it because there's a contract with somebody who's a couple of thousand kilometres away who's got to come in and fix this. You're deskilling the community, you're demotivating the community. So yes, it's a great alternative, but it's got to be done properly and I've seen so many examples, particularly in remote Indigenous communities, where it's done badly.

Just very briefly on the tech and mergers, it's a really good point. If you at Jim's slides, one of the issues that Harper said is going okay is mergers law. I'm concerned about mergers law in Australia. Two of Jim's slides showed an uptick in return on equity or reduction in effective competition in Telcos and banking and both of those, the upticks in Jim's graphs, were mergers: Vodafone taking out Hutch, which I think publically I said at the time I opposed, I thought it should've been stopped - I'd just left the ACCC at the time so I didn't count anymore - and the bank mergers. I was there during the bank mergers. We didn't think we could stop them, certainly St George/Westpac. CBA/Bankwest was a bit of a different matter because that was during the crisis and their parent had gone bankrupt, but St George/Westpac we didn't think could be stopped under our current merger laws, but it seems to be associated with a reduction in competition in Jim's graphs. So yes, I'm worried about our merger laws. Maybe we need to be tighter there.

CARON BEATON-WELLS: I can respond very briefly, just given we want to hear some more questions. On the point about consumer inertia and government paternalism, well haven't we just seen that in energy with Turnbull calling in the big power companies and saying, "Get those low socioeconomic customers off your high deals", which they are now acting pronto on. So when things do go wrong there is a role for government not just to steward, but to actually get in and row. I think we've seen that. On the question down here, I think banking is an excellent example of a sector where we've got a situation with the Big 4 sitting very comfortably in the haven of the four pillars policy, but having been able to cherry-pick and take up the challenger and the maverick firms, whether it was Bank of Melbourne, St George, Rams, Aussie Home Loans. It's a long list of those who have sought to take on the Big 4, only to be swallowed up. Unfortunately, Harper didn't do anything on the substantive merger test, which remains substantial lessening of competition or the way in which it's interpreted and applied by the ACCC, but what I think it did rightly encourage the ACCC to do is more exposed evaluations of mergers. Let's take a look back at a sector where merger has been let through three/five years later and ask did we get our assumptions and our predictions about the future with and without this merger right? Some of the results of those reviews might be very telling.

AUDIENCE: You pointed to the issue of asymmetric information for human services and also the supermarkets. What role do you see in government trying to bridge this information gap? I just think of

myself going to the health system and I have not the faintest clue what each hospital is going to do to me or each specialist, so I just fall into whatever this guy says. That's not competition.

AUDIENCE: It seems like there's a fair bit of action in Europe at the moment with anti-competition cases brought against some of those big data people. I'd like your thoughts on that, is that going to come here and is it a good or a bad thing?

JIM MINIFIE: Terrific. I think that's it for this round. Caron?

CARON BEATON-WELLS: On information asymmetry, yes, of course, all of us are in the same boat. I'm in that boat when I go to get my car repaired; I wouldn't have a clue when they tell me what they've done and then justify the huge figure at the end of the bill and I go, "Well that's good. Okay, thank you" and get my credit card out. We are in that situation and that is the very reason, as Stephen's pointed out, that we have in the one act and one enforcement agency not just set of competition laws and enforcement, but consumer protection. Because it's all very well to give consumers choice and diversity, but they'll only be able to activate that choice if they have the relevant information and they understand it. That also is the reason why we have things now called unfair contract terms laws, that is laws that are intended to stop companies from putting in front of us some highly complex set of fine print that, one, we'll never read and, two, if we did we would never understand. So there are laws there that are intended to protect us in that way.

On the question about Europe, the European Commission is in fact leading the competition agency world in thinking through and taking action against some of the big tech companies and, of course, the big news earlier this year was the knee-wobbling 2.4 billion Euro fine against Google for the way in which it was organising and displaying its search results and favouring its own comparison shopping service against rivals. But there is a lot of talk in the competition community about whether we actually have the right tools to understand the competition problems in the tech sector and I'll give you one example of that. Many of the services that those tech companies provide us are provided for free. So it's a multi-sided market where we are obtaining services for free as consumers, whether it's social media or blogs or other online services but, on the other side of the market, advertisers are paying to advertise to us. So there's a complex dynamic going on there, but on the free side of the market those approaches or tools that we apply in competition where we look for a possible increase in prices to say that conduct is anticompetitive don't apply where consumers are getting things for free. So you have to ask yourself what we are actually paying when we get those services. We are paying with our data because that is what is the most valuable thing and that is what's generating power in these companies, and we don't know half the time what we're giving out and we don't know that these companies know more about us than we know about ourselves. So there are some really fascinating and, I think, highly challenging issues for competition laws and enforcers to actually get a handle on, and hopefully they won't fall too far behind in doing it.

JIM MINIFIE: Stephen?

STEPHEN KING: Firstly, great example public hospitals. If you go to the UK you can look up publically available information presented nicely on websites which will tell you where individual hospitals rank in terms of not just at a macro level, but down to individual procedures. If you've got a particular specialist or you need a particular specialist in an area you can go and see where that specialist ranks, you can see the number of operations they've done of the particular sort that you're after in the last year and the

last two years. It has an amazing effect. It doesn't just help consumers but, my God, it puts a rocket up the backside of the poor performers, because if you were a cardiologist and you're, "Damn, I'm one of the worst two cardiologist in England" you either retire or you pretty quickly pick up your act.

JIM MINIFIE: You certainly try to pick healthy patients.

STEPHEN KING: Ah, well, they're all risk-adjusted so that they get over the cherry-picking. Our draft report on human services, we'd love to get some of that stuff going here in Australia. So yes, I think there's a lot more that can be done in that space in terms of information, particularly for some of the human services. On the internet and new technology firms, they are just fascinating. This is going to keep competition economists and competition lawyers happy for the next two decades. Some of the issues are here, so online travel agents and price parity clauses have been a big issue in Europe for a number of years. The ACCC made a ruling on that last year I think, the only trouble is that all the rulings around Europe, even within Europe, are inconsistent with each other because no-one's sure what they're doing. On data, yes, exactly right. The Productivity Commission's data report, we started trying to deal with that issue by saying that consumers should have a right to their data. Now, on that, again, our recommendation was trying to learn from some of the experience of what they're trying to do in Europe. Europe is trying to allow consumers to own data. We see problems with that because how do you actually check that Google has deleted your data or if Facebook has deleted your data? But you should have some rights over your data. Just making things clearer to consumers can have a huge effect.

A couple of Chicago economists recently wrote in the New York Times that perhaps one way of getting competition with Facebook is to give you rights over your social graph and then requiring access. So a new social media platform, if you want to go to it you can go to it, you can take essentially all the links so that your Facebook friends will contact you on the new platform and they won't even realise that it's a different platform to Facebook. It's the sort of thing we did a decade ago with mobile phones when the ACCC ruled that you should be allowed to take your mobile phone with you when you jump between carriers, that's what put mobile phone competition on steroids in this company. So there's stuff that we can do.

CARON BEATON-WELLS: You could do the same with bank accounts.

STEPHEN KING: Do the same with bank accounts, that's being looked at in Australia. Open banking reforms are being looked at in Europe and the Productivity Commission is currently looking at financial services, and I'm on that one and can't tell you any more.

JIM MINIFIE: I think it would be fair to say that my assertion at the beginning of this discussion that we couldn't have had two more skilful and insightful people to learn from on this broad array of competition issues tonight was correct. Thank you so much Caron and Stephen for hosting this discussion. Thank you so much to our hosts, the State Library of Victoria, and to all of you for joining in what I found a fascinating discussion. I've learned a huge amount and we'll try to cram as much of it into our forthcoming report on competition as we possibly can. Thanks again.

CARON BEATON-WELLS: Thanks Jim.

END OF RECORDING