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IMPLICATIONS OF THE NATIONAL COMPETITION POLICY REVIEW FOR AGRICULTURE

S. Davenport, C. James, G. Buggie and J. Booth

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Abstract

In October 1992 the Prime Minister commissioned an independent inquiry into national competition policy following agreement to such action by Australian Governments. Recommendations of the Hilmer Report potentially have significant implications for agricultural industries, particularly those operating under statutory marketing arrangements.

In this paper, as well as reviewing the Hilmer recommendations and their implications for agriculture, issues such as the national approach being pursued and the potential for government failure in this area due to a static rather than dynamic interpretation of key concepts such as 'markets', 'competition' and 'efficiency' are discussed.

Note: The authors are employed by NSW Agriculture in the Economic Services Unit. The views expressed in this paper are those of the authors, rather than those of NSW Agriculture or the NSW Governm

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1. INTRODUCTION

In October 1992, the Prime Minister commissioned an independent Inquiry into national competition policy following an agreement to such action by Australian Governments. The Inquiry Committee was chaired by Professor Hilmer, Dean and Director of the Australian Graduate School of Management at the University of New South Wales. In August 1993, the Committee submitted its Report to the Heads of Australian Government. The recommendations of the Report are now subject to a process of negotiation between the Commonwealth, State and Territory Governments and will be discussed at the forthcoming Council of Australian Governments meeting in February.

The Hilmer recommendations can be divided into the following three parts.

(a) Those dealing with competitive conduct rules. It is recommended that a slightly modified version of the rules currently contained in Part IV of the Trade Practices Act should apply universally to all business activity.

(b) Those dealing with procedures and mechanisms such as the principles and processes governing the reform of regulatory restrictions on competition, the structural reform of public monopolies and competitive neutrality between government and private businesses; a general access regime; and a more focussed prices oversight mechanism.

(c) Implementation issues of the proposals including institutional, legal, transitional and resource matters. Two new institutions are proposed: a National Competition Council formed jointly by Australian Governments to assist in progressing cooperative reforms and an Australian Competition Commission which would administer the competitive conduct rules.

If implemented, the recommendations of the Hilmer Report would have significant implications for many agricultural industries, particularly those operating under statutory marketing arrangements. The full impact on SMAs will be determined not only through changes to the Trade Practices Act but also through changes in the States' approach to granting statutory powers. In general, under the Hilmer recommendations SMAs will be subject to compliance with public benefit criteria at a national level and continuation of an arrangement would be subject to regular reassessment.

Given the significance to a market based economy of regulation directed specifically at competition, the aim of this paper is to encourage debate on assumptions underlying the Hilmer recommendations and to outline their significance for statutory marketing arrangements in NSW. In section 2, background to the development of a national competition policy is provided and in section 3 components of competition policy are outlined. In section 4 the Hilmer recommendations are reviewed and in sections 5 and 6 conceptual issues in relation to the TP Act and issues specific to agriculture are discussed, respectively.

2. THE NATIONAL APPROACH

In recognition of the need to complement structural reform with regulatory measures that more fully address market failure a national approach to competition policy was initiated at the Special Premiers Conference in October 1992. Heads of Government agreed to a competition policy inquiry based on the following principles:

- No participant in the market should be able to engage in anti-competitive conduct against the public interest.

- As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership.

- Conduct with anti competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed.

- Any changes in the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:

  (i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition;

  (ii) in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.

More generally the case for a National Competition Policy is based on the assumption that greater consistency in the application of competition policy across industry sectors and between states will increase the efficiency of the reform process. The Commonwealth Treasury in its submission to the Hilmer Inquiry (Department of Treasury 1993) proposed for example that "a modified TP Act would provide the basis for a uniform regulatory competition policy framework across all sectors of the Australian economy and help deliver the full benefits of microeconomic reform on a nationwide basis". Treasury also proposed that this would complement the work of the Industry Commission and Price Surveillance Authority in identifying impediments to competition.

As with any 'national policy' however, transferring what might be conceptually appealing into something that is practically effective, relies on such policies being 'correctly' specified and implemented. Otherwise, the extent of government failure may well be minimised by maintaining existing regulatory arrangements.

3. COMPETITION POLICY

The term competition policy is open to interpretation. Broad definitions fail to distinguish the components of competition policy and their relationships. Fels (1993) states for example that "competition policy will include a wide range of policy instruments concerning international trade, foreign investment, intellectual property, tax, small business, the legal system, public and private ownership, licensing, contracting out and bidding for monopoly franchises".

For the purpose of conceptualising competition policy it is perhaps most useful to consider it in terms of its structural and regulatory components. Structural reform of markets on the one hand often involves reducing barriers to entry, removing inappropriate regulation and exposing publicly owned bodies to competitive market forces - activities often associated with the Industry Commission. Regulatory measures on the other hand, aim to address cases of market failure through anti-competitive conduct provisions and it is this latter area that is the primary focus of the Hilmer Report.

Further perspective on competition policy is provided by the Commonwealth Treasury (Department of Treasury 1993) in the following points:

> *The objective of competition policy is to enhance economic efficiency and equity and thus increase living standards for the Australian community, through increased output and employment, lower prices, and better quality, and dynamic, flexible and internationally competitive industries.*
>
> *Regulatory forms of competition policy can play a key role in promoting competition and more efficient use of resources by acting as a safety net against market structures failing to produce competitive outcomes.*
>
> *An effective framework for regulating anti-competitive behaviour must therefore be viewed as a necessary complement to structural reform if competition policy is to be comprehensive.*

Hilmer's Committee used the following definition of competition policy:

- encompassing all policy dealing with the extent and nature of competition in the economy. As such, competition policy is much wider than the anti-competitive behaviour provisions in Part IV of the Commonwealth Trade Practices Act.

  aiming to foster the competitive process rather than competition for its own sake.
  "... it (competition policy) seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives." (p.6)

From a policy perspective it is important to understand the perceived market failures at which TP legislation is directed. Fels (1993) states that:

> "market failure may occur, *inter alia*, if there is a lack of effective competition. In these circumstances there is a case for intervention via competition policy in order not to override the market mechanism, but to make it work better in achieving economic efficiency".

A concern in relation to such statements is that terms such as 'competition', 'markets'and 'competition' are assumed to be easily defined within regulation and that greater efficiency is something governments through intervention are well placed to achieve. It could be argued that TP legislation represents a coarse application of market failure theory, insofar as it places emphasis on processes rather than outcomes, its application to business activity is absolute with a guilty until proven innocent philosophy and success is often gauged by administrative concerns, such as consistency in application, rather than an accurate understanding of the resultant efficiency gains or losses.

Consistent with these concerns, the Industry Commission recommended a more strategic application of the TP Act and proposed the following areas as the main forms of market failure:

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

As well as monopoly (both natural and mandated) and imperfect competition (competitive conduct), ABARE in its submission to the Hilmer Inquiry (ABARE 1993) also discusses goods with inadequate property rights (free-rider problems) as being relevant to competition policy. While these areas of market failure provide a focus for competition policy and TP legislation, debate continues on the extent of intervention required. This point is discussed further in section 5.

4. THE HILMER RECOMMENDATIONS

Hilmer defines six key elements of a National competition policy and devotes significant attention to each which include:

- limiting anti-competitive conduct of firms;
- reforming regulation which unjustifiably restricts competition;
- reforming the structure of public monopolies to facilitate competition;
- providing third-party access to certain facilities that are essential for competition;
- restraining monopoly pricing behaviour; and
- fostering "competitive neutrality" between government and private businesses when they compete.

These are discussed in turn.

4.1 Modified Application of Competitive Conduct Rules

Part IV of the Trade Practices Act contains "Restrictive Trade Practices" provisions which regulate agreements and conduct which influence competition (see Attachment 1). The provisions are designed to maintain competition by controlling or prohibiting anti-competitive behaviour such as collusion, price fixing and abuse of market power. At present exclusion from competitive conduct rules is permitted for some enterprises, such as statutory marketing authorities. Those excluded from TP legislation include State government enterprises exempt under 'Shield of the Crown' doctrine and individuals involved in intrastate trade.

The main recommendations are:

- to extend the application of the Act to unincorporated businesses, statutory marketing authorities and government business;

- to modify slightly the competitive conduct rules stated within Part IV of the Trade Practices Act; and

- to reduce the currently available mechanisms within the Trade Practices Act for obtaining an exemption from the Act. Hilmer's proposed removal of the current exemption procedure under Section 51(1) of the Trade Practices Act is of particular significance to SMAs.

Under the proposed changes, competitive conduct rules will apply to all business activities with exemptions only granted when a clear public benefit can be demonstrated. The primary procedure by which future exemptions would be granted would be the current authorisation procedure of the Trade Practices Act.

Under current arrangements exclusion from competitive conduct rules may be possible due to factors such as:

- reliance on "Shield of the Crown" doctrine where the Crown and its instrumentalities are not bound by statute;

- constitutional limitations (where an organisation is a non-trading or financial corporation);

- exemptions conferred by Commonwealth or State legislation;

- State legislation or regulations authorising or requiring conduct (legislation enabling price fixing or imposition of quotas);

- specific exemptions and exemption by regulation available under the TPA (exemptions by regulation include certain conduct by primary marketing bodies, Commonwealth businesses and certain international agreements).

A point of particular significance about the Trade Practices Act is that it applies to the voluntary behaviour of firms. Proposed changes to the Act may increase the exposure of SMAs as organisations to the Act, but changes to the Act will not render unlawful an SMAs compliance with government regulation. It is stated in the report for example that:

> "Compliance by a business (private or public) with government regulation is not prohibited by the TPA, however anti-competitive the consequences. Nor is imposition of the regulation. Application of the TPA will not be sufficient to overcome regulatory arrangements that establish monopolies, provide for the compulsory acquisition of crops, regulate prices, restrict the performance of certain activities to licensed occupations or a host of other regulatory restrictions on competition. Even if all exemptions from the TPA were eliminated - including the potential for Commonwealth, State or Territory laws to authorise certain conduct - these regulatory arrangements would be disturbed little if at all" (p.184)

Removing (or reducing) the existence of statutes and regulation which sanction anti-competitive behaviours is the second aspect of competition policy as it has been structured by Hilmer.

4.2 Reforming Regulatory Restrictions on Competition

Certain behaviours such as vesting or licensing arrangements for various occupations have anti-competitive effects but are sanctioned by various State statutes and regulations. State activities remain valid within legislative boundaries since compliance with a government regulation is not prohibited by the Trade Practices Act, nor the imposition of the regulation. Even if the current exemptions from the Trade Practices Act were eliminated, this would not be sufficient to override regulatory arrangements which permit activities such as price regulation and vesting.

To overcome these problems of regulatory restrictions on competition, Hilmer "recommends that all Australian governments adopt a set of principles aimed at ensuring that statutes or regulations do not restrict competition unless the restriction is justified in the public interest. This would involve:

- acceptance of the principle that any restriction on competition must be clearly demonstrated to be in the public interest;

- new regulatory proposals being subject to increased scrutiny, with a requirement that any significant restrictions on competition lapse within a period of no more than 5 years unless re-enacted after further scrutiny through a public review process;

- existing regulations which impose a significant restriction on competition being subject to systematic review to determine if they conform with the first principle, and thereafter lapsing within no more than 5 years unless re-enacted after scrutiny through a further review process; and

- reviews of regulations taking an economy-wide perspective to the extent practicable.

The Hilmer Committee advocated a co-operative, consistent approach to the problem by all Governments. At the same time, he envisages a particular role for the National Competition Council in fostering an informed and co-ordinated approach to this issue by the separate Governments involved.

4.3 Structural Reform of Public Monopolies

Reform in terms of privatisation of public monopolies *per se* is not prescribed by the Report. Instead the Committee recommends a similar approach be taken with regard to public monopolies as suggested for regulatory restrictions. The removal of regulatory restrictions alone would not prohibit the operation of established monopolies. The Report maintains that monopolies should be screened for anti-competitive impacts and evaluated on their ability to generate a net public benefit. Separation of regulatory and commercial functions of public monopolies, separation of natural monopolies and potentially competitive activities, and the division of potentially competitive activities into a number of smaller independent units, are suggested principles for appropriate restructuring.

4.4 Access to "Essential Facilities"

Provision of competitive access to certain facilities which cannot be duplicated economically, such as railheads and electricity transmission grids, requires particular management procedures. The Committee recommends that, because of the magnitude of impact that abuse of market power can have in this situation, the allocation of rights to essential facilities should be directly administered by the proposed National Competition Council (NCC).

4.5 Monopoly Pricing

The Committee recognised that the most desirable response to monopoly activities would be exposure to competitive pressures including the removal of regulatory restrictions, restructuring public monopolies and if appropriate, providing third party access.

Where these changes are not feasible the Committee proposes a regime of price monitoring be applied to the relevant enterprise. Surveillance would be conducted with or without the consent of the enterprise depending on whether the NCC deems it necessary following a public inquiry. This procedure would be restricted to businesses with "substantial market power in a substantial market in Australia" The regime would be limited to price monitoring, there would be no price control and declarations for price monitoring would be approved by a designated Commonwealth Minister and would lapse automatically in three years unless renewed after a further public inquiry.

4.6 Competitive Neutrality

The Committee recommends that certain government owned businesses comply with competitive neutrality requirements when competing with private organisations.

4.7 Proposed Administration

The key elements of Hilmer's proposals for new administrative arrangements are:

- That a National Competition Council be established to advise Australian Governments on competition policy issues. Continuation of the Council beyond five years would be subject to review.

- That an Australian Competition Commission be established as the organisation to administer competition policy. This Commission would replace the current Trade Practices Commission. It would also incorporate the current Prices Surveillance Authority whose function would be realigned to the monitoring of pricing behaviour by monopolies.

- The current Trade Practices Tribunal would continue to consider appeals on authorisation decisions of the Australian Competition Commission and might be renamed the Australian Competition Tribunal.

5. CONCEPTUAL ISSUES IN REGULATING COMPETITION

5.1 Universal Application of the TP Act

As previously noted, the need for a national approach to competition policy, while notionally correct, warrants close consideration in application. While markets may fail to deliver socially desirable outcomes, the assumption that governments can effectively intervene in markets continues to come under close scrutiny. Relevant to this point, Pincus (1993) provides a useful critique of contemporary policy theory and market failure, opting for the more pragmatic view that there is either market or government failure and that one should be wary about market failure being used as a basis for government intervention due to the difficulties in assessing the relevant costs and benefits. Pincus provides an interesting discussion on the relevance of 'shadow' prices as opposed to the more commonly used exchange prices to cost benefit analysis in this area.

While the case for government intervention may be more easily justified in areas such as monopoly control, the TP Act would appear to contain sufficient anomalies (see Pengilly 1993) to indicate an element of government failure is an inherent feature of the current TP Act. An important unknown in relation to a national competition policy is therefore the significance of these efficiency losses and how they might be magnified with the more widespread application of the Act. A certain disregard for the magnitude of these potential efficiency losses is reflected in the following statement from the Hilmer Report which emphasises the greater importance being placed on implementing a national policy, rather than ensuring its adequacy:

> *"the Committee is mindful that unnecessary tinkering with the current rules could create uncertainty and delay extending the application of the rules, which is seen as the more pressing objective. Accordingly, the Committee has adopted a deliberate policy of limiting proposed changes to those areas where the current rules were found to be clearly deficient from the standpoint of a national competition policy".*

The potential for government failure may also underpin views put forward by the Industry Commission (Industry Commission 1993) that increased attention be given to monopoly access and pricing and to defining those markets in which the TP Act should be applied. The Commission stated that "progress in the deregulation of many markets during the 1980's now requires a shift in the focus of pro-competitive regulation. For example less regulation of the traded goods sector is necessary, because as tariff reductions continue throughout the 90's, this sector of the economy is becoming increasingly driven by international competitive forces". The internationalisation of markets will therefore have the effect of highlighting the shortcomings of process based, domestically orientated competition regulation based on narrow definitions of markets and competition.

5.2 Defining Markets, Competition and Efficiency in Regulation

A central theme of the Hilmer Report is the more widespread application of Part IV of the TP Act. Part IV is directed at overcoming anti-competitive conduct such as the use of market power by individual firms and collusive activity aimed at increasing market power.

Conduct currently prohibited in the TP Act includes:

- . arrangements between competitors which reduce competition including price agreements and exclusionary actions such as boycotts;
- . use of market power to damage or threaten existing or potential competitors;
- . exclusive dealing such as imposing conditions which impede the ability of buyers or suppliers to deal with third parties;
- . resale price maintenance involving minimum prices being prescribed for the resale of a product;
- . 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 powers to dominate.

Given the generally accepted requirement that the benefits of government intervention exceed the costs, the adequacy of public benefit (efficiency) tests becomes a central issue to the wider application of the TP Act. Two competition tests are applied to evaluate compliance with the above rules, these being whether:

- "there is a substantial lessening of competition" (Sections 45, 47 and 49";
- or "an abuse of market power designed to damage a competitor or competition" (Section 46).

Given these tests, the importance of definitions of 'markets', 'competition' and 'efficiency' in the application of competition policy becomes apparent. A common criticism of the rules based approach associated with anti-trust legislation is that it fails to take a dynamic view of these factors. The static textbook definition of a competitive market (many buyers and sellers) has heavily influenced competition policy, such that the major focus remains on monopolies, market concentration, collusive activity and mergers. More recent thinking indicates that such activities are likely to be normal features of contestable markets and in many cases will be associated with greater efficiency. The Industry Commission (IC, 1992) cite various rulings by both the High Court (*Queensland Wire*) and the Trade Practices Tribunal (*Tooth and Co*) where static and narrow definitions of markets and competition have been used.

The following sub-points from the Industry Commission's submission to the Hilmer Inquiry highlight potential shortcomings of traditionally views of competition and markets.

Industry concentration - while the number of domestic firms in an industry may influence the level of competition, it is a poor indicator of the absolute level of competition due to account not being taken of import competition, the potential for new entrants to the market and the possibility of substitution in production. At one extreme efficiency may be maximised by a single firm. It is therefore more appropriate to consider the contestability of markets. The Commission summarises the point by stating that "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".

Firm profitability - profitability is sometimes used as an indicator of competition, however high returns (as opposed to rents) will often be a reward to good investment decisions and risk taking. Endeavouring to eliminate high returns will therefore have the effect of 'engineering demand', such that consumers may be denied access to certain goods and services.

Barriers to entry - the concept is relevant to defining a contestable market, however there is significant debate over what constitutes a legitimate entry barrier ie the earning of economic rents over the medium to long term. Often cited barriers include product differentiation, high capital requirements, scale economies and absolute cost advantages of established firms. The Commission dismisses each as being legitimate entry barriers on a per se basis. however, use of such provisos may render the Commission itself guilty of using static definitions.

Product differentiation is dismissed on the basis that while the associated rents may not be fully contestable, other firms can compete for other niche markets. High capital requirements are dismissed to the extent that there is no capital market failure and scale economies (declining average costs over the relevant range of production) are dismissed on the basis that new entrants have access to the same cost function as established firms and such economies simply dictate the level of output new firms must achieve to minimise costs. For absolute cost advantages to represent a barrier to entry, competing firms must be denied access to essential inputs. The real barrier will therefore more often be a function of regulation or systems of property rights.

Relevant barriers to entry - from a competition policy perspective these include:

- unavoidable sunk costs - committed capital that cannot be withdrawn without significant loss, including exit costs;
- privileged access to information or technologies, such as patents; and
- regulatory barriers to entry and exit .

While the latter two are self explanatory, unavoidable sunk costs relate to a more dynamic interpretation of start-up costs, in that new firms may be required to incur additional costs in overcoming strategic behaviour of existing firms and developing their own differentiated product.

Barriers to imports - the level of imports is sometimes viewed as a measure of competition, however it is the threat of imports rather than their actual level which imposes competitive discipline on firms.

Quasi substitutes - the term refers to less than exact substitutes. Their relevance to competition policy is that by exerting market discipline, quasi-substitutes are relevant to any assessment of market power and markets. They are likely to be ignored in applications of the TP Act based on product and geographic markets.

Countervailing market power - this is an argument often used to support statutory marketing arrangements. The arguments merit remains subject to debate. It is often not clear whether the objectives of such arrangements relate to efficiency or equity. Equity is concerned with how wealth is distributed among members of the community. Given that many services offered by government to agriculture, can be, or are also, provided by the private sector (ie information and training), at best such interventions would appear to be based on equity (political) considerations. The provision of subsidised services however limits the scope for competition and thus reduces efficiency.

By limiting the scope for competition, equity based policy settings dissipate variations in returns across industries which otherwise provide signals for resource adjustment. Attempts to achieve equity among firms may therefore be inconsistent with economic efficiency and therefore difficult to reconcile with the promotion of community welfare (reference).

5.3 Assessment of Net Public Benefit in Agriculture

The use of static and inconsistent interpretations of markets, competition and efficiency is also reflected in recent rulings by the Trade Practices Commission on agricultural marketing activities. In considering an application for exemption from the Trade Practices Act, the Commission applies the following rational described as a statutory test:

> "For an arrangement that may substantially lessen competition, the applicant must satisfy the Commission that it will result in a benefit to the public that outweighs any anti-competitive effect." (TPC Authorisation Handbook 1993)

Determination of what constitutes a public benefit is the key issue in applying the test. The TPC does not define what constitutes public benefit. Types of public benefits previously recognised by the Trade Practises Tribunal include the following:

- promotion of competition in an industry;
- economic development, eg in natural resources through encouragement of exploration, research and capital investment;
- fostering business efficiency, especially where this results in improved international competitiveness;

- industry rationalisation resulting in more efficient allocation of resources and lower or contained unit production costs;

- expansion of employment or prevention of unemployment in efficient industries and employment growth in particular regions;

- industrial harmony;

- assistance to efficient small business, eg guidance on costing and pricing or marketing initiatives which promote competitiveness;

- improvements in the quality and safety of goods and services and expansion of consumer choice;

- supply of better information to consumers and business to permit informed choices in their dealings;

- promotion of equitable dealings in the market,

- promotion of industry cost savings resulting in contained or lower prices at all levels of the supply chain;

- development of import replacements;

- growth in export markets; and

- steps to protect the environment (TPC Authorisation Handbook 1993).

Applicants are required to supply estimates of the financial (exchange) costs and benefits of the applications. The value of public benefits are also often submitted in applications. The Commission does not have a prescribed estimation technique for assessment of public benefit. This is in part due to unresolved debate stemming from a lack of agreement regarding the magnitude of industry multiplier effects, both in theory and practice.

Four TPC determinations which successfully demonstrated net public benefit and were subsequently authorised as TP Act exemptions were :

- Southern Farmers Co-operative Ltd (1986) ATPR (Com) 50-109
- Ardmona Fruit Products Co-op Ltd (1987) ATPR (Com) 50-065
- Tasmanian Oyster Research Council Ltd (1991) ATPR 50-106
- Macadamia Processing Co and Suncoast Gold Pty Ltd (1991) ATPR 50 -109

The Commission was swayed by arguments presented in these cases including:

- without regulation agricultural product marketing can be too risky and chaotic to effectively generate stable incomes;

- that price stabilisation will ensure stable incomes ;

- the anti-competitive market barrier effect of compulsory levies can be disregarded when the financial burden of compulsory levies is small;

- private benefits will be passed on to the public so that even if private benefits are greater than public benefits, net public benefit is still achieved.

The extent to which these arguments are consistent with the achievement of economic efficiency is questionable. Regulation of agricultural product marketing reduces efficiency by sheltering industries from adjustment pressure. Incomes are determined by production and sales in addition to prices. Compulsory levies are anti-competitive by imposing a barrier to new entrants and may reduce incentives for individual activity in areas such as promotion and research. There is no compulsion on private industry to pass on benefits of regulation to the public.

There is therefore an important inconsistency between previous TPC rulings indicating that net public benefits can be achieved through sub-optimal efficiency scenarios and Hilmers' principle that efficiency maximisation via competition policy also maximises community welfare.

For competition policy to most effective, changes need to go beyond Hilmer's recommendations for greater scope of application of competition policy to include a far more rigorous application of competition principles than has been evident to date.

In summary, the issue is that static definitions of markets and competition, while useful in conveying basic principles to the novice, upon transfer to legislation may impose unnecessary strictures on the operation of markets. The point is emphasised by the fact that the operation of markets is something that in many instances remains largely unknown and subject to considerable research. At the very least, such concerns imply a more strategic application of competition policy .

6. IMPLEMENTATION AND IMPLICATIONS FOR STATUTORY MARKETING ARRANGEMENTS

6.1 Compliance With National Competition Policy

Hilmer's ideal approach to administration of the Trade Practices Act is for the States and Territories to refer all powers to authorise arrangements to the Commonwealth Government, or more specifically - the Australian Competition Commission (ACC). The Trade Practices Tribunal would continue its role as appeal tribunal for authorisation under competitive conduct rules operating under the title of Australian Competition Tribunal (ACT).

Restructuring these administrative organisations and their reach is aimed to promote a more universal and uniform approach to competition policy. Review of industry regulation by a single independent body would also minimise the risk of regulators being captured by industry.

Despite the desirability of these proposals, Hilmer recognises the right of States to authorise activities within their jurisdiction and according to their own agenda under current constitutional arrangements. To reconcile State and Commonwealth interests a National Competition Council is proposed in addition to the Australian Competition Council and the Australian Competition Tribunal.

The National Competition Council would be actively involved in reform of agricultural arrangements given their protected status under current arrangements.

Under Hilmer's approach, implementation of recommendations would impact on State agricultural industries in the following ways:

- The Australian Competition Commission would have the power of approval over all voluntary activities of any future statutory marketing arrangements. Voluntary activities include those that a statutory marketing authority is not compelled to enforce, but has the option to apply unlike involuntary activities which once granted to an authority must be applied. This recommendation would apply to existing arrangements following a transition period of three years after which application for ACC authorisation is required.

- Involuntary activities will be subject to National Competition guidelines as outlined in Section 4.2.

- All future statutory marketing arrangements including voluntary and involuntary would be expected to meet a national, public benefit test. "Public benefit" is defined as arrangements that are least injurious to competition and the welfare of the community as a whole (p.6). The public benefit concept is defined on the basis of economic efficiency criteria.

Statutory agricultural marketing boards were identified as a group that often fails to comply to this condition. It was stated:

> "... particular firms may seek exemption from rules governing competitive conduct to allow them to increase their returns relative to those that would be available in a more competitive market. Thus, for example, some agricultural producers have been permitted to collude to restrict output or fix prices at least in part to raise farm incomes or regional employment at the expense of consumers and other producers." (p.5)

- An implication of this emphasis on public benefit is that where industries receive a benefit from regulatory arrangements, such arrangements will be required to be explicitly addressed through legislation.

- Some existing statutory marketing arrangements would be unlikely to continue in their present form - eg those with a power to set minimum prices. Such power is banned absolutely under the Trade Practices Act with no provision for authorisation.

- Applicants for authorisation will face an up-front application fee that does not exist under current State legislation.

6.2. Exemption Arrangements

There are currently three ways in which statutory marketing arrangements can either be fully of partially exempt from part IV of the TPA (Industry Commission 1991). These are:

- though legislation - conduct specifically endorsed by Commonwealth, State or Territory acts or by regulations under such acts the TPA. This includes marketing orders in NSW which are legal instruments created by the Marketing of Primary Product Act usually issued by a Minister or delegated authority;

- through regulation - partial or complete exemption from some sections of the TPA can be granted through specific regulations under the TPA. The procedure is initiated by the requesting rural group for consideration by the Attorney General; and

- through authorisation - the ACT may grant authorisations to requesting organisations allowing them to engage in certain restrictive practices provided such behaviour is beneficial, established through a public benefit test;

Involuntary Activities Through Legislation and Regulation - There are various regulatory restrictions than can be issued through State and Territory legislation and regulations. Barriers to market entry can be created through regulatory restriction. Restrictions permitting the creation of monopoly or quasi monopoly rights are common in agricultural industries. Most frequently such arrangements take the form of compulsory acquisition, price controls production quotas and producer restrictions. Agricultural industries involved have argued for such mechanisms on the rationale of countervailing power. Restrictions on production were based on perceptions of protection of public health and maintenance of orderly marketing. The trend towards deregulating monopolised commodities such as deregulation in the egg industry , indicates the inappropriateness of these rationales and the increasing awareness by State governments of the detrimental impacts of regulations which restrict competitive behaviour.

Australian governments assess the application of regulatory restriction of competition according to the impact on the public interest. The process of evaluation, however, varies between States and the Commonwealth. The Commonwealth generally uses an independent body, the Office of Regulation Review, part of the Industry Commission, to scrutinise regulation. Various government and independent authorities are used by States to assess regulatory impacts, in NSW the government organisation is the Business Deregulation Unit.

Agricultural industries with vesting powers prescribed by legislation and industries which operate on a national basis could be considerably effected by the Hilmer recommendations regarding regulatory restrictions. The continuance of vesting powers and other regulatory barriers instituted through State legislation will be subject to a more stringent review process. Similarly, national statutory marketing authorities such as Australian Wheat Board and the Australian Wool Corporation will be subject to a more rigorous assessment.

Through various Commonwealth, State and Territory legislation or legislative bodies vesting power in primary products has been issued. Vesting power, once it has been authorised to an industry is viewed as a involuntary activity. Consequently, it is viewed as being excluded from Trade Practices Act. No fundamental evaluation has been made by the Trade Practices Commission regarding the general validity of vesting power in terms of it's public interest impact. In other Trade Practices Commission determinations, however, the rationales used to achieve monopolisation of product which are also used to justify vesting control have been evaluated.

Arguments for vesting power are often based on the need to create countervailing power. In recent rulings the Commission has recognised the weak bargaining power position common in agricultural industries where a large number of producers would be exploited by a small number of processing firms and therefore permitted market controls (Southern Farmers Co-operative Limited 1986 - permission granted for a milk equalisation scheme). Hence, while there is renewed scrutiny of vesting operations, it is unclear whether they will be dissolved.

Voluntary Activities Through Trade Practices Authorisation - Equalisation schemes, price fixing and the appropriation of compulsory levies are common mechanisms used by agricultural industries. In the past such arrangements have been possible via section 88 of the Trade Practices Act permitting conduct to be specifically approved or authorised by State or Territory law or regulation. If Hilmer's recommendations are adopted this option will no longer be available.

Some voluntary activities such as various marketing arrangements have been subject to public benefit tests under the TP Act for various reasons, including that there has been no enabling legislation at the state level. These authorisations serve as precedents for future rulings on voluntary activities that may be exposed to the TP Act under the Hilmer recommendations.

Equalisation schemes

A milk equalisation scheme to operate in the Adelaide metropolitan area was granted by the Trade Practices Commission in the Southern Farmers Co-operative Limited (1986) case which had the effect to dampen price fluctuations.

Price fixing

The Ardmona Fruit producers Co-op (1987) case determined the applicants right to set recommended minimum prices pursuant to agreement between growers and processors. In this application the Commission recognised that price stability in a primary industry represents a benefit to the public insofar as the arrangement provides the necessary element of stability while falling short of elimination of price competition altogether .

Direct price controls are not allowed by the Trade Practices Commission, however it appears that setting of recommended minimum prices may be permitted under a new competition policy regime provided net public benefit can be demonstrated.

Compulsory levies

In the Tasmanian Oyster Research Council Limited (1991) case the Commission allowed the research organisation to impose a compulsory levy on all producers of oysters in Tasmania through a charge attached to the purchase of oyster spat. The Commission recognised that a levy may have an anti-competitive effect with its imposition forcing out farmers who refuse to pay the levy and have no alternative supply of oyster spat, however, the financial impact of the levy was considered negligible. Significant economic advantages were also identified. Since all research findings were accessible to the public, it was considered that there was little risk of the research gains being captured solely by industry, hence generating public benefit.

6.3 Summary - Impact on Agriculture

1. Where an activity is specifically prescribed in State, Commonwealth or Territory legislation or regulation it is a "regulatory restriction". A "regulatory restriction" lies outside TPA jurisdiction. Its validity is subject to the individual government's evaluation. Hilmer recommends a consistent method of assessment be adopted including a standard five year review schedule for all regulatory restrictions

2. The NCC co-ordinates assessment of Commonwealth "regulatory restrictions". If the State or Territory "regulatory restriction" is of national significance, the NCC may oversee a national evaluation. The NCC determines if the State regulatory restriction is of national significance. The Commonwealth cannot compel the State to adopt the NCC's recommendations;

3. Section 172 (2)(a) of the TPA providing partial or complete exemption through specific regulation for marketing of primary products to be repealed (agricultural industries have not utilised the exemption since 1992) ;

4. Section 51(1) of the TPA , under which activities have been protected is to be repealed (no agricultural industries have shield of the Crown immunity).

5. Given ongoing deregulation of industries with "regulatory restrictions" then following deregulation the activities of the industries change from involuntary to voluntary and fall within TPA jurisdiction. In order for the industries to continue activities they will need to apply to the ACC for exemption from TPA under Section 88.;

6. Types of activities which have been previously evaluated by the TPC include equalisation, compulsory acquisition, price fixing, imposition of compulsory levies- it is expected the ACC will examine similar arrangements;

7. The doctrine for both ACC authorisations and evaluations of regulatory restrictions is that the public benefit of the activity is greater than the anti-competitive detriment.

6.4 Other Considerations

Deregulation - the possibility that deregulation of an industry may lead to industry concentration in the marketing process is reason for careful planning of deregulation and close monitoring of its consequences. Deregulation of rural industries should not be treated differently in principle to deregulation of public utilities that are statutory monopolies. Hilmer gave significantly more attention to the various issues associated with the deregulation of these statutory monopolies.

Recommendation 10.2 in particular emphasised:

- the need for gradual and deliberate progress through the processes of commercialisation and corporatisation before privatisation;

- not proceeding to privatisation before market structure issues are properly addressed; and

- preference for the vertical separation of a statutory monopoly for the purpose of avoiding a dominant firm operating throughout the marketing process.

Market information - one means of enhancing the flow of market information to farmers has been through the development of outlook meetings or conferences. It is possible that participation of buyers at an industry meeting or conference might be seen as collusive behaviour; yet such participation may be desirable to provide a proper flow of market information to the affected farmers. This is a matter that might be considered further by the Trade Practices Commission, to alleviate the need for authorisation application.

User pays - approving anti-competitive behaviour - at present the Trade Practices Act imposes significant costs on potential applicants including application fees (for authorisation or notification) and case preparation and legal advice. The latter of these costs can rise significantly when an application is denied by the Trade Practices Commission and is taken to the Trade Practices Tribunal.

This cost imposition is consistent with an Act in which the onus of proof of "public benefit" is placed on the proponent of anti-competitive behaviour. However, to the extent that so-called anti competitive behaviour may simply be a function of the Act failing to encapsulate a more dynamic definition of markets and competition, it might argued that at least a proportion of the cost should be met by government thereby imposing an incentive for the more judicious application of the Act.

Hilmer recommended a review and possible waiver of recently introduced fees for an application to the Trade Practices Commission.

Co-operatives - historically statutory marketing arrangements grew out of the failure of co-operatives. For SMAs facing deregulation, reformation as a co-operative is an option. Potential problems of for such action include the following.

1. Co-operatives are currently established under State legislation and there are differences in the relevant legislation between States. These differences are of some significance where interstate co-operation is involved.

2. One of the key principles of co-operatives is co-operation among co-operatives. Taken to its limit, the application of the principle would appear to sit uneasily with certain aspects of the Trade Practices Act.

3. Supply contracts between members of a co-operative and the incorporated body may also have some conditions that need closer consideration in relation to the Trade Practices Act.

The issue of co-operatives (and incorporated structures generally) was not discussed by Hilmer. It is an issue that needs further consideration, particularly in any context of planned deregulation.

Compensation and planned deregulation - given longstanding statutory marketing arrangements changes to current practices will be met with strong resistance and bids for compensation. The Committee leaves this issue for State and Commonwealth consideration with phased deregulation being the trade-off to the payment of compensation. An issue is whether the transition period recommended by Hilmer will be sufficient to avoid compensation payments. Some industries already have a deregulatory timetable that may extend beyond three years. The dairy industry is an example, even though the currently planned deregulation might be considered only partial.

Separation of activities - the competition policy debate has heightened the focus on the commercial operations of SMA's. In particular, it is argued that there should be a separation of commercial activities from community service obligations and that the commercial activities should not be subject to any competitive advantages or disadvantages that have a statutory origin.

This competition policy perspective to industry restructuring needs to be combined with various other issues that have emerged over recent years. For example, it has been policy at Commonwealth level over recent years, to form separate industry bodies to perform the function of policy advice, marketing, and research and development. Recent developments in the wool industry suggest some reversal of these trends.

7. CONCLUSIONS

Hilmers recommendations serve to broaden the scope of competition policy by:

- increasing the reach of TPA by reducing exemption avenues available within Part IV;

- creating a regular and consistent review process for government incorporating net public benefit evaluation of anti-competitive activities;

- creating more effective administrative structures.

Expanding the scope of competition policy through these reforms will ensure more industries are examined and that there is greater consistency in the evaluation of industry behaviour. An important consideration however is the adequacy with which key concepts such as markets , competition and efficiency are applied within the context of competition policy and the adequacy of public benefit tests.

In the context of agricultural statutory marketing authorities, Hilmer's new competition policy will expose more marketing activities to an economic evaluation than is currently the case. Both voluntary and involuntary activities of SMA's will be subject to public benefit evaluation.

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ATTACHMENT - PART IV OF THE TRADE PRACTICES ACT

1. Part IV of the TP Act

Part IV targets conduct which has the purpose or effect of substantially lessening competition in a market,however such activities may be authorised providing they meet particular tests.

Part IV consists of sections 45-51 of the Act:

Section 45 prohibits agreements and arrangements between competitors to prevent, the supply of goods or services to particular persons or the acquisition of goods and services from particular persons, and prohibits contracts, arrangements or understandings which substantially lessen competition.

Section 46 prohibits a corporation with a substantial degree of market power from using that power to eliminate or substantially damage a competitor: prevent the entry of a person into a market; or deter or prevent a person from engaging in competitive conduct in a market. This may include competitors access to facilities essential to its competitors in a market.

Section 47 prohibits exclusive dealing, which broadly means interfering with the freedom of buyers to buy from other suppliers or to sell to whom they choose by imposing conditions on sale of a good or service.

Sections 48, prohibits a supplier from specifying a minimum price below which goods cannot be resold or advertised for resale.

Section 49 specifies that suppliers may not discriminate in price or other similar terms between purchasers of goods of like grade and quality if that discrimination causes a substantial lessening in competition. Price discrimination is not prohibited if it can be shown that it makes reasonable allowance for cost differences in manufacture, distribution, sale or delivery or that it is to meet a price or benefit offered by a competitor.

Section 50 prohibits mergers and acquisitions that result in or enhance market dominance. The TP Act is being amended to prohibit mergers and acquisitions which result, or would be likely to result, in a substantial lessening of competition.

Section 51 outlines conditions where exemptions from application of the previous Sections 45-50 may be issued. Section 51(1) of the TP Act exempts conduct that is specifically authorised or approved by Commonwealth, State or Territory legislation. According to the TPC this section is the chief source of immunity for State enterprises from the Act. Section 51 also specifically exempts from the Act matters such as:

- employee remuneration

- standards approved by Standards Australia

- certain clauses concerning termination of partnerships, goodwill as well as certain contracts of service

- certain export arrangements; and

- certain patent, trademark and copyright laws.

2. Hilmer Recommendations - competitive conduct

Hilmer recommends that rules pertaining to contract arrangements or understandings which restrict dealings or affect competition contained in Section 45 and Section 46 remain, but that the current exemption for price fixing arrangements with 50 or less participants be abandoned (Section 45A (3)).
section.